



**THE ROLE OF INSTITUTIONS IN ELIMINATING THE  
PROBLEMS OF TAX POLICY IN THE FORMAL AND INFORMAL  
ECONOMY**

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***Abstract:*** *This article examines the structural differences between formal and informal tax policy in Uzbekistan, analyzing the economic consequences of tax evasion on state budget revenues and GDP dynamics. Drawing on official statistical data for 2019–2025, the research identifies institutional weaknesses that enable the shadow economy to persist and proposes a set of policy-driven solutions involving inter-agency cooperation, tax incentive reforms, and international integration. The findings suggest that a multi-layered institutional approach is essential for achieving sustainable fiscal transparency.*

***Keywords:*** *tax policy, formal economy, informal economy, shadow economy, tax rates, fiscal transparency, institutional reform, Uzbekistan*

**Introduction**

Tax policy reflects the state's overarching strategy and philosophy toward taxation. As a comprehensive system of rules, rates, exemptions, and obligations applicable to both individuals and legal entities, it serves as one of the most powerful instruments available to governments for managing macroeconomic activities. A well-designed tax policy can stimulate investment, reduce unemployment, redistribute national wealth, and secure stable public revenues.[6]

The global economy operates through two distinct layers: the formal sector, which functions in full compliance with state regulations and tax obligations, and the informal sector, which largely circumvents these legal frameworks. In developing and transition economies, the informal sector often constitutes a significant share of



GDP, yet contributes disproportionately little to public revenue.[1] Uzbekistan is no exception to this challenge.

The problem of informality in Uzbekistan has attracted increasing attention at the highest levels of government. President Shavkat Mirziyoyev, at a video selector meeting on January 16, 2024, identified the hidden economy as “the most urgent issue today,” warning that it poses a direct threat to fair market competition and fiscal integrity.[2] This article seeks to analyze the institutional dimensions of this challenge and propose evidence-based solutions.

### **Conceptual Framework: Formal vs. Informal Economy**

The formal economy comprises all economic activities that are registered, regulated, and taxed by the state. Participants in the formal economy maintain official accounting records, pay mandatory taxes, and operate under legal protections. In contrast, the informal (or shadow) economy encompasses economic activities deliberately concealed from state authorities to avoid taxes, social contributions, and regulatory requirements.

Key distinctions between the two sectors include:

- **Regulatory compliance:** Formal entities comply with tax codes and reporting standards; informal ones avoid these obligations.
- **Access to finance:** Formal businesses can access bank loans and government grants; informal ones cannot.
- **Legal protection:** Formal entities have recourse to commercial courts; informal ones lack legal standing.
- **Contribution to GDP:** Both sectors contribute to national output, but only the formal sector is accurately measured.
- **Social security:** Formal workers receive pension and health coverage; informal workers are excluded from these protections.

The International Labour Organization (ILO) estimates that in emerging economies, informal employment accounts for up to 70% of total employment in some regions.[7] For Uzbekistan, estimates of informal sector share have ranged from 40–55% of GDP, underscoring the urgency of institutional reform.



## Root Causes of Informality in Uzbekistan

Understanding why businesses and individuals choose to operate informally is essential for designing effective solutions. Research and field evidence point to several interrelated causes:[5]

1. High tax burden and complex compliance costs. Many small and medium enterprises (SMEs) perceive the tax system as burdensome. Complex documentation requirements discourage entrepreneurs from registering formally, particularly in early stages of operation.

2. Limited institutional trust. Low confidence in state institutions means that taxpayers do not perceive tax payments as beneficial. When citizens doubt that revenues will be efficiently spent on public goods, the moral incentive to pay taxes diminishes.

3. Informational asymmetry. Many entrepreneurs, especially in rural areas, lack adequate knowledge of tax regulations and the benefits of formal status. This ignorance (not merely evasion) leads to non-compliance.

4. Weak enforcement mechanisms. Inconsistent enforcement creates opportunities for tax evasion. When penalties for non-compliance are perceived as low or avoidable, the incentive to operate informally remains high.

5. Short-term profit orientation. Newly established enterprises or micro-entrepreneurs often prefer immediate cost savings over long-term formal growth, not realizing that expansion requires legal formalization.

