



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 27-Oct-2020 | Report No: PIDA30606



BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Tonga	P174683	Tonga: Supporting Recovery after Dual Shocks Development Policy Operation (P174683)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EAST ASIA AND PACIFIC	01-Dec-2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Kingdom of Tonga	Ministry of Finance		

Proposed Development Objective(s)

The program development objective is to: (1) assist firms to maintain business continuity, protect livelihoods and support vulnerable households to maintain their investment in human capital; and (2) lay the foundations for a sustainable economic recovery.

Financing (in US\$, Millions)

SUMMARY

Total Financing	30.00
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DETAILS

Total World Bank Group Financing	30.00
World Bank Lending	30.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The proposed operation provides a US\$30 million grant to support Tonga to address the adverse effects of the dual external shocks of the COVID-19 pandemic and Tropical Cyclone (TC) Harold. The proposed operation is a stand-alone



Development Policy Operation (DPO), comprising US\$20 million from the IDA Crisis Response Window and US\$10 million from Tonga's IDA Performance-Based Allocation. COVID-19 is having severe negative effects on Tonga's tourism-dependent economy and government finances. While suffering the severe consequences of the COVID-19 crisis, Tonga was hit by a severe tropical cyclone in April 2020, leading to significant damages and losses. The combined effects of the dual crises represent an economic shock of unprecedented scale for the Tongan economy. Households have felt the full force of the dual shocks, with the poorest and most vulnerable likely to be most severely affected. The proposed DPO will support the Government of Tonga (GoT) to address the immediate response needs and lay the foundations for an inclusive and sustainable recovery. The DPO engagement aligns closely with the World Bank Group (WBG) COVID-19 Crisis Response Approach Paper.

The severe economic impacts of the global pandemic and TC Harold are estimated to have led to a contraction in economic activity of 3.5 percent in FY20. The economy is expected to contract by a further 5.3 percent in FY21. A large budget deficit is projected for FY21, although the fiscal balance is expected to return to surplus over the projection period as tax revenues recover and crisis-related public spending is unwound. Public debt is sustainable despite the impacts of the dual shocks, reflecting the government's commitment to seek available grant financing and only to consider highly concessional debt as a last resort. The macroeconomic policy framework is assessed as adequate for the purposes of this operation.

Relationship to CPF

The proposed operation addresses all four of the focus areas articulated in the World Bank Group's Regional Partnership Framework (RPF) for nine Pacific Island Countries (PICs), including the Kingdom of Tonga. The RPF priorities remain highly relevant to Tonga's efforts to respond to and recover from COVID-19 and TC Harold. The proposed operation contributes to the first theme of the RPF—fully exploiting the available economic opportunities—by supporting increased access to finance for Micro, Small and Medium Enterprises (MSMEs) in the three target sectors articulated in the RPF (fisheries, agriculture, and tourism). The second focus area—enhancing access to employment opportunities—is addressed through the measure to protect existing employment and household investments in human capital. The operation contributes to the third focus areas—protecting incomes and livelihoods—by: (i) supporting crisis-responsive social protection payments; and (ii) establishing a new institution to lead housing sector resilience and an event-specific housing recovery strategy. Finally, the program supports the fourth focus area—strengthening the enablers of growth and opportunities—by introducing international arbitration legislation that will enhance the business climate and encourage higher foreign trade and investment.

Actions supported by this DPO are also closely linked to the IDA19 special themes and WBG COVID-19 Crisis Response Approach Paper. The operation supports actions related to the themes of "Climate Change" and "Gender and Development" and the cross-cutting issues of "Disability" and "Human Capital". These actions address the areas of enhancing resilience to climate change and natural hazards, supporting and reinforcing households' investments to build human capital, promoting and protecting disability-inclusive development, and improving women's access to finance. Finally, the operation directly addresses a key priority to mitigate gender inequalities and close gender gaps—namely, low access to finance for women—which is a priority in the East Asia & Pacific Gender Action Plan and the Bank's Gender Strategy 2016-2023. The operation supports measures that are critical to the immediate relief and restructuring phases of the crisis response and address three of the four pillars of the WBG Approach – namely the social response, the economic response, and the strengthening of policies, institutions, and investments. The proposed operation builds on and complements the ongoing programmatic DPO series, as well as several investment projects and technical assistance activities.



C. Proposed Development Objective(s)

The Program Development Objective (PDO) and pillars of the operation are to: (1) assist firms to maintain business continuity, protect livelihoods and support vulnerable households to maintain their investment in human capital; and (2) lay the foundations for a sustainable economic recovery.

