



Report and Recommendation of the President to the Board of Directors

Project Number: 48361-003
May 2019

Proposed Policy-Based Grant for Subprogram 3 Kingdom of Tonga: Building Macroeconomic Resilience Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 26 April 2019)

Currency unit	–	pa'anga (T\$)
T\$1.00	=	\$0.44
\$1.00	=	T\$2.28

ABBREVIATIONS

ADB	–	Asian Development Bank
COA	–	chart of accounts
ERB	–	employment relations bill
GDP	–	gross domestic product
IMF	–	International Monetary Fund
JPRM	–	joint policy reform matrix
MOF	–	Ministry of Finance
PAT	–	Ports Authority Tonga
PFM	–	public financial management
PMS	–	performance management system
SOE	–	state-owned enterprise
TA	–	technical assistance
TSDF	–	Tonga Strategic Development Framework, 2015–2025

NOTES

- (i) The fiscal year (FY) of the Government of Tonga and its agencies ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 30 June 2019.
- (ii) In this report, “\$” refers to United States dollars, unless otherwise stated.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 48361-003	
Project Name	Building Macroeconomic Resilience Program, Subprogram 3	Department/Division	PARD/PASP
Country Borrower	Tonga Kingdom of Tonga	Executing Agency	Ministry of Finance
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		0.82
	Public administration		1.68
	Public expenditure and fiscal management		1.68
	Reforms of state owned enterprises		0.82
	Total		5.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional systems and political economy	Effective gender mainstreaming (EGM)	✓
Partnerships (PAR)	Public financial governance		
	Bilateral institutions (not client government)		
	Implementation		
Private sector development (PSD)	International finance institutions (IFI)		
	Conducive policy and institutional environment		
	Promotion of private sector investment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
General Intervention on Poverty	No		
SDG Targeting	Yes		
SDG Goals	SDG5, SDG8, SDG10		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		5.00	
Sovereign Programmatic Approach Policy-Based Lending (Grant): Asian Development Fund		5.00	
Cofinancing		10.50	
European Union - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		2.20	
Government of Australia - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		2.80	
World Bank - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		5.50	
Counterpart		0.00	
None		0.00	
Total		15.50	
Currency of ADB Financing: USD			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based grant to the Kingdom of Tonga for subprogram 3 of the Building Macroeconomic Resilience Program.

2. The program, consisting of three subprograms, aims to strengthen Tonga's long-term growth prospects and capacity to respond to external shocks. It supports government efforts to improve (i) its fiscal position by adopting prudent policies and better public financial management (PFM); and (ii) the business climate by continuing policy, regulatory, and public enterprise reforms. Subprogram 3 is the final subprogram, and builds on progress under two earlier subprograms of the Asian Development Bank (ADB) and other development partners approved in fiscal year (FY) 2016 and FY2017.¹ The program is consistent with ADB's Strategy 2030 priority of strengthening governance and institutional capacity, particularly in small island developing states.²

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Development constraints.** Tonga faces challenges to macroeconomic resilience because of geographic disadvantages, exposure to shocks, and internal bottlenecks. The population of 108,000 is dispersed across 36 of Tonga's 172 islands, with about a quarter of the population based in the capital, Nuku'alofa. Small size and remoteness increase the cost of providing services, limit competitiveness, and reduce economies of scale. Institutional capacity is a challenge, with a small cadre of qualified public servants implementing several government functions. Legislative, cultural, and social barriers limit women's labor force participation and economic empowerment.

4. Although the fiscal position has improved since the global economic crisis, Tonga remains heavily dependent on external assistance.³ Frequent external shocks such as substantial crop and infrastructure damage from Cyclone Ian in 2014, Cyclone Winston in 2016, and Cyclone Gita in 2018 jeopardize fiscal sustainability. Procurement and financial management capacity and systems are improving, but need further strengthening. Tonga's business environment is stronger than that of most Pacific developing countries,⁴ but the private sector faces several constraints (footnote 3) and foreign investment is about 2%–3% of gross domestic product (GDP). While the commercial returns of Tonga's state-owned enterprise (SOE) portfolio have improved since FY2009, performance is still volatile and can be further improved through reforms to the governance and ownership structure of individual SOEs.⁵

5. **Recent macroeconomic performance.** Economic growth, which is highly volatile, is driven largely by the public sector. Tonga's GDP grew 1.9% on average during FY2009–FY2018,

¹ The design and monitoring framework is in Appendix 1. The program is in ADB. 2018. *Country Operations Business Plan: 11 Small Pacific Island Countries, 2019–2021*. Manila. It aligns with ADB. 2016. *Pacific Approach, 2016–2020*. Manila. The concept paper for the program was circulated to the ADB Board of Directors on 22 July 2015.

² ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

³ Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2).

⁴ In the 2019 Doing Business survey, Tonga was the top-ranked Pacific developing country after Samoa, but was 91st among 191 countries worldwide. World Bank. 2019. *Doing Business 2019: Training for Reform*. Washington, DC.

⁵ ADB. 2016. *Finding Balance 2016: Benchmarking the Performance of State-Owned Enterprises in Island Countries*. Manila.

compared with 2.4% for small island developing states globally. In FY2018, Cyclone Gita caused damages of about \$164.3 million (36% of GDP), and the economy is estimated to have expanded by only 0.4%. Recovery and reconstruction are expected to drive growth during FY2019–FY2021, with the economy projected to grow at an annual average rate of about 2.0%.

6. Tonga's fiscal stance has generally been prudent, helped by increasing grants. Public expenditure prioritization and strong domestic revenue performance saw the overall deficit (including grants) shrink from 1.3% of GDP in FY2013 to a surplus of 2.1% of GDP in FY2017 (Table 1). Higher tax rates on petroleum products and unhealthy foods (partly offset by tax reductions on healthy alternatives) contributed to domestic revenue, and the tax–GDP ratio rose from 17.0% in FY2013 to 21.1% in FY2018. Public expenditure also increased from 26.5% of GDP in FY2013 to 42.8% in FY2018, in response to reconstruction needs following periodic cyclones; investments in key maritime, transport, and energy infrastructure; and increases in wages for civil servants amid frequent pressure for pay increases and cost-of-living adjustments.⁶

7. Despite reconstruction needs after Cyclone Gita, delays in scaling up public spending resulted in a fiscal surplus of 1.6% of GDP in FY2018. The government exercised control on capital spending by freezing various sports- and leisure-related investments. Small fiscal deficits are projected during FY2019–FY2021 as capital expenditure resulting from reconstruction increases. A new remuneration structure introduced in FY2017 is expected to stabilize longer-term wage growth, after an initial cost of transitioning to the new structure in FY2018–FY2019.

