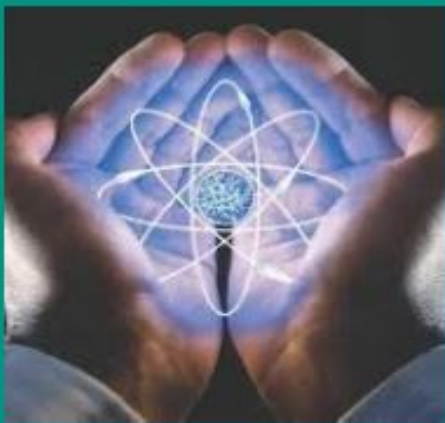


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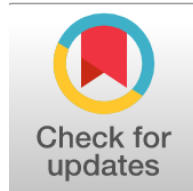
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## **Shadow Economy in Uzbekistan: National Trends and International Perspectives**

### *Ekonomi Bayangan di Uzbekistan: Tren Nasional dan Perspektif Internasional*

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#### **Abstract**

There has been a persistent shadow economy in the development of Uzbekistan, existing from an economic transition context along with tax evasion, informal employment, and illicit activities. However, government reforms have not reduced the size of informal sector which stands at about 27.2% of GDP, with the maximum being 52%. Addressing a knowledge gap, this study uses a mixed methods approach of statistical analysis and policy evaluation to analyse the drivers and the implications of the shadow economy. They found that high tax burdens, regulatory barriers, and attitudes among the general public concerning governance promoting informal practices. The results indicate that while recent efforts at curbing corruption and making the economy more open, are assisting in 'shedding' the shadow economy, there are still important yet residual obstacles in formalizing the labor market and achieving equitable economic development. Through these insights it is clear that legislative reforms, digitalization, and international cooperation is needed to ensure that targeting, long term strategies are used to promote transparency and sustainable growth in Uzbekistan.

#### **Highlights:**

Uzbekistan's shadow economy persists due to high taxes, regulation, and informal practices.  
Recent reforms aid transparency, but obstacles remain in labor market formalization.  
Legislative reforms, digitalization, and international cooperation needed for sustainable growth.

**Key words:** shadow economy, Uzbekistan, informal employment, tax evasion, economic reforms, governance, anti-corruption, economic development, regulatory barriers, digitalization.

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## Introduction

The analysis of the shadow economy in Uzbekistan reveals a complex socioeconomic problem having important implications for the development and governance of the country[1]. After Soviet Union's dissolution in 1991, Uzbekistan suffered in economic crisis, stimulating growth[2] of a substantial informal sector where the environment had widely prevalent tax evasion, illegal employment and illegal business, among others[3]. Earlier on, Uzbekistan's shadow economy has long been estimated to be approximately 40-50% of the national economy, but most recent surveys are reporting around 27.2% of Uzbekistan's GDP, which is nothing short of a significant pullback, despite evidence that the shadow economy is still as much as 52%. This undermining of government revenue, and complicating policy making and the work of economic reform, is this issue[4].

Much of the shadow economy has roots in an authoritarian governance style by President Islam Karimov, whose government's tightly regulated and heavy taxation of companies compelled many businesses to run outside the formal economic framework[5]. Localized efforts to formalise the economy, and anti corruption initiatives, form part of the transition to a broader economic model under the presidency of Shavkat Mirziyoyev, designed to tackle these challenges[6]. But underlying customerism and 'bureaucratic inertia' remain ongoing obstacles to these reforms and create the possibility of a revival of shadow economic practices[1].

In Uzbekistan, informal employment continues to be a highly prevalent form (about 59.8 percent of the workforce engaged in unregistered jobs) of labor and as such has characterized issues of social security and labor rights to a certain extent[7]. Legislative reforms and such programs like increased transparency and accountability, which do contribute to combating the shadow economy have nevertheless still not been able to overcome these barriers[8]. Shadow economy has a great impact on economy of Uzbekistan as a whole, causing a loss of revenues from taxes and jeopardising the integrity of the formal sector, which keeps speaking of economic inequality and instability[9].

Thus, the shadow economy in Uzbekistan is an urgent task that requires a detailed strategy for simultaneous management and integration into legitimate economy[10]. The government's efforts of ongoing reforms in line with international cooperation are aimed at these challenges in order to mitigate[12] them and the process of sustaining and growing[13] the economy while giving the citizens the maximum standards of their well-being[14].

