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REDUCING THE SHADOW ECONOMY: TAX ADMINISTRATION, CASHLESS PAYMENTS AND INFORMAL EMPLOYMENT

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Abstract: The article analyzes the nature, causes and consequences of the shadow and informal economy in a market economy, as well as the effectiveness of measures to reduce the share of the unobserved economy in Uzbekistan. Based on official data for 2017–2025, the share of the unobserved economy in GDP, its sectoral structure, the level of informal employment, and the impact of cashless payments and digitalization of tax administration are examined. Comprehensive proposals for reducing the shadow economy are developed.

Key words: market economy, shadow economy, informal economy, informal employment, tax administration, cashless payments, legalization, tax culture.

Introduction

A market economy functions efficiently when economic activity is visible to the state, contracts are legally enforceable, and all participants compete under the same rules. The shadow economy undermines each of these conditions. Firms that conceal their revenues and employees avoid taxes and social contributions, obtain an unfair cost advantage over law-abiding competitors and remain small in order to stay invisible. Workers employed informally are deprived of pensions, sick leave and legal protection. The state, in turn, loses tax revenue and must either raise rates for those who do pay or reduce spending on public goods.

The phenomenon of the shadow economy is complex, and different concepts are used to describe it. According to the methodology applied by the statistical authorities of Uzbekistan, the “unobserved economy” includes all economic activity not fully captured by regular statistical observations, and it consists of two parts: the informal economy, which covers small unregistered household and individual production, and the shadow economy, which represents legal activities deliberately hidden from the authorities to avoid taxes [9; 10].

The scale of this problem in Uzbekistan has historically been very large. According to the Minister of Economy and Finance, the unobserved economy accounted for 50–55% of GDP in 2016–2017, and informal employment covered 60% of the employed, or 7.9 million people, in 2017 [11]. As a result of reforms, the share of the unobserved economy declined to 34.8% of GDP in 2024 and to 32.9% in the first half of 2025, while informal employment fell to 38%, or 5.4 million people [8; 10; 11]. Nevertheless, about one-third of the country’s economy remains outside full official coverage, which makes this problem one of the main obstacles to building a competitive market economy.

The purpose of this article is to analyze the dynamics and structure of the shadow economy in Uzbekistan, to assess the effectiveness of tax, payment and labor reforms in reducing it, and to develop proposals for further legalization of economic activity. The objectives of the research are: to summarize theoretical approaches to the causes of the shadow economy; to analyze its dynamics and sectoral structure; to identify the main factors that drive firms and workers into the shadow; and to formulate policy recommendations.

Literature Review

The economic theory of the shadow economy is based on a comparison of the costs and benefits of operating formally. F. Schneider and D. Enste, in a fundamental review, identified the main causes of the shadow economy as a high burden of taxes and social security contributions, intensive regulation of labor and product markets, low quality of public services and weak tax morale [1]. In their view, it is not only the level of taxes that matters but also the complexity of the tax system and the perceived fairness of the state.

H. de Soto, based on research in Peru, showed that informality is often the result not of the desire to evade taxes but of excessively costly and time-consuming procedures for registering a business and property [2]. When legal entry requires months of paperwork and bribes, entrepreneurs rationally choose to remain informal, losing access to credit, courts and large markets. This approach emphasizes that simplifying registration and regulation is a key tool for formalization.

L. Medina and F. Schneider, in an IMF study covering 158 countries, estimated that the average size of the shadow economy worldwide declined over the past two decades, and that the most important factors associated with its reduction were improvements in the rule of law, lower tax burdens, the development of financial systems and the spread of electronic payments [3]. Electronic payments leave a digital trace of transactions, which makes concealment more difficult and increases the expected costs of tax evasion.

Among Uzbek researchers, J. Abduganiev, combining statistical analysis and policy evaluation, estimated the informal sector of Uzbekistan at about 27.2% of GDP and identified high tax burdens, regulatory barriers and public attitudes toward governance as its main drivers [4]. He concluded that anti-corruption and transparency efforts help but do not yet solve the problem of formalizing the labor market. The Center for Economic Research and Reforms (CERR), in a survey of entrepreneurs, found that 22% of enterprises employ workers without official registration and 18% pay wages “under the table”, with low costs (49%), simplified hiring and dismissal (36%) and seasonal work (33%) being the main reasons [11].

