Technical Assistance Report

Project Number: 45270–001
Capacity Development Technical Assistance (CDTA)
December 2011

Kingdom of Tonga: Implementing Strategic Economic Management
CURRENCY EQUIVALENTS
(as of 25 November 2011)

Currency Unit – pa’anga (T$)
T$1.00 = $0.582699
$1.00 = T$1.716149

ABBREVIATIONS

ADB – Asian Development Bank
GDP – gross domestic product
MFNP – Ministry of Finance and National Planning
MTBF – medium-term budget framework
PEFA – public expenditure and financial accountability
TA – technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

<table>
<thead>
<tr>
<th>Type</th>
<th>Capacity development technical assistance (CDTA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Targeting classification</td>
<td>General intervention</td>
</tr>
<tr>
<td>Sector (subsector)</td>
<td>Public sector management (public expenditure and fiscal management)</td>
</tr>
<tr>
<td>Themes (subthemes)</td>
<td>Economic growth (promoting macro-economic stability), governance (economic and financial governance, capacity development (institutional development)</td>
</tr>
<tr>
<td>Location impact</td>
<td>National (high)</td>
</tr>
</tbody>
</table>

NOTE

(i) The fiscal year (FY) of the government and its agencies ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2011 ends on 30 June 2011.

(ii) In this report, "$" refers to US dollars unless otherwise stated.

<table>
<thead>
<tr>
<th>Vice-President</th>
<th>S. Groff, Operations 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director General</td>
<td>R. Wihtol, Pacific Department (PARD)</td>
</tr>
<tr>
<td>Director</td>
<td>A. Ruthenberg, South Pacific Subregional Office, PARD</td>
</tr>
<tr>
<td>Team leader</td>
<td>L. Tora, Senior Public Management Officer, PARD</td>
</tr>
<tr>
<td>Team members</td>
<td>M. Lototele, Senior Economics Officer, PARD</td>
</tr>
<tr>
<td></td>
<td>M. Melei, Country Specialist, PARD</td>
</tr>
<tr>
<td></td>
<td>E. Veve, Principal Economist, PARD</td>
</tr>
<tr>
<td>Peer reviewer</td>
<td>S. Shrestha, Senior Public Management Specialist, Regional and Sustainable Development Department</td>
</tr>
</tbody>
</table>

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.
I. INTRODUCTION

1. The focus of the technical assistance (TA) project is to support the Government of Tonga’s efforts to sustain the momentum of its economic management reforms. This is consistent with the aims of the Tonga Strategic Development Plan (TSDP)\(^1\) and the Pacific Approach 2010–2014 of the Asian Development Bank (ADB).\(^2\) The TA builds on achievements under ADB’s TA for Support for Economic and Strategic Management, which is scheduled for completion on 31 December 2011.\(^3\)

2. A TA fact finding mission visited Tonga on 22–26 August 2011 and reached an understanding with the government and other stakeholders on the impact, outcome, outputs, implementation arrangements, cost, financing arrangements, and terms of reference for consulting services. The design and monitoring framework is in Appendix 1.\(^4\)

II. ISSUES

3. The Tongan economy contracted by 1.4% in FY2010 owing to domestic banking consolidation, weak export and tourism receipts due to the global economic crisis, and slow recovery in major remittance source economies such as the United States and New Zealand. Remittances, typically equivalent to 30% of gross domestic product (GDP), fell to 22% of GDP in FY2010 and are unlikely to return to pre-FY2009 levels in the medium term. GDP growth is estimated to rebound to 1.4% in FY2011 on the back of stronger tourism activity and an expansionary fiscal policy financed by development partner funds and previously contracted loans. However, risks to this outlook include rising inflation, weak global demand, and Tonga’s high public debt. The International Monetary Fund expects growth to remain at about 1.7% over the medium term—in line with the average of the past 15 years, but slightly above the average of the past 10 years. This medium-term outlook, however, assumes implementation of the government’s plans, including increased donor-financed capital spending, structural reform, and improved fiscal management to support fiscal consolidation.\(^5\)

4. According to the 2010 public expenditure and financial accountability (PEFA) assessment, the Tongan public financial management system is, overall, operating at average or above average levels when compared to international best practice.\(^6\) However, some areas are worthy of continued attention, especially in light of the difficult fiscal situation that the government faces over the medium term. Tonga, already at high risk of debt distress, requires ongoing budget support grants to fund its development priorities, while at the same time achieving fiscal consolidation through lower fiscal deficits and no additional borrowing. The areas requiring continued attention include maintaining budget credibility, the need to embed multi-year perspectives in budgeting, and presenting the budgetary impacts of policy changes (a symptom of weak links between the corporate planning and annual budget process).

