



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 27-Apr-2018 | Report No: XXXXXXXXXX



BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Tonga	P167330	Tonga Second Inclusive Growth Development Policy Financing: Supplemental Financing	P159262
Region	Estimated Board Date	Practice Area (Lead)(s)	Financing Instrument
East Asia and Pacific	June 15, 2018	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Kingdom of Tonga	Ministry of Finance and National Planning		

Proposed Development Objective(s)

The objectives are to:

- Support fiscal resilience by means of strengthened revenue mobilization and strategic fiscal and debt policies;
- 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
- Support a more dynamic and inclusive economy by adopting investor-friendly foreign investment legislation, extending coverage of the credit bureau, improving oversight and private participation in public enterprises, and introducing regulation to private sector labor markets

Financing (in US\$, Millions)

SUMMARY

Total Financing	US\$10 million
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DETAILS

Source:
IDA

Decision

[From the decision meeting]



B. Introduction and Context

Country Context

A severe tropical cyclone (TC) hit Tonga in February 2018, leading to significant damages and losses. On February 12 the islands of Tongatapu and 'Eua were hit by TC Gita, a level 4 cyclone with average wind speeds of 130 km/h and gusts of up to 195 km/h – the strongest tropical cyclone to impact these islands since TC Isaac in March 1982. An accompanying storm surge reached one meter above normal high tide levels, and 200mm of rainfall fell over a 24-hour period, resulting in localized flooding. The cyclone caused widespread damage to power lines, schools, crops and fruit trees, and public infrastructure including the domestic airport and parliament building. Over 800 houses were destroyed and a further 4,000 damaged. The disaster is estimated to have affected 75 percent of Tonga's population (80,000 people), and caused damages and losses of TOP\$356 million (US\$164 million, or around 38 percent of 2017 GDP).

Despite budget reallocations, and pledged support from development partners, recovery and reconstruction needs have created a substantial unanticipated financing gap which the GoT does not on its own have the capacity to fill. The government's Disaster Recovery Framework estimates the total value of public financing required for cyclone recovery and reconstruction to be TOP\$246 million (US\$113 million) over the four years from FY2018 to FY2021. After accounting for substantial donor commitments, reprogramming of GoT spending, and some additional debt issuance, a government financing gap of TOP\$21.7 million (US\$10 million) remains. This supplemental budget support operation will fill this remaining financing gap.

The proposed US\$10 million supplemental financing for the Second Inclusive Growth Development Policy Operation (DPO2; approved by Board on 27 April 2017) is required to support the GoT in its recovery efforts, given the inability of the government to obtain sufficient funds from other sources in the required timeframe. Tonga is already at a high risk of debt distress and has no access to international capital markets, limiting the alternative sources of funding available. Quick disbursement of budget support will allow government the fiscal space to provide cash or in-kind assistance to facilitate (inter alia) housing repair and rebuilding and agriculture sector recovery, which are two key government priorities that currently remain unfunded. On the other hand, in the absence of further budget support, fiscal resilience – the first development objective of the DPO program – would be significantly weakened, with the government forced to run down cash balances and/or increase debt to potentially unsustainable levels to meet its recovery needs. Moreover, completion of the reforms supported by the current DPO series could face an increased risk of substantial delays due to competing budgetary and capacity priorities arising from the post-disaster recovery effort.

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 supplemental financing contributes directly to protecting incomes and livelihoods by providing government with the resources to fund critical cyclone recovery activities while maintaining fiscal sustainability over time. By supporting continued implementation of the policy reform actions completed under DPO2, it also contributes to the first focus area of exploiting economic opportunities through public enterprise reform and by making it easier to invest in Tonga, and the third and fourth focus areas by strengthening fiscal policy so as to build fiscal buffers



and improve the resilience of the government to shocks, increasing taxes on alcohol, tobacco, and unhealthy foods and drinks to combat NCDs, and strengthening the regulatory environment for the energy sector.

C. Proposed Development Objective(s)

The Program Development Objectives of the parent operation are 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, extending coverage of the credit bureau, improving oversight and private participation in public enterprises, and introducing regulation to private sector labor markets.

Key Results

The expected results are:

- Increase in excise tax revenue as a proportion of domestic revenue
- Analysis of relationship between current fiscal outcomes, budget projections, and the path toward fixed medium-term fiscal targets conducted as part of Budget preparations
- Reduction in public wage-bill as a proportion of domestic revenue over time
- All new external debt taken on is highly concessional
- Increase in proportion of contracts above the small purchases threshold that are subject to open competition
Improvement in the proportion of audit recommendations acted on (Proportion of outstanding audit recommendations 12 months after submission of the audit report to the Legislative Assembly)
- Monitoring reports for regulated sectors published on at least an annual basis
- Number of basic labor rights enshrined in domestic legislation
- Increase in vetted applications for foreign investment
- Increase in number of Credit Bureau checks for new loan requests for; i) sole male applicants; ii) female applicants or joint applications.
- Public enterprises reformed to increase private participation

D. Program Description

TC Gita recovery and reconstruction needs have created a substantial unanticipated financing gap which the GoT does not on its own have the capacity to fill. The GoT's Disaster Recovery Framework estimates the total value of public financing required for recovery and reconstruction needs to be TOP\$246.2 million (US\$113.4 million) over the four years FY2018-FY2021. As outlined in **Error! Reference source not found.**, despite considerable grants pledged by donor partners, TC Gita reconstruction and recovery creates an unanticipated public financing need of TOP\$112.7 million (US\$52 million). In the absence of further financial support, fiscal resilience – the first development objective of the DPO program – would be significantly weakened, and implementation of the reforms supported by the current DPO series could be at risk of substantial delay due to competing budgetary and capacity priorities arising from post-disaster recovery. DPO supplemental financing is the fastest way for the World Bank to provide significant financing to Tonga and has successfully been used to rapidly disburse CRW financing following natural disasters in several other Pacific countries in the past.



