



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 21-Oct-2019 | Report No: PIDC27550



**BASIC INFORMATION**

**A. Basic Project Data**

Country Tonga	Project ID P171071	Project Name Tonga First Resilience Development Policy Operation (P171071)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Mar 31, 2020	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 Program Development Objective is to: (i) strengthen public finances; (ii) enhance resilience to the effects of climate change and natural disasters; and (iii) improve skills and labor mobility.

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

**SUMMARY**

<b>Total Financing</b>	5.50
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**DETAILS**

<b>Total World Bank Group Financing</b>	5.50
World Bank Lending	5.50

**Decision**

The review did authorize the preparation to continue

**B. Introduction and Context**

**Country Context**

Tonga is a small Pacific island nation with a population of 108,000 is dispersed across 36 of its 177 islands with around one quarter of the population based in the capital of Nuku’alofa. Like many other small Pacific island countries (PICs), Tonga’s economic growth potential is constrained by structurally high costs of production and public service delivery and exposure to economic and environmental shocks. Tonga’s vulnerability to natural disasters was again highlighted in February 2018, when Tropical Cyclone (TC) Gita is estimated to have caused physical damages and economic losses of



TOP\$356 million (US\$164 million), equivalent to 38 percent of Tonga's FY2017 GDP. Extreme poverty is rare in Tonga but there are significant levels of material deprivation, especially in rural areas, posing a serious challenge to securing prosperity for all. Social and human development indicators are amongst the strongest in the Pacific, but challenges remain and there are important gender disparities that adversely affect development outcomes for women. Over the past decade, development policy operations (DPOs) have helped Tonga move out of crisis, respond to natural disasters, strengthen the fiscal position and improve private sector prospects.

Tonga's economic growth has been low by global standards, and adversely affected by the frequent occurrence of natural disasters and external price shocks. Following a sharp slowdown in growth in FY2018 due to the impacts of TC Gita, the economy is estimated to have expanded by over 3 percent in FY2019. Inflation remained high in FY2018 due to policy-induced price changes and the impact of the cyclone on food stocks but is expected to moderate in FY2019 and over the medium term. Despite the ongoing substantial recovery and reconstruction needs, delays in the scaling up of public spending are estimated to have resulted in another small fiscal surplus in FY2019. The public-sector wage bill continues to place pressure on overall spending, but growth should be contained over the medium-term because of recent reforms. Generally prudent fiscal management has kept public debt in check, though Tonga's external debt distress rating moved from moderate to high risk in December 2017. Reconstruction activities and a recovery in the agriculture sector will be the key drivers of the economic outlook over the next three years. The current macroeconomic policy stance is adequate for the proposed program, but outcomes remain subject to uncertainty and are contingent on continued prudent fiscal management and ongoing contributions from development partners.

#### 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 non-communicable diseases); and fourth, strengthening the enablers of growth and opportunities (macro-economic management, infrastructure and addressing knowledge gaps). The proposed operation contributes to the second theme by introducing policy frameworks that will guide public and private actors in enhancing access, inclusivity and quality of the Technical and Vocational Education and Training (TVET) sector and overseas employment opportunities. The operation contributes to the third and fourth focus areas by introducing policy instruments to improve the management and resilience of public fixed assets and future housing reconstruction programs; and strengthening fiscal policy so as to build fiscal buffers and improve the resilience of the government to shocks.

The proposed operation builds on a number of technical assistance projects of the World Bank and other development partners. The World Bank, in coordination with Asian Development Bank (ADB), Department of Foreign Affairs and Trade (DFAT) and Ministry of Foreign Affairs and Trade (MFAT), has provided guidance to the development of an implementation plan and reforms to the public service remuneration and performance management systems, in addition to other assistance the GoT has received. The revised Revenue Services Administration Act (RSAA) regulations and framework policy on public fixed assets have been developed with technical assistance from IMF-PFTAC. World Bank supported the development of the National Housing Reconstruction Policy, and the liquidity buffer and debt servicing policies. The TVET sector policy framework was developed with support from DFAT.