Table 1: Fiscal Framework, FY2016–FY2021
(% of GDP, unless otherwise indicated)

Item	FY2016	FY2017	FY2018e	FY2019p	FY2020p	FY2021p
Total revenue and grants	40.6	42.5	44.4	51.9	50.3	47.1
Total revenue	30.4	29.3	29.7	29.9	29.7	29.9
of which: tax revenue	20.6	21.0	21.1	22.9	21.9	21.7
Grants	10.2	13.2	14.7	22.0	20.6	17.2
Total expenditure	41.1	40.4	42.8	53.0	51.3	47.6
Current expenditure	31.8	29.9	33.2	36.3	34.2	31.2
of which: wages and salaries	12.1	11.3	12.1	13.1	12.5	12.0
Capital expenditure	9.3	10.5	9.6	16.7	17.1	16.4
Overall balance, including grants	(0.4)	2.1	1.6	(1.2)	(1.1)	(0.5)
(\$ million)	(1.6)	9.5	7.2	(5.6)	(5.3)	(2.5)
Overall balance, excluding grants	(10.6)	(11.1)	(13.1)	(23.2)	(21.7)	(17.7)
(\$ million)	(42.8)	(50.2)	(59.0)	(107.6)	(105.3)	(89.5)
External debt	43.7	39.5	41.8	40.9	40.2	39.9
GDP (\$ million, current prices)	403.7	452.0	450.2	463.8	485.3	505.4

() = negative, e = estimates, FY = fiscal year, GDP = gross domestic product, p = projection.

Sources: Asian Development Bank, Government of Tonga, International Monetary Fund, and World Bank.

8. Tonga's medium-term external debt–GDP ratio is expected to remain stable, although its external debt distress rating changed from *moderate* to *high* risk in 2017 as the debt sustainability analysis of the International Monetary Fund (IMF) incorporated the effects of potential natural disasters into the methodology.⁷ The government has successfully avoided non-concessional external borrowing consistent with its debt strategy adopted under subprogram 1,⁸ and external debt is well below 50% of GDP, which is the threshold established under subprogram 2. External

⁶ The wage bill was 10.4% of GDP in FY2012. Public pressure led to two pay increase settlements of 6% in FY2014 and 5% in FY2016.

⁷ IMF. 2018. *2017 Article IV Consultation—Press Release; and the Staff Report for Tonga*. IMF Country Report No. 18/12. Washington, DC.

⁸ Overview of Past and Planned Policy Reform Actions, 2009–2019 (accessible from the list of linked documents in Appendix 2).

debt declined from 45.3% in FY2013 to an estimated 41.8% in FY2018, and is projected to decline further to 39.9% by FY2021 in view of continued government commitment to (i) the revenue, expenditure, and debt management reforms supported by the program; and (ii) seeking only concessional financing as required. In 2018, ADB and the World Bank moved to 100% grants for Tonga, which helps mitigate fiscal risks.⁹ The recent 5-year extension of the grace period on two external loans has also reduced medium-term fiscal pressures.¹⁰

9. **Recent political developments.** Tonga underwent political changes after the approval of subprogram 2 in FY2017. In August 2017, the King dissolved the Parliament more than a year before the end of its term. In the November 2017 national elections, the incumbent party was returned to power with an expanded majority in Parliament. These developments were accompanied by several changes in the administration, including at the ministerial level.

10. **ADB contributions.** ADB has supported government reforms through budget support and technical assistance (TA) to improve Tonga's fiscal performance and business environment. ADB disbursed budget support for Tonga in FY2010, FY2014, FY2016, and FY2017 to address development financing needs and provide incentives for implementation. Earlier policy-based operations backed the government's tax mobilization measures, which led to rapid domestic revenue growth (para. 6). Reforms have addressed civil service performance management, introduced a new debt management law and transparent fiscal targets to support medium-term fiscal sustainability, implemented a procurement tracking database, and supported better procedures to follow up on audit recommendations (including preparing new biannual reports on audit recommendations and actions). Advisory services provided by ADB through the Pacific Private Sector Development Initiative¹¹ helped the government strengthen corporate governance practices, improve the SOE monitoring framework, implement skills-based SOE director selection, commercialize selected SOEs, and approve a foreign investment bill (footnote 8). Progressive implementation of reforms has improved the performance of the SOE portfolio.¹²

11. **Lessons learned.** Subprogram 3 reflects several lessons from previous budget support operations, including that (i) budget support can achieve results if there is strong government ownership; (ii) a programmatic engagement backed by sustained policy dialogue is an important means to advance policy reforms; (iii) close coordination with development partners is critical to progress reforms in sectors where ADB has limited engagement; and (iv) TA support, coordinated across development partners and provided parallel to budget support programs, can help push the reform agenda. Another key lesson is that a 3-year program can involve significant implementation challenges, 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 became evident in the current program, originally expected to be implemented over FY2016–FY2018, under which reform priorities were initially established with the authorities in 2015. Since then, a change in administration in 2017, followed by a major natural disaster in 2018, have affected progress in some reform areas. Subprogram 3 has highlighted the importance of flexibility in adjusting the reforms to ensure that policy actions remain relevant and informed by the latest evidence and conditions.

⁹ A country's eligibility for Asian Development Fund grants is determined by its risk of debt distress. Since Tonga is at high risk of debt distress, it is eligible to receive 100% of its Asian Development Fund allocation as grants.

¹⁰ The two loans from the Export–Import Bank of China, signed in FY2009 and FY2010, are valued at \$70 million and \$45 million. Instead of FY2019–FY2024 and FY2020–FY2025, the principal repayment periods for each loan will now be FY2024–FY2029 and FY2025–FY2030 respectively.

¹¹ ADB. 2013. *Technical Assistance for the Pacific Private Sector Development Initiative, Phase III*. Manila.

¹² Following a decrease in the return on equity of Tonga's SOE portfolio from about 5.6% in FY2006 to 0.1% in FY2009, ADB-supported measures helped increase the return to 4.0% in FY2016, based on latest available data (footnote 5).

B. Policy Reform and ADB's Value Addition

12. **Government reforms.** Tonga has adopted a vision for “a more progressive Tonga supporting a higher quality of life for all,” following the Tonga Strategic Development Framework (TSDF), 2015–2025.¹³ This vision is translated into five pillars: economic institutions, social institutions, political institutions, infrastructure and technology, and environment. The TSDF emphasizes sustainability, good governance, shared prosperity, and gender equality.

