

TAX POLICY APPROACHES

WHEN THIRD-BEST IS BEST

FIRST-BEST

First-best approaches form a 'perfect' tax system, with no barriers to information or enforcement. In practice, these are not used as they are impractical and inequitable (e.g., lump sum tax).

SECOND-BEST

High-income countries use **second-best approaches** to tax collection to maintain production efficiency. With good information and enforcement, they can collect **30–40% of GDP** in revenue.

Low-income countries use the same approach. But a lack of information and enforcement capacity means that they can typically generate only **10–15% of GDP** in revenue.

THIRD-BEST

In many low-income countries, a **third-best approach**, which addresses limits to information and enforcement, could reduce tax evasion and generate more revenue.

