



# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 19-Mar-2019 | Report No: 135419



**BASIC INFORMATION**

**A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Tonga	P159263	Third Inclusive Growth Development Policy Operation	P155133
Region	Estimated Board Date	Practice Area (Lead)(s)	Financing Instrument
East Asia and Pacific	May 16, 2019	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Kingdom of Tonga	Ministry of Finance		

**Proposed Development Objective(s)**

The objectives are to:

- (i) Support fiscal resilience by means of strengthened revenue mobilization and strategic fiscal and debt policies;
- (ii) Support improved government accountability by improving compliance with public procurement regulations, improving budgetary classifications, and improving the adequacy of responses to external audit; and
- (iii) Support a more dynamic and inclusive economy by adopting investor-friendly foreign investment legislation, improving oversight and private participation in public enterprises, introducing regulation to private sector labor markets, and strengthening regulatory frameworks in selected sectors.

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	US\$5.5 million
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**DETAILS**

Source:  
IDA

Decision

The summary Decision from the Decision Meeting is authorization to appraise and negotiate the DPF.



## **B. Introduction and Context**

### Country Context

Tonga is a small Pacific island nation with a population of 108,000 dispersed across 36 of its 177 islands with around one quarter of the population based in the capital of Nuku'alofa. Like many other small Pacific island nations, Tonga's economic growth potential is constrained by structurally high costs of production and public service delivery and exposure to economic and environmental shocks. Its location makes Tonga the most geographically remote nation from major centers of economic activity in the world<sup>1</sup>. Over the last twenty years, per capita GDP has grown by 1.3 percent on average, compared to 2.3 percent globally. While this growth is modest by developing country standards, it is faster than the small Pacific islands average (0.9 percent). In any given year, it is likely that Tonga is either hit by or recovering from a major natural disaster. Small size and remoteness combine to push up the cost of economic activity in Tonga, limiting the competitiveness of its exports of goods and services in world markets and reducing the potential to realize economies of scale. Small size and remoteness also push up the cost of providing public services. High dependence on imports combined with a lack of sufficient size for meaningful diversification makes Tonga highly vulnerable to external economic shocks. These factors combine to make growth, inclusive or otherwise, particularly elusive in Tonga. This operation is the last in a programmatic series of three operations designed to build fiscal resilience, support accountability and promote inclusive growth in Tonga.

### Relationship to CPF

The World Bank Group's Regional Partnership Framework (RPF) for nine PICs, including the Kingdom of Tonga, is built around four focus areas. These are: first, fully exploiting the available economic opportunities (including in fisheries, agriculture, and tourism); second, enhancing access to employment opportunities (including by broadening opportunities for labor mobility and improving education outcomes); third, protecting incomes and livelihoods (including through strengthening resilience to natural disasters and climate change, and addressing NCDs); and fourth, strengthening the enablers of growth and opportunities (macro-economic management, infrastructure and addressing knowledge gaps). The proposed operation contributes to the first theme of exploiting economic opportunities through public enterprise reform and by making it easier to invest in Tonga, and the second and fourth focus areas by introducing a legal framework that protects fundamental labor rights, and strengthening fiscal policy so as to build fiscal buffers and improve the resilience of the government to shocks.

## **C. Proposed Development Objective(s)**

The program supports objectives that are critical to strengthening the foundations for inclusive growth in Tonga. The Program Development Objective is to: i) Support fiscal resilience by means of strengthened revenue mobilization and strategic fiscal and debt policies; ii) support improved government accountability by improving compliance with public procurement regulations, improving budgetary classifications, and improving the adequacy of responses to external audit; and iii) support a more dynamic and inclusive economy by adopting investor-friendly foreign investment legislation, improving oversight and private participation in public enterprises, introducing regulation to private sector labor markets, and strengthening regulatory frameworks in selected sectors.

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<sup>1</sup> Using a GDP-weighted measure of distance from all other countries, Tonga is the most remote developing country in the world. Only Australia and New Zealand are more remote, excluding their own sizeable domestic markets.



## Key Results

Reforms supported by this operation will contribute to all three pillars of the Program Development Objective. To support fiscal resilience, policy actions include the adoption of revised revenue and customs legislation that will support improved revenue administration and efficiency, sets updated and graduated penalties for non-compliance, and aligns customs practices with international standards; and improvements to the administration of the new public sector remuneration framework and performance management system. To support improved government accountability, this operation supports reform that improves the GoT's accounting and financial reporting system. To support a more dynamic and inclusive economy, the operation supports legislation that—for the first time in Tonga—codifies basic labor rights and protections and reduces gender disparities; the adoption of revised foreign investment regulations; and reforms the management model of an important public enterprise.

