Emerging analysis and ideas

Mobilising revenue: opportunities for lower-income countries during the pandemic

Hazel Granger, Iain Steel, Kyle McNabb and Harshil Parekh (ODI) and David Phillips and Lucie Gadenne (IFS)

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Hazel Granger is a Research Fellow in ODI's Development and Public Finance team and ODI's lead on the DFID-funded TaxDev programme.

Iain Steel, **Kyle McNabb** and **Harshil Parekh** and are ODI Research Associates providing tax policy research and technical assistance to the TaxDev programme.

David Phillips is an Associate Director at the Institute for Fiscal Studies, helping lead work on local and devolved government finance and the TaxDev programme.

Lucie Gadenne is an Assistant Professor of Economics at Warwick University and a Research Fellow at the Institute for Fiscal Studies.

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Key messages

- The fiscal response to the Covid-19 crisis can be framed in terms of three phases of intervention – support to vulnerable households and struggling businesses to help keep their heads above water during lockdowns; stimulus to restart economic activity once lockdowns are lifted; and consolidation to shore up public finances after recovery.
- Public spending to support the vulnerable during the crisis and build resilience against future shocks helps foster a sense of solidarity and builds the case for greater tax contributions from those who are able to pay. Changes that are normally politically difficult could begin now.
- Domestic revenue mobilisation (DRM) efforts, which are likely to continue after the shock, already include a range of strategies for broadening the tax base and addressing non-compliance. But governments could make use of the opportunities this shock provides to make changes to tax systems now that might otherwise be too politically difficult later.
- We suggest five tax policy strategies that could help mitigate revenue losses in the short term and help build more effective tax systems for the future:
    1. Taxing pockets of wealth and levying solidarity payments. Efforts to tax the rich need to be stepped up, and companies receiving windfalls from the crisis could contribute more now to help pay for the response.
    2. Benefiting from low oil prices and environmental taxation. Carbon pricing needs to capture the wider costs of climate change. A step towards this might be to use the low oil price to introduce or increase fuel taxes to generate revenue and lock in revenue increases for the future.
    3. Expanding voluntary compliance through incentives. With limited resources for enforcement and taxpayers coming forward for help, information could be collected on a voluntary basis that would help manage compliance in future.
    4. Cutting wasteful spending through the tax system. Tax expenditures often lack transparency, are poorly targeted and inequitable. They are also difficult to remove. Current sentiments of solidarity may provide the momentum to start rationalising tax expenditures.
    5. Ensuring businesses that get support now contribute more in future. Countries in a position to offer assistance to struggling businesses may consider a quid pro quo approach to aid recovery.
- Each of these ideas should be considered in the context of the particular country concerned and with analysis of the specific impacts that Covid-19 is having on different sectors and types of taxpayers. Some will be more feasible than others.

About this article

This paper was produced as part of the DFID-funded Centre for Tax Analysis in Developing Countries (TaxDev) project. TaxDev aims to contribute to more effective tax policy-making in lower-middle-income countries (LMICs) through applied research and policy analysis, as well as a focus on improving the analytical capacity of partner governments.

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There is an opportunity now to change tax systems for the better

While the spread of coronavirus and its health impacts are unclear and still unfolding across lower-income countries, the economic impact of lockdown measures and trade disruption is already being felt. Economic forecasts remain highly uncertain, but early data indicate there will be a sharp downturn in growth in the short to medium term, The economies of low-income countries now forecast to grow 0.4% in 2020, down from pre-coronavirus projections of 5.1% (IMF, 2020).

The fiscal response to the Covid-19 crisis can be framed in terms of three phases of intervention: (i) support to vulnerable households and struggling businesses to keep their heads above water during lockdowns; (ii) fiscal stimulus to restart economic activity once lockdowns are lifted; and (iii) consolidation to shore up public finances after recovery (Steel and Phillips, 2020). Discussions of the role of tax systems in lower-income countries during the current early phase have focused on striking a balance between providing targeted relief and sustaining revenue flows to finance the health and social protection response, where there may be limited access to domestic central bank liquidity and capital markets, and with external financing from international institutions and development partners in high demand.

