



THE IMPACT OF THE SHADOW ECONOMY ON THE NATIONAL ECONOMY AND ITS PREVENTION

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ABSTRACT

One of the key factors hindering the economic development of many countries, particularly developing states, today is the shadow economy. Informal employment, which is considered one of the sectors of the hidden economy, negatively affects not only the state's economy but also the well-being of the population. This article discusses the impact of informal employment primarily on the economy, as well as proposals for reducing the share of this sector in employment and its legalization, based on international experiences

Introduction. Currently, one of the factors hindering both economic and social development in the country is the growing share of the shadow economy. One of the harmful components of the shadow economy is informal employment. Numerous factors can be cited as the reasons for the emergence of such economic issues. Among the main reasons are the insufficient legal awareness of the population and entrepreneurs' evasion of tax payments. The higher the share of the shadow economy within the country or its GDP, the slower the pace of economic and political growth and development in that region. Today, many developed countries and academic scholars are actively working on measures to reduce the share of this sector within national economies. For instance, a "roadmap" to reduce the share of informal employment for 2022–2024 has been developed. Additionally, specific target indicators aimed at decreasing informal employment were adopted for 2023–2026 [1]. In Uzbekistan, efforts in recent years have also been directed toward legalizing informal employment, which is a structural component of the shadow economy, and improving the welfare of the population.

Employment in informal sectors, where individuals earn income through their own labor, may offer certain advantages to the population. However, alongside these benefits, informal employment can lead to limitations in access to various forms of state-provided assistance and pensions, both during the working period and upon reaching retirement age.

Literature review and methods. The shadow economy is closely linked to corruption and organized crime, which in turn leads to the gradual weakening of state institutions.

Additionally, it creates significant challenges in ensuring the rule of law and maintaining order among the population. Enterprises and entrepreneurial entities operating in the informal sector often evade tax payments and ignore regulatory requirements, aiming to minimize costs and maximize profits. However, such tax evasion reduces the amount of revenue flowing into the state budget, hindering the timely and adequate provision of social protection, pensions, scholarships, and wages to the population. It also obstructs the development of infrastructure within the country.

A number of methodological approaches have been developed by academic scholars to study the informal labor market. Notable contributions have been made by academician T.I. Zaslavskaya and professors such as A. Surinova, V.E. Boykov, E.S. Kubishkin, E. Varshavskaya, and O. Fadeev. These scholars focused their research on identifying the key factors and criteria associated with informal employment. In their scientific works, they analyzed the income of workers engaged in the shadow sectors, including wages, and identified the gap between household overall needs, their financial assets, and the expenditures resulting from an increase in officially declared income. This approach helped to quantify the discrepancies and measure the economic impact of informal employment on both individual households and the broader economy [3].

The more a country develops, the smaller the share of the shadow economy becomes within its overall economy. According to the International Labour Organization (ILO), 60% of the world's 2 billion employed individuals aged 15 and older spend part of their time working in the informal sector. Workers engaged in informal employment often face significant social challenges. The latest ILO report states that approximately 2 billion people worldwide are employed in the informal economy. Globally, over 60% of the workforce is engaged in informal labor. In North and South America, the rate of informal employment is 40%, while in some South Asian countries, it reaches up to 80%. In Africa, the share of informal employment is 86%. In Europe and Central Asia, this figure stands at 25%, and in Arab countries, it is nearly 70%. According to official statistics, 39% of the total employed population in Uzbekistan works in the informal sector. The report from Uzbekistan's Ministry of Poverty Reduction and Employment for January-March 2023 indicates that the number of people employed in the informal economy reached 5,619,941 [7].

In Uzbekistan, the share of the informal economy is particularly high in the construction, trade, and service sectors. According to various estimates, its share in relation to GDP ranges from approximately 25% to 45%. In 2023, unregistered economic activity amounted to 140 trillion UZS in the service sector, 50 trillion UZS in construction, and 40 trillion UZS in industry. As a result, the country's GDP suffered a loss of 135 trillion UZS, while the state budget lost around 30 trillion UZS in potential revenue. Furthermore, out of 27 000 construction companies, 41%-nearly 11 000 firms-reported having only one official employee on their records. Meanwhile, nearly 5 million people worked in the informal sector, with business owners paying their salaries without contributing taxes [4].

According to data from the Ministry of Poverty Reduction and Employment, in 2022, the total economically active population in Uzbekistan amounted to 14.98 million people. Of these, 13.7 million were employed, with 6.5 million (47%) working in the formal sector. Economically active populations include both those employed and the unemployed. Among the various types of economic activities, the largest share of those employed in the informal sector—34%—worked in agriculture, forestry, and fisheries. The share was 14% each in trade and construction, and 11% in industry. Informal employment encompasses workers in enterprises without legal status. This category includes individuals working in shadow sectors without formal labor contracts, unregistered self-employed individuals, and their employees.

It is noted that the large size of the informal sector poses challenges for governments in effectively implementing economic policies and regulating the economy. If it is assumed that workers in the informal sector receive the same wages as those in the formal sector, over 9 million people working informally in 2022 resulted in an estimated loss of 32.9 trillion Uzbek soums in tax revenues for the state budget. Given that more than half of the state budget is allocated to social sectors, this lost revenue could have been used to build 4,100 general education schools with 500 student places each, ensuring access to quality education across all regions. Additionally, it could have funded the modernization of 10,522 schools with updated technical resources, the construction of 3,737 outpatient medical facilities, or increasing the salaries of medical personnel in the healthcare system to 7.8 million soums. Similarly, it could have raised the salaries of general education teachers to 7.2 million soums [8].

