Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 22-Mar-2020 | Report No: PIDA28205

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Tonga	P171071	Tonga First Resilience Development Policy Operation (P171071)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EAST ASIA AND PACIFIC	28-May-2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Kingdom of Tonga	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 disasters; and (iii) improve skills and labor mobility.

Financing (in US$, Millions)

SUMMARY

Total Financing	5.50

DETAILS

Total World Bank Group Financing	5.50
World Bank Lending	5.50

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

This operation is the first in a programmatic series of two operations designed to support objectives that are critical to enhancing resilience in Tonga—one of the Government of Tonga's (GoT) key priorities in the post-Tropical Cyclone (TC) Gita environment and in light of the global COVID-19 pandemic. The focus of this multiyear engagement is on strengthening the foundations for resilient development in Tonga by enhancing the resilience of public finances (by means of improved revenue mobilization and strategic fiscal and debt policies), infrastructure (both private and public),

and households (through improved labor opportunities), along with strengthening the institutional and legislative structures for disaster risk management and disaster recovery.

Like 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 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.

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 1 percent in FY2019. Inflation remained high in FY2018 due to policy-induced price changes and the impact of the cyclone on food stocks but eased during FY2019. Private sector credit growth remains solid, supported by government initiatives and accommodative monetary policy. The current account deficit—which widened in FY2019—is driven by construction cycles, with remittances a key source of support, and is largely financed by development grants. Despite the ongoing substantial recovery and reconstruction needs, delays in the scaling up of public spending combined with increased grants from development partners are estimated to have resulted in another fiscal surplus in FY2019.

Reconstruction activities and a recovery in the agriculture sector will be the key drivers of the economic outlook over the medium term, although the economic impact of the COVID-19 pandemic has led to a sharp downgrade in the FY2020 growth projection. Overall, the economy is expected to expand by less than 1 percent in FY2020, then accelerate to around 3 percent in FY2021 and FY2022, before easing to 1.8 percent in FY2023—consistent with the its historical average rate. Inflation is expected to ease as agriculture production recovers, while the current account deficit will remain sizeable due to sustained high imports supporting reconstruction activities, and COVID-19-related impacts on the tourism sector in FY2020. Reserves are projected to stabilize at a still-healthy 5.5 months of imports cover, following a modest decline due to COVID-19-related impacts on the tourism sector in FY2020 and the temporary spike in imports to support reconstruction activities. Domestic revenues are projected to expand gradually over the projection period due to policy-induced increases in tax collections, while current expenditures are expected to peak in FY2020 before easing back towards pre-TC Gita levels —although the COVID-19 shock has led to a deterioration in the short-term fiscal outlook. Further strengthening of wage bill management, including through reforms supported by this program, is key to maintaining fiscal space for other essential recurrent spending, including recovery efforts. Overall, the impacts of the global pandemic are expected to push the budget into deficit in FY2020, before returning to a balanced position over the period FY2021 to FY2023, with TC-Gita reconstruction and recovery spending financed primarily by additional donor grants. To the extent that the COVID-19 pandemic and associated global economic slowdown are more pronounced or protracted than currently projected, additional development partner grant financing may be required to close any unexpected fiscal gap. Due to the GoT's demonstrated commitment to ensuring that public spending remains within the overall revenue envelope, the debt trajectory has improved relative to the 2017 Debt Sustainability Analysis, despite the fiscal impacts of TC Gita. The current macroeconomic policy stance is adequate for the proposed program.

Relationship to CPF

The World Bank Group's Regional Partnership Framework for nine PICs (PIC9, Report #120479), 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 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 recovery and resilience programs; and strengthening fiscal policy so as to build fiscal buffers and improve the resilience of the government to shocks. Actions supported by this Development Policy Operation (DPO) are also closely linked to the IDA18 special themes of "Governance and Institutions", "Climate Change" and "Gender and Development", including in the areas of supporting domestic revenue mobilization, enhancing resilience to climate change and natural hazards and expanding women's access to skills training and employment opportunities. Finally, the operation directly addresses a key priority gender gap—namely, low female labor force participation—which is a priority in the PIC9 Gender Action Plan, as well as the East Asia & Pacific Action Plan and the Bank's Gender Strategy 2016 – 2023 (Report #102114).

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 disasters; and (iii) improve skills and labor mobility.

Key Results

Under Pillar 1 (strengthen public finances), reforms supported by this operation are expected to result in: (i) an increase in public resources available for budget priorities; (ii) enhanced management of government cash balances; and (iii) improve public-sector wage bill affordability. The reforms under Pillar 2 (enhance resilience to the effects of climate change and disasters) are expected to result in: (i) enhanced institutional capacity for housing-sector recovery and risk-reduction; and (ii) improved financial reporting on public fixed assets. Under Pillar 3 (improve skills and labor mobility), reforms are expected to result in increased labor mobility and relevance of skills training, supporting female inclusion.

D. Project Description

This programmatic DPO series is designed to strengthen the foundations for the achievement of key national outcomes under the Government's Tonga Strategic Development Framework 2015-2025, namely: 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 second operation in this programmatic series is expected to be combined with a Catastrophe-Deferred Drawdown Option (CAT-DDO) to provide both upfront and contingent financing to address shocks related to natural disasters and/or health-related events.