Domestic revenue mobilisation (DRM) efforts across developing countries already include a range of strategies for broadening the tax base and addressing non-compliance, many of which may be on hold for now, but which will continue after the shock. While the current crisis has many negative consequences, there are opportunities that, if acted upon now, could help mobilise revenue to mitigate some of the anticipated losses. The urgent need to bring communities together to support the vulnerable provides a platform for governments to take tough decisions that may otherwise be too sensitive, and to ask individuals and businesses to contribute more where they are able to do so. For example, efforts to tax the rich, remove ineffective tax incentives or push forward new tax agendas may be possible now in a way that would be difficult in more ‘normal’ times.

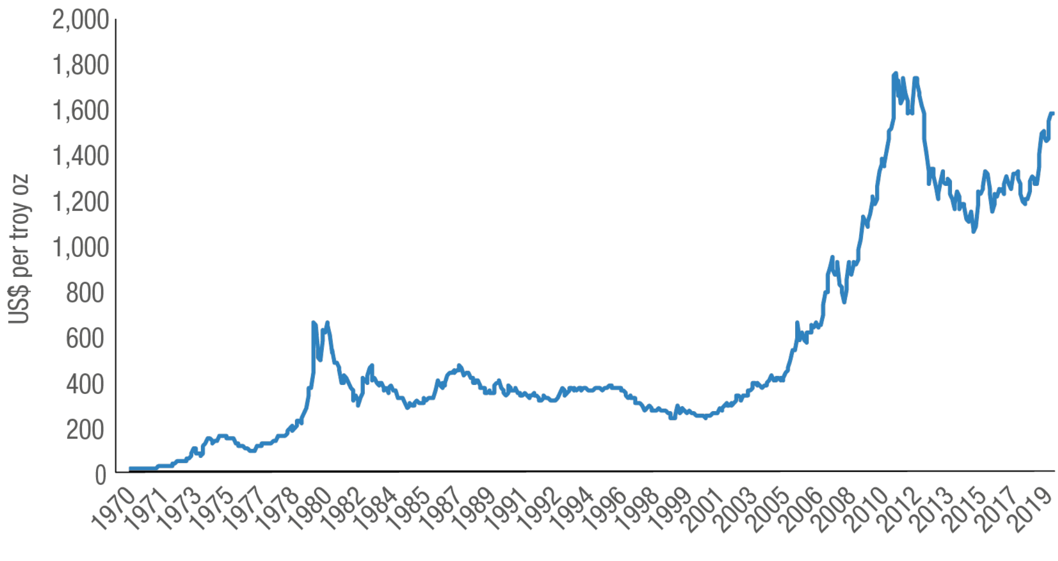
A positive case for public spending, funded through tax revenues, has to be made, alongside any tax changes. Providing clear messages and justification in the form of targeted support to those who need it most, funding the recovery and building resilience against future shocks will help to bring communities together and foster a sense of solidarity. From this foundation of common purpose, introducing policy changes in line with this strategy may become more acceptable and therefore more likely to succeed over the longer term.

There are several options that may help mitigate revenue losses and contribute to longer-term development objectives. Identifying pockets of wealth during these uncertain times will require investment in data-gathering and ongoing analysis to understand the channels of impact and the nature and scale of opportunities arising, from a tax perspective. This means that the case for any individual policy needs to be considered in its specific economic and political context. In keeping with the concept of 'no regret policies' (Dercon, 2020) during uncertainty, this note provides five examples of tax policy strategies that may have merit, both under current circumstances and for building more effective tax systems in the future.

1. Taxing pockets of wealth and levying solidarity payments

Not all individuals and sectors will suffer equally from the effects of lockdowns, trade restrictions and supply disruptions. Indeed, some will be in a position to ride out the storm or even switch investment portfolios or activities to take advantage of areas of high demand or rising prices. Some businesses may be able to adapt their output to meet new demand during the crisis, such as home deliveries or digital services for remote working. While falling global commodity prices may cause difficulties for some producers of natural resources, such as oil, other commodities may fare less badly. With its intrinsic value and limited supply, gold is typically held during periods of uncertainty and has been rising in value in recent months. Gold mines that are not adversely impacted by lockdowns and disruptions to supply and distribution networks might therefore make windfall profits.