### **C. Proposed Development Objective(s)**

The Program Development Objective is to: i) strengthen public finances; ii) enhance resilience to the effects of climate change and natural disasters; and (iii) improve skills and labor mobility.

#### Key Results

The proposed program supports policy reforms under three pillars: i) strengthen public finances; ii) enhance resilience to the effects of climate change and natural disasters; and iii) improve skills and labor mobility. To strengthen public finances, policy actions include: the adoption of new revenue services regulations to strengthen revenue compliance and collection; the introduction of a fiscal target for the cash liquidity buffer to support fiscal discipline; and the strengthening of the new public-sector remuneration framework and Performance Management System (PMS). To enhance resilience to the effects of natural disasters, this operation supports: the establishment of an overarching policy framework to enhance the quality and timeliness of future event-specific housing reconstruction programs; and a new policy to improve the management, recording and reporting of public fixed asset. To support improved skills and labor mobility, the operation supports: the adoption of a new TVET sector policy framework to support greater sectoral coordination and alignment between skills training and labor market needs; and the introduction of the nation's first labor mobility strategy to maximize the development impact of overseas employment opportunities while mitigating the negative social effects.

### **D. Concept Description**

This programmatic development policy operation (DPO) series is designed to strengthen the foundations for the achievement of key national outcomes under the Government's Tonga Strategic Development Framework (TSDF) II. The series supports National Outcomes one to five: i) a more dynamic, knowledge-based economy; ii) more balanced urban-rural development; iii) more empowering human development and gender equality; iv) responsive and good governance, including law and order; and v) successful provision and maintenance of infrastructure and technology. Fiscal management reforms under pillar one support the government's sustainable development priority and improve the resourcing of key public service delivery. Pillar two supports enhanced resilience through more responsive and effective government systems. Pillar three supports key sectoral opportunities to foster more inclusive and sustainable economic development. The supported outcomes are consistent with the comparative advantage of development policy programming, while other outcomes are being supported by investment operations and with technical assistance from the World Bank and other development partner programs.

The reforms supported will boost resilience to economic and environmental shocks, as well as expand skills training and labor opportunities, all of which should particularly benefit the poor and vulnerable. The reform program is expected to directly support poverty reduction and shared prosperity by addressing key risks that have a disproportionate impact on poor and vulnerable groups, while also targeting key pathways through which these groups can achieve greater economic independence and resilience. The reform program will help to mitigate the potential impacts of external shocks and natural disasters by improving the management of public infrastructure and boosting government resources for resilient and inclusive education, health and community development services on which the poor and vulnerable disproportionately rely. Given their higher exposure to the direct impacts of extreme weather events (e.g. because they tend to live in poorer quality housing) and lower likelihood to have completed the level of formal schooling necessary to prepare them for a professional career, vulnerable households are also expected to disproportionately benefit from improvements in the quality and responsiveness of future housing reconstruction programs, and reforms designed to increase their participation in skills training and overseas employment programs.



The proposed operation reflects key lessons learned from previous DPOs that the Bank has undertaken in Tonga. Past operations have demonstrated that DPOs in Tonga can achieve good results in the context of solid government ownership and can be an important means of advancing economic and fiscal policy reforms. A key lesson from the previous series is that a three-year program can involve significantly greater implementation challenges than a two-year program (the standard duration in the Pacific, and the duration of two previous programmatic series in Tonga), given high rates of turnover (both within the civil service and at the Ministerial level) and Tonga’s exposure to disruptive external shocks. These challenges were evident in the previous series which spanned several years (the reform priorities were first discussed with authorities in FY2015 and were not concluded until FY2019), different governments, and a major natural disaster—all of which affected the capacity of government to achieve as much progress in some specific reform areas as was envisaged when the series was formulated. The previous series thus highlighted the importance of flexibility to adjust the reform program (including the flexibility to adjust indicative triggers) in order to ensure multi-year reform programs remain relevant and informed by the latest evidence and conditions. Past operations have also highlighted that adequate investment in policy dialogue is vital but resource intensive, and that close coordination and engagement with other development partners in the identification of policy priorities is critical in sectors where the Bank has more limited knowledge and engagement. Finally, coordinated management of fiscal needs and budget support can provide vital support to mitigate the impact of external shocks.