Under Pillar 1, Strengthen Public Finances, the Prior Actions and indicative triggers are:
Prior Action #1. The Recipient, through its Cabinet, has approved amendments to the regulations under the Revenue Services Administration Act to improve compliance and the efficiency of revenue collection;
Prior Action #2. The Recipient, through its Cabinet, has approved a policy that establishes a liquidity buffer target band to support enhanced cash management;
Prior Action #3. The Recipient has adopted and commenced implementation of: (a) a standardized public service job descriptions template; and (b) a revised public service Classification of Positions;
Indicative Trigger #1. The Recipient, through its Cabinet, has approved a policy that applies a nutrition profile to determine the application of excise taxes to improve revenue mobilization and strengthen incentives to consume healthy foods;
Indicative Trigger #2. The Recipient, through its Cabinet, has approved a new medium-term debt strategy to support enhanced debt management and medium-term fiscal sustainability;
Indicative Trigger #3. The Recipient, through its Cabinet, has approved a policy that establishes the procedures for assessing and approving requests for Government guarantees to support enhanced debt management and medium-term fiscal sustainability;
Indicative Trigger #4. The Recipient, through its Cabinet, has approved a policy that strengthens the guidelines governing overtime allowances in the public sector to support improved wage bill management.

Under Pillar 2, Enhance Resilience to the Effects of Climate Change and Disasters, the Prior Actions and indicative triggers are:
Prior Action #4. The Recipient, through its Cabinet, has approved a national housing recovery and resilience policy to improve the resilience and responsiveness of future event-specific housing programs;
Prior Action #5. The Recipient, through its Cabinet, has approved a comprehensive policy framework for the public fixed-asset registry to help improve the life-cycle management and resilience of public infrastructure to natural disasters and the accuracy of financial reporting;
Indicative Trigger #5. The Recipient, through its Cabinet, has approved for submission to Parliament the National Emergency Management Bill that establishes a new, more decentralized and consultative model of disaster recovery management;
Indicative Trigger #6. The Recipient, through its Cabinet, has approved a framework contract for the procurement of one or more specific goods or services required immediately after a natural disaster.

Under Pillar 3, Improve Skills and Labor Mobility, the Prior Actions and indicative triggers are:
Prior Action #6. The Recipient, through its Cabinet, has approved a technical and vocational education and training sector policy framework to enhance the quality and relevance of skills training;
Prior Action #7. The Recipient, through its Cabinet, has approved a labor mobility policy framework to foster greater participation and gender equity in access to overseas employment opportunities.
Indicative Trigger #7. The Recipient, through its Cabinet, has approved a policy or governance reform that addresses an identified skills gap in secondary education or the technical and vocational education and training sector.

E. Implementation

Institutional and Implementation Arrangements

The existing institutional structure for aid management in Tonga will be used to implement and monitor the policy actions

supported by the operation. Through the Budget Support Management Committee, the Ministry of Finance (MoF) will provide overall guidance for the budget support program, and will assume overall responsibility for coordinating the implementation, monitoring and evaluation of the operation. The MoF will also be ultimately responsible for reporting progress and coordinating actions among other concerned government agencies.

Specific indicators that the Bank will monitor for each of the policy areas supported by the proposed operation are set out in Annex 1 of the Program Document. The Bank will work with the Government to assess the progress of implementation of the policy actions supported by the proposed operation. The Bank will also work with the Government to monitor the specific indicators associated with each of the policy areas supported by the proposed operation. The Bank will play a coordinating role among development partners to ensure that there is a single, agreed assessment of the implementation of the policy actions and a single, agreed evaluation of the monitoring indicators. This will reduce the administrative burden on Government.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource 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. 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 Pillar 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 recovery programs. The third pillar aims to address poverty by encouraging greater participation in higher-quality skills training and overseas employment opportunities for women, rural households and youths, which will encourage labor market participation and narrow gender disparities.

Environmental, Forests, and Other Natural Resource Aspects

The policy actions supported under the operation—including those related to the housing recovery and resilience 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 recovery programs are assessed 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 responsible for the 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 (now the Ministry of Meteorology, Energy, Information, Disaster Management, Environment, Climate Change and Communications) which is now the principal Ministry responsible for the protection and proper management of the environment and the promotion of sustainable development.

G. Risks and Mitigation

The overall risk level for the proposed program is “Substantial”, based on the interaction of GoT’s thin institutional capacity and the nations high vulnerability to external shocks (including the fast-evolving COVID-19 pandemic). Environmental and social risks are rated as “Substantial”, given Tonga’s high degree of vulnerability to natural disasters and the effects of climate change, along with the potential negative impacts of some policy actions—although there is strong GoT commitment to implement mitigating measures and the actions are assessed to have net positive poverty and social impacts. The risks around limited institutional capacity are “Substantial”, but are being mitigated by strong dialogue between the Bank and the Government, the selection of a limited number of reform actions, and the coordination of technical assistance. The macroeconomic risk is rated as “Substantial” due to Tonga’s exposure to a range of potential external economic and fiscal shocks (including an outbreak of COVID-19 in Tonga and a more severe or protracted global downturn than is currently projected) which—should they materialize—could detract from the focus on the reform program, although these risks are being mitigated, to the extent possible, by prudent fiscal management on the part of the government, and prior actions that further strengthen fiscal resilience. Political and governance risks are assessed as “Substantial”, though these are being mitigated by strong dialogue between the Bank and the Government at both the political and administrative levels.

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APPROVAL

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