Figure 1 50-year average monthly gold reference price



Source: World Bank Commodity Price Data.

Companies in sectors that receive a windfall could potentially make a greater contribution to public finances in the short term. In the past countries have used solidarity payments, such as forced loans or capital levies, to pay off large debts or finance major reconstruction efforts, as in Germany after the Second World War and for housing construction in the 1980s (Bach, 2012). Temporary increases to the rate of corporate income tax, applied either across the board or to particular sectors that are expected to makehigher profits, could raise revenues from companies that remain or become more profitable. Ghana, for example, uses a National Fiscal Stabilisation

Levy (NFSL) to raise additional revenue over and above corporate income tax from specific companies and institutions.

Governments might also be able to generate short-term cash flow without increasing corporate tax rates or overall liabilities by adjusting advance payment schedules for companies that are expected to make higher end-year profits than anticipated at the start of the year. This would bring forward payments that might otherwise not be due until months after the end of the fiscal year. In the case of gold mining, provided operations are not adversely affected, royalty surcharges that are creditable against future income and resource rent taxes could be used. However, this would likely need to be negotiated with mining companies. This is often fraught with difficulty and can lead to multinationals getting a better deal than the host country – especially where governments are prioritising short-term revenues over long-term value.

Individuals with high incomes or wealth could also contribute more. Income and property taxes are typically under-utilised in lower-income countries, especially in sub-Saharan Africa. In response to revenue losses caused by the coronavirus pandemic, the International Monetary Fund (IMF) suggests introducing a 'solidarity surcharge' on higher-rate taxpayers or untapped property and wealth (IMF Fiscal Affairs, 2020). Where countries may be unable to afford to update costly valuation rolls for effectively taxing property, they may be able to introduce a temporary surtax until such time as property tax bases can be updated (Prichard, 2020).

Evidence suggests that many wealthy individuals in low-income countries contribute less than they are required to by law (Kangave et al., 2018), and efforts are already under way to improve compliance. Practical steps could include widening the tax net on the rich or identifying pockets of wealth that are currently untaxed or associated with avoidance. For example, luxury vehicles are a visible indicator of high incomes or wealth. Tax enforcement efforts could consider whether owners of luxury vehicles declare incomes in their tax returns commensurate with their vehicle ownership, and if not, target audit efforts accordingly. Sales of luxury vehicles and other luxury goods could also be taxed more than standard goods, effectively acting as an indirect tax on the higher incomes of those able to afford to buy them.

Efforts to tax the rich and powerful elites often face political challenges, and there is concern that revenue shortfalls from shocks such as the current coronavirus crisis may be paid for by micro and small businesses and the poor, as countries focus DRM efforts on broadening the tax base across the informal sector (Gallien and van den Boogaard, 2020). The current situation may provide an opportunity to gain wider political support for this agenda, demonstrate greater fairness in the tax system and build trust between taxpayers and governments by using the additional revenues to increase spending on social protection.

2. Benefiting from low oil prices and the role of environmental taxation

Global oil prices are at their lowest since 2001, after dropping 70% during the coronavirus crisis. The implications for domestic revenues in developing countries will differ for oil producers and oil-importing countries. For oil producers, the need to diversify the revenue base is more urgent than ever. As inputs to industry and the transport sector, however, low-cost oil-based fuels could have significant benefits, particularly for countries dependent on oil imports.

Figure 2 50-year average monthly crude oil prices (April 1988–April 2020)

Source: World Bank Commodity Price Data.