13. **Partner coordination.** Since 2011, the government has prioritized and sequenced reforms through the joint policy reform matrix (JPRM) process, which brings together key ministries and development partners to map out critical constraints, design policy and TA solutions, monitor reform implementation, and mobilize financial assistance.¹⁴ ADB, the governments of Australia and New Zealand, the European Union, and the World Bank coordinate their budget support and/or TA operations through the JPRM process. The IMF has provided an assessment letter for the grant.¹⁵

14. **Programmatic approach.** ADB's Building Macroeconomic Resilience Program supports government reforms through three subprograms, originally envisaged for FY2016–FY2018.¹⁶ The programmatic design allows for reform sequencing across multiple areas to account for Tonga's limited implementation capacity, while providing flexibility to respond to emerging opportunities and constraints. ADB developed the policy matrix (Appendix 4) in consultation with the government and other development partners, and in alignment with national priorities. All the policy actions set out under subprograms 1 and 2 were completed in FY2016 and FY2017,¹⁷ and supported reforms focused on fiscal consolidation, PFM, and improving the business environment.

15. Following Cyclone Gita, which hit Tonga on 12–13 February 2018, the government's focus shifted to response, recovery, and reconstruction. To meet the government's revised priorities in the aftermath of the cyclone, ADB disbursed \$6.0 million in disaster-contingent financing on 16 February 2018 from ADB's Pacific Disaster Resilience Program.¹⁸ On 22 February, ADB provided an additional \$1 million under the Asia Pacific Disaster Response Fund for humanitarian relief efforts. Subsequently, in June 2018, ADB approved a \$6.8 million grant for the reconstruction and upgrade of electricity network infrastructure damaged by the cyclone.¹⁹

16. Although the reform momentum was interrupted in FY2018, continuation of the program is appropriate given the progress achieved under the first two subprograms, the need to focus on implementation, the new government's commitment to the JPRM, and the importance of budget support. Under subprogram 2, nine indicative triggers for subprogram 3 were identified (footnote 17), in line with government priorities and capacity. Consultation with the government

¹³ Government of Tonga, Ministry of Finance and National Planning. 2015. *Tonga Strategic Development Framework, 2015–2025*. Nuku'alofa. p. 49.

¹⁴ The Joint Policy Reform Matrix, FY2016–FY2019 (accessible from the list of linked documents in Appendix 2) forms the basis for reforms supported under the program. The program supports a subset of broader JPRM reforms.

¹⁵ International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2).

¹⁶ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan and Grant for Subprogram 1 to the Kingdom of Tonga for the Building Macroeconomic Resilience Program*. Manila.

¹⁷ ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Grant for Subprogram 2 to the Kingdom of Tonga for the Building Macroeconomic Resilience Program*. Manila.

¹⁸ ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loans, Policy-Based Grants, and Technical Assistance Grant for the Pacific Disaster Resilience Program*. Manila.

¹⁹ ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to the Kingdom of Tonga for the Cyclone Gita Recovery Project*. Manila.

on the evolution of reform priorities and context led to some changes during the preparation of subprogram 3. Two indicative triggers were dropped from subprogram 3 as they are only feasible in the medium term because of delays arising from exogenous factors and issues around partner TA mobilization.²⁰ A new indicative trigger was added, reflecting revised priorities. Eight prior actions were finalized for subprogram 3. The program will close on 30 June 2019.

17. **Program description.** The program aligns with the following TSDF impacts: (i) more inclusive and sustainable growth and development; (ii) a more inclusive, sustainable, and dynamic knowledge-based economy; and (iii) more responsive good governance (footnote 13). The effect of the reforms will be an improved fiscal position and business environment in Tonga. Eight prior actions under three reform areas have been completed under subprogram 3 (Appendix 4). ADB has added value through TA support for five prior actions, as outlined below.

18. **Reform area 1: Fiscal resilience.** Policy actions completed under subprograms 1 and 2 included measures to strengthen tax revenue mobilization (primarily taxes on unhealthy foods) and develop a fiscal strategy with medium-term targets for debt, revenue, and public service wage affordability. The government conducted a civil service remuneration review under subprogram 1. Based on this review, under subprogram 2, the government introduced a new public service salary structure with a revised pay scale for fair and appropriate remuneration, along with a performance management system (PMS) for competitive and fair performance assessments as a basis for in-grade pay progression rather than automatic increments for public officials starting in 2018.

- (i) **Tax administration.** Since 80% of Tonga's tax revenues come from consumption and trade taxes, maximizing the efficiency of tax and customs administration is crucial. As a subprogram 3 prior action, the cabinet approved a revised revenue services administration bill that introduces additional avenues for revenue recovery and sets updated and graduated penalties to incentivize compliance.²¹ The legislation obligates taxpayers to apply for a tax identification number, which is expected to improve compliance management. As another subprogram 3 prior action, the cabinet approved a new customs bill that ensures that national rules are consistent with key international standards (including the Revised Kyoto Convention and World Customs Organization recommended practices) and improves customs administration. The reforms will standardize and simplify declaration procedures and supporting documentation, clarify principles for customs valuation of imported goods, and enhance the predictability and transparency of customs actions. They will also reduce documentary compliance costs by facilitating the online access and lodgment of documents, payments, and customs clearance. These bills will be implemented following Parliamentary approval expected in 2019, and implementation regulations are under preparation.
- (ii) **Civil service reforms.** The public sector wage bill, about 56% of FY2018 domestic revenue, remains a major fiscal challenge. To continue reforms in this area, the government requested an assessment of PMS implementation introduced under subprogram 2. A review was undertaken through ADB TA.²² While commending the Public Service Commission for undertaking potentially contentious reforms in a very competent manner, the review made 17 recommendations to strengthen

²⁰ Indicative Triggers and Policy Actions Accomplished for Subprogram 3 (accessible from the list of linked documents in Appendix 2) summarizes the changes in the policy actions for subprogram 3.

²¹ Penalties related to tax administration (i.e., registration, late lodgment and payment, false or misleading statements, and dishonored checks) and tax offences (i.e., failure to maintain proper records, fraud, and obstruction) are clearly defined, and graduated penalties (i.e., where the penalty increases, depending on the severity and/or length of time of the infraction) have been introduced for several offences to encourage compliance.

²² ADB. 2013. *Technical Assistance for Pacific Economic Management (Phase 2)*. Manila.

and streamline the PMS, which the cabinet considered in August 2018. As a subprogram 3 prior action, the Public Service Commission implemented three key recommendations: (a) realignment of the PMS year to de-link it from the peak periods of activity in the budget cycle, ensuring that management and staff have sufficient time to complete the performance assessment process adequately; (b) provision of target performance rating distributions to ministries to reduce the need for substantial moderation by the Oversight Moderation Committee of performance ratings heavily skewed toward the highest ratings; and (c) clarification of eligibility for performance rewards and procedures for managing poor performance.

19. **Reform area 2: An inclusive, modern, and accountable state.** Policy actions under subprogram 1 included the approval of new public procurement regulations and PFM improvements, such as audit follow-up procedures (footnote 8). A procurement database introduced under subprogram 2 established an institutional mechanism to enable the Ministry of Finance (MOF) to maintain a detailed record of all procurements above the small item threshold (T\$7,500) and to monitor key performance indicators on procurement, which can help the MOF identify bottlenecks in the procurement process. An independent regulator with powers to regulate communication services was also established under subprogram 1.