The government remains committed to the implementation of the supported actions in DPO2 and to the overall reform agenda as encapsulated by the three-DPO programmatic series. The government has taken significant steps toward completion of the indicative triggers for DPO3, despite several factors beyond its control acting to hinder progress, including the unexpected dissolution of Parliament in August 2017 and subsequent national elections in November 2017 (one year earlier than originally expected), and then the impact of TC Gita in February 2018 just as the new government had been established. Overall, the program is being implemented in compliance with the provisions of the legal agreement with the Bank.

The proposed US\$10 million supplemental financing is needed to support the GoT in its recovery efforts, given the inability of the government to obtain sufficient funds from other sources in the required timeframe. Tonga is already at a high risk of debt distress and has no access to international capital markets, limiting the sources of funding available. The existing IDA portfolio is already fully programmed, and the large-scale reallocation of IDA18 resources to address cyclone recovery needs would at this stage be highly disruptive and prevent the GoT from implementing a series of well-advanced and transformative projects in the areas of transport, youth employment, fisheries, and e-government. Supplemental financing for DPO2 remains the most appropriate instrument for providing timely support to the GoT. In particular, early disbursement of budget support will allow government to quickly provide cash or in-kind support to facilitate housing repair and rebuilding and agriculture sector recovery, which are two key priorities identified by the government's recovery framework that currently remain unfunded.

E. Implementation

Institutional and Implementation Arrangements

Through the Budget Support Management Committee, the Ministry of Finance and National Planning continues to provide overall guidance for the budget support program, and assumes overall responsibility for coordinating the implementation, monitoring and evaluation of the operation. The MFNP is also responsible for reporting progress and coordinating actions among other concerned government agencies. The Bank will continue to work with the Government to assess the progress of implementation of the policy actions supported by the parent operation, including through an assessment of the specific results indicators.

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, which TC Gita is likely to have exacerbated. 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 a far 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 were particularly high in rural and remote areas relative to urban areas: 17 percent in rural Tongatapu and 47 percent on the other islands on average (56 percent on 'Eua), relative to 14 percent in urban Tongatapu. The substantial estimated losses in the agriculture sector, including in small-scale and subsistence farming activities, mean that TC Gita is likely to have had a particularly serious impact on some of Tonga's poorest and most vulnerable; roughly half the country's poor are living in the rural areas directly hit by



TC Gita (rural Tongatapu and ‘Eua). Weaker domestic supply will also put upward pressure on food prices, disproportionately affecting those poor and vulnerable who are net consumers, such as those living in urban areas. Nevertheless, government responses to date have already mitigated some of these impacts. The temporary consumption tax exemption for imports of food, clothing, household tools, construction materials and capital goods recently approved by GoT should help bolster household budgets in the wake of TC Gita, as will the top-up social assistance payment already disbursed to some of the most vulnerable households in Tongatapu and ‘Eua.

The supplemental financing will help further poverty reduction in Tonga, both by safeguarding the development objectives of the program and by directly providing government with the fiscal space necessary to fund its recovery efforts and address the cyclone’s impacts on the poorest and most vulnerable. Each of the development objectives supported by the program is expected to help reduce poverty and boost shared prosperity in Tonga. 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 policy actions under the first pillar of the program will help ensure that the government has more fiscal space to respond to TC Gita as well 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. Efforts to build up fiscal space in recent years have already put the government in a stronger fiscal position than it otherwise would have been to deal with the pressing cyclone recovery needs outlined above. The US\$10 million supplemental financing provided by this proposed operation will help to further strengthen the government’s fiscal position and support its pro-poor recovery efforts. Reforms under the second pillar of the program should ultimately help to reduce the costs of basic goods and services by helping to facilitate more effective regulation and competition and more efficient procurement, while supporting inclusive growth by setting standards in the labor market which will improve the quality of jobs and narrow gender disparities. Finally, by improving the environment for private sector activity, reforms under the third pillar should help bring jobs and opportunities to Tonga, including for the poorest and most vulnerable.

Environmental Aspects

The policy actions supported under the operation are not expected to have a significant impact on Tonga’s environment. Based on the expectation that very limited, if any, green field development would result from the program, it is considered that adequate protection would be provided by the existing legal and administrative frameworks for environmental assessment and land management in Tonga.

G. Risks and Mitigation

The overall risk level remains substantial, in line with the risk assessment for the parent operation. The main risks stem from external economic shocks (of which TC Gita is the most recent example) and limited institutional capacity for policy reform and implementation. In particular, given the recent impact of TC Gita, there is now a risk that the policy reform agenda supported by the second DPO (and to be continued in DPO3) loses momentum due to competing capacity or budgetary priorities arising from post-disaster recovery.



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APPROVAL

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