From an environmental perspective, low oil prices would typically mean increased consumption and more carbon emissions. While recent events have temporarily reduced economic activity and therefore emissions, the stock of global greenhouse gas (GHG) emissions remains and there is still an urgent need to find ways to meet the goals for global temperature containment set out in the Paris Agreement. While low-income countries may have less of a moral obligation to reduce GHGs, there are economic benefits in doing so, such as avoiding the up-front investment costs in fossil fuel infrastructure that will later become obsolete in the transition to low-carbon economies. The benefits of tackling local congestion and pollution externalities are even clearer for national governments. Many developing countries also regulate or subsidise energy consumption and fuels to compensate for typically higher costs of generation and distribution, or to provide wider access to those who could not otherwise afford it. Now might be a good time to review these policies, not least because energy tends to be consumed proportionately more by the rich, and thus subsidies are generally regressive policies. With historically low prices, there is less need to provide subsidies and a greater need to find savings and additional revenues.

Environmental taxes make carbon-intensive activities, energy sources and technologies more expensive, and therefore encourage people to make greater use of low-emission alternatives. Carbon-intensive activities are often also price inelastic in the short run – it takes time for investment in clean energy sources to come onstream – and therefore potentially a valuable source of domestic revenue in the short term. Some studies have found a positive impact on emissions and a progressive effect on redistribution (Dorband et al., 2019), but the very limited use of carbon taxes in less developed countries means that there is little evidence available on their impacts. Nonetheless, there has been interest across a range of countries in introducing some form of carbon pricing, a trend which may continue to gather momentum (World Bank, 2019).

A fully fledged carbon tax is a significant structural reform that would need careful consideration. It would also need to be announced well in advance to give firms time to adjust their production processes (as has been the case in South Africa, for example[1]). Governments would also need to consider how the implications of proposed tax increases might differ between rural and urban areas, and the possible substitution of non-market alternatives that might be more carbon intensive (such as burning wood or charcoal instead of fuel). What can be done now is increasing taxes on fuels, which achieves only part of the benefits of a carbon tax. While the global price is low, there is an opportunity to introduce or reform fuel duties and energy pricing without adding significantly to the local market price. This may help 'lock in' government revenues for the future, as well as helping to address environmental impacts.

The ease with which fuel duties could be increased during a period of low oil prices will depend on how price changes are passed through to consumers at the pump. There is evidence to suggest that pump prices in sub-Saharan Africa adjust more slowly and by less when oil prices fall than when they rise (Kpodar and Abdallah, 2016). This may reflect a lack of competition between petroleum companies, or in some cases could be because governments have responded by increasing fuel taxes or reducing subsidies, as we suggest here. Where pass-through is slow this does not necessarily mean that higher fuel duties could not be imposed (or that they could lead to pump price increases). Higher duties could mean the government takes the benefit of lower oil prices through taxation rather than producers (through larger margins) or consumers (through lower prices). But if consumers have yet to see pump prices fall, the political case for increasing fuel taxes may be harder to make. Where governments consider there is less room to raise fuel duties directly, they could pursue alternative strategies, such as introduding a solidarity surcharge on petroleum companies or seeking early dividends from state-owned petroleum companies or distributors whose margins increase when oil prices are low and the benefit is not passed through to consumers via lower pump prices.

3. Expanding voluntary compliance through incentives

Many businesses are in need of assistance during the crisis, and as they come forward to seek help there is an opportunity to rethink tax compliance strategies. Firms 'revealing' themselves at this time may provide information that will prove useful for managing compliance in the future, for example helping to expand registration databases and encouraging filing (even if not payment) to ensure that governments receive up-to-date taxpayer information. For large multinational companies using tax havens (and that are likely to be more resilient during this crisis), requests for assistance could be conditional on providing the required information to help countries manage harmful tax planning in the future.

Some governments are providing packages of assistance to help smooth cash flow or support job retention. As part of this, tax administrations have responded with a range of adjusted or simplified procedures, including extended payment deadlines and temporary reductions in penalties and/or interest for outstanding tax arrears. Tax amnesties sometimes go further and waive outstanding debts. Ethiopia has written off debts from before 2015 and is waiving penalties and interest on outsanding taxes due between 2015 and 2018 as part of its package of tax relief for companies hurt by the crisis (Gebre, 2020).