5. ADB approved a $500,000 TA for Support for Economic and Strategic Management in December 2009, funded by the Japan Fund for Poverty Reduction, to help the government achieve (i) regular monitoring and reporting on progress made by the TSDP, (ii) use of a GDP

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\(^4\) The TA first appeared in the business opportunities section of ADB’s website on 2 December 2011.
\(^5\) International Monetary Fund. 2011. *Tonga Article IV Consultation–Staff Report*. Washington, DC.
and revenue forecasting model, (iii) robust and timely economic policy analysis and proposals, (iv) a medium-term budgeting framework (MTBF) that is strategically aligned and used, and (v) improved policy coordination.

6. A subsequent change in scope dropped work on the GDP and revenue forecasting model, to direct additional resources to the MTBF. This reflected government commitment to bring forward the establishment of the MTBF through the preparation of an in-depth scoping report. All outputs have been fully achieved. The report contains 48 detailed recommendations that have been endorsed by the government and which will assist it to develop a framework for implementing a sustainable medium-term budgeting system over the two year period of the TA (2012 and 2013).

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

7. The intended impact of the TA is enhanced resource allocation to foster economic growth and achieve national development priorities. The impact will be monitored through demonstrated improvements in country performance assessment ratings in macroeconomic management, and the quality of budgetary and financial management. The expected TA outcome will be the adoption by the government of improved economic management processes and practices. The achievement of this outcome will be reflected in improvements in PEFA ratings.

B. Methodology and Key Activities

8. The TA will support the strengthening of Tonga's GDP and revenue forecasting model, and ongoing development and implementation of the MTBF. The MBTF is envisaged to take a minimum of two budget cycles, and will require extensive work with line ministries, as well as outreach with parliamentarians, nongovernment organizations (NGO), and the general public. Work with the line ministries will involve developing a sector-based approach to budget planning, as well as methods of intersectoral prioritization. Outreach will be focused on creating awareness about, and building demand for, medium-term budgeting reforms.

9. Strengthening the forecasting model and implementation of the MTBF, will support the government in addressing the weaknesses identified in the 2010 PEFA. This will improve the overall quality of public financial management and reduce the significant financial pressure that the government is under. Discussions are also underway with the Pacific Financial Technical Assistance Centre to leverage their comparative advantage in the area of economic modeling. To strengthen the analytical base for the reforms and to raise policy awareness, the TA will fund short-term, ad hoc, issues papers on macroeconomic and fiscal policy, public financial management, and corporate planning. Of particular importance is the need to prepare an overarching public financial management reform plan that links all ongoing efforts in this space. The Ministry of Finance and National Planning (MFNP) can draw on this expertise as needs emerge during TA implementation.

10. The following outputs and activities are envisaged:
(i) an MTBF that is strategically aligned:
   (a) developing a sequenced and prioritized implementation plan for the scoping report recommendations;
(b) developing comprehensive and accurate multiyear costings of the TSDP, or any future decisions by the cabinet;
(c) improving development partner reporting mechanisms to ensure the government’s medium-term budget is inclusive of monies from all sources, including in-kind assistance;
(d) identifying and enumerating updated fiscal targets for Tonga, which will underpin the country’s medium-term budget for future years; and
(e) preparing ad hoc discussion papers on macroeconomic and fiscal policy, public financial management, and corporate planning to guide TA implementation.

(ii) an MTBF that is used by the whole of government:
   (a) conducting relevant training and capacity building in medium-term budgeting, including preparation of manuals and guidelines for the MFNP and line ministries;
   (b) conducting outreach to parliamentarians, NGO, and the general public; and
   (c) implementing a policy of movement of staff between the MFNP work groups, that is, budget, policy and planning, and project and aid management to build skills and experience across different functional areas.

(iii) strengthened GDP and revenue forecasting:
   (a) evaluating and customizing a GDP and revenue forecasting model for Tonga;
   (b) establishing the model in policy and planning; and
   (c) conducting relevant training and capacity building in use of the model, including preparation of manuals and guidelines.

