The tax gap and fiscal convergence

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I am in Brussels (again) today speaking at a conference organised as part of the Enlighten Horizon 2020 programme. The panel I am a part of is discussing various issues relating to fiscal convergence. My own part addresses the tax gap and fiscal convergence and in essence suggests that unless failure to address the tax gap is taken into account fiscal convergence is a fairly meaningless concept as GDP will be incorrectly stated and so too will real levels of government spending, which will be disproportionately overstated. These are my slides:

Fiscal convergence and the tax gap

* Richard Murphy

* Professor of Practice in International Political Economy, City, University of London

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Fiscal convergence

* Can be defined as the fiscal prudence intended to achieve the goals for unified economic management specified in the Maastricht Treaty

* The problem with this is that this assumes that available economic data is sufficient to confirm compliance with this objective

* I suggest that this is an inappropriate assumption and new conditions for fiscal convergence need to be established

The failings of existing criteria

* The existing criteria are applied within a framework that:

* Assumes existing macroeconomic data is fit for purposes

* Ignores much of the GDP lost to the shadow economy

* Ignores the tax gap

* Imposes no requirement to address these issues

* Implicitly endorses the current structures that permit their existence as a result

* Does not require convergence as a consequence

The scale of the issue

* For convenience I am using data from my 2012 report on the EU tax gap

* **http://www.socialistsanddemocrats.eu/sites/default/files/120229_richard_murphy_eu_tax_gap_en.pdf**

* **There is no doubt that this could be updated**

* **It's also undoubtedly true that with more work the methodology could be improved**

* **And I stress nothing in this work suggests that sums noted represent tax recoverable in current tax structures.**

The size of the EU's shadow economies

Convergence requires

* Assessment of economic capacity based on GDP inclusive of the shadow economy

* Assessment of deficits on the basis of tax spending ***including*** uncollected tax as if it is a budgeted tax spend

* A requirement that this spend be controlled like all others

The pre-condition of accepting this goal

* There has been a reluctance to tackle this issue

* This is based on the widespread belief that if the tax gap is tackled the economic activity brought within the scope to tax will be lost altogether

* This is not true. Microeconomic theory says that markets work best to maximise social well-being when there is a level playing field on which all market participants compete

* The tax gap destroys that level playing field. The result must be that markets deliver sub-optimal results because of misinformation, distorted rates of return, misapplication

of capital and reduced productivity

* Closing the tax gap will overcome these market defects. Accepting this market based argument is the pre-condition for change in the convergence criteria

There is a need to deliver change

* Improve measures of the shadow economy
* Improve measurement of the tax gap
* Invest in closing the tax gap
* Develop the tools to help achieve this goal

The necessary tools

* Country-by-country reporting
* Effective company registries
* Including verified beneficial ownership data
* Full accounts on public record or the loss of limited liability
* Domestic automatic information exchange from banks to tax authorities and company registries to identify who is trading within an economy
* Regulatory staff to monitor the supply of data
* Enforcement staff to tackle tax gaps
* Then we might have something like convergence
* Right now we only have a pretence of it.