## Statistical Analysis of Tax Revenues in Uzbekistan (2019–2025)

Official data published by the Ministry of Economy and Finance of Uzbekistan provide a clear picture of the relationship between GDP growth and tax revenue performance over the period from 2019 to 2025.[9]

**Table 1. Analysis of the share of tax revenues in 2019–2025 (in billion soums)**



Indicators	2019	2020	2021	2022	2023	2024	2025
GDP amount	529,391	602,193	734,588	888,342	1,066,569	1,535,400	1,700,000
State budget revenues	112,165	132,938	164,680	202,043	183,443	274,300	308,500
Tax revenues	97,785	112,892	138,257	159,750	175,955	199,500	247,800
Tax revenues to GDP (%)	18.5%	18.7%	18.8%	17.9%	16.5%	13.0%	14.6%

*Source: Ministry of Economy and Finance of Uzbekistan; State Tax Committee of Uzbekistan (2024–2025)*

Analysis of the table reveals several important trends. From 2019 to 2021, the ratio of tax revenues to GDP showed a modest upward trajectory, rising from 18.5% to 18.8%. However, this ratio declined sharply in subsequent years, falling to 17.9% in 2022 and 16.5% in 2023. This is particularly striking given that nominal GDP grew substantially over the same period—from 529 trillion soums in 2019 to over 1,066 trillion soums in 2023.[5]

Furthermore, state budget revenues declined in absolute terms in 2023 (183,443 billion soums) compared to 2022 (202,043 billion soums), even as GDP continued to rise. This decoupling between economic growth and fiscal performance is a strong indicator of expanding informal economic activity. It suggests that a growing share of wealth creation is occurring outside the formal tax net.[9]

In 2024, the situation showed partial recovery. Tax revenues reached 199.5 trillion soums, exceeding the projected 196.5 trillion soums - the first time actual



collections surpassed forecasts in several years. State budget revenues rose to 274.3 trillion soums, an 18.3% increase over 2023. However, a major methodological revision of GDP - incorporating previously unrecorded shadow economy activities, off-budget expenditures, and data from international auditors - raised the 2024 GDP figure from 1,454.6 trillion to 1,535.4 trillion soums (\$121.4 billion). As a result, the ratio of tax revenues to revised GDP declined to approximately 13%, reflecting both the improved measurement of GDP and the still-significant scale of informal activity.[10]

In 2025, the State Tax Committee reported total budget revenues of 247.8 trillion soums for the full year - a 24% increase year-on-year. Corporate income tax was the single largest contributor at 72.3 trillion soums (+37%), followed by VAT at 45.2 trillion soums (+14%) and personal income tax at 42.4 trillion soums (+20%). GDP was projected to reach approximately \$135 billion (around 1,700 trillion soums), reflecting real growth of 7.7% — the highest since 2021. These positive signals indicate that institutional reform efforts are beginning to bear fruit. Nevertheless, the tax-to-GDP ratio remains significantly below the 2019–2021 baseline, underscoring the structural challenges that remain.[10]

## **The Role of Institutions in Addressing Tax Informality**

Institutions play a central role in shaping taxpayer behavior. Both formal institutions (laws, tax authorities, courts) and informal institutions (social norms, trust in government, cultural attitudes toward compliance) determine the extent to which economic actors choose to operate within or outside the formal system.

### **1 The State Tax Service**

The State Tax Service of Uzbekistan operates under the motto “The State Tax Service is a reliable partner of the honest taxpayer.” However, the challenge of building genuine partnership with the taxpayer community remains considerable. Rather than purely punitive enforcement, modern tax administration theory emphasizes service-oriented approaches: simplifying registration procedures, offering taxpayer education programs, and creating digital platforms that reduce compliance costs.[3]



## 2 The Ministry of Internal Affairs Bureau (MIB)

The Enforcement Bureau (MIB) collaborates with the Tax Service in identifying and prosecuting tax evasion. Strengthening inter-agency cooperation between these institutions-through joint databases, coordinated investigations, and shared enforcement protocols-can significantly reduce the operational space available to informal actors. International experience demonstrates that integrated enforcement platforms dramatically increase detection rates and reduce administrative duplication.[4]

