



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 28-Nov-2018 | Report No: 132745



**BASIC INFORMATION**

**A. Basic Project Data**

Country Tonga	Project ID P159263	Project Name Third Inclusive Growth Development Policy Operation	Parent Project ID (if any) P155133
Region East Asia and Pacific	Estimated Board Date April 22, 2019	Practice Area (Lead)(s) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Kingdom of Tonga	Implementing Agency Ministry of Finance and National Planning		

**Proposed Development Objective(s)**

The objective is to:

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

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

**SUMMARY**

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

Source: IDA	US\$5.5 million
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**Decision**

Following the consideration of a concept-stage Status Memo, the decision was taken to proceed with the preparation of the operation.



## **B. Introduction and Context**

### Country Context

Tonga is a small Pacific island nation of approximately 106,000 people that has undergone major democratic changes. This operation is the third of a programmatic series of three and reflects continued Government commitment to policy reforms and the long-running policy dialogue with the World Bank and other development partners. The Bank has worked with the Government of Tonga (GoT) and development partners to elaborate key policy actions via the formulation of a Joint Policy Reform Matrix (JPRM) that outlines shared reform priorities and is fully aligned with the Government's national development plan – the Tonga Strategic Development Framework 2015 – 2025 (TSDF).

### Relationship to CPF

This operation is consistent with the World Bank Group's Regional Partnership Framework for nine Pacific island countries (Report # 120479), contributing to three of the four focus areas. The proposed operation supports the first theme of fully exploiting the available economic opportunities through public enterprise reform and by making it easier to invest in Tonga. It also supports the third and fourth focus areas – protecting incomes and livelihoods, and strengthening the enablers of growth and opportunities – by ensuring basic labor protections and reducing gender disparities, strengthening fiscal sustainability by introducing more avenues for revenue recovery and improved mechanisms to manage public sector performance and remuneration, and strengthening the regulatory environment for the energy sector.

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

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### Key Results

The policy actions supported in this operation aim to strengthen the foundations for inclusive growth by improving revenue administration, strengthening performance management in the public service, strengthening the legal frameworks of the labor market and the energy sector, adopting investor-friendly foreign investment regulation, and introducing greater private participation in public enterprises. Key expected results include: An increase in the number of registered Taxpayer Identification Numbers; a reduction in the public wage bill as a proportion of domestic revenue; adoption of key labor market protections in national legislation; an increase in foreign investment applications; and increased private sector participation in the public enterprise portfolio.

## **D. Concept Description**

Supported reforms will improve fiscal resilience, support a modern and accountable state and support a more dynamic and inclusive economy. To support fiscal resilience, policy actions in this operation include introducing more avenues for revenue recovery and setting more realistic penalties through revisions to the revenue administration legislation; and



the strengthening of the new public sector performance and remuneration frameworks. To support improved democratic and government accountability, this operation supports policy actions that improve Tonga's public accounting and financial reporting system; and legislation to establish a multi-sector energy regulator. To support a more dynamic and inclusive economy, the operation supports new foundational employment legislation; the approval of new foreign investment regulations; and increased private sector participation in at least one public enterprise.

The programmatic Development Policy Operation (DPO) series is designed to set the foundations for achievement of key national outcomes under the Government's TSDF. The series as a whole will support national outcomes one to five under the TSDF, which relate to promoting a dynamic knowledge-based economy, balanced urban and rural development, empowering human development and gender equality, good governance, and improved infrastructure and technology. Fiscal and economic management reforms under Pillar 1 will support the government's inclusive development priority, and improve the resourcing of key public services. Pillar 2 will support more responsive and effective government systems and the delivery of key utility and infrastructure services for all of Tonga. Pillar 3 will support the preconditions for more dynamic, inclusive and sustainable growth. Other outcomes are being supported by investment operations and technical assistance from the World Bank and other development partners.

## **E. 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 systems of support 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. 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 a higher share of the population are struggling to meet the cost of local basic needs. Tonga's national poverty statistics, based on the Consensual Method of estimation (a sociological approach which reflects the extent to which people are able to achieve a basic standard of living as defined by a majority of the population), indicate that around a quarter of the population were living in poverty in 2015/16. Poverty rates are higher in rural and remote areas than in urban areas.

Reforms supported by this operation are expected to help reduce poverty, boost shared prosperity, and narrow gender gaps. By supporting enhanced revenue generation and ensuring that the public wage bill grows in an affordable fashion, the reforms under Pillar 1 of the program 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 energy sector reform under Pillar 2 is focused on ensuring effective regulation and increased competition, which should ultimately support lower prices and improved service delivery in the sector (relative to the status quo). This has potentially important implications for the basic-needs poor, who have less access to electricity and for whom electricity costs are a substantial burden. Finally, reforms under the third pillar aim to support inclusive growth by setting standards in the labor market which will improve the quality of jobs, safeguard employee rights and narrow gender disparities, as well as address poverty by improving the environment for private sector activity, which would help bring jobs and opportunities to Tonga.

Supported reforms have been designed to minimize potential negative impacts on the poor, and the poverty impacts of the program will be monitored as it proceeds. Public enterprise reforms will address possible short-term negative impacts by using poverty and social impact assessments to identify any groups that might have been affected and include



measures to make sure negative impacts are mitigated.

#### Environment Impacts

The policy actions supported under the operation are not expected to have a significant impact on Tonga's environment.

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**APPROVAL**

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