ANALYSIS OF THE IMPACT OF THE SHADOW ECONOMY ON THE STATE FINANCIAL SYSTEM

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Abstract: In this paper, the scientific approach and views of the representatives of various economic schools regarding the hidden economy, as well as the influence of the hidden economy on public finances, are studied. Scientific conclusions related to scientific research are formed.

Keywords: Hidden economy, public finance, classical, dualistic theory, modernization.

Introduction. The following 6 theories are important factors in clarifying the meaning of the term «hidden economy» and expressing critical opinions about the «hidden economy».

These theories; classical/Marxist theory, dualistic theory, structuralist theory, formal legal approach.

According to the modernization or dualistic theory, the informal sector encompasses low-profit activities independent of the formal sector and provides income to the poor in times of economic distress. This theory expresses the functions of the two-way labor market and divides the labor market into four main categories: primary, secondary, informal and illegal. The core sector includes taxed and regulated permanent wage occupations. The secondary sector consists of occupations with a lower level of security than the main job and is not controlled. This may include low-wage occupations in the service sector. The informal sector is made up of cash-only groups of people and unregulated contracts whereby groups of people work secretly for employers. The fourth category includes all criminal activities aimed at making a profit. One problem with this typology is that it creates separate categories based on class, race, or gender.

Literature review. Research has shown that many people with easy access to the primary sector want to work in the informal economy as their main source of income or to earn additional income.[1] In our opinion, the representatives of the dualistic school cannot find the connection between the concepts of «formality» and «informality». Representatives of the dualistic school claim that the informal sector is an integral part of the agricultural economy. The problem is that they do not take into account the linkages between networks and the consistent growth of the informal sector.

In accordance with the theory of structuralist globalization, the informal sector is studied through subordinate economic units, i.e., micro-firms or groups of workers, and

[1]Losby, JL; Else, JF; Kingslow, ME; Edgcomb, EL; Malm, ET; Kao, V. 2002. Informal economy literature review. Washington, DC: Aspen Institute, Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination. 58 p. http://www.ised.us/doc/Informal%20Economy%20Lit%20 Review.pdf. (June 16, 2007).

the issue of increasing competition between large capitalist firms is seen while reducing the costs of raw materials and labor. Unlike other schools of theory, structuralist theory sees the informal sector as a link in capitalist development. A key aspect of the informal economy is that it has a unique relationship with the formal economy.[2] This theory is built on the basis of Wallerstein's world systems model, which is formed between the official link between the national economy and nations, which summarizes the concepts of high monthly wages and high efficiency economic activity, and the informal periphery, which summarizes the results of low monthly wages and low efficiency economic activity between countries[3]. According to Maloney, the group of workers refers to workers in the informal sector, small firms, and the self-employed sectors who are engaged in specialized work activities that are not protected by job security.[4]

According to the neoliberal/legislative theory, the informal sector is composed of a group of micro-level entrepreneurs operating informally, whose main goal is to avoid the cost, time and effort of formal registration. The main element of this theory is the delay of economic development due to low level of efficiency, limited amount of investments, ineffective tax policy, lack of implementation of technological processes and difficulties in macroeconomic policy. When government procedures are costly, micro-level entrepreneurs continue to produce illegally. According to Godfrey, legalists differ from dualists in the following ways:

A) Dualists see informality in the deep structure of economic roots (marginal value of labor), while legalists declare informality to arise mainly from institutional preferences and agreements;

B) Also, legalists differ from structuralists because structuralists see informality as a free choice in the shadow economy as a selective constraint with previous model participation. Thus, we can see that the way out of the shadow economy is to create institutions and incentives that encourage formality and remove the relevant barriers.

Poststructuralist/illegal/voluntarist/utilitarian theory is closely related to neoliberalism and neoclassical economics. According to these theories, entrepreneurs understand informality as an avoidance of taxes and labor market regulations. They are skeptical about the role of the shadow economy in the wider development. First, the marginal benefits of informality may be relevant for the population, who are least likely to have the lowest income and social benefits from formal employment.[5] [6] Furthermore, due

[2]Routh S. (2011): Building informal workers agenda: Imaging 'informal employment' in conceptual resolution of 'informality' (p. 208 - 227), Global Labor Journal, 2 (3).