Discussion and Results. In our country, the identification of informality in the labor market has its own unique characteristics. The informal sector is the part of the economy that is not taxed, is not controlled by the government, and is excluded from GDP calculations. In general, on one hand, informal employment limits workers' social rights, which leads to deteriorating employment conditions, a decline in living standards, and a decrease in the quality of human capital. Moreover, the reduction in tax revenues results in a decrease in government expenditure on social policies and a decline in the effectiveness of economic governance. On the other hand, employment in the informal sector often serves as a social stabilizer, alleviating the shortcomings of the economic system, such as high business development costs, high taxes, a lack of job opportunities in the corporate sector, and increasing unemployment. Therefore, the development of the informal sector can be seen as a natural adjustment of the labor market to existing economic conditions.

In recent years, measures have been taken to significantly reduce the scale of the shadow economy in order to promote healthy competition and the development of private businesses in the country. Specifically, the "Uzbekistan-2030" strategy emphasizes the expansion of the tax base through the reduction of the shadow economy. Moreover, the strategy gives special attention to increasing employment levels and ensuring decent working conditions to stabilize the labor market [5].

To reduce and eliminate the share of the shadow economy in Uzbekistan, the President of the Republic signed Decree No. PF-6098, "On Organizational measures to reduce the shadow economy and improve the efficiency of tax authorities", on October 30, 2020 [2]. The primary goal of this decree was to decrease the informal economy, regulate entrepreneurial activities, ensure fair competition, and reduce administrative burdens. Additionally, it aimed to automate tax compliance procedures and simplify the tax system. As a result of these efforts, the share of the share of unregistered economic activity in the industrial sector decreased from 20% to 6%. Reforms were also introduced in the tax system, including a reduction in personal income tax from 16% to 12%. Consequently, the number of taxpayers contributing to corporate profit tax, value-added tax (VAT), and resource taxes increased approximately 15 times [9].

One of the fastest and most effective ways to reduce the shadow economy in Uzbekistan today is digitalization. Several electronic platforms have been introduced to support this process. For example, the launch of the Unified Interactive Public Services Portal (my.gov.uz) has made it possible to access government services online. Additionally, the implementation of the electronic tax reported system (E-soliq) has improved transparency in tax payments. In commercial sector, online payment platforms such as Payme, Click, and

Xazna have helped reduce corruption and informal economic activities. To further support entrepreneurs and limit the shadow economy, the government has introduced the “One-stop shop” principle, which simplifies business registration and licensing processes. The number of required permits has been reduced, and processing times have been shortened. Moreover, in 2019, the Anti-Corruption Agency was established to combat corruption and bureaucracy in state institutions through digitalization. As a result of these reforms, the share of the shadow economy in the country has been gradually decreasing over the years.

In recent years, the proportion of the working-age population employed in the informal sector in Uzbekistan has decreased to some extent (42.8% in 2020, 39% in 2023). This means that informal employment has decreased by 3.8 percentage points or 0.2 million people over the last four years. One of the main reasons for this reduction is the state's support for self-employment. Additionally, the reduction in the unemployment rate (by 3.7 percentage points from 2020 to 2023) shows a direct correlation with the decrease in informal employment. The results of the observations reveal notable regional differences in the level of informal employment. The highest levels of informal employment are found in Namangan (50%), Surkhandarya and Jizzakh (49%), and Kashkadarya (48.4%) regions. The lowest levels are observed in Tashkent city (10.9%) and Navoi (21.8%) region, with relatively low rates also recorded in Bukhara (32.3%) and Tashkent (34.9%) regions. The regional disparity is significant, with a 2.3 times higher level of informal employment in regions outside Tashkent city. The decrease in the number of informal sector workers is primarily due to a sharp reduction in the number of temporary, one-time, and seasonal workers (94.4 thousand people), as well as a decline in informal employment within households without legal status (141.2 thousand people). This trend reflects both a structural shift in the labor market and the success of measures aimed at formalizing employment in Uzbekistan [5]. Although positive changes have been observed in the reduction of informal employment, there are still unresolved issues that need to be addressed.

Conclusion .

The shadow economy plays a significant role in Uzbekistan, impacting state revenues, the social protection system, and economic stability. The existing challenges are associated with the complexity of business regulations, and the low attractiveness of working in the formal sector. Although, there are many ways to decrease the rate of shadow economy in the country, the government should take additional measures to address this problem. For example:

1. Strengthening control and penalty systems

To reduce the informal economy, it is necessary to strengthen control and penalty mechanisms implemented by state authorities. The following measures are of great importance:

- a) Developing digitization of Tax and Labor Inspections. The use of artificial intelligence and big data technologies will improve the efficiency of detecting hidden economic activities.
- b) Encouraging citizens to report informal employment. Establishing a reliable anonymity system and providing protection guarantees to whistleblowers is essential.

2. Strengthening public trust in government

Increasing public and business trust in the formal economy requires enhancing transparency and efficiency in state governance. The following measures will contribute to this goal:

- a) Intensifying anti-corruption efforts. Digitizing public services, introducing transparent government procurement systems, and ensuring the independence of law enforcement agencies.
 - b) Implementing efficient public services. Eliminating bureaucratic delays and introducing fast and user-friendly online services to simplify the legalization of business activities.
 - c) Strengthening the social protection system
- 3.** Enhancing social protection for individuals working in the formal sector is crucial.
- a) Developing pension and health insurance systems. Citizens should be guaranteed access to quality pension and healthcare services through formal employment.
 - b) Improving social benefit mechanisms. Expanding access to mortgage loans, education grants, and other incentives for formally employed individuals.

The implementation of these strategic measures will significantly reduce the scale of the informal economy in Uzbekistan and ensure sustainable economic development.

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