Key Results

Pillar 1— Assist firms to maintain business continuity, protect livelihoods and support poor and vulnerable households to maintain their investment in human capital

Prior Action #1. To support livelihoods and household investments in human capital, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which provides school fee relief and targeted crisis-responsive social protection payments drawing on newly developed social registries and using new electronic payment methods. *Results:* (i) 100 percent of Disability Welfare Scheme (DWS), Social Welfare Scheme for the Elderly (SWSE) and Conditional Cash Transfer (CCT) beneficiary households receive crisis-responsive social protection payments (FY20); (ii) 50 percent of SWSE beneficiaries receive social protection via electronic payment systems (FY21); over 5,800 female students and over 6,300 male students benefit from school fee relief (FY20)

Prior Action #2. To support firms to retain workers at risk of unemployment or furlough, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which establishes an institutional mechanism for the payment of wage subsidies to workers affected by the crisis.

Results: Over 1,800 female workers and over 3,400 male workers receive wage subsidy (FY20)

Prior Action #3. To assist firms to maintain business continuity, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which establishes an institutional mechanism for the provision of financial assistance to formal and informal businesses affected by the crisis.

Results: Over 600 formal firms and over 1,500 informal firms benefit from direct financial assistance (FY20)

Pillar 2 — Lay the foundations for growth and sustainable economic recovery

Prior Action #4. To facilitate increased access to microcredit for MSMEs, the Recipient, has expanded and extended the Government Development Loan (GDL) scheme.

Results: Over 650 MSMEs receive a microcredit from the GDL scheme, 32 percent female borrowers (FY21)

Prior Action #5. To provide greater certainty to foreign investors, the Recipient, through its Cabinet, has approved an international arbitration bill for submission to Parliament.

Results: A stable, globally accepted dispute resolution framework is established and brought into force (FY22)

Prior Action #6. To support climate and disaster-resilient housing reconstruction, the Recipient, through its Cabinet, has approved: (i) the establishment of the Housing Sector Resilience Office; and (ii) an event-specific Tropical Cyclone Harold housing recovery strategy.

Results: 100 percent of eligible houses destroyed by TC Harold have been rebuilt (FY22)

D. Project Description

This DPO is designed to reinforce and strengthen the foundations for the achievement of key national outcomes under the Government's Tonga Strategic Development Framework 2015-2025. The operation supports six of the seven key National Outcomes. Pillar 1 supports the government's sustainable and inclusive development priorities and reinforce the development of a knowledge-based economy. Pillar 2 supports key initiatives to enhance resilience to climate change and natural hazards and lay the foundations for a sustainable economic recovery. The supported outcomes are consistent



with the comparative advantage of DPOs, while other outcomes are being supported by investment operations and with technical assistance from the WB and other development partner programs.

The reform program will directly support poverty reduction and shared prosperity. The first pillar will contribute to these objectives by supporting key crisis-response measures to maintain livelihoods of the most vulnerable, drawing on newly developed social registries and using new electronic payment methods. In doing so, the pillar will also support actions that reinforce household investments in human capital through which these groups can achieve greater economic independence and resilience. The measures also comprise key institutional advances that strengthen GoT's adaptive social security system. The first pillar also supports the establishment of new institutional mechanisms to deliver financial assistance for firms to retain workers and support business continuity in both the formal and informal sectors—measures that provide critical income protection to vulnerable workers and informal firms. Under the second pillar, vulnerable households are expected to disproportionately benefit from the institutional and policy reforms to strengthen housing sector resilience and reconstruction, given their higher exposure to the direct impacts of extreme weather events (e.g. because they tend to live in poorer quality housing). Finally, the action supporting improved access to finance for micro, small and medium enterprises (MSMEs) is designed to catalyze the economic recovery, support livelihoods and retain and create jobs in sectors in which a high proportion of vulnerable households earn a living. This stand-alone DPO is closely aligned with the ongoing programmatic DPO series, with the two operations jointly designed to support Tonga to address the three phases of crisis response to the dual shocks.

E. Implementation

Institutional and Implementation Arrangements

The existing institutional structure for aid management will be used to implement and monitor the policy actions supported by the operation. Through the Budget Support Management Committee (BSMC), the Ministry of Finance (MoF) will provide overall guidance for the budget support program, and will assume overall responsibility for coordinating the implementation, monitoring and evaluation of the operation. The MoF will also be ultimately responsible for reporting progress and coordinating actions among other concerned government agencies.