## D. Program Description

This programmatic development policy operation (DPO) series is designed to strengthen the foundations for the achievement of key national outcomes under the Government's TSDF 2015-2025, namely: i) a more dynamic, knowledge-based economy; ii) more balanced urban-rural development; iii) more empowering human development and gender equality; iv) responsive and good governance, including law and order; v) successful provision and maintenance of infrastructure and technology. Fiscal and economic management reforms under pillar one support the government's inclusive development priority and improve the resourcing of key public service delivery. Pillar two supports more responsive and effective government systems. Pillar three supports the preconditions for more dynamic, inclusive and sustainable growth. The supported outcomes are consistent with the comparative advantage of development policy programming, while other outcomes are being supported by investment operations and with technical assistance from the World Bank and other development partner programs.

## E. Implementation

### Institutional and Implementation Arrangements

The existing institutional structure for aid management in Tonga will be used to implement and monitor the policy actions supported by the operation. Through the Budget Support Management Committee, the 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.

Specific indicators that the Bank will monitor for each of the policy areas supported by the proposed operation are set out in the Program Document. The Bank will work with the Government to assess the implementation of the policy actions, and 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 Environment Aspects

### Poverty and Social Impacts



Extreme poverty is rare in Tonga but there are significant levels of material deprivation, particularly in rural areas. While traditional family- and community-based social safety nets have typically provided some protection to poor and vulnerable households, economic shocks, urbanization and social change have put pressure on these informal risk-sharing mechanisms. Preliminary estimates based on the 2015/16 Household Income and Expenditure Survey (HIES) show that less than 1 percent of Tongans live below the international poverty line of \$1.90 a day, but around 25 percent of the population are struggling to meet the cost of local basic needs. These rates are even higher in rural and remote areas, with 47 percent of the rural populations in outer islands experiencing material deprivation on average, relative to 14 percent in urban Tongatapu.

Reforms supported by this operation are expected to help reduce poverty and boost shared prosperity by creating fiscal space to maintain critical public services and through shared proceeds from growth. The public sector is a key provider of infrastructure and services that low-income households need to improve their opportunities. By supporting fiscal resilience, the reforms under Pillar 1 will help ensure that the government has the fiscal space to respond to future economic shocks and natural disasters (which tend to have a particularly adverse impact on the poor) while maintaining critical health, education, and community services on which the bottom 40 per cent are particularly dependent. The third pillar aims to address poverty by improving the environment for private sector activity, which would help bring jobs and opportunities to Tonga, and supports inclusive growth by setting standards in the labor market which will improve the quality of jobs and narrow gender disparities.

#### Environmental Aspects

The policy actions supported under the operation are not expected to have a significant impact on Tonga’s environment. Tonga has a well-established environmental impact assessment (EIA) process administered by the Ministry of Environment and Climate Change. It is noted that the Transport Sector Consolidation Project (TSCP) has been implemented using the Tongan legislation and to date, the project is being implemented effectively and no environmental issues have been identified.

#### **G. Risks and Mitigation**

The overall risk level for the proposed program is substantial. The risks around limited institutional capacity are rated as “High”, but are being mitigated by strong dialogue between the Bank and the Government, the selection of a limited number of reform actions, and the coordination of technical assistance. Though the frequency and magnitude of potential shocks leads to macroeconomic risks that are rated as “Substantial”, these risks are being mitigated by prudent fiscal management on the part of the government, and prior actions that further strengthen fiscal resilience. Political and governance risks are assessed as “Substantial”, though these are being mitigated by strong dialogue between the Bank and the Government at both the political and administrative levels. While the policy framework includes major reforms that may meet with opposition from vested interests—meaning stakeholder risk is judged to be “Substantial”—this is mitigated by extensive and ongoing consultation processes and the provision of transition periods for some groups. There is a “Moderate” risk that policy actions could have negative social impacts for some groups, although there is strong government commitment to ensure mitigating measures are in place.



**CONTACT POINT**

**World Bank**

Andrew Blackman  
+612 9235 6400  
Sydney  
Australia

**Borrower/Client/Recipient**

Balwyn Fa’otusia  
+676 23066  
Ministry of Finance  
Kingdom of Tonga

**Implementing Agencies**

Veiongo Fa’otusia  
+676 28120  
Ministry of Finance  
Kingdom of Tonga

**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 and Kim Edwards
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**Approved By**

Country Director:	Michel Kerf	
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