



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 20-Feb-2023 | Report No: PIDC34860

**BASIC INFORMATION****A. Basic Project Data**

Country Tonga	Project ID P179813	Project Name Tonga Development Policy Operation with a Catastrophe-Deferred Drawdown Option (P179813)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Jun 27, 2023	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Kingdom of Tonga	Implementing Agency Ministry of Finance		

Proposed Development Objective(s)

The proposed Development Policy Operation supports the Government of Tonga to: i) strengthen public finance to support economic stability. ii) enhance resilience to climate change and disasters. iii) strengthen human capital accumulation and enhance export competitiveness.

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

Total Financing	25.00
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DETAILS

Total World Bank Group Financing	25.00
World Bank Lending	25.00

Decision

The review did authorize the preparation to continue



B. Introduction and Context

Country Context

Tonga, like other small Pacific Island Countries (PICs), has many attributes which makes it highly vulnerable to shocks. Those include small size, remoteness, dependence on imports of essential goods, reliance on external financing, and susceptibility to natural disasters and other adverse shocks, including commodity price shocks. Tonga has recently been experiencing an increasing frequency of highly disruptive weather events linked to climate change. Two successive natural disasters have delayed recovery from the pandemic-induced shock. The impact of the dual shock was broad-based and severe, especially among the poorest and most vulnerable households. The impact of the shocks has been exacerbated by rising international commodity prices. Barring any unforeseen shocks, growth is projected to rebound in 2023. Despite the projected rebound, a recovery in Tonga from the pandemic and the HT-HH disaster will remain incomplete. Output in 2023 is projected to remain significantly below its pre-pandemic trend.

The macroeconomic policy framework for the proposed operation is adequate. The reconstruction, a rebound in agriculture and services, resumption of international tourist arrivals, and sustained inflows of remittances are expected to help to attain 3 percent growth in FY23 following two years of contraction. Inflation will remain elevated in FY23 but is expected to drop below the National Reserve Bank of Tonga's 5 percent reference rate in FY24. Significant reconstruction needs will contribute to a temporary widening of both fiscal and current account deficits in FY23. The GoT is committed to implement a gradual fiscal adjustment plan to support the economic recovery, effectively manage a scheduled increase in debt service payments, and safeguard the long-run fiscal sustainability. Fiscal deficit is expected to gradually decline to 2.1 percent of GDP in FY24 to 1.1 percent of GDP in FY25, and a moderate surplus expected in FY26. Public debt is sustainable despite the impacts of the shocks, reflecting the government's commitment to seek available grant financing and only to consider highly concessional debt as a last resort.

Relationship to CPF

The proposed operation addresses key development challenges articulated in the WBG's Systematic Country Diagnostic for nine Pacific Island Countries (PIC9), including the Kingdom of Tonga. Among others, the PIC9 SCD highlighted the following focus areas as high priorities for Tonga, 1) ensuring macroeconomic, fiscal and debt sustainability, 2) strengthening climate and disaster risk policies and building resilient systems, 3) developing adaptive social protection systems, 4) improving quality of education and increasing access to secondary and higher education, and 5) enhancing economic infrastructure and investment climate under GRID. The first focus area is addressed by PA#1 and PA#2 which increase domestic revenue mobilization by increasing consumption tax compliance and introduce fiscal and debt responsibility principles through an amended Public Financial Management Bill. The second focus area is addressed through PA#3 and PA#4 which introduce a comprehensive and proactive disaster risk management through the introduction of a Disaster Risk Management Policy and a Multi-Hazard Early Warning System Policy. The third focus area is addressed by PA#5 and which introduces an integrated social protection policy. The fourth focus area is addressed through PA#6 which improves the quality of education through the introduction of a national curriculum and assessment framework. The fifth focus area is addressed through PA#7 which improves the economic infrastructure for exporters through the introduction of an Authorized Operator Program (AO). The reform program is consistent with the Global Crisis Response Framework (GCRF), which provides the World Bank's operational response to multiple current crises. Actions supported by this DPO are also closely linked to the IDA20's overarching framework of "Building Back Better from the Crisis –Toward a Green, Resilient and Inclusive Future". The proposed operation builds on reforms supported previously, as well as several investment projects and technical assistance activities.