11. The TA faces several risks, including lack of public awareness of the extent of Tonga’s fiscal difficulties, ongoing financial difficulties (which might strain budget allocation and prompt ad hoc changes in policy focus), and turnover of key staff in the MFNP. However, the government, and members of Parliament, are aware of the critical need to strengthen budget management (the fiscal difficulties are well publicized) and remain fully committed to these reforms. ADB will continue to engage a wide range of stakeholders in programming discussions and TA management to ensure that a minimum level of awareness is maintained, and allow for continued support during implementation.

12. There is a need for continuing coordination—through regular dialogue and information sharing—with other key development partners, and with ADB’s regional TA for Pacific Economic Management. ADB’s joint country focal office with the World Bank Group in Tonga will continue to strengthen collaboration between ADB and the World Bank, and with other development partners with an on-the-ground presence.

C. Cost and Financing

13. The government has requested ADB to finance $675,000 equivalent. The TA will be financed on a grant basis by ADB’s Technical Assistance Special Fund (TASF-IV). The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and secretarial assistance. The cost estimates and financing plan are in Appendix 2.

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D. Implementation Arrangements

14. The MFNP will be the executing agency, while implementing agencies will include the Budget, and Policy and Planning divisions of the MFNP. The MFNP will use a TA steering committee mechanism (chaired by the permanent secretary, and comprising the heads of Budget, Policy and Planning, and Project and Aid Management) to coordinate activities. Staff from the Budget Division and the TA consultants will serve as the committee’s secretariat. The consultants will also liaise with development partner programs and projects, so as to promote coordination and complementarity.

15. The TA will be implemented over 24 months (9 January 2012–31 December 2013) and is expected to finance 20 person-months of full-time and intermittent international consulting, and 12 person-months of intermittent national consulting services. The consultants will work as a cohesive team. The international consultant team will comprise a medium-term budgeting specialist and team leader (8 person-months); an economic modeling specialist (3 person-months); and policy advisors (9 person-months). They will be joined by a budget advisor (national, 12 person-months). The outline terms of reference for the consultants are in Appendix 3.

16. The consultants will be selected and engaged on an individual basis and according to ADB’s Guidelines on the Use of Consultants (2010, as amended from time to time). The costs estimates and financing plan are in Appendix 2. The proceeds of the TA will be disbursed in accordance with the ADB’s Technical Assistance Disbursement Handbook (2010, as amended from time to time).

17. The team leader will produce a concise inception report outlining the work program and milestones for the TA, and a final report summarizing achievements, issues, lessons learned, and next steps. Throughout the TA, the team leader will submit (by e-mail) mission reports summarizing the progress of TA activities, progress, issues, and constraints. The team leader will also prepare a mid-point report, which will be used as the basis for a midterm review of TA progress. Team members will produce inputs (reports) on their activities for the team leader’s progress, mid-point, and final reports. The team leader's final report will be submitted in draft form at least 5 weeks prior to the end of the assignment, and the final report within 2 weeks of receipt of comments from the government and ADB.

18. The progress of the TA will be monitored using intended outcome and outputs described in the design and monitoring framework in Appendix 1. ADB will assist the government in sharing all reports with other development partners. This will be disseminated through round table meetings, radio interviews, and through the ADB website.

IV. THE PRESIDENT’S DECISION

19. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of $675,000 on a grant basis to the Government of Tonga for Implementing Strategic Economic Management, and hereby reports this action to the Board.
## DESIGN AND MONITORING FRAMEWORK

<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Performance Targets and Indicators with Baselines</th>
<th>Data Sources and Reporting Mechanisms</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Impact</strong></td>
<td>Enhanced resource allocation to improve rates of economic growth and achieve national development priorities</td>
<td>Demonstrated improvements in the country performance assessment (CPA) ratings for macroeconomic management in 2016 (2010 baseline: 3.0) and quality of budgetary and financial management (2010 baseline: 4.0)</td>
<td>Assumption: Strong government commitment, Risk: Lack of public awareness of the ongoing fiscal difficulties</td>
</tr>
<tr>
<td><strong>Outcome</strong></td>
<td>Improved economic management processes adopted by the Ministry of Finance and National Planning (MFNP)</td>
<td>Improvements in public expenditure and financial accountability (PEFA) ratings from C to C+ by 2016 (2010 baseline: PEFA ratings of C for PI-9 and PI-10, which relate to budget credibility, and comprehensiveness and transparency)</td>
<td>Assumptions: Well-coordinated approaches with all stakeholders, Availability of sector plans, budgets, and corporate plans, Risk: Ongoing financial difficulties strain budget allocation and prompt change in focus</td>
</tr>
<tr>
<td><strong>Outputs</strong></td>
<td>1. A strategically aligned medium-term budget framework (MTBF) 2. An MTBF that is used by the whole of government 3. A strengthened gross domestic product (GDP) and revenue forecasting model</td>
<td>Comprehensive and accurate multiyear budget estimates published in annual budgets. PEFA PI-12 rating improves to C+ by 2016 (2010 baseline: PEFA rating of C for PI-12, which relates to policy-based budgeting)  Annual budget includes monies from all sources. PEFA ratings for D2 and D3 improve to C by 2016 (2010 baseline: PEFA rating of D for D2 and D3, which relate to donor practices) Reporting on fiscal ratios in FY2013 budget (2010 baseline: Capital)</td>
<td>Assumption: Strong and timely support from all stakeholders, Risk: Staff turnover in key ministries</td>
</tr>
</tbody>
</table>