## **E. Poverty and Social Impacts and Environmental Aspects**

### Poverty and Social Impacts

Extreme poverty is rare in Tonga but there are significant levels of material deprivation, particularly in rural areas. While traditional family and community based social safety nets 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. Preliminary estimates based on the 2015/16 HIES show that less than 1 percent of Tongans live below the international poverty line of \$1.90 a day, but around 25 percent of the population are struggling to meet the cost of local basic needs. These rates are even higher in rural and remote areas, with 47 percent of the rural populations in outer islands experiencing material deprivation on average, relative to 14 percent in urban Tongatapu.

Reforms supported by this operation are expected to help reduce poverty and boost shared prosperity by creating fiscal space to maintain critical public services, enhancing resilience to climatic events, and supporting greater access to skills training and employment opportunities. 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 Pillars 1 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. Relatedly, the reforms supported under Pillar 2 are expected to disproportionately benefit vulnerable households to the extent that they are more likely to rely on publicly-funded infrastructure and housing reconstruction programs. The third pillar aims to address poverty by encouraging greater participation in higher-quality skills training and overseas employment opportunities for rural households, youths and women, which will encourage labor market participation and narrow gender disparities.

### Environmental Impacts

The policy actions supported under the operation—including those related to the National Housing Reconstruction Policy and public asset management—are not expected to have a significant impact on Tonga’s environment. Policy actions



related to revenue regulations, liquidity management, public sector performance management, the TVET sector and labor mobility are not expected to have any significant environmental impacts. The actions to strengthen public infrastructure management and to introduce an overarching policy to guide the design and implementation of future housing reconstruction programs are expected to yield climate co-benefits due to their positive impact on Tonga’s resilience to the impacts of climate change and natural disasters. The Ministry for Infrastructure is responsible for ensuring that any associated residential or public infrastructure works have minimum environmental and social impact through its legislative framework. Furthermore, it is considered that direct and indirect environmental impacts from these reform actions should be minimal, and that—to the extent that there could be downstream environmental impacts—adequate protection would be provided by the existing legal and administrative frameworks for environmental assessment and land management in Tonga.

Tonga has a well-established environmental impact assessment (EIA) process administered by the Ministry of Environment and Climate Change. It is noted that the Transport Sector Consolidation Project has been implemented using the Tongan legislation and to date, the project is being implemented effectively and no environmental issues have been identified. Nevertheless, although the legal framework is reasonably sound, capacity for monitoring and enforcement is relatively thin and the quality of EIAs can be variable. Legislation includes the Environmental Impact Assessment Act 2003 which provides for the application of environmental impact assessment to the planning of development in Tonga. The Act is structured in five parts, starting with definitions of key terms in Part I and clarifying functions and powers in Part II. Part III outlines the EIA process. Part IV deals with cases of non-compliance with the previous provisions and Part V contains further miscellaneous provisions. Secondly, the Environmental Impact Assessment Regulations 2010 regulates major development projects and the application of notifications consistent with the EIA Act 2003. Finally, the Environment Management Act 2010 established the Ministry of Environment & Climate Change which is now the principal Ministry responsible for the protection and proper management of the environment and the promotion of sustainable development.

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## **CONTACT POINT**

### **World Bank**

Andrew Blackman  
Economist

### **Borrower/Client/Recipient**

Kingdom of Tonga  
Pohiva Tu'i'onetoa  
Minister of Finance  
minister@finance.gov.to

### **Implementing Agencies**



Ministry of Finance  
Balwyn Faotusia  
Chief Executive Officer  
bfaotusia@finance.gov.to

**FOR MORE INFORMATION CONTACT**

The World Bank  
1818 H Street, NW  
Washington, D.C. 20433  
Telephone: (202) 473-1000  
Web: <http://www.worldbank.org/projects>

**APPROVAL**

Task Team Leader(s):	Andrew Blackman
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**Approved By**

Country Director:	Michel Kerf	09-Nov-2019
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