## 3 The Ministry of Economy and Finance

Fiscal policy design, which falls under the purview of the Ministry of Economy and Finance, directly influences the incentive structure for formal versus informal operation. Well-calibrated tax rates that balance revenue needs with business viability can lower the attractiveness of informality. Similarly, targeted tax incentives linked to employment creation and GDP contribution can motivate enterprises to formalize.[8]

### Proposed Solutions and Policy Recommendations

Based on the analysis above, the following recommendations are proposed for policymakers and institutional actors in Uzbekistan:

1. **Rationalize tax rates for SMEs.** Reducing the tax burden on small and medium enterprises-particularly in their initial years of operation-can lower the incentive to operate informally. Progressive tax structures that increase obligations only as enterprise income grows would be more equitable and effective.
2. **Expand taxpayer education programs.** Nationwide financial literacy campaigns, conducted through schools, community centers, and digital media, should focus on the long-term benefits of operating formally: access to credit, legal protection, social security, and business expansion opportunities.
3. **Develop employment-linked tax incentives.** Entrepreneurs who create employment should receive proportional tax benefits. Linking fiscal incentives to job creation and GDP contribution would align private incentives with public goals.



4. **Strengthen inter-agency data integration.** Establishing a unified digital platform shared by the Tax Service, MIB, and the Ministry of Economy and Finance would enable more effective detection of informal activities through cross-referencing of financial and operational data.

5. **Leverage WTO accession for fiscal reform.** Uzbekistan's ongoing accession process to the World Trade Organization presents an opportunity to align domestic tax policy with international standards, improving transparency, reducing non-tariff barriers, and creating a more level playing field between formal and informal operators.

6. **Introduce graduated penalties and amnesty programs.** While enforcement must be strengthened, amnesty programs offering reduced penalties for voluntary disclosure can incentivize informal operators to transition to formal status without the fear of punitive retroactive taxation.

7. **Support formalization through digital public services.** Streamlining business registration, tax filing, and compliance reporting through user-friendly digital platforms can dramatically reduce the transaction costs associated with formal operation.

## **Uzbekistan's WTO Accession and Its Fiscal Implications**

Uzbekistan's accession to the World Trade Organization represents a transformative milestone for the country's fiscal and trade policy landscape. WTO membership would require Uzbekistan to implement a range of reforms in customs, taxation, and trade regulation that are broadly consistent with the goals of reducing informality and increasing fiscal transparency.[8]

Under WTO rules, Uzbekistan would be obligated to reduce tariff and non-tariff barriers, harmonize domestic regulations with international standards, and increase transparency in its trade and fiscal policies. These obligations, while requiring adjustments, would simultaneously create pressure to formalize domestic economic activities, as informal operators would find it increasingly difficult to compete in a more transparent regulatory environment.



Additionally, WTO membership would likely attract greater volumes of foreign direct investment (FDI), which tends to operate formally and contributes to tax revenues, further reducing the relative share of the informal sector in total economic activity.

## Conclusion

The persistence of the informal economy in Uzbekistan represents one of the most significant structural challenges to fiscal sustainability and equitable economic development. Statistical data for 2019–2025 clearly demonstrate that despite robust nominal GDP growth, the ratio of tax revenues to GDP has been declining, signaling an expansion of informal economic activity.

Addressing this challenge requires a coordinated institutional response that goes beyond punitive enforcement. Tax authorities must reposition themselves as service partners rather than mere regulators.[3] The Ministry of Economy and Finance must design incentive-compatible tax structures that make formal operation economically attractive.[9] The MIB must work in closer integration with tax authorities.[4] And the broader policy framework must be aligned with international standards, as embodied by Uzbekistan's WTO accession aspirations.

Ultimately, the transition from informal to formal economic activity will occur only when entrepreneurs genuinely perceive formalization as beneficial-not merely compliant. Achieving this perceptual shift is as much an institutional challenge as it is a fiscal one, requiring sustained commitment from policymakers, regulators, and civil society alike.[6]

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