- (i) **Financial management.** As a subprogram 3 prior action, the MOF has removed the noneconomic items from the economic segment of the chart of accounts (COA), which will improve the accuracy of budget reporting. A comprehensive economic segment is critical to the government's reporting requirements—classifying items as revenues, expenditures, assets, or liabilities, and assigning these into standard categories such as salaries, goods and services, and capital investment. In Tonga, the integrity of the economic segment had been compromised by the inclusion of noneconomic concepts, e.g., items related to projects, programs, funds, or activities (such as spending for national celebrations), undermining the effectiveness of budget controls and presenting risks of inaccurate or misclassified information. The IMF's Pacific Financial Technical Assistance Centre supported the removal of noneconomic items from the COA. In parallel, ADB and the Government of Australia are providing TA for the upgrade of Tonga's financial management information system (footnote 22), with the addition of new modules for aid information, project management, budget preparation, and forecasting, which will be impacted by changes to the COA. Further revisions to the COA will be implemented concurrently with the finalization of the financial management information system upgrade in 2019 to ensure compatibility.
- (ii) **Labor market regulations.** A policy objective under the program is to improve the functioning of the labor market, which can in turn promote inclusive growth. Tonga lacked labor regulation in the private sector to ensure many standard basic protections, including rights to leave from work, nondiscrimination, and fair dismissal. The absence of flexible work arrangements and maternity leave entitlements affected women disproportionately. As a subprogram 3 prior action, the cabinet approved for submission to Parliament a landmark employment relations bill (ERB), which will ensure basic labor protections and reduce gender disparities at work. This legislation, prepared with assistance from the International Labour Organization, has been widely consulted with stakeholders over more than five years. It reflects key issues and priorities from consultations with women and women's organizations and includes a new entitlement for maternity leave, as well as legislative backing for new fundamental rights such as equal pay for equal work, freedom of association, and prohibition of forced labor.

20. **Reform area 3: A more dynamic and inclusive economy.** Business environment reforms under subprograms 1 and 2 included public enterprise governance improvements, and steps toward the commercialization of Tonga Water Board, Tonga Cable Limited, and Tonga Communications Corporation. Under subprogram 2, the cabinet approved a foreign investment bill to attract foreign investment. Progressive implementation of government initiatives has helped increase the profitability of the SOE portfolio (footnote 5).

- (i) **Foreign investment.** The Foreign Investment Act was passed by Parliament in 2019 after extensive consultation, reflecting work ongoing since 2013 with ADB support (footnote 11). Replacing the 2002 Foreign Investment Act, the new act (a) clarifies the definition of foreign investment, (b) provides clearer principles for reviewing reserved and restricted activities, and (c) sets out a more transparent framework for screening foreign investment applications. As a subprogram 3 prior action, the cabinet approved revised foreign investment regulations,²³ subject to formal enactment of the 2019 Foreign Investment Act.²⁴ The new regulations will help ensure that the foreign investment registration process is simpler, streamlined, and clearer about information requirements.
- (ii) **Public enterprises.** Subprogram 3 continued successful reforms to improve the financial viability of selected SOEs. Currently, stevedoring (cargo handling) activities at Nuku'alofa port are fragmented, with three private stevedores aligned to separate shipping lines but drawing on the same small labor pool, providing ship-to-shore handling of cargo. Ports Authority Tonga (PAT) provides the remaining functions to facilitate container transport to the terminal gate. A review conducted with ADB TA (footnote 11) noted that a single operator providing seamless cargo handling services from ship to terminal gate would lead to efficiency gains in port operations, and allow greater incentives to invest in equipment and staff. As a subprogram 3 prior action, the cabinet approved that PAT will issue a concession contract for all cargo handling activities at Nuku'alofa port to be provided by a single private sector operator, with PAT acting as the port landlord. PAT will no longer incur ongoing operation and maintenance costs associated with cargo handling, while collecting a concession fee from the private operator. PAT will issue a competitive tender for a concession contract to provide stevedoring and related services at the port. The 28 PAT employees potentially affected by the transition have been offered the option of employment with the new concessionaire or a redundancy package, limiting employment impacts. The Ministry of Public Enterprises, with ADB support, aims to sign a concession agreement with a private company in 2019.
- (iii) **Private sector development.** As a subprogram 3 prior action, the cabinet approved a private sector development strategy,²⁵ setting out a prioritized and sequenced list of gender-sensitive reforms—addressing the business environment, market competition, access to finance, targeted business development, and public enterprises. The strategy was prepared with ADB support (footnote 11), with input from women and women's organizations. It includes recommendations that address the challenges faced by women, such as measures to improve access to finance and financial literacy; support tourism-related industries, which are dominated by women; and create more employment opportunities for women by

²³ Regulations include processes, templates, and instructions for (i) registration as a foreign investor; (ii) reissuance, reinstatement, or transfer of registration; (iii) submission of annual reports; and (iv) cessation of business activity. A list of reserved and restricted activities is also part of the regulations.

²⁴ Enactment follows assent by the King of Tonga, which will formally bring the 2019 Foreign Investment Act into effect.

²⁵ This action was originally part of subprogram 1, but was postponed because the limited development partner TA resources were re-prioritized to support other reforms.

contracting out government services such as home health care. The strategy also addresses the needs of disabled and young people in training and employment.

21. **Reform area 4: Effective response to disasters.** The program originally included a reform area for effective disaster response. Subprogram 1 supported a response plan to Cyclone Winston. This reform area was not part of subprograms 2 and 3, and ADB's support for disaster resilience reforms is provided outside of the program framework (footnote 18).

C. Impacts of the Reform

22. Subprogram 3 reforms build on good progress under the two earlier subprograms to strengthen Tonga's macroeconomic resilience and ability to respond to economic shocks. Under reform area 1 (para. 18), more efficient customs administration and indirect tax collection will further enhance domestic revenue mobilization (including through better compliance),²⁶ and a declining wage bill in the medium term will improve the fiscal position. These reforms can help build fiscal space to respond to economic shocks and disasters, and promote long-term growth. Envisaged reform impacts also include allocative efficiency gains from the rebalancing of expenditure to priority areas. Under reform area 2 (para. 19), financial management improvements will help the government to monitor budget spending and strengthen internal controls more systematically. Under reform area 3 (para. 20), clarity about foreign investment registration requirements will reduce uncertainty about application review and screening, encouraging foreign investors. More efficient SOEs will lead to less demand for government fiscal support. Implementation of the private sector development strategy will improve the business environment, which will help create more jobs and promote growth.