## Methods

The shadow economy in Uzbekistan is analyzed with a mixed methodology combining the quantitative and qualitative techniques, highlighting its scale, drivers and implications in this study. Data sources were derived from national and international reports including assessments by the World Bank, United Nations as well as government publications related to the contributions of GDP, statistics on employment and the fiscal impacts of the shadow economy. Descriptive statistics were used to analyze these data in order to determine trends and correlations. Qualitative data in the form of review of anti-corruption strategies, economic reform programs, digitalization efforts in the relevant policies of Uzbekistan were complemented this. Quantitative findings were contextualized by examining policy documents, legal frameworks and case study.

To understand the socio cultural and regulatory factors behind informal economic activities, the study also relied on expert interviews and secondary literature. These helped reveal why people participate in the shadow economy and how to achieve transition to formal work. Reliability and validity were guaranteed by data triangulation whereby data from separate sources were cross verified in order to get to this conclusion. Qualitative data were thematically coded and quantitative datasets were pattern recognized to provide analytical insights. Using these methods, the research provides a robust analysis of the size of the data gap in the Uzbek economic and social institutions. These insights are powerful and comprehensive, and appropriate for policymakers to design strategic approaches to fight the shadow economy in favor of desired economic development.

## Result and Discussion

Uzbekistan's shadow economy has become a big problem since the breakup of the USSR, which left the country with several economic problems. Worsened by this economic turmoil, a shadow economy acquired, dominated by criminal activities, tax evasion and the creation of the informal working environment, grew. According to estimates, the share of informal activities on the national economy accounts for some 27.2% (around 73 billion USD by PPP). The fact that Uzbekistan ranks among the countries with the lowest rates of shadow economy activity in the Asia Pacific region, according to this figure, constitutes a major reduction, as it previously has estimated, earlier, about 40-50% from the declared figures four years ago, the United Nations. But other sources claim the shadow economy could be as high as 52 percent, placing Uzbekistan first among Central Asian countries by shadow economy share in relation to GDP.

Informal employment is of much concern. Of the 13.2 million employed people in Uzbekistan, 7.9 million or 59.8 percent work informally, according to the World Bank. The extremely high proportion of informally employed



persons is a matter of serious concern regarding social security and tax contributions, since they generally do not have social insurance coverage and are at risk of underpayment. In order to overcome these challenges, the government of Uzbekistan has carried out a range of measures aimed at shrinking the shadow economy's size and scope. The "Strategy of Action for 2017-2021" has significantly solved the economic problem and thus created the possibilities for formal employment services. Targeted assistance to vulnerable populations as well as improved access to social services electronically are accomplished through social protection measures, such as 'iron book' and 'social register.' In addition, Uzbekistan's efforts to further strengthen economic freedom (as measured by its improved position in the Index of Economic Freedom) have been pursued. These improvements, however, don't solve all challenges, as many entrepreneurs aren't able to join the legal economy primarily because of regulatory burdens and a dearth of support.

There are numerous reasons to believe that the persistence of the shadow economy is due to a variety of factors. Weighty taxation rates are a principal catalyst, encouraging people and businesses to stay away from taxes. Take for instance regions where essential goods such as tobacco products are very highly taxed, creating black markets, where sellers sell to meet consumer demand but sidestep government oversight. Just like that, strict rules even force businesses into the informal sector; especially when compliance is so costly or that it is difficult for small and medium enterprises (SMEs) to afford. Particularly in developing countries bureaucratic hurdles and low support discourage efforts at formalization. And the problem is made worse by limited job opportunities. In many transitional and developing economies, high unemployment and underemployment have motivated many people to take up alternatives to income other than the typical wage, which have frequently been outside of the formal economy. This is visible especially in cases where temporary or subsistence work that isn't formally recognized or regulated.

Growing the Shadow Economy is also contributed by economic volatility. Businesses may find it difficult to continue operations in the formal sector during disruptive financial markets, leading many to pursue informal ways of doing things. Thus, the shadow economy offers a surprising flexibility that becomes a tempting proposition during economic downturns. Cultural and social norms influence this as well: In societies experiencing broad distrust of government institutions, or approximately where people can believe that taxes are not being used efficiently. Such attitudes could erase the sense of responsibility for filing tax laws and regulations that would later cause the informal economic activities.