[3]Paul C. Godfrey (2011), Toward a Theory of the Informal Economy, The Academy of Management Annals, Pages 231-277

[4]Maloney, WF (1998b). Are Labor Markets in Developing Countries Dualistic? Policy Research Working Paper No. 1941, World Bank, Washington DC

[5]Maloney, W. (2004) Informality Revisited. World Development, 32, 1159-1178

[6]Chen, M. (2004), Rethinking the Informal Economy: Linkages with the Formal Economy and the Formal Regulatory Environment, Paper presented at the EGDI-WIDR Conference´Unleashing Human Potential: Linking the Informal and Formal Sectors, Helsinki, Finland, 2004.

to low-skilled workers and low capitalization, most small informal enterprises fall victim to low efficiency and high failure rates, thus perpetuating the cycle of poverty.

Banks use different lending technologies when issuing loans. The choice of lending arrangement is determined by various factors, such as the primary source of information, screening and underwriting policies and procedures, loan agreement structure, and monitoring strategies and mechanisms.[7] The idea is that lending technologies can also be affected by the level of the shadow economy through the following mechanism.

In terms of share in GDP and share of employment, the size of the shadow economy is lower in more developed countries. The share of the shadow economy is negatively correlated with income per capita across different country samples and periods. In more developed economies, the shadow economy is dominated by tax evasion and undeclared work in registered firms.[8]. In contrast, the relatively high share of informal workers in developing countries is generally indicative of a lack of opportunities in the formal sector, which in turn increases the potential cost to public finances.[9] As the economy develops, informal firms are more likely to be replaced by new or existing registered firms rather than moving into the formal sector.[10] Shadow economies can have significant economic, social and financial consequences, and they create inefficiencies and inhibit growth and development along a number of dimensions:

Research methodology. In this study, research was conducted using the method of comparative comparison, that is, the data of the Tax Committee of the Republic of Uzbekistan was used and the analysis of this data was carried out.

Analysis and results. In recent years, we are witnessing an increase in the number of literatures that seek to better understand the characteristics of the underground economy. Theoretically and empirically, researchers are investigating how to better measure the size of this economy and how to explain its existence in the first place. Questions such as what motivates legal entities and individuals not to declare their income to the state (in whole or in part) and what economic and institutional factors may influence this choice remain in the usual focus. The answers to these questions may seem obvious at times, but there are often subtleties as well. For example, tax evasion is one factor that immediately comes to mind as an explanation for clandestine activity, and some recent research supports this assumption; At the same time, data show that the size of the shadow economy varies greatly between regions and economies with comparable levels of taxation, and that the level of shadow activity is little affected by

[7]Berger, A. & Udell, G. (2002). "Small Business Credit Availability and Relationship Lending: The Importance of Bank Organizational Structure," Economic Journal, Royal Economic Society, vol. 112 (477), F32-F53

[8]Schneider, F., & Buehn, A. (2012). Shadow Economies in highly developed OECD countries: What are the driving forces? IZA DP No. 6891, October 2012

[9]Oviedo, AM (2009). Economic Informality: Causes, Costs, and Policies: A Literature Survey of International Experience. Background Paper prepared for Country Economic Memorandum (CEM)–Informality: Causes, Consequences, Policies

[10]Porta, RL, & Shleifer, A. (2008). The unofficial economy and economic development (No. w14520).

changes in the fiscal system. Another sector affected by the level of the hidden economy is the financial market. It is natural to ask the question why activities carried out in the financial market can affect the level of the hidden economy. By affecting access to credit, financial market imperfections, particularly information asymmetries between borrowers and lenders, can force firms to operate (fully or partially) in the informal sector. An enterprise operating in the shadow economy can provide less information about its potential revenues and profitability and therefore cannot report its ability to repay loans. As a result, the cost of borrowing, i.e. the cost of capital, increases. Financial intermediaries (including banks) generally use standardized procedures for screening borrowers and issuing loans. These procedures are based on profitability parameters obtained from official balance sheets and profit tax documents. If part of the enterprise's activity is hidden, then it is more difficult to meet the requirements of intermediaries and the cost of credit may be higher. For example, income or goods hidden in the informal sector are not used as collateral to secure business loans in the formal sector. which means that such loans are less expensive and/or more expensive. Therefore, a firm trades off the benefits and costs of concealment when choosing its optimal behavior. This idea is reflected in recent analyzes that show how a company's decision to operate in the shadow economy is influenced by its ability to obtain credit, the associated costs, and the efficiency of financial markets.[11]. Taking into account the above, it can be noted that improving the functioning of financial markets, that is, financial development, is an important means of limiting hidden economic activity. Such improvements can take many forms, the most important being the reduction of costs for lenders to collect information about the characteristics and behavior of borrowers. Asymmetric information is a particularly acute problem in financial markets, for example, affecting the allocation of resources to informal (less efficient) sectors of the economy. As financial markets develop and the problem becomes more serious, better terms and conditions of financial contracts may be offered. The general idea is that information asymmetry between borrowers and lenders leads the latter to design contracts in such a way that the former faces the possibility of lending. A borrower can reduce this probability by declaring a large amount of his wealth publicly, but in doing so he faces a greater tax liability. The goal is to show how the marginal benefit of this choice positively affects the level of financial development. Financial intermediaries determine the terms of loan agreements based on their limited knowledge of the amount of declared wealth, uncertainty about project outcomes, and the type of agent. These conditions are characterized by the interest rate on loans and the probability of granting a loan. Given the structure of the financial agreement, both of these characteristics depend on the amount of collateral that agents put up: in particular, agents are more likely to declare their wealth if they have lower loan repayments and higher credit prospects. Given this, agents choose the optimal level of tax evasion to maximize expected profits. Moreover, this choice depends on the level of financial development measured by financial intermediation costs: in particular, tax