D. Development Financing Needs and Budget Support

23. Excluding grants, the fiscal deficit in FY2019 is estimated to be \$107.6 million (23.2% of GDP). FY2019 grants are estimated to total \$102.0 million, of which \$15.5 million is through the JPRM. Of this amount, ADB is expected to contribute \$5.0 million. JPRM budget support grants also include \$2.2 million from the European Union, \$2.8 million from the Government of Australia, and \$5.5 million from the World Bank, as parallel collaborative partner financing not administered by ADB.²⁷ JPRM budget support will finance 14.4% of the FY2019 projected fiscal deficit.

24. The government has requested a grant not exceeding \$5.0 million from ADB's Special Funds resources (Asian Development Fund) to help finance subprogram 3. The grant proceeds will support development financing needs, excluding ineligible items.²⁸

E. Implementation Arrangements

25. The existing institutional structure for aid management in Tonga will be used to implement and monitor the policy actions supported by the program. The MOF will be the executing agency. The government's Budget Support Management Committee, which leads the JPRM process, oversees the program. Through the committee, the MOF will provide overall guidance and assume responsibility for coordinating program implementation, monitoring, and evaluation as the

²⁶ Reforms under the program helped raise the tax-GDP ratio in Tonga to an estimated 21.1% in FY2018, higher than the Pacific average of 18.1% (Table 1).

²⁷ The World Bank's policy matrix for its parallel Third Inclusive Growth Development Policy Operation, expected to be approved in May 2019, supports seven of the eight prior actions in ADB's subprogram 3 policy matrix. The action on cabinet approval of the private sector development strategy (para. 20) appears only in the ADB matrix.

²⁸ List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

executing agency. The Ministry of Trade and Economic Development, the Ministry of Public Enterprises, the Ministry of Revenue and Customs, the Public Service Commission, and the Prime Minister's Office are the implementing agencies. The JPRM process will continue to facilitate broad consultations on reform priorities. Government authorities have consulted on individual reform initiatives, with the private sector and civil society as needed.²⁹ Subprogram 3 is implemented from 1 July 2017 to 30 June 2019, extended by a year because of external events (para. 11). The proceeds of the policy-based grant will be withdrawn, upon effectiveness, following ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

26. **Governance.** Promoting good governance is a key national priority. The government is implementing its PFM reform road map, FY2015–FY2019, to close the gaps identified through two PFM assessments.³⁰ Despite capacity limitations, the assessments indicate that, compared with international best practice, Tonga's PFM system is mostly operating at average levels. The government has the ability to implement its budget but there are procurement, accounting, financial reporting, and auditing weaknesses (footnote 3). This program, complemented by development partner TA (para. 19 and footnote 8), addresses many of those weaknesses. Tonga has taken steps to strengthen anticorruption measures, including by creating the Parliament Standing Committee on Anti-Corruption in 2015. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the MOF and the government.

27. **Poverty and social.** The public sector is a key provider of services to low-income households, and reform area 1 will help ensure that the government has the fiscal resources to respond to future economic shocks and natural disasters (which tend to have an adverse effect on the poor) while maintaining critical public services. Reform area 2 will improve work conditions for all employees, to the extent that basic labor rights are protected by law once the ERB is enacted. The ERB provides the legal framework to establish minimum wages in the future, which could have negative employment consequences. However, the ERB also stipulates that any minimum wage must be endorsed by representatives from the government, employers' organizations, workers' associations, and the Forum of Directors of Education. Given such mitigating measures, the ERB is considered supportive of vulnerable groups by protecting basic labor rights and protections that are already standard in many countries. Reform area 3 will improve the environment for private sector activity, which will help create more jobs in Tonga.

28. **Gender.** Subprogram 3 is classified as *effective gender mainstreaming* and includes proactive gender actions that will address a number of constraints to women's labor force participation and economic empowerment. The ERB (para. 19) addresses key legislative barriers to women's employment by providing new fundamental rights for women in the labor market. New provisions for flexible work arrangements and maternity leave entitlements will support women's advancement in the workplace; and ensure that women returning from maternity leave face no loss of wages, benefits, or seniority. In addition, legislation on freedom from discrimination and equal remuneration for equal work will help to address wage discrimination and sexual harassment in the workplace. The approval of the private sector development strategy (para. 20) will lead to concrete steps to improve women's participation in the private sector, including measures to improve access to finance and financial literacy; employment opportunities for

²⁹ Extensive consultations have been undertaken around foreign investment legislation, the ERB, and the private sector development strategy.

³⁰ Public Expenditure and Financial Accountability. 2010. *Public Financial Management Performance Report: Kingdom of Tonga*. Nuku'alofa; and Government of Tonga. 2014. *Public Expenditure and Financial Accountability Self-Assessment*. Unpublished.

women from contracting out of government services such as home health care; increased tourism marketing that will assist tourism-related industries dominated by women (such as handicrafts, accommodation, and food and beverages); and investigation of constraints that restrict women's ability to use land for entrepreneurial activities.³¹

29. **Safeguards.** Following ADB's Safeguard Policy Statement (2009), subprogram 3 is classified as *category C* for the environment, involuntary resettlement, and indigenous peoples. Program activities will be confined to policy and institutional reforms. The prior policy actions have been assessed, and are not expected to result in or lead to involuntary resettlement, or negatively affect indigenous peoples or the environment.

30. **Risks.** Major risks and mitigating measures are summarized in Table 2 and described in detail in the risk assessment and risk management plan.³² Development partners assess that PFM systems can support mostly reliable services for budget support. Policy reforms and TA support address remaining fiduciary risks (para. 26). The program's integrated benefits and impacts are expected to outweigh the costs.

Table 2: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
High staff turnover aggravates existing capacity constraints, which delays reform implementation and impedes policy reform coordination and formulation among key government agencies.	Reforms are prioritized and sequenced to avoid overburdening the small public administration and decision makers. Technical assistance will be mobilized by development partners on a needs basis to supplement capacity.
External shocks undermine the fiscal position and growth, and divert political and administrative attention and capacity away from reforms.	Reforms that promote domestic revenue mobilization, lead to a lower wage bill, and enhance efficiency of public enterprises will help create fiscal space to respond to shocks. The government will seek development partner assistance in case of disasters.

Source: Asian Development Bank.

IV. ASSURANCES

31. The government and the MOF have assured ADB that implementation of subprogram 3 shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the grant document. The government has agreed with ADB on certain covenants for subprogram 3, which are set forth in the grant agreement.