- Annual CPA narratives and ratings
- Periodic public expenditure and financial accountability assessments
- Monthly in-year budget reports
- FY2013 budget (and future budgets)
- Notes to file of meetings
<table>
<thead>
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<th>Assumptions and Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>expenditure and maintenance to be maintained at a level of no less than FY2010. Capital expenditure of 5% of the total government funds. Sovereign debt to be maintained within levels that are sustainable over time, which is less than 40% of GDP. No new debt will be taken on. Debt service will be maintained at up to 15% of government funds</td>
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**Activities with Milestones**

1.1 Develop a sequenced and prioritized implementation plan for the scoping report recommendations (March 2012).

1.2 Develop comprehensive and accurate multiyear costings of the Tonga Strategic Development Plan, or any future decisions by the cabinet (June 2012).

1.3 Improve development partner reporting mechanisms to ensure the government’s medium-term budget is inclusive of monies from all sources, including in-kind assistance (December 2012).

1.4 Identify and enumerate updated fiscal targets for Tonga. These targets will underpin Tonga’s medium-term budget for future years (June 2012).

1.5 Prepare a minimum of 6 ad hoc issues papers on macroeconomic and fiscal policy, public financial management, and corporate planning.

2.1 Conduct relevant training and capacity building for medium-term budgeting, including preparation of manuals and guidelines for the MFNP and line ministries (ongoing throughout the technical assistance).

2.2 Conduct outreach for parliamentarians, nongovernment organizations, and the general public to create awareness on, and build demand for, medium-term budgeting reforms (ongoing throughout the technical assistance).

2.3 Implement policy of movement of staff between work groups (Budget, Policy and Planning, and Project and Aid Management) in order to build skills and experience across functional areas (March 2012).

3.1 Evaluate and customize a GDP and revenue forecasting model for Tonga (June 2012).

3.2 Establish the GDP and revenue forecasting model in the Policy and Planning Division of the MFNP (October 2012).

3.3 Conduct relevant training and capacity building in use of the model, including preparation of manuals and guidelines (ongoing throughout the technical assistance).

**Inputs**

Asian Development Bank: $675,000

The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and secretarial assistance.

## COST ESTIMATES AND FINANCING PLAN

($'000)

<table>
<thead>
<tr>
<th>Item</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asian Development Bank Financing</strong>&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>1. Consultants</td>
<td></td>
</tr>
<tr>
<td>a. Remuneration and per diem</td>
<td></td>
</tr>
<tr>
<td>i. International consultants</td>
<td>400.00</td>
</tr>
<tr>
<td>ii. National consultant</td>
<td>108.00</td>
</tr>
<tr>
<td>b. International and local travel</td>
<td>22.00</td>
</tr>
<tr>
<td>c. Reports and communications</td>
<td>25.00</td>
</tr>
<tr>
<td>2. Training, seminars, and conferences</td>
<td>20.00</td>
</tr>
<tr>
<td>3. Miscellaneous administration and support costs</td>
<td>50.00</td>
</tr>
<tr>
<td>4. Contingencies</td>
<td>50.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>675.00</strong></td>
</tr>
</tbody>
</table>

Note: The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and secretarial assistance.

<sup>a</sup>Financed by the Asian Development Bank’s Technical Assistance Special Fund (TASF-IV).

Source: Asian Development Bank estimates.
OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. The technical assistance (TA) will require the services of a team of international and national consultants in medium-term budgeting, economic modeling, and macroeconomic management.

