

**PROGRAM INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

January 25, 2017  
Report No.: 113034

<b>Operation Name</b>	Second Inclusive Growth Development Policy Operation
<b>Region</b>	East Asia and Pacific
<b>Country</b>	Tonga
<b>Sector</b>	Central government administration (70%); General public administration (20%); General finance sector (10%);
<b>Operation ID</b>	P159262
<b>Lending Instrument</b>	Development Policy Lending
<b>Borrower(s)</b>	Kingdom of Tonga
<b>Implementing Agency</b>	Ministry of Finance and National Planning
<b>Date PID Prepared</b>	December 9, 2016
<b>Estimated Date of Appraisal</b>	March 3, 2017
<b>Estimated Date of Board Approval</b>	April 27, 2017
<b>ROC Decision</b>	Following the ROC review, the decision was taken to proceed with the appraisal and negotiation of the operation

**I. Key development issues and rationale for Bank involvement**

Tonga is a small Pacific island nation of approximately 106,000 people that has recently undergone major democratic changes. This operation is the second of a planned programmatic series of three, and reflects a strong reform program under the new Government, and a continuation of the reform partnership with the World Bank and other development partners. This program builds on two previous programs over the last four fiscal years. The Bank has worked with the Government of Tonga (GoT) and development partners to elaborate key reform 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).

**II. Proposed Objectives**

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 democratic and government accountability 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.

### **III. Preliminary 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 strengthening of revenue collection through further excise tax increases; the adoption of a new rules-based fiscal strategy; and the implementation of a new public sector remuneration framework. To support improved democratic and government accountability, this operation supports policy actions that introduce a new procurement monitoring system; and legislation to establish a multi-sector energy regulator. To support a more dynamic and inclusive economy, the operation supports the submission of a revised Foreign Investment Bill to the Legislative Assembly; and the commercialization of two public enterprises.

The programmatic 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. Fiscal and economic management reforms under pillar i will support the government's inclusive development priority, and improve the resourcing of key public services. Pillar ii will support more responsive and effective government systems and the delivery of key utility and infrastructure services for all of Tonga. Pillar iii will support the preconditions for more dynamic, inclusive and sustainable growth. These supported national outcomes are aligned with the comparative advantage of development policy programming, while other outcomes are being supported by investment operations and technical assistance by the World Bank and by other development partner programs.

### **IV. Poverty and Social Impacts and Environment Aspects**

#### *Poverty and Social Impact*

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. Statistics based on the 2009 Household Income and Expenditure Survey (HIES) show that about one in ten rural households lives below the \$3.10 a day poverty line.

Reforms supported by the program are expected to help reduce poverty and boost shared prosperity via market-based protections and 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 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 reforms under Pillar 2 of the program are focused on increasing the level of government accountability and ensuring effective regulation and private sector competition, which should also help to minimize the costs of basic goods and services. Pillar 2 reforms also support inclusive growth by setting standards in the labor market which will improve the quality of jobs and narrow gender disparities. Finally, the third pillar aims to 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. HIES data indicate that the poorer quintiles and those that live on the outer islands tend to spend less on transport, both in level terms and as a percentage of the total household budget, suggesting that the fuel excise increases could be pro-poor if the revenue was used to finance services benefitting these groups. The substantial fall in oil prices in recent years also means that the cost to the consumer remains lower than previously, despite the rise in excise. Excise duty increases on alcohol, tobacco and unhealthy foods could put pressure on household budgets in the absence of a behavioral response, but any potential negative budget effects are judged to be outweighed by the potential positive health effects of lowering consumption, as well as the implications for revenue. 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 Aspects*

The policy actions supported under the operation are not expected to have negative impacts on Tonga's environment, natural resources or forests. 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.

## **V. Tentative financing**

Source:	(US\$m.)
Borrower/Recipient	0.0
International Development Association (IDA)	5.0
Australia Department of Foreign Affairs and Trade	3.0

New Zealand Ministry of Foreign Affairs and Trade	1.0
Total	5.8

## **VI. Contact point**

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