V. RECOMMENDATION

32. I am satisfied that the proposed policy-based grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$5,000,000 to the Kingdom of Tonga, from ADB's Special Funds resources (Asian Development Fund) for subprogram 3 of the Building Macroeconomic Resilience Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Takehiko Nakao
President

9 May 2019

³¹ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

³² Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objectives			
More inclusive and sustainable growth and development attained (Tonga Strategic Development Framework, 2015–2025) ^a			
A more inclusive, sustainable, and dynamic knowledge-based economy promoted (Tonga Strategic Development Framework, 2015–2025) ^a			
More responsive good governance achieved (Tonga Strategic Development Framework, 2015–2025) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Reform Fiscal position and business environment in Tonga are improved	Programmatic approach FY2018–FY2020 annual average: a. Tax revenue as a proportion of gross domestic product increased to at least 21.7% (FY2011–FY2015 baseline average: 17.4%) b. Public wage bill as a proportion of total revenue decreased to 53.0% or lower (FY2014 baseline: 57.4%) c. Vetted applications from foreign investors increased to at least 30 applications (FY2015 baseline: 21)	a. International Monetary Fund Article IV staff reports b. International Monetary Fund Article IV staff reports c. Ministry of Trade and Economic Development annual reports	External shocks undermine the fiscal position and growth, and divert political and administrative attention and capacity away from reforms.
Reform Areas^b 1. Fiscal resilience	Key Policy Actions Programmatic approach By the end of FY2019: 1a. Four legal instruments for customs, excise, consumption, and corporate tax approved by the cabinet (FY2015 baseline: not applicable) 1b. New public service remuneration structure and performance management framework approved for implementation (FY2015 baseline: not applicable) Subprogram 3 By the end of FY2019: 1c. Revised revenue services administration bill that introduces additional avenues for revenue recovery and sets updated and graduated penalties to incentivize compliance approved by the cabinet for submission to Parliament (FY2018 baseline: not applicable)	1a. Copies of legal instruments, cabinet decisions 1b.–1d. Cabinet decisions	High turnover of staff in specific government agencies delays implementation.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p>2. An inclusive, modern, and accountable state</p> <p>3. A more dynamic and inclusive economy</p>	<p>1d. New customs bill that ensures alignment with international standards and streamlines customs administration approved by the cabinet for submission to Parliament (FY2018 baseline: not applicable)</p> <p>Programmatic approach By the end of FY2019: 2a. Two improved processes and systems for procurement, accounting, financial reporting, and auditing approved for implementation (FY2015 baseline: not applicable)</p> <p>2b. Three new regulatory and policy frameworks for competition, communication, and utility services approved by the cabinet (FY2015 baseline: not applicable)</p> <p>Subprogram 3 By the end of FY2019: 2c. Noneconomic items from the economic segment of the chart of accounts removed, which will improve the accuracy and integrity of budget reporting (FY2018 baseline: not applicable)</p> <p>2d. Employment relations bill that ensures basic labor protection and addresses gender disparities^c at work approved by the cabinet for submission to Parliament (FY2018 baseline: not applicable)</p> <p>Programmatic approach By the end of FY2019: 3a. Two policy frameworks and legislation for foreign investment, contracting (only the policy framework), and bankruptcy approved by the cabinet (FY2015 baseline: not applicable)</p> <p>3b. At least five public or state-owned enterprises approved for privatization, liquidation, substantial restructuring, or outsourcing of services (FY2015 baseline: not approved)</p>	<p>2a.–2b. Cabinet decisions</p> <p>2c. Letter from the Ministry of Finance certifying removal of noneconomic segments</p> <p>2d. Cabinet decision</p> <p>3a.–3d. Cabinet decisions</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks						
	<p>Subprogram 3 By the end of FY2019: 3c. Decision for Ports Authority Tonga to issue a concession contract for all cargo handling activities at Nuku'alofa port to be provided by a single private sector operator approved by the cabinet (FY2018 baseline: not applicable)</p> <p>3d. Prioritized and sequenced private sector development strategy that supports inclusive growth and economic participation of women,^d youth, and people with disabilities approved by the cabinet (FY2018 baseline: not applicable)</p>								
<p>Budget Support^e</p> <p>Asian Development Bank: \$5.0 million (Asian Development Fund grant)</p> <table data-bbox="201 926 1224 1024"> <tr> <td>European Union</td> <td>\$2.2 million grant (€2.0 million equivalent)</td> </tr> <tr> <td>Government of Australia</td> <td>\$2.8 million grant (A\$4.0 million equivalent)</td> </tr> <tr> <td>World Bank</td> <td>\$5.5 million grant</td> </tr> </table>				European Union	\$2.2 million grant (€2.0 million equivalent)	Government of Australia	\$2.8 million grant (A\$4.0 million equivalent)	World Bank	\$5.5 million grant
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Government of Australia	\$2.8 million grant (A\$4.0 million equivalent)								
World Bank	\$5.5 million grant								

FY = fiscal year.

^a Government of Tonga, Ministry of Finance and National Planning. 2015. *Tonga Strategic Development Framework, 2015–2025*. Nuku'alofa.

^b The reform areas in the design and monitoring framework align with the joint policy reform matrix (JPRM) pillars (footnote 14 of the main text). The JPRM is a living document that is updated based on government priorities and the reform context. The JPRM guides the overall reforms undertaken by the government. Not all actions in the JPRM are prior policy actions for the Asian Development Bank's budget support operations. However, the policy actions in subprogram 3 are a subset of the JPRM actions.

^c The employment relations bill includes a new entitlement for maternity leave; provisions for equal pay for equal work, flexible working, freedom of association, and prohibition of forced labor; and legislation on freedom from discrimination and harassment in the workplace.

^d The private sector development strategy includes recommendations to (i) review women's constraints to land tenure, (ii) improve women's access to finance and financial literacy programs, and (iii) increase employment opportunities for women in the service industry.

^e Development partners support several policy reforms across all three reform areas, which are necessary to reach the outcome, as outlined in the JPRM (footnote 14 of the main text). Joint partner engagement in reform dialogue and technical assistance and advisory across all three outputs make it unfeasible to split outputs by partner. The World Bank's policy matrix for its parallel Third Inclusive Growth Development Policy Operation, which is expected to be approved in May 2019, supports seven of the eight prior actions in the Asian Development Bank's subprogram 3 policy matrix.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=48361-003-2>

1. Grant Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Overview of Past and Planned Policy Reform Actions, 2009–2019
11. Indicative Triggers and Policy Actions Accomplished for Subprogram 3
12. Joint Policy Reform Matrix, FY2016–FY2019

DEVELOPMENT POLICY LETTER

OFFICE OF THE MINISTER FOR FINANCE

MINISTRY OF FINANCE, NUKU'ALOFA
TONGA**Reference:** MF. 14/334th April 2019

Ms. Kristalina Georgieva
Interim-President
World Bank Group

Mr. Takehiko Nakao
President
Asian Development Bank

Dear President Georgieva and President Nakao,

Letter of Development Policy

Despite a number of challenges in recent years, including Tropical Cyclone Gita which swept our country in early 2018, the Government of Tonga continues to focus on reforms to achieve inclusive, sustainable growth and development. In this we are guided by the *Tonga Strategic Development Framework (TSDF), 2015–2025: A more progressive Tonga: Enhancing Our Inheritance*, which provides an overarching strategic framework for our efforts to support a better quality of life for all.