[11]Antunes, AR & Cavalcanti, TV (2007). "Start-up costs, limited enforcement and the hidden economy", European Economic Review, 51, pp. 203-224.

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Entrepreneurs operating in the shadow economy hide their income and structure their financial accounts primarily to avoid tax burdens and social security contributions. Nevertheless, they remain obscure to potential lenders and their ability to signal their income and funds is diminished. The result of this action is a decrease in the probability of obtaining credit.

In fact, financial accounts and tax reports are one of the main sources of information that banks need for lending. These types of documents represent a relatively inexpensive way to collect information about borrowers. However, transactional lending technologies can be implemented optimally only when the bank first faces transparent borrowers. Conversely, if a bank is operating in a market saturated with informal firms that can provide unreliable information, standardized lending procedures may reduce banks' profits to an unprofitable level.

In our research, we consider the dynamics of the number and types of tax violations, as tax evasion, disclosure of incomein case of failure, it affects the financial system of the state (Fig. 1).Xucan, not submitting tax reports, not submitting them on time, or submitting them in an unspecified form during the years 2016-2020, and not submitting payment instructions to the bank for paying taxes and other mandatory payments during this period, or not submitting them on time, as well as during these years The overall tendency scale was widely used to determine the number of tax violations, such as conducting business activities without state registration.

