

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

July 7, 2014
Report No.: AB7604

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	June 17, 2014
Estimated Date of Appraisal	August 18, 2014
Estimated Date of Board Approval	October 29, 2014
Concept Review Decision	Following the concept review, the decision was taken to proceed with the preparation 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 substantial and prolonged 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 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, commercializing a major state-owned hotel and introducing electricity tariff reforms.

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 tariff reforms will improve the operating environment in the electricity sector. Under public financial management, the operation will support reforms in Government procurement processes and stronger budget credibility by reforming existing budget processes and execution controls. Under fiscal policy, the operation will support the review and revisions to Government tax exemption procedures that will increase the scrutiny and reduce the scope of ad-hoc tax exemptions and provide an excise duty regime that is more targeted to consume healthy products.

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 and improved health outcomes. The business enabling environment reforms will further private sector and investment 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

Supported reforms will deliver direct improvements to living standards and better prospects of growth and job creation. Policy priorities are focused on achievable improvements in the business environment, ensuring a sound macroeconomic environment, getting the most out of the limited public resources available. The measures are intended to improve living standards in the short and longer-term, even in the context of limited growth over the medium term. Supported measures are not, on their own, expected to lead to any step-change in growth performance, but will better position the country to take advantage of business opportunities as they arise. As long as Tonga seeks to maintain an improving standard of living for all, Government finances are likely to remain reliant on budget support from development partners which plays a key role in maintain core service provision and supporting the delivery of the Government's development agenda.

Reforms aimed at strengthening public financial management and improving the business environment will help reduce poverty and boost shared prosperity. Maintenance of public services is vital to the living standards of the poor. The introduction of a lifeline

electricity tariff will deliver direct gains in disposable income to those households most in need. Excise duties to promote healthy products will help to improve diet and reduce the incidence of debilitating chronic disease over time. Business enabling reforms are targeted to support labor-intensive sectors which will help create jobs for all, and gains in revenue mobilization and effective allocation will benefit all via better delivery of core public services.

Environment Aspects

The policy actions supported under the operation are not expected to have a significant impact on Tonga's environment, natural resources, or forests. The policy actions supported under the operation aim to strengthen public financial management, strengthen fiscal policy, and enhance the business-enabling environment. They do not bear directly on environmental risks. Energy sector reforms are expected to incentivize energy efficiency, and over time lead to a change in energy mix towards renewable generation. The introduction of the lifeline tariff provides a modest incentive that encourages households consuming above a minimal level of electricity to make efficiency savings to realize savings, although this is not expected to have a significant impact on overall energy demand.

V. Tentative financing

Source:	(US\$m.)
Borrower/Recipient	0.0
International Development Association (IDA)	5.0
Australia Department of Foreign Affairs	5.0
Total	10.0

VI. Contact point

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