The Bank will work with the Government to assess the progress of implementation of the policy actions supported by the proposed operation. The Bank will also work with the Government to monitor the specific indicators associated with each of the policy areas supported by the proposed operation. The Bank will play a coordinating role among development partners to ensure that there is a single, agreed assessment of the implementation of the policy actions and a single, agreed evaluation of the monitoring indicators. This will reduce the administrative burden on Government.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

Extreme poverty is rare but there are significant levels of hardship, particularly in rural areas. The policy actions supported under Pillar 1 are likely to result in a progressive distribution of benefits, supporting the welfare of poor and vulnerable households through the dual shocks. The additional cash transfers under PA#1 are well-targeted, as they utilize existing registries of vulnerable population groups (households with the elderly, disabilities, and school-aged children). The policy actions supported in Pillar 2 will support poor and vulnerable households to maintain their livelihoods. The focus on supporting the recovery in the tourism sector via the extension of the Government Development Loan (GDL) scheme in PA#4 is likely to result in a progressive distribution of benefits. The microfinance program is expected to support greater



access to finance for female entrepreneurs, thus addressing a key gender inequality that is material to women's economic participation.

Environmental, Forests, and Other Natural Resource Aspects

Policy actions related to social protection, school fee relief, support to firms and workers, international arbitration and enhanced access to microcredit are not expected to have a significant impact on the environment. The action to establish the Housing Sector Resilience Office (HSRO) and a TC Harold housing recovery strategy is expected to yield positive impact on the nation's resilience to the impacts of climate change and disasters. To the extent that there could be downstream environmental impacts, adequate protection would be provided by the existing legal and administrative frameworks for environmental assessment and land management in Tonga.

Tonga has a well-established environmental impact assessment (EIA) process administered by the ministry responsible for the environment and climate change. It is noted that the Tonga Climate Resilient Transport Project is being implemented effectively (with no significant environmental issues identified to date) using the national-level legislation. This includes the Environment Management Act 2016, Environmental Impact Assessment Act 2016 and Environmental Impact Assessment Regulations 2010. EIA registrations in the country have increased in recent years, indicating improved oversight of proposed developments including residential housing. However, further efforts are needed to: (i) review and possibly update legislation (including to further address urbanization and disaster vulnerability aspects); (ii) establish a registration scheme for EIA consultants to strengthen accountability; and (iii) increase public awareness and technical training to enhance compliance. The HSRO will be responsible for ensuring that any housing projects it oversees will undergo the necessary environmental reviews, including EIAs, as deemed necessary by the regulatory provisions.

G. Risks and Mitigation

After accounting for mitigation measures, the overall risk level for the proposed program is substantial. Other risk is rated as high, because the spread of COVID-19 to Tonga would pose a high risk to the achievement of the PDO. GoT is mitigating the risk of a local outbreak through its border closure, preparation of isolation centers and procurement of protective and lab equipment. However, there remains a residual risk to the operation that the virus could enter the country once borders reopen. Environmental and social risks are rated as substantial despite mitigation measures, given Tonga's high degree of vulnerability to disasters and the effects of climate change. This risk is mitigated somewhat by the selection of a limited number of high-priority reform actions, but in the event of a major disaster, implementation of the reform program may be delayed while disaster response and recovery take precedent. Macroeconomic risks are rated as substantial, despite the GoT's strong commitment to ongoing reform through budget support operations and ample foreign reserves. These risks are being mitigated to the extent possible by: i) GoT's ongoing collaboration with development partners and commitment to pursuing reforms via budget support operations; ii) the revenue, public remuneration, and cash and debt management reforms supported by the ongoing programmatic DPO program; iii) the recent accumulation of ample foreign exchange reserves to manage shocks; and (iv) GoT's ongoing collaboration with the Governments of Australia and New Zealand to ensure that regional temporary worker programs can restart as quickly and safely as possible. The risks around institutional capacity are moderate, after accounting for selectivity in the number of reform actions and the provision of dedicated technical assistance. Technical design risks are judged to be moderate, after accounting for mitigating measures.



CONTACT POINT

World Bank

Andrew Blackman, Matthew Selwyn Dornan
Senior Economist

Borrower/Client/Recipient

Kingdom of Tonga
Tevita Lavemaau
Minister of Finance
minister@finance.gov.to

Implementing Agencies

Ministry of Finance
Balwyn Faotusia
Chief Executive Officer
bfaotusia@finance.gov.to

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader(s):	Andrew Blackman, Matthew Selwyn Dornan
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Approved By

Country Director:	Paul Vallely	09-Oct-2020
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