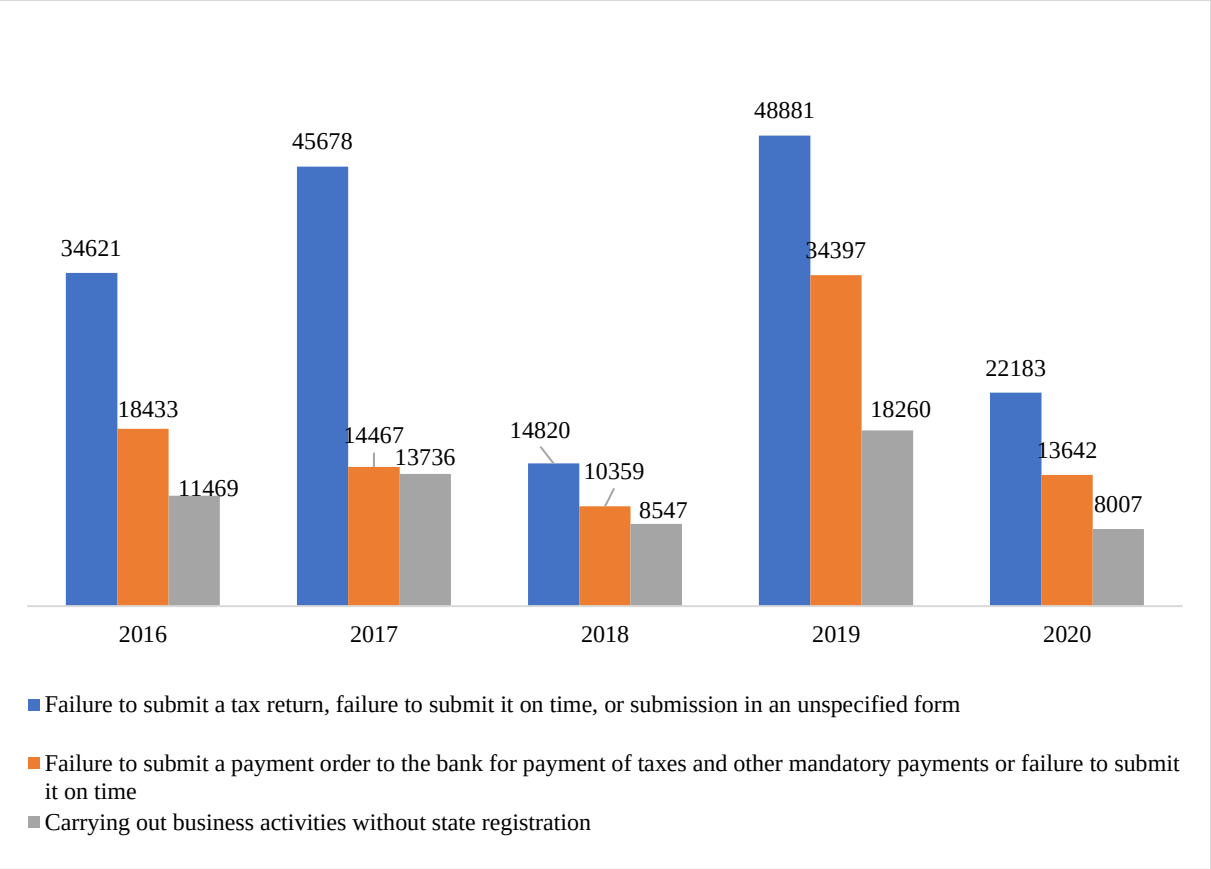


Figure 1. The number of the most observed violations recorded during the tax control process[12]

The existence of the underground economy can seriously affect economic performance and government revenues. Public finances may suffer as a result of a reduction in the tax base, which weakens the government's ability to generate revenue. For these reasons, a large amount of research has focused on understanding the factors that contribute to the size of the shadow economy. By its very nature, the shadow economy is difficult to study empirically. Nevertheless, great progress has been made in developing techniques to determine its size and significance. The existing literature focuses mainly on various aspects of public policy and public administration as incentives to engage in clandestine activities. These include the burden, complexity, fairness of tax systems, the burden of social security payments, the extent of bureaucracy and procedures,

State budget revenues and services: The activities of the shadow economy are often not taxed and therefore cause a decrease in state budget revenues. This in turn leads to fewer and/or weaker public goods and services. Weak public services such as education, social support or training programs can by themselves undermine growth prospects and poverty reduction efforts. But it can also have a dynamic effect, as weak public services negatively affect public perceptions of government effectiveness, which

[12]Formed through the information of the State Tax Committee

increases citizens' incentive or willingness to avoid taxes, increases informality, and further weakens public revenues and services.[13] Therefore, lower incomes may require higher taxation across the economy.

Combating the shadow economy, in turn, requires systemic reforms. Because before companies move to the shadow economy, they analyze what they will gain and what they will lose by working in the shadow economy. If what they are losing is higher than what they can gain, then they rarely go into the shadow economy (Table 1).

Table 1

Advantages and disadvantages of operating in the underground economy[14]

Advantages of operating in the underground economy	Aspects that are lost by operating in the shadow economy
Exemption from excess tax burden	Inability to use bank loans
Freedom from excessive government control and regulation	Inability to expand activities
Ineffective activity of state regulatory bodies	Inability to use state aid programs
	Inability to use corporate insurance services
	Inability to export products and services

It can be seen that the advantages of operating in the underground economy are greater and more important than the disadvantages, if the financial system in the country does not function effectively as a whole, the motives of enterprises to operate in the underground economy will increase.

Conclusions and suggestions. Some studies link the tax burden to tax avoidance, as higher tax rates are a reason to avoid paying higher taxes. Therefore, small reductions in tax rates can lead to large changes in the behavior of taxpayers and may actually cause them to disclose higher incomes to a greater extent. Conversely, an increase in the tax rate may lead to more income being hidden from the tax authorities. Another aspect that can affect budget revenues is tax incentives (political incentives) given to foreign investors. We believe that individuals pay taxes primarily because of the real or perceived benefits they can receive by paying taxes. Secondly, they pay them out of fear of the negative consequences of not paying them, and only thirdly (and to a lesser extent) out of «fiscal literacy» and out of a desire to help achieve the «common good». Thus, people usually pay taxes first to enjoy the relevant social benefits, and then to avoid the risk of paying a penalty. Fiscal literacy actually relies on the law. It is true that moral constraints can prevent tax evasion, but this depends on the existence of laws. Individuals fear being penalized for not paying taxes. On the other hand, issues of tax compliance or non-compliance are relevant to the tax burden and tax refunds in each country. usually people pay taxes first to enjoy the relevant social benefits and then to avoid the risk of paying a penalty. Fiscal literacy actually relies on the law. It is true that moral constraints

[13]Schneider, F. (2004). The Size of the Shadow Economies of 145 Countries all over the World: First Results over the Period 1999 to 2003.

[14]Developed by the author

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