Since the global financial and economic crisis in the late 2000s, the Kingdom of Tonga has embarked on an ambitious reform program. Reforms implemented to date have strengthened our public financial management systems, increased tax collections and improved public enterprise performance. As a result of the reforms, our debt position has stabilized, our allocation of public resources is more strategic, and their use is more efficient. Efforts to improve the policy and regulatory environment for the private sector have led to substantial improvements in the ease of doing business. Successive governments have persisted in efforts to implement reforms, which has resulted in substantial achievements despite limited administrative capacity in our small country.

In pursuing these efforts we have very much appreciated the ongoing support from our development partners. Since 2011 the Government and development partners have been working together through the Joint Policy Reform Matrix (JPRM) process to prioritize, implement and monitor reforms that are critical for Tonga's sustainable and inclusive development. This year marks the continuation of a reform program that was interrupted last year by the impact of Tropical Cyclone Gita, during which time we were again grateful for the quick and substantial response from our development partners in support of our recovery efforts. The current year's budget support operations continue to support us by providing fiscal resources to support public service

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Member of Parliament of Tongatapu 10

delivery, and technical assistance to guide the formulation of sound policies and reforms that help us to achieve our goals.

Closely aligned to the priorities of Government as reflected in the TSDF, the JPRM aims at building macroeconomic resilience, supporting accountability, and driving inclusive growth and improved living standards.

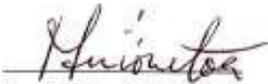
In the first two years of this program we undertook tax reforms to raise collections and provide incentives to consume healthy foods by raising the price of some unhealthy foods while cutting duty rates on healthy alternatives. A new medium-term debt management strategy was put in place, and we introduced a set of fiscal anchors to support our efforts to maintain revenue collections, keep external debt to a manageable level, and ensure a sustainable wage bill, so that sufficient resources can be allocated to critical spending for public services and infrastructure. A new public service remuneration framework was approved and implemented, which ensures that good performance is rewarded and that skills and expertise receive a fair and attractive return, while at the same time helping to secure the sustainability of the overall public sector wage bill. New procurement regulations were introduced and a procurement database was launched to help monitor key performance indicators. New institutions and processes were put in place to manage and ensure appropriate government follow-up of audit recommendations. A new ICT regulator was established in law, and work on a new Energy Bill was progressed to create an integrated regulatory framework for the entire sector. New foreign investment legislation was approved by Cabinet to provide more clarity and certainty for foreign investors looking to invest in our country. The governance of public enterprises was overhauled by introducing new and more professional shared boards, and the Government agreed to a transaction to sell a minority share of Tonga Cable Limited to a private telecommunications operator, which has provided us with new capital for investments in high-speed and affordable internet connectivity throughout the country.

The current, final year of the program has seen steps being taken to extend and strengthen many of these reforms. Domestic revenues have increased dramatically over the last eight years, in large part due to policy reforms supported by previous budget support engagements, and we have recently approved sweeping revisions to the Revenue Services Administration Act and to our customs legislation, to improve the effectiveness of our domestic revenue collection practices and to align our customs operations with best practice internationally. We have reviewed the first year of implementation of the new public service performance management system, and undertaken several measures to respond to the most pressing recommendations of this review. We have updated our Chart of Accounts, which will improve the quality of our budget reporting and help us to better monitor trends in our public spending. After several years of concerted reform effort, our Parliament has now passed the Foreign Investment Act and we have approved foreign investment regulations that will help make applying for a foreign investment certificate simpler and more transparent. We have also approved a Private Sector Development Strategy to guide our efforts to ensure Tonga is a country in which businesses – small and large – can grow and flourish. To continue our successful public enterprise reform program, we have approved a recommendation to adopt a landlord model for Nuku'alofa port, which will directly promote increased private sector participation in the provision of cargo handling services, improve the efficiency of the port operations, and allow Ports Authority Tonga (PAT) to concentrate on its core functions of managing and regulating port activities. In pursuing this reform we will ensure that transition arrangements are put in place to reduce any adverse impact on PAT employees.

Notably, and after many years of consultations and preparation, the Government has now finalized employment relations legislation to ensure that the fundamental labor rights of all workers are protected in Tonga, including the most vulnerable. Up until now our country has not had any laws around private sector employment conditions, creating risks of reduced participation in the labour market (particularly for women) and exploitation of workers by unscrupulous employers. This new legislation therefore fills a critical gap in helping to ensure that the benefits of economic growth are shared broadly among the population.

Having now completed such a substantive series of policy reforms, the Government remains firmly committed to implementing this JPRM reform program, which will be instrumental to achieve the country's ambitious development goals. The Government looks forward to the continued active engagement of its major development partners, including the Asian Development Bank and the World Bank, in Tonga's reform and development efforts.

Sincerely,


Dr. Pohiva Tu'i'onetoa
Minister for Finance



POLICY MATRIX

All actions for Subprograms 1, 2, and 3 are complete.

Reform area	Policy Objectives	Subprogram 1 Actions Accomplished (FY2016)	Subprogram 2 Actions Accomplished (FY2017)	Subprogram 3 Actions Accomplished (FY2019)
I. SUPPORTING FISCAL RESILIENCE				
Fiscal strategy	Improve fiscal sustainability and resilience, and public expenditure effectiveness		1. Cabinet approval of a fiscal strategy with debt, revenue, and public service wage affordability targets, and a corresponding monitoring framework	
Revenue	Improve tax compliance, revenue collection, and incentives for healthier living	1. Increase in the rate of fuel duty by 12% and other excise duty and import duty rates in order to improve revenue mobilization and strengthen incentives to consume healthy foods¹	2. Increase in the rate of fuel excise tax by 16%, and changes in other excise duty and import duty rates as documented in the 2016 Excise Duty (Amendment) Order and the 2016 Customs Duty (Amendment) Order to improve revenue mobilization and strengthen incentives to consume healthy foods²	1. Cabinet approval for submission to Parliament of a revised Revenue Services Administration Bill that introduces additional avenues for revenue recovery and sets updated and graduated penalties to incentivize compliance, and the revised Revenue Services Administration Bill attached to such approval 2. Cabinet approval for submission to Parliament of a new Customs Bill that ensures alignment with international standards and streamlines customs administration, and the revised Customs Bill attached to such approval

¹ Excise duty on alcohol and tobacco has been increased, a new excise duty on instant noodle implemented, import duty on turkey tails increased to 15% and import duties on various fruits, vegetables and fresh fish decreased.

² Tax changes are as listed in the Government of Tonga's 2016 Excise Duty and Customs Duty amendment orders. Key among the changes introduced are: higher excise duties on alcohol, tobacco, mayonnaise, lard, and fizzy sweetened drinks; higher import duties on lamb flaps, lamb breast, and turkey tails; lower import duties on education materials, construction materials, sports materials, fruits, and vegetables.

