Funding the Future

The EU tax gap is at least â‚¬825 billion a year

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I have this morning published a new estimate of the tax gap in the EU. The [report that supports this estimate]was commissioned by the Socialists and Democrats Group of MEPs in the EU Parliament, for whom I prepared [a similar estimate in 2013].

The executive summary is as follows and the report, plus appendices that explain the methods used, [is here.]

A decade after the collapse of 2008 the European Union is only slowly getting back to economic recovery. Across the member states, whether within or outside the Eurozone, the constraints of tight fiscal rules, austerity and a shortage of tax revenues continue to limit the scope for action by governments needing to stimulate their economies. Many are frustrated at the consequent constraints on innovation, including those necessary to tackle climate change. The announced and long awaited economic recovery risks benefiting only the most powerful; while the distribution of the potential economic growth will be critically monitored by EU citizens.

In the same decade that these issues have changed the nature of European politics awareness of tax injustice has grown, considerably. Much of this attention has rightly focussed on the actions of the multinational corporations that have used international tax rules to avoid their obligations to many of the countries that host their operations. Another tax issue has received less attention but is of large-scale and great impact on European Union member states. This is the tax loss — or tax gap — arising from the non-payment of tax within the domestic economies of EU member states. This illegal tax evasion is the focus of this report.

The evidence now available suggests that the EU tax gap resulting from largely domestic tax evasion might be â‚¬825 billion a year, based on data for 2015. It is harder to estimate corporate tax avoidance in the EU, but available evidence suggests different amounts, from â‚¬50bn a year to â‚¬190bn a year according to previous European Parliament studies.

The good news is that these estimates are smaller than in 2009, which was the base year for the last EU wide tax gap estimate of this sort. The reduction in the tax gap, when allowing for inflation, is at least 11.8% over that period. That suggests that tax authorities have become more effective in tackling tax abuse since the 2008 downturn began. The size of the shadow economy in the European Union has fallen according to all available evidence. Effort expended has clearly worked.

That said, the remaining tax gap is large. Percentage tax gaps, expressed as a proportion of expected tax revenue, vary from 7.98% in Luxembourg to 29.51% in Romania. In absolute amounts the biggest tax gaps are in Italy, France and Germany. In half of all EU member states have tax gaps that might exceed their healthcare spending, and often by considerable amounts.

This suggests that there is considerable scope for further action to tackle the tax gap. Taking that action is really important for three reasons.

Firstly, in the EU and across the world monetary policy is now ineffective: very low interest rates guarantee that. Fiscal management now has to rely on tax-based incentives but these only work if the tax gap is small. The only available economic weapon to tackle a future recession requires then that the tax gap be reduced as much as possible.

Secondly, the tax gap indicates the scale of inequality between those who do, and do not, pay tax. This is a social injustice that needs to be tackled as much as other forms of inequality need to be addressed.

Third, it is clear that when there are economic constraints collecting taxes owing makes sense, either to ensure expenditure is matched by appropriate funding or to deliver lower tax rates to those who are tax compliant.

The good news is that the evidence shows that action is possible, and benefits can accrue. But as this report shows, across the EU far too many governments are refusing to even measure their tax gaps, let alone take action to address them. Acknowledging the importance of the tax gap, and improving the ways to measure and tackle it as suggested in this report, is now essential to the future economic well-being of the European Union member states. In the face of increasingly difficult economic circumstances now is the time to act.

I will be publishing more ion this issue over the next few days.