

## THE INFLUENCE OF THE SHADOW ECONOMY ON SOCIETY.

<https://doi.org/10.5281/zenodo.10304429>

**Salayeva Quvonchoy Rustam qizi**

*Economics Faculty,*

*Tashkent State University of Economics, Islom Karimov*

*49, Tashkent 100066, Uzbekistan*

[\*quvonchoysalayeva2004@gmail.com\*](mailto:quvonchoysalayeva2004@gmail.com)

### **Abstract**

*This article is devoted to the impact of the shadow economy on various aspects of society, including economic, and social development. The shadow economy is a phenomenon of great importance. Because of this it deserves a lot of attention and study. It is especially important for the implications that it has for the competitiveness of enterprises and for the equity and efficiency of the market economy. The shadow economy encompasses all economic activities that are not recorded in official statistics, such as unreported income, informal employment, and illegal activities.*

### **Key words**

*underground economy, growing economy, official economy, institutional sclerosis, formal and informal economy, social development.*

### **Introduction**

Shadow or underground economic activity is a fact of life around the world, and there are strong indications that it is increasing. Most societies attempt to control these activities through various punitive measures or through education, rather than through reforms of the tax and social security systems which could improve the dynamics of the official economy. Although a large literature exists on single aspects of the hidden economy, a current comprehensive survey is lacking. Disagreement persists about definitions and estimation procedures, and about the use of estimates in economic analysis and policy. The feature "Controversy: On the Hidden Economy" in Economic Journal (Vol. 109, No. 456, June 1999) documents the differing opinions of, e.g., Vito Tanzi (1999), James J. Thomas (1999), and David E. A. Giles (1999a). The size, causes, and consequences of the shadow economy vary for different types of countries, but some comparisons can be made which might be useful for social scientists and politicians, who must deal with this phenomenon sooner or later.

There are several important reasons why policy makers should be especially concerned about the rise of the shadow economy. Among the most important of these are:

(i) A growing shadow economy can be seen as the reaction of individuals who feel overburdened by the state and who choose the "exit option" rather than the "voice option" (Albert O. Hirschman 1970). If the increase of the shadow economy is caused by a rise in the overall tax and social security burden together with "institutional sclerosis" (Mancur Olson 1982), then the "consecutive flight" into the shadow economy may erode the tax and social security bases. The result can be a vicious circle of a further increase in the budget deficit or tax rates, additional growth of the shadow economy, and gradual weakening of the economic and social basis of collective arrangements.

(ii) A prospering shadow economy may cause severe difficulties for politicians because official indicators-on unemployment, labor force, income, consumption-are unreliable. Policy based on erroneous official indicators is likely to be ineffective, or worse.

(iii) The effects of a growing shadow economy on the official one must also be considered. On the one hand, a prospering shadow economy may attract (domestic and foreign) workers away from the official economy and create competition for official firms. On the other hand, at least two-thirds of the income earned in the shadow economy is immediately spent in the official economy, thus having a positive effect on the official economy.

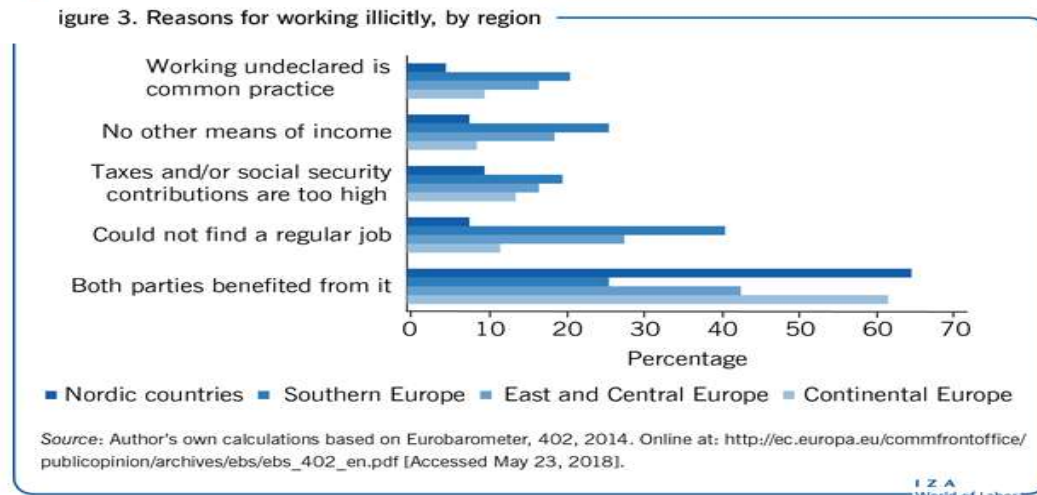
#### The Main Causes of the Increase in shadow economy

The growth of the shadow economy is caused by many different factors. The most important and often cited ones are: the rise of the burden of taxes and social security contributions; increased regulation in the official economy, especially of labor markets; forced reduction of weekly working time; earlier retirement; unemployment; and the decline of civic virtue and loyalty towards public institutions combined with a declining tax morale.

