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The Impact of the Shadow Economy on Economic Development: International Experience and Lessons for Uzbekistan

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Abstract: The shadow economy refers to economic activities that are not included in official statistics, significantly affecting the state budget, labor market, and investment environment. This article analyzes the impact of the shadow economy on various countries' economies based on international experience and derives key lessons for Uzbekistan. The research employs analytical, comparative, and statistical methods. The findings suggest that digitalization, tax simplification, and strengthening social protection are effective measures to reduce the shadow economy. The study compares data from multiple countries.

Keywords: Shadow economy, taxation, labor market, investments, economic reforms, digitalization, international experience.

INTRODUCTION

The shadow economy encompasses economic activities that remain outside state control, including tax evasion, informal employment, and illicit trade. According to the World Bank and the International Monetary Fund (IMF), the shadow economy accounts for 30-40% of GDP in some countries (World Bank, 2023). In developed countries, it mainly manifests in the form of illegal financial transactions, whereas in developing countries, informal employment and tax evasion are more prevalent.

Uzbekistan is among the countries facing challenges associated with the shadow economy. The government has introduced electronic tax systems and implemented measures to improve the business environment; however, the issue remains pressing. This paper examines the economic impact of the shadow economy based on international experiences and provides recommendations for Uzbekistan.

METHODS

This study employs the following research methods:

- Analytical approach: Data published by the World Bank, IMF, OECD, and other international organizations were analyzed.
- Comparative method: The levels of the shadow economy, its economic impact, and countermeasures in Uzbekistan, Russia, Germany, Brazil, and India were compared.
- Statistical analysis: The share of the shadow economy, its impact on tax revenues, and informal employment indicators were examined.

RESULTS

The findings indicate that the shadow economy significantly affects state budget revenues. Undoubtedly, it leads to lower tax collections, jeopardizing fiscal stability and, in some cases, even contributing to economic crises. Official statistics confirm the impact of the shadow economy on economic indicators in several countries. Examining their implemented reforms provides valuable insights into effective countermeasures.

European Union. According to OECD (2022), the shadow economy in European countries accounts for approximately 10-15% of GDP, with lower figures observed in economically stable nations. Countries such as Germany and France have successfully reduced this share to below 10% through strict tax policies and digitalization.

- Germany has implemented automated systems enabling tax authorities to monitor transactions in real time, thereby reducing the share of illicit financial activities.
- France has imposed strict restrictions on cash transactions and promoted digital payment systems to combat the shadow economy.

Such approaches contribute to increased state revenues and an improved investment climate across the European Union.

Another example is Russia. According to the International Monetary Fund (IMF, 2023), the shadow economy in Russia constitutes approximately 30% of GDP, resulting in an annual budget loss of nearly $50 billion.