For participants in the shadow economy coping or deliberate strategies are adopted. The former consist of people who do informal work because there are no opportunities and the latter are those who deliberately do not pay taxes or comply with the laws in order to maximize profits[15]. This duality reflects the multi-level nature of walk-their-found path, and all the reasons why individuals and businesses choose to operate outside the official economy. To address the problems of the shadow economy underlying the issue, a comprehension of these multilayered drivers is needed for Uzbekistan.

Economic activities that occur outside formal markets without official recognition and regulation are embraced by the shadow economy. The amount reported includes revenue that is unreported, income from jobs that occur outside of the formal economy and transactions conducted illegally, and is extremely important for developing countries which may account for over 20 percent of a country's Gross Domestic Product (GDP). High tax burdens, restrictive regulatory environments, and limited formal sector employment opportunity are some of the factors to its prevalence. In 2020, globally the shadow economy was believed to be approximately 22.1% of GDP. The percentage of the shadow economy with respect to the GDP is high in the case of developing countries, compared with developed one, since it makes up 39-45% of GDP in Russia and Brazil for instance, and only 7,5% of GDP in developed countries such as France or USA. Aside from this, the scale of informal financial activities involved in these operations means money laundering, which is a central part of the shadow economy, contributes 2-5% of global GDP.

To deal with the problems of shadow economy, international organizations like International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN) have for example developed strategy and working groups to introduce standards in the fight against bribery and corruption. The OECD's Anti-Corruption Network for Eastern Europe and Central Asia has generated frameworks to improve transparency and accountability in governance while the Financial Action Task Force (FATF) has a central role in developing international standards for combatting money laundering and the financing of terrorism. Digital platforms have also become platforms to reduce the shadow economy. This is also what Turkey and Russia did: They'd implemented electronic government services to increase transparency and efficiency in public procurement. For example, Russia's AIS system eliminates shortcomings and opportunities for corruption by automating procurement processes. Like Uzbekistan, it has also begun an initiative such as the Single Window and Public Service Centers to modernize public administration and reduce shadow economy.

Reforms against the black economy and transparency in governance have been promoted in recent years by Uzbekistan. More than 70 regulatory acts aimed at fighting corruption across the different sectors of state and public administration have been adopted. Important in this effort was the signing in 2017 of the Law "On Combating Corruption", which defines key terms used in the context of corruption, outlines principles of state policy and provides legal definition of criminal acts related to corruption. Evidently, making poverty reduction its objective, the State Anti-Corruption Program for 2017-2018 affected the enactment of laws such as the Law on



Public Procurement and the Law on Public-Private Partnership, which aimed at promoting economic growth by reducing corruption. In 2018, a presidential resolution required that public councils be created under each ministry to enhance public oversight over government activities.

Taking advantage of these practices, Uzbekistan has built a National Anti-Corruption Strategy for 2021-2025, intended to overcome corruption by means of the all-rounded solution. The success of the organized experience of the international experiences is leveraged in this strategy; that political documents could help bring about progress. As a parallel, the government has made decisive steps to reduce the shadow economy by creating a Special Commission to encourage business to operate legally, simplifying tax regime, and formulating the Strategy for the Reduction of the Shadow Economy for 2021-2025. The President has stressed the need for a technically strong response and has coordinated efforts by 14 agencies to battle economic crime and the shadow economy.

To facilitate the integration of state owned enterprises to the formal economy and to put a stop to the excessive usage of tax and customs privileges that distort competition and hinder economic development, the program for transforming the state owned enterprises has been launched in Uzbekistan. By 2024, we expect that these reforms will not only help to boost economic growth but also greatly increase revenues in the legal sector. Despite remaining a still pressing challenge to Uzbekistan, it is made to progress in dealing with this shadow economy, which has been implemented those comprehensive strategies and reforms.

## Conclusion

A plummeting informal sector observed in Uzbekistan, now seen at 27.2% of GDP, is attributed to high taxation, bureaucratic burdens and socio-cultural factors (e.g. mistrust in governance). Progress in anti corruption reforms, let alone digital transformation and attempts to improve economic transparency has been patchy, and despite considerable progress barriers to formalization persist, most notably in informal employment and small business compliance. These results also emphasize the multilayered nature of the shadow economy and its unintended consequences for fiscal revenues, social security and equitable economic development. The implications of this study are that targeted and long term strategies that combine policy reform, improved governance and international cooperation are necessary to manage the shadow economy's role and encourage a sustainable growth. As mediators in the transition from informal to formal economic practice, further research should be focused on the role of digital financial systems and public trust in governance.

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