C. Proposed Development Objective(s)

The proposed Development Policy Operation supports the Government of Tonga to: i) strengthen public finance to support economic stability. ii) enhance resilience to climate change and disasters. iii) strengthen human capital accumulation and enhance export competitiveness.

Key Results

Pillar 1: Strengthen public finances to support economic stability

The reforms supported by this pillar will help the GoT to achieve a sustainable fiscal policy through improved domestic revenue mobilization and enhanced fiscal and debt management. The implementation of reforms under this pillar is expected to lead to the following results: (i) increased tax compliance and higher collections of consumption tax revenues, with the domestic revenue as share of GDP expected to increase from 23.3 percent of GDP in FY15-19 to 25 percent in FY25-27; (ii) the strengthened fiscal framework consistent with the 2020 PEFA Assessment, Tonga's PFM Action Plan 2020 and the IMF 2022 Article IV Consultation Staff Report. Following repayments of the EXIM Bank loan and no new non-concessional borrowing, government guaranteed debt stock as a share of GDP will decline from 46.3 percent of GDP in FY15-19 to 42 percent of GDP in FY25-27 and remain below the mandated maximum limit for government guaranteed debt.

Pillar 2: Enhance resilience to climate change and disasters

This pillar will support the GoT in strengthening its disaster risk management regulatory and policy framework, reforming the National Emergency Fund (NEF), and strengthening adaptive social protection. The implementation of reforms under this pillar is expected to lead to the following results: (i) stronger institutional and regulatory systems for DRM within Tonga measured via the development of disaster risk management plans, required under the DRM Policy, for 40 percent of Tonga's outer island groups; (ii) the share of population in outer island groups covered by transmission of multi-hazard early warning and impact messages increases from 0 to 90 percent and (iii) budget allocations to NEF are consistent with revised legal framework (up to 1 percent of GDP). The reforms will contribute to the reframing of the DRM focus within Tonga's legislation and institutions from primarily disaster response to a more proactive and integrated disaster preparedness and response model. (iv) increased coverage within the CCT database up to 30 percent of households, with sex-disaggregated and vulnerability data readily available to use for disaster response.

Pillar 3. Strengthen human capital accumulation and enhance export competitiveness

This pillar will support actions to promote human capital accumulation through relevant reforms to improve the quality of primary education and enhance export competitiveness through advancements in trade facilitation. The implementation of reforms under this pillar is expected to lead to the following results: (i) The revised curricula and assessment frameworks are expected to lead to an improvement in the quality of education in Tonga. The outcomes will be measures as an increase in the share of primary education students being taught based on the revised curricula for the mentioned four core subjects in class levels 1 to 8 and improved learning assessments, disaggregated by gender from 0 to 90 percent; (ii) a reduced time for exporters to submit required documents, a reduced number of paper documents required to be submitted to the government by exporters and more secure transmission of critical data elements for trading partner countries. The outcomes will be measures as an increase in the share of exporters using the electronic Phyto Sanitary Certification system from 0 to 15 percent.

D. Concept Description

This DPO is designed to strengthen the foundations for achieving the Tonga Strategic Development Framework (TSDf) II.



The operation directly supports the first six national outcomes of the TSDF. Pillar 1 will contribute to broadening fiscal space and ensuring fiscal sustainability. Those elements are essential for economic recovery, delivering better public services, and promoting development more generally. Pillar 1 supports amendments to the PFM Act 2002, which is also one of Tonga's two FY23 Performance and Policy Actions (PPAs) under the WB's Sustainable Development Finance Policy (SDFP). Pillar 2 supports critical initiatives to enhance resilience to climate change and natural hazards, strengthen the capacity of the Government for disaster preparedness, and lay the foundations for a sustainable post-disaster recovery. Pillar 3 aims at promoting human capital and enhancing export competitiveness to achieve quality growth and enhance growth potential. The WBG's investment operations and technical assistance as well as support programs financed by other development partners complement this operation and target other outcomes articulated in the Government's TSDF II.