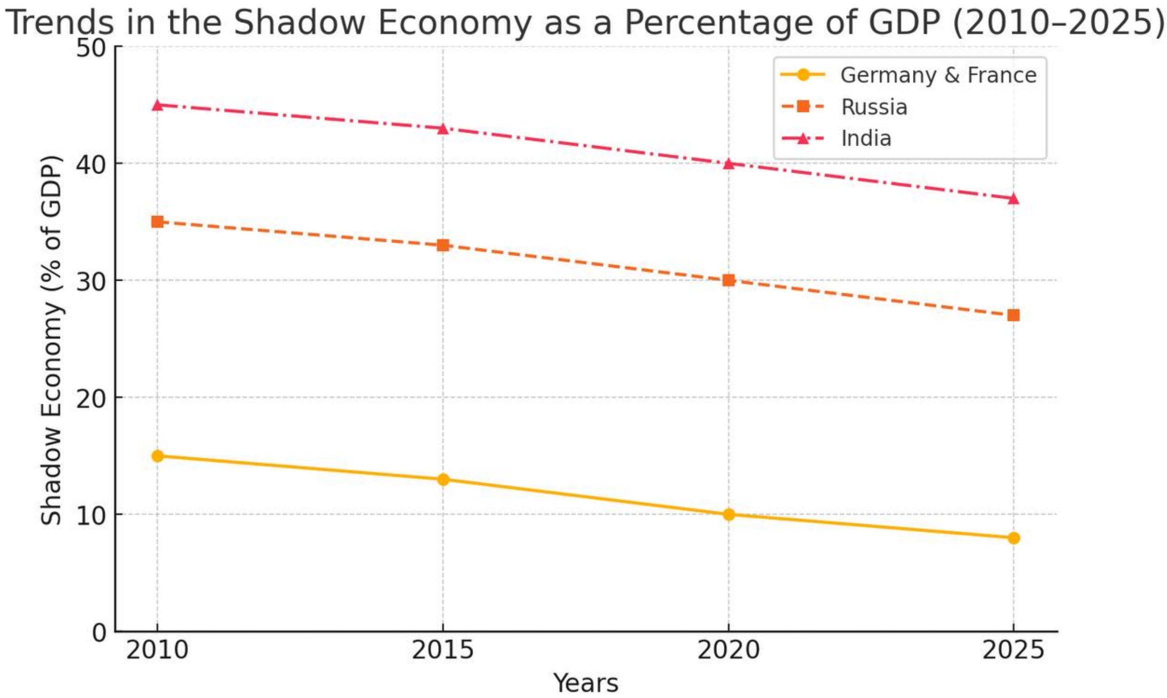
- As of 2022, over 35% of Russia's working-age population is employed in the informal sector.
- The Central Bank of Russia and the government have introduced various reforms aimed at curbing illegal cryptocurrency transactions, tax evasion schemes, and unregistered entrepreneurial activities.

However, high levels of corruption and an excessive tax burden continue to hinder substantial reductions in the shadow economy.

Moreover, approximately 40% of India's economy operates within the informal sector, largely due to the widespread use of cash transactions and low tax compliance.

- In 2020, the Indian government launched the "Digital India" initiative to reduce cash-based transactions and expand the tax base by promoting electronic payments among small business owners and entrepreneurs.
- Additionally, the introduction of the Goods and Services Tax (GST) system replaced multiple indirect taxes, ensuring more efficient tax collection.

Despite these efforts, many sectors in rural India remain heavily dependent on cash transactions, sustaining the size of the shadow economy. Furthermore, the high prevalence of unregistered employment necessitates additional measures to expand formal labor market participation.Data analysis can also be presented in graphical form.(1-picture: Trends in the Shadow Economy as a Percentage of GDP)



[1]

The graph illustrates that the size of the shadow economy continues to decline in European countries, while in Russia, the reduction is occurring at a slower pace. India, despite maintaining a high level of informal economic activity, is gradually decreasing its shadow economy due to digitalization and tax reforms.

It is important to emphasize that the prevalence of informal economic activities is influenced by factors such as government policies, the social status of the population, and even societal mentality. Lower-income groups are often participants in the shadow economy, primarily to evade taxes, which in turn affects the scale of government tax revenues. Reducing social disparities and poverty levels can contribute to limiting the operations of the shadow economy.

Having analyzed the impact of the shadow economy on state budgets, we now turn our attention to its effects on the labor market. One of the major drawbacks of the shadow economy is its tendency to shift jobs into the informal sector, thereby weakening social protection systems. Below are some country-specific examples illustrating these effects:

- Brazil, one of the leading economies in South America, has more than 40% of its working-age population employed in the informal sector. This prevents workers from accessing social security and pension funds, potentially exacerbating poverty levels (ILO, 2023).
- Uzbekistan, a Central Asian country, exhibits a similar trend. According to the State Statistics Committee, approximately 50% of the country's labor force is engaged in the informal sector. Although the government has implemented electronic tax systems and employment reforms, the results remain insufficient. Enhancing incentives and support for the private sector is currently one of Uzbekistan's key policy priorities.