The literature shows that reducing the shadow economy requires a combination of measures: lowering the costs of formality, simplifying regulation, strengthening tax administration through digital technologies, and building trust in the state. The impact of the large-scale expansion of cashless payments in Uzbekistan on the size of the unobserved economy in 2024–2025 has not yet been fully analyzed

Methodology

The study is based on the following methods:

– theoretical analysis of the concepts of the shadow, informal and unobserved economy;

– dynamic analysis of the share of the unobserved economy in GDP for 2016–2025;

– structural analysis of the unobserved economy by sectors (agriculture, construction, services, industry);

– survey data analysis of entrepreneurs' reasons for informal employment based on CERR results;

– correlation-based comparison of the dynamics of cashless payments and the share of the unobserved economy;

– SWOT analysis of the policy to reduce the shadow economy.

The empirical base consists of data from the National Statistics Committee, the Ministry of Economy and Finance, the Central Bank of Uzbekistan and national news agencies.

Results and Discussion

Dynamics of the unobserved economy. The share of the unobserved economy in Uzbekistan's GDP has declined substantially over the past decade. The main indicators are presented in Table 1.

Table 1.

Dynamics of the unobserved economy and informal employment in Uzbekistan

Indicator	**Earlier level**	**Latest level**
Share of the unobserved economy in GDP	50–55% (2016–2017)	34.8% (2024); 32.9% (H1 2025)
Share of the shadow component in GDP	—	8.4% (Q1 2025); 8.0% (H1 2025)
Gross value added of the unobserved economy	—	265.5 trillion soums (H1 2025, ~USD 21.2 billion)
Informal employment, share of employed	60% (2017)	38% (2025)
Informal employment, number of people	7.9 million (2017)	5.4 million (2025)

Table 1 shows that over about eight years the share of the unobserved economy fell by roughly 20 percentage points, and informal employment decreased by 22 percentage points, which means that the number of informally employed people decreased by about 2.5 million. It is important to note that the "shadow" component in the narrow sense — deliberately concealed legal activity — amounted to only about 8% of GDP in 2025, while the larger part of the unobserved economy consists of the informal sector, primarily household agriculture and small unregistered services [10].

Sectoral structure. The level of unobserved activity differs considerably across sectors (Table 2).

Table 2.

Share of unobserved activity by sectors of the economy

Sector	**2024**	**H1 2025**
Agriculture, forestry and fisheries	63.6%	75.1%
Construction	41.3%	35.9%

Services	40.1%	35.2%
Industry	8.9%	10.5%

The data in Table 2 show that agriculture is the most “unobserved” sector, which is explained by the large role of dehqon (household) farms producing for their own consumption and for local markets. The increase in the indicator for agriculture in the first half of 2025 is largely seasonal [10]. In construction and services, about 35–40% of activity remains unobserved, which reflects widespread informal hiring of workers and cash payments. Industry, dominated by large registered enterprises, has the lowest share.

Factors behind informality. The results of the CERR survey make it possible to identify the main reasons why firms choose informal employment (Table 3).

Table 3.

Reasons for informal employment according to entrepreneurs (CERR survey)

Indicator / reason	**Value**
Enterprises employing workers without official registration	22%
Entrepreneurs paying wages “under the table”	18%
Reason: lower costs	49%
Reason: simplified hiring and dismissal	36%
Reason: seasonal nature of work	33%
Reason: no tax obligations	13%
Average wage gap between formal and informal workers	1.3 million soums

The survey results confirm the theoretical conclusions of Schneider and Enste and de Soto [1; 2]: the decision to stay informal is driven not only by taxes (13%) but to a much greater extent by overall labor costs and the rigidity of labor regulation (49% and 36%). The large number of responses related to seasonal work (33%) is especially important for agriculture and construction, where the legal framework for short-term employment remains complicated.