2. The consultants will assist the Ministry of Finance and National Planning (MFNP) to develop and implement a medium-term budget framework (MTBF), designed to improve macroeconomic stability, and a gross domestic product (GDP) and revenue forecasting model that will strengthen the data and information underpinning strategic economic management in Tonga.

3. **Medium-term budget specialist and team leader** (international, 8 person-months, intermittent). The specialist and team leader will have a strong background in expenditure management, especially performance-based budgeting; capacity building and training; and project and/or program development and management. The specialist should have at least 10 years of experience providing such advice to a variety of Pacific governments and societies, including having demonstrated strong political, negotiation, and process facilitation skills, and should hold a tertiary degree, preferably a master’s degree or doctorate, in finance, economics, or a related field. This specialist should have excellent communication skills, both written and verbal, and be skilled in the use of consultative and participatory processes.

4. The specialist will work closely with the budget adviser to provide ongoing support to the development and implementation of a MTBF for FY2013–FY2015, based on the 48 recommendations contained in the MTBF scoping report.

5. In addition, the specialist will define improved budget and corporate plan outputs, and performance monitoring indicators; strengthen links between the annual budget and the national, corporate, and annual management plans and strategies leading toward an MTBF; improve service to MFNP clients (in particular the line ministries) on budget management issues; provide training and capacity building for staff of the MFNP and line ministries and agencies in these various budget and MTBF-related processes; and work with the MFNP to create awareness among parliamentarians, nongovernment organizations and the general public of the benefits of MTBF, and to build demand for sustaining these reforms beyond the TA period. In relation to this, the team leader will also administer trainings, seminars, and conferences under the TA.

6. In addition, the specialist should assist in building the capacity of the MFNP to develop a sectoral-based approach to budget planning for line ministries. This would primarily be done through training of trainers and the development of manuals and guidelines. The specialist will also assist in developing and disseminating to the MFNP and line ministries methods of intersectoral prioritization between different sectoral projects and plans, as well as developing MTB systems that can be independently maintained by the MFNP and line ministries. Methodology must be robust, clearly set out in manuals and guidelines, and easily assimilated.

7. **Economic modeling specialist** (international, 3 person-months, full time). The specialist will have a background appropriate to undertaking the tasks set out below, with at least 10 years practical experience in economic modeling and significant experience specific to TA in small island states and should hold an advanced degree, preferably a Master’s degree in economics, finance or a related field.
8. The specialist will:
   (i) coordinate closely with the medium-term budget specialist and team leader on the macroeconomic framework needed to underpin the MTBF;
   (ii) work closely with the Pacific Financial Technical Assistance Centre macroeconomic advisor to evaluate and customize the current GDP and revenue forecasting model;
   (iii) based on the outcomes of the above work, establish a new model for forecasting GDP and revenue in the MFNP (to be located in Policy and Planning, and the Statistics Department);
   (iv) develop support manuals for the models; and
   (v) conduct training and capacity building for the MFNP and relevant agencies in key economic sectors to develop their understanding and ability to effectively and sustainably use the GDP and revenue forecasting model.

9. **Budget adviser** (national, 12 person-months, intermittent). The adviser will have a background appropriate to undertaking the tasks set out below, with at least 10 years practical experience in budget management and significant experience specific to small island states and should hold a tertiary degree, preferably a bachelor’s degree in economics, finance or a related field.

10. The adviser will:
    (i) coordinate closely with the medium-term budget specialist and team leader on the overall MTBF work;
    (ii) assist with the development and implementation of a strategically aligned MTBF;
    (iii) assist the MFNP and line ministries with the alignment of annual budget provisions to the medium-term financing envelopes set out in the MTBF;
    (iv) assist the MFNP in incorporating policy directives and other ministerial initiatives in the budget;
    (v) work closely with the policy advisors on issues related to fiscal policy and public financial management;
    (vi) support the Budget Division’s consultations with line ministries on the MTBF during the annual budget preparation; and
    (vii) provide capacity building for staff of the Budget Division on budgeting principles, good practices, and the incorporation of strategic objectives in budget formulation.

11. **Policy advisors** (international, 9 person-months, full time). These advisors are reserved to respond to needs emerging during TA implementation, and may encompass skills in macroeconomic and fiscal policy, public financial management, and corporate planning.

12. An inception report will be prepared for Asian Development Bank and the government by the team leader within 8 weeks of the start of field activities. Mission progress reports will be submitted throughout the TA, and a draft final report completed by October 2013. The final report is to be submitted within 2 weeks of the incorporation of comments from Asian Development Bank and the government.