Impact on Business and Investment Attractiveness. The shadow economy can also negatively affect business and investment attractiveness. Investors typically assess the economic indicators of a country before making financial commitments, and the presence of a large informal sector can undermine stability and attractiveness. This partly explains why developing countries often struggle to attract significant foreign investment. Below are some case studies of challenges faced by developed economies and their corresponding solutions:

[1] Trends in the Shadow Economy as a Percentage of GDP (2010-2025), based on OECD and IMF data

- ➢ Turkey: The widespread presence of the shadow economy has created obstacles for foreign investors seeking market entry. The government has responded by enhancing digitalization measures to improve economic cooperation. As a solution, Turkey is focusing on digitizing public services and creating favorable conditions for entrepreneurs to attract foreign investment.
- ➢ South Korea: The government has successfully reduced the size of the shadow economy by lowering tax rates and simplifying business procedures. As a result, since 1960, the country has maintained an average annual economic growth rate of 6% and currently ranks 4th in Asia and 14th globally in economic size.

DISCUSSION

The cases presented above highlight key international strategies and lessons for combating the shadow economy. The most effective approaches include:

- ✓ Strengthening digitalization and monitoring systems
- ✓ Implementing technological innovations to streamline public institutions
- ✓ Enhancing simplified and transparent regulatory frameworks

These measures can significantly reduce the negative impact of the shadow economy on national economies and improve overall economic stability.

The role of tax reforms and social protection in reducing the shadow economy can be important as well.

Estonia and Georgia have successfully reduced the size of their shadow economies by implementing electronic tax systems. In Estonia, 95% of tax declarations are submitted electronically, which has significantly increased tax revenues and reduced informal economic activities.

Uzbekistan is also taking steps to automate tax data and introduce electronic accounting systems. The State Tax Committee has launched nearly 50 remote services through the "my.soliq.uz" portal, contributing to the improvement of tax administration. However, further expansion and efficiency improvements in electronic tax systems are necessary to effectively combat the shadow economy.

Given that taxation policies and systems serve as a primary source of government revenue, tax incentives and reforms can create significant opportunities for individuals aiming to start new businesses.

Germany and Scandinavian countries have successfully reduced the share of their shadow economies by lowering tax rates. In Germany, almost all economic sectors are subject to taxation, and according to various analytical agencies, tax revenues constitute 80-89% of the national income. Additionally, countries like Ireland attract foreign investors by reducing corporate tax rates. For instance, Ireland's corporate income tax rate is 12.5%, which serves as a crucial factor in drawing foreign investments.

In Uzbekistan, formalizing small businesses is of great importance. However, challenges remain in enforcing existing laws. Government policies play a decisive role in shaping the country's economic landscape. Providing tax reductions or subsidies to small entrepreneurs could serve as an effective tool for encouraging business legalization and reducing informality. As a final solution, strengthening social protection systems can be seen as a logical continuation of the previously discussed measures.

Brazil and Mexico are striving to reduce their shadow economies by legalizing informal workers and providing them with benefits. For example, Brazil's "Simples Nacional" program introduced a simplified tax regime for small and medium-sized businesses, reducing informal employment from 40% to 35%. Similarly, Mexico's "Incorporación Fiscal" program led to a decrease in informal employment from 55% to 50%.

In Uzbekistan, introducing social protection programs for informal sector workers could also be beneficial. The "Strategy for Social Protection of the Population of the Republic of Uzbekistan", adopted in 2022, outlines measures to formalize informal employment and provide social guarantees to workers. For instance, in 2023, the number of low-income families receiving social assistance quadrupled, reaching 1.9 million.

CONCLUSION

The experience of different countries shows that digitalizing tax administration, simplifying business regulations, and strengthening social protection systems are key measures in reducing the shadow economy. In this regard, Uzbekistan can achieve significant progress by enhancing electronic tax systems, supporting small businesses through incentives, and expanding social protection for informal workers.

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