Reform area	Policy Objectives	Subprogram 1 Actions Accomplished (FY2016)	Subprogram 2 Actions Accomplished (FY2017)	Subprogram 3 Actions Accomplished (FY2019)
Debt	Ensure prudent and least cost borrowing to (1) maintain manageable debt and debt service levels, and (2) improve economic and disaster resilience	2. Cabinet has approved a new Medium-Term Debt Strategy which has been made public		
Public service management	Establish a fair and fiscally affordable remuneration system linked to good performance and reduce share of wage bill in total government spending over time	3. Cabinet approval of remuneration review that aligns with the aggregate fiscal targets and which includes a new relative salary structure that ensures fair and appropriate remuneration based on a robust analytical assessment	3. Implementation of a public service remuneration structure in line with the new public service wage affordability target 4. Cabinet approval of a new moderated public service performance management framework	3. Certification by the Office of Public Service Commission confirming implementation of reforms from a review of the new public service remuneration structure and performance management system: (i) realignment of the performance management system year; (ii) provision of target performance-rating distributions to public institutions; and (iii) clarification of eligibility for performance rewards and procedures for managing poor performance
II. SUPPORTING AN INCLUSIVE, MODERN AND ACCOUNTABLE STATE				
Procurement	Improve service delivery through value-for-money and timely procurement of goods and services	4. Cabinet has approved a revised set of Procurement Regulations, and prepared standard bidding documents and procurement manual in support of the Regulations	5. Implementation of a new procurement tracking database for procurement above the small item threshold (TOP 7,500), and adoption of compliance and performance indicators and associated targets for monitoring performance	

Reform area	Policy Objectives	Subprogram 1 Actions Accomplished (FY2016)	Subprogram 2 Actions Accomplished (FY2017)	Subprogram 3 Actions Accomplished (FY2019)
Financial management, accounting, reporting and audit	(1) Improve functioning of IFMIS for better reporting, budgeting and funds control; and (2) audit to systematically contribute to improved financial management	5. A new Audit Oversight Committee of cabinet established that (i) maintains a comprehensive database on past audit recommendations and follow-up actions, and (ii) reports regularly to cabinet, with the aim of ensuring timely and thorough follow-up of audit recommendations		4. Certification by the Ministry of Finance confirming the removal of the non-economic items from the Chart of Accounts, which will improve the accuracy and integrity of budget reporting
Utility and service regulation	Improve access and affordability of utilities (e.g., electricity, water and waste) and other goods and services (ICT) through effective and efficient regulation	6. Parliament has approved a new Communications Act and a Communications Commission Act that will establish an independent regulator	6. Cabinet approval for public consultation of a National Energy Bill, which includes provisions for multi-sector regulation for all energy sub-sectors (electricity, gas, petroleum)	
Labour market	Establish foundational employment legislation that will increase labour market functioning while safeguarding employee rights			5. Cabinet approval for submission to Parliament of Employment Relations Bill that ensures basic labour protection and addresses gender disparities at work, including: (i) a new entitlement for maternity leave; (ii) provision for equal pay for equal work; (iii) provisions for flexible working and freedom of association; (iv) provisions for the prohibition of forced labor; (v) provisions for freedom from discrimination and harassment in the workplace, and the Employment Relations Bill attached to such approval

Reform area	Policy Objectives	Subprogram 1 Actions Accomplished (FY2016)	Subprogram 2 Actions Accomplished (FY2017)	Subprogram 3 Actions Accomplished (FY2019)
III. SUPPORTING A MORE DYNAMIC AND INCLUSIVE ECONOMY				
Business law reform, including foreign investment	(1) Reduce risks and costs of doing business through formalization of the business regulatory framework; and (2) attract foreign investment to promote growth and create jobs while safeguarding national interests		<p>7. Cabinet approval of foreign investment legislation for submission to Parliament</p> <p>8. Cabinet approval of Receivership Act for submission to Privy Council³</p>	<p>6. Cabinet approval of revised foreign investment regulations, including reserved and restricted lists</p> <p>7. Cabinet approval of a prioritized and sequenced private sector development strategy that supports inclusive growth and economic participation of women, youth and disabled, including recommendations to (i) improve women’s access to financial and financial literacy programs; (ii) increase women’s employment opportunities through contracting out government services and supporting women in the tourism sector; and (iii) investigate the constraints of women’s land tenure on economic empowerment, and the private sector development strategy attached to such approval</p>

³ Receivership applies when a company or statutory corporation or person is in trouble financially and the Supreme Court orders that its property be placed in the hands of a receiver. A receiver is a person or manager who is appointed through terms of agreement or by an order from the Court. The Receivership Bill establishes a process for identifying and nominating receivers and establishing clear receivership procedures.

Reform area	Policy Objectives	Subprogram 1 Actions Accomplished (FY2016)	Subprogram 2 Actions Accomplished (FY2017)	Subprogram 3 Actions Accomplished (FY2019)
Public enterprise reform	(1) Deliver affordable services through efficient and financially viable public enterprises under effective governance and management; and (2) increase private sector participation and expertise to improve management of public enterprises	<p>7. Cabinet tasks MPE to implement the Reform Plan of the new PE Ownership, Performance Improvement and Divestment Policy</p> <p>8. Cabinet has approved the appointment of shared boards of directors, in accordance with the PE director selection and appointment process, of public enterprises in the information, communications, and technology sector, and the utilities sector in order to streamline the number of Directors and achieve greater efficiency</p> <p>9. Tonga Water Board concluded contract with a private sector business to outsource asset maintenance and pipe-laying services</p>	9. Cabinet approval to reform Tonga Cable Limited in accordance with the PE Reform Policy, where ‘reformed’ may consist of privatization, liquidation, substantial restructuring, outsourcing or another form of public-private partnership	8. Cabinet approval to reform Ports Authority Tonga in accordance with the PE Reform Policy, where ‘reformed’ may consist of privatization, liquidation, substantial restructuring, outsourcing or another form of public-private partnership
IV. SUPPORTING AN EFFECTIVE RESPONSE TO DISASTERS				
Disaster response	Effective and efficient emergency response to alleviate hardship and secure livelihoods of affected populations, and increase disaster resilience through building back better	10. Cabinet approval of a costed response plan, based on a post-disaster needs assessment, to guide effective and efficient response to damages caused by Tropical Cyclone Winston		

ADB = Asian Development Bank; FY = fiscal year; ICT = information and communication technology; IFMIS = integrated financial management information system; MPE = Ministry of Public Enterprises; PE = public enterprise

Note: Joint policy reform matrix actions not supported under ADB’s program are excluded from the policy matrix but are part of the supplementary documents. Output IV is not part of the joint policy reform matrix.

Source: Asian Development Bank, Government of Tonga.