

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

August 25, 2014
Report No.: AB7603

Operation Name	Tonga Second Economic Reform Support Operation
Region	East Asia and Pacific
Country	Tonga
Sector	General public administration (40%); General energy sector (15%); General industry and trade sector (15%); General agriculture, fishing and forestry sector (15%); Other social services (15%)
Operation ID	P149963
Lending Instrument	Development Policy Lending
Borrower(s)	Kingdom of Tonga
Implementing Agency	Ministry of Finance and National Planning
Date PID Prepared	August 26, 2014
Estimated Date of Appraisal	September 8, 2014
Estimated Date of Board Approval	October 29, 2014
Regional Operations Committee Decision	Following the ROC meeting, the decision was taken to proceed with the appraisal and negotiation of the operation

I. Key development issues and rationale for Bank involvement

Despite recent reform progress, Tonga has faced a slow and difficult recovery from the Global Economic Crisis and has been struck this year by a devastating cyclone. Tonga was negatively impacted by the Global Economic Crisis through a decline in remittances and tourism receipts. Growth is also hampered by regular cyclones and flooding, with Cyclone Ian, a category 5 cyclone, devastating much of the Ha'apai island group in January 2014. This program supports a strong Government-led reform program that builds on previous engagement.

II. Proposed Objectives

The Program Development Objective is to: i) Strengthen public financial management by improving the quality of public procurement processes and the execution as planned of the annual budget; ii) strengthen fiscal policy with new procedures for granting tax exemptions and reflecting health externalities in excise duty rates; and iii) enhance the business enabling environment by establishing a new policy to support foreign investment, and introducing targeted reductions in the cost of electricity.

III. Preliminary Description

Support to reforms in public finance and fiscal policy will improve the mobilization and targeting of public resources to support public service delivery goals. Business environment reforms will address constraints to private sector development and foreign investment, while supporting targeted reductions in the cost of basic services. Under public financial management, the operation will support reforms in Government procurement processes and budget credibility by reforming existing budget processes. Under fiscal policy, the operation will support revisions to Government tax exemption procedures that will increase the scrutiny and reduce the scope of ad-hoc tax exemptions, and put in place an excise duty regime that helps address growing Non-Communicable Diseases (NCDs) burdens.

The proposed operation will support national development objectives as set out in the Tonga Strategic Development Framework. The public financial management reforms in the proposed operation will support the objective of good governance, as well as the enabling theme on good fiscal management. Fiscal policy reforms will support good fiscal management, improved health outcomes and conducive frameworks for partnership with the private sector. The business enabling environment reforms will further support private sector and infrastructure objectives, as well as more targeted electricity tariffs to support delivery of basic services whilst maintaining a sustainable operating environment for the sector.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impact

Reforms supported by the operation will help reduce poverty and boost shared prosperity. Energy sector reform included in this operation will have a positive poverty impact. Reduced costs of energy will directly benefit low-income households, increase disposable income and increase availability of electricity for basic needs like cooking and lighting. Improved access to electric lighting is also expected to support educational attainment of school children, allowing them to do homework after nightfall. Analysis from the most recent HIES indicates that lower income households spend a large proportion of their total outgoings on electricity, so a reduction in costs would have a significant impact. NCDs are a major cause of mortality, morbidity and economic inactivity in Tonga, all of which are drivers of poverty. Tax reforms will improve the Government's ability to mobilize resources to finance improved public service delivery that addresses causes of poverty. Improved management of public resources will also, over time, contribute to improved economic performance and an expansion in economic opportunities, with international studies showing that increases in disposable household income are associated with higher investment in education, especially for girls.

Environment Aspects

58. The policy actions supported under the operation are not expected to have a significant impact on Tonga's environment, natural resources or forests, or increase climate change or disaster risks. 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	5.0
Total	10.0

VI. Contact point

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