[1] https://www.sars.gov.za/ClientSegments/Customs-Excise/Excise/Environmental-Levy-Products/Pages/Carbon-Tax.aspx

Any form of amnesty needs to be time-limited and credible. Evidence of the efficacy of tax amnesties is mixed (Ajayi, 2018) and countries that have offered repeated amnesties have been less effective in reducing tax avoidance. With the likelihood of another amnesty in the future, why come forward now if you can wait for the next one? In more normal times, tax amnesties are also inherently unfair because they benefit the non-compliant.

Nonetheless, showing leniency in times of crisis could help build trust in revenue authorities. Temporarily waiving penalties (and potentially interest too) for those who self-disclose – but obtaining the principal – may provide a benefit to taxpayers by easing sanctions, but also helps governments maintain a flow of cash during difficult times. In the medium to longer term, encouraging voluntary compliance in this way may be a more cost-effective strategy, especially for less well-resourced administrations.

The extent to which this is effective depends on several factors: taxpayers may weigh up the potential cost of evasion (the chances of getting caught later and the severity of the penalty) against the cost of coming forward now. On the authorities' side, effectiveness depends on weighing up the likelihood and value of getting the principal now (and/or the prospect of revenue from these taxpayers in future once on the register) against the revenue foregone from waiving penalties (and possible interest) and the costs that would have been incurred in detection, audit and enforcement. Governments might also consider waiving penalties but not interest. Since interest accrues the longer a debt is outstanding, payment becomes time-sensitive. Where interest rates have not been adjusted for several years, they may now be excessively high and could be adjusted in line with current central bank rates, which are historically low across the world.

4. Cut wasteful spending through the tax system

Countries around the world use their tax systems to achieve social or economic objectives, such as helping poorer households afford essential goods through VAT exemptions or encouraging business investment through tax incentives such as income tax holidays. These policies are known as 'tax expenditures' as they are effectively public spending through the tax system – governments could often achieve the same objectives through direct spending outlays, for example by providing grants to poorer households to purchase essential goods.

Tax expenditures usually have several drawbacks compared to spending outlays. Their costs are opaque and difficult to estimate compared to the relatively easy task of reporting on cash payments. Tax expenditures are often not included in annual budgets and are therefore not subject to regular reviews and appropriation. They can also be less effective and more expensive than equivalent spending policies because they are harder to target, tend to benefit higher-income groups disproportionately, and in the case of corporate tax incentives are often redundant as companies would have invested even without the incentive (IMF, 2015; Abramovsky et al., 2018). Indeed, TaxDev research has found that, even where intended to reduce regressivity, VAT expenditures can be ill-targeted at supporting the poor (Harris et al., 2018).

Many countries are starting to strengthen the governance of tax expenditures by reporting the cost of expenditure through the tax system. In many cases these costs are high, for example more than 40% of total tax revenues collected in Costa Rica, the Dominican Republic, Ghana[2] and Guatemala (Gupta, 2018). Some countries have identified ways to rationalise tax expenditures,

[2] Note that this estimate is from 2011, and so rather dated.

but there are often political constraints to their removal once they have been offered to powerful elites. Yet, the argument that ill-targeted tax incentives undermine the revenue base is now more pertinent than ever, and there is a much stronger justification for removing them. As discussed, governments will be expected to take tougher action to support those in need, and solidarity contributions may extend to giving up unnecessary dependence on subsidies paid through the tax system.

Many lower-income countries are likely to face difficult decisions in upcoming budgets, as revenues fall and pressures to spend on healthcare and economic support measures increase. Some will likely need to cut spending in other areas. As countries prepare their tax expenditure reports for forthcoming budgets, there may be an opportunity to review tax expenditures alongside spending, with a view to removing costly and ineffective expenditures. Income tax holidays, for example, benefit companies making the highest profits the most, while doing nothing to support businesses that are temporarily loss-making due to coronavirus.