The role of cashless payments and tax administration. One of the most powerful tools for reducing the shadow economy has been the expansion of cashless payments, which create a digital record of transactions. The share of cash in the money supply decreased from 24.8% in 2023 to 18.9% in 2025, and the share of terminal receipts in total cash desk receipts increased from 41% to 43% [12]. The number of bank cards reached 77.3 million and the number of payment terminals 456.4 thousand by September 2026 [13]. Account ownership among adults rose from 44% in 2021 to 59% in early 2025, and 72% of adults now use digital payments [7], a level comparable with the global benchmarks of the Global Findex database [5]. Digital technologies sharply reduce the costs of tracking and verifying transactions [6], which makes concealment of turnover increasingly difficult. The simultaneous decline of the share of cash and the share of the unobserved economy in 2023–2025

is consistent with the international evidence that electronic payments reduce informality [3]. In addition, the President has instructed the authorities to continue improving and digitizing tax administration, to foster a tax culture and to apply sector-specific approaches, including allowing seasonal hiring without fines [11].

Table 4.

SWOT analysis of the policy to reduce the shadow economy (author's development)

Strengths	**Weaknesses**
• Steady decline of the unobserved economy since 2017 • Rapid expansion of cashless payments • Digitalization of tax administration • Separate statistical measurement of the shadow economy since 2024	• High share of informal activity in agriculture, construction and services • Rigid labor regulation • Complicated rules for seasonal work • Low tax culture
Opportunities	**Threats**
• Simplified regimes for self-employed and seasonal workers • Incentives for cashless payments (cashback, lotteries) • Data analytics and AI in tax control • Linking social benefits to formal employment	• Excessive control pushing small businesses back into the shadow • Growth of cash withdrawals and P2P transfers outside tax control • Distrust in the state • Corruption in inspections

Conclusion

The study shows that Uzbekistan has achieved a substantial reduction of the shadow and informal economy: the share of the unobserved economy in GDP fell from 50–55% in 2016–2017 to 34.8% in 2024 and 32.9% in the first half of 2025, the narrowly defined shadow economy amounts to about 8% of GDP, and informal employment decreased from 60% to 38% of the employed. These results were achieved through liberalization of the economy, simplification of tax and business registration procedures, and the rapid spread of cashless payments. At the same time, about one-third of the economy remains outside full official coverage, with agriculture, construction and services being the most problematic sectors, and the main reasons for informality are related to labor costs and the rigidity of labor regulation rather than to tax rates alone.

To further reduce the shadow economy, the following measures are proposed:

1. Introduce a simplified regime for seasonal and short-term employment in agriculture and construction, with registration through a mobile application and reduced social contributions for short-term contracts.

2. Reduce the burden on wages for small businesses during the first years after formalization, so that legalization of workers does not lead to a sharp increase in costs.

3. Expand incentives for cashless payments — cashback on VAT, receipt lotteries and lower fees for small merchants accepting QR payments.

4. Use data analytics and artificial intelligence in tax administration to identify risky sectors and taxpayers, shifting from blanket inspections to risk-based control.

5. Link access to preferential loans, state support and public procurement to the formal employment of workers and transparent turnover.

6. Conduct regular public campaigns explaining how tax revenues are used, in order to strengthen tax culture and trust in the state.

In conclusion, reducing the shadow economy is not only a fiscal task but also a condition for fair competition, the protection of workers' rights and the efficient functioning of a market economy. The most effective approach combines lower costs of formality with digital tools that make concealment unprofitable.

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LEXICAL DIFFERENCES BETWEEN BRITISH AND AMERICAN ENGLISH AND THEIR PLACE IN TEACHING

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Annotatsiya: Maqolada Britaniya va Amerika ingliz tillari o‘rtasidagi leksik farqlar ko‘rib chiqilgan. Kundalik hayot, transport, ta’lim, oziq-ovqat va uy-joy bilan bog‘liq so‘zlar misolida farqlarning turlari tasniflangan va ularning kelib