An interdisciplinary analysis of the causes of the increase of the shadow economy seems necessary, since economic factors can only partly explain the increase. Micro-sociological and psychological approaches can provide interesting additional insights in the decision making process of individuals choosing to work underground (Schneider and Enste 2000).

Based on survey data, the main reasons given for illicit work are "Both parties benefited from it"; "Could not find a regular job"; "Taxes and/or social security contributions are too high"; "No other means of income"; and "Working

undeclared is common practice.” But there are large differences between the regions in Europe.



Many empirical studies find the rising burden of taxes and social security contributions to be one of the most important drivers of the development of the shadow economy. Up to half the variance of the differences in the size of the shadow economy across countries can be explained by this factor, depending on the model and number of factors included. Since taxes affect the labor-leisure choice and stimulate labor supply in the shadow economy, the distorting effect of this influence is a major concern of economists. According to economic theory, the bigger the difference between the total cost of labor in the official economy and the after-tax earnings from work, the greater the desire to reduce this difference and to work in the shadow economy. This difference depends largely on the overall burden of taxes and social security contributions in the official economy, a burden that is evaded in the shadow economy.

#### Effects of the Shadow Economy on the Official Economy

In order to study the effects of the shadow economy on the allocation of resources, several studies integrate underground economies into macroeconomic models. 18 John F. Houston (1987) develops a theoretical model of the business cycle as well as tax and monetary policy linkages with the shadow economy. He concludes that, on the one hand, the shadow economy's effect should be taken into account in setting tax and regulatory policies, and on the other hand, the existence of a shadow economy could lead to overstatement of the inflationary effects of fiscal or monetary stimuli. In their study for Belgium, Markus C. Adam and Victor Ginsburgh (1985) focus on the implications of the shadow economy on official growth. They find a positive relationship between the growth of the shadow

economy and the official one, and they conclude under certain assumptions (i.e. low entry costs into the shadow economy due to low probability of enforcement) that an expansionary fiscal policy is a positive stimulus for both the formal and informal economies.

Consequences of Shadow Economies Serious consequences can arise from the existence of the shadow economy.

We shall list some of the main ones. The first important consequence has to do with equity. The fact that some individuals buy goods and services at prices that fully reflect the taxes imposed by the government while other individuals may buy similar but cheaper goods or services produced by the shadow economy makes the economic system less fair. All of these individuals benefit from government services. Similar considerations are relevant to those who sell the services. Those who operate in the official economy pay taxes while those who operate in the shadow economy do not. The existence of a shadow economy and especially of a large one has implications for the market system and for competition. When enterprises that operate in the official economy, and that must comply with the full tax and regulatory obligations, compete with enterprises that operate in the shadow and that do not comply with those obligations, they inevitably face unfair competition.

### CONCLUSION

Social development remains a topical problem in many developing countries as well as in developed ones. The researchers have made large efforts to estimate the size of the shadow economy, the causes and economic consequences, but there has been less attention in the empirical studies on the effect of the informal activities on social development. Mass of the literature presents findings of effects of the shadow economy. This issue still remains urgent, as researchers found the positive effects as well as negative. Therefore, the literature review discussed findings of supporters of both sides. Schneider is one of the leading experts on the shadow economy and he made detailed research for different aspect of the informal economy and noticed versatility of effects of the shadow economy (Schneider and Enste, 2013), while majority of other researchers paid attention to more narrow areas or to special cases.

### REFERENCES:

1. Journal of Economic Literature, Vol. XXXVIII (March 2000), Schneider and Enste: Shadow Economies: Size, Causes, and Consequences: pp 77-89

2. Enste, D. The shadow economy in industrial countries. IZA World of Labor 2018: 127 doi: 10.15185/izawol.127.v2

3. Bovi, M. (2002). The nature of the underground economy. ISAE

4. Allingham, M. G. and A. Sandmo, 1972, "Income Tax Evasion: A Theoretical Analysis", Journal of Public Economics, 1972, 1 (314) (November), 323-38.