The revenue foregone from tax incentives is not directly equivalent to revenue that would be gained from their removal, because taxpayers change their behaviour when the incentive is removed. For example, removing the VAT exemption on a specific good would increase its price, and consumers would likely buy less of that good at the higher price. However, there is likely to be some immediate revenue benefit, as well as longer-term gains, through broadening the tax base and improving the efficiency and fairness of the tax system. Reforming tax expenditures may, in some cases, require more fundamental structural change, which would need to be researched and implemented over a longer period after the current crisis has ended. Nonetheless, there is an opportunity now to begin a conversation with the public and taxpayers to build broad support for reform over the medium term.

5. Ensure businesses that get support now contribute more in future

Many industries are being adversely affected by coronavirus, including in sectors that are often important to lower-income countries, such as natural resources, tourism and hospitality, and businesses that rely on international trade for supply chains or export markets. In some instances, businesses are likely to seek government support to alleviate cash flow shortages.

When considering whether to support businesses – either through the tax system or through spending or loan guarantees – governments in lower-income countries with more binding resource constraints will need to weigh up the costs and benefits carefully, including against other uses for scarce resources. Priority would likely be given to strategically important businesses and industries that provide wider economic and social benefits, such as those that employ large numbers of people or are integrated into domestic supply chains and make greater use of local content. The costs of failure in these businesses would be higher given the knock-on effects for jobs and suppliers.

Governments could also set conditions for support. One common approach is to refuse specific support to businesses that are still planning to pay dividends to shareholders this year, as that cash, rather than taxpayer money, could be used to weather the coronavirus storm. Where government reduces overall tax liabilities or provides direct cash support, governments should consider the benefits they will receive in return for their support. There is an opportunity for help to be provided on a quid pro quo basis, with support now in return for companies making a greater contribution in the future. This could include waiving tax payments in return for a government taking equity in companies that can pay dividends in future, or that can be sold when markets recover, to generate gains for taxpayers.

One option for countries that have used tax incentives to attract foreign investment, including those granted to specific firms through negotiated agreements, is to make short-term support conditional on removing those incentives in the future. When renegotiating tax incentive agreements, priority should be given to removing those that are poorly targeted and expensive (such as income tax holidays), facilitate international tax avoidance (such as exemptions from international withholding taxes), or are easily abused (such as broad exemptions from import duties).

Concession agreements that include bespoke tax provisions are common in many countries across different sectors, including extractive industries, agriculture and major infrastructure projects. Some countries have recently introduced reforms to improve the taxation of foreign investment, including natural resource tax regimes that support investment through cost-based incentives and ensure a fairer share of benefits through progressive income tax and resource rent taxes. However, concession agreements often include fiscal stability clauses, and companies continue to be taxed under bespoke agreements rather than the generally applicable tax system. Where these companies seek government support, there is an opportunity to level up their tax contributions in the future by renegotiating stability clauses and migrating companies to the general tax regime.

Many countries are negotiating payment schedules suited to the individual circumstances of taxpayers. Measures such as these are helpful to many struggling businesses, but are of course likely to benefit only those already registered, not the informal businesses common in lower-income countries. Support for these businesses would need to be provided outside the tax system, potentially working with and through institutions such as trade associations. Formal registration and a commitment to pay taxes in the future could be a condition of support provided it does not deter those who most need help from coming forward.

Conclusion

Governments all over the world are facing enormous challenges in mitigating the health and economic impacts of coronavirus. Lower-income countries may have fewer policy instruments, financing options and delivery infrastructure to respond effectively. Nonetheless, many have already taken positive steps to contain and limit the spread of the virus, and to respond to the most urgent needs of those in lockdown or affected by disruptions to trade.

The next phase will be critical in determining how quickly economies can bounce back. With huge spending pressures and limited financing, it is important that lower-income countries find ways to shore up domestic revenues. Despite the multiple difficulties, there are also opportunities arising from the crisis that could help adapt tax systems in positive ways. The political window may be short, but action now could have long-lasting effects. Getting the political messages right over the short term will help to build a strong foundation during this difficult time, to enable some of the changes that governments need, but have been unable to make, during the good times.

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ODI
203 Blackfriars Road
London SE1 8NJ

+44 (0)20 7922 0300
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