The proposed reform program builds on the previous DPO series.¹ This DPO deepens reforms to support fiscal sustainability, enhance resilience to climate change and disaster, and achieve inclusive and sustainable growth. Pillar 1 supports strengthening domestic revenue mobilization through adoption of regulations for the Electronic Sales Register System (ESRS) and enhancing debt management and fiscal sustainability through a revised Public Financial Management bill and ensuing regulations. Pillar 2 supports enhancing resilience to natural and climate-change related disasters through more comprehensive, proactive, and integrated model of disaster risk management by introducing regulations under the Disaster Risk Management Act 2021 and a Multi-Hazard Early Warning System/Disaster Risk Management Policy. This pillar also builds resilience at the household-level through a National Social Protection policy. Pillar 3 aims at promoting human capital accumulation through the relevant foundational education reforms on the revision of the national curricula and improvement of assessments of students learning outcomes. The pillar also aims at boosting competitiveness by reducing trade costs and advancement of trade facilitation.

There are four key lessons that have informed the design of this operation. First, DPOs in Tonga can achieve tangible results in advancing economic and fiscal reforms in the context of solid government ownership. The close partnership between the MoF and the WB has facilitated real-time policy advice that helped the GoT to maintain a broadly solid macroeconomic framework, despite multiple shocks. Second, maintaining a strong policy dialogue and close coordination with other development partners is resource intensive but critical for advancing significant reforms and achieving development outcomes. Third, the hybrid DPO/Cat-DDO model reduces transaction costs of operations by coupling up-front financing with contingent financing for disaster risk management. Fourth, access to contingent financing be extended to public health emergencies as well as natural disasters. This was also highlighted in the Pacific Region in 2019 following the measles outbreak in Samoa. Over the years, the GoT has achieved a solid track record in implementing an ambitious reform program supported by the DPOs.

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

Poverty and Social Impacts

The reforms supported by this DPO are expected to have a positive impact on poverty in the medium- and long-run, through strengthening public finance, enhancing resilience to climate, environment, and health-related disasters, improving human capital, and boosting export competitiveness. The effect of the prior actions supported by the first pillar is indirect and conditional on the allocation of increased revenues and broadened fiscal space to, among other things, public services and social programs benefiting the poor. By contrast, the prior actions under the second and third pillars are expected to have direct and positive impacts on poverty. Prior actions under the first pillar improve the

¹ Tonga Second Resilience DPO with a Cat-DDO Option (P172742).



government's revenue collection and broaden fiscal space, which is likely to support the allocation of resources into pro-poor investments and programs. Prior actions under the second pillar are expected to have a positive impact on poverty, by enhancing resilience against climate, extreme weather events, and health-related shocks among the poor and vulnerable population. Prior Actions under the third pillar are expected to bring positive poverty impact in the medium- and long-run through human capital development and increased agricultural exports. Prior Action #7 increases agricultural productions by streamlining the export process for Tongan export companies.

Environmental, Forests, and Other Natural Resource Aspects

The policy actions supported under the operation, including those related to climate and disaster resilience, are not expected to create negative impacts on Tonga's environment, natural resources or forests compared with the status quo. Policy actions under Pillar 1 and Pillar 3 are not expected to have any significant impact on the environment. Pillar 2 and PAs related to enhancing resilience to climate change and disasters are likely to have positive effects on Tonga's environment and climate change adaptation and mitigation efforts. This would likely have positive impacts through the encouragement of sustainable risk reduction investments. Existing legal and administrative frameworks for environmental and land management in Tonga, including for impact assessments, will mitigate downstream environmental impacts (such as infrastructure investments for risk reduction). PA#3 with focus on supporting a comprehensive, proactive, and integrated model of disaster risk management will help provide more informed decisions on development and response in areas of high risk from floods, and/or landslides. Use of such information ensures reduced risk of damage or loss of assets and, as a result, provides for better use of environmental resources, such as building materials as well as reduce likelihood of pollution from disaster waste. PA#4 with focus on impact based early warning will help save lives and assets and, in some cases, could decrease the demand on forests and natural resources (such as through having to rebuild fewer houses). PA#5 with focus on strengthening the nation's social protection system will help support the poor and vulnerable that may contribute to extending the life of public assets (such as buildings) and could subsequently have positive effects on the environment, forests, and natural resources. These actions will also contribute to climate adaptation co-benefits.

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APPROVAL

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