



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 27-Sep-2020 | Report No: PIDC30265



**BASIC INFORMATION**

**A. Basic Project Data**

Country Tonga	Project ID P174683	Project Name Tonga Supporting Recovery after Dual Shocks Development Policy Operation (P174683)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Dec 01, 2020	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Kingdom of Tonga	Implementing Agency Ministry of Finance		

**Proposed Development Objective(s)**

The program development objective is to: (i) assist firms, protect livelihoods and support vulnerable households to enhance human capital; and (ii) lay the foundations for growth and sustainable economic recovery.

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

**SUMMARY**

<b>Total Financing</b>	30.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	30.00
World Bank Lending	30.00

**Decision**

The review did authorize the preparation to continue

**B. Introduction and Context**

**Country Context**

The proposed operation provides a US\$30 million grant to support Tonga to address the adverse effects of the dual external shocks of the COVID-19 pandemic and Tropical Cyclone (TC) Harold. The proposed operation is a stand-alone Development Policy Operation (DPO). COVID-19 is having severe negative effects on Tonga’s tourism-dependent economy and government finances. While suffering the severe consequences of the COVID-19 crisis, Tonga was hit by a severe tropical cyclone in April 2020, leading to significant damages and losses. The combined effects of the dual crises



represent an economic shock of unprecedented scale for the Tongan economy. Households have felt the full force of the dual shocks, with the poorest and most vulnerable likely to be most severely affected. The proposed DPO will support the Government of Tonga (GoT) to address the immediate response needs and lay the foundations for an inclusive and sustainable recovery. The DPO engagement aligns closely with the World Bank Group (WBG) COVID-19 Crisis Response Approach Paper.

The severe economic impacts of the global pandemic and TC Harold are estimated to have led to a contraction in economic activity of 3.5 percent in FY20. The economy is expected to contract by a further 6.1 percent in FY21. A large budget deficit is projected for FY21, although the fiscal balance is expected to return to surplus over the projection period as tax revenues recover and crisis-related public spending is unwound. Public debt is sustainable despite the impacts of the dual shocks, reflecting the government's commitment to seek available grant financing and only to consider highly concessional debt as a last resort. The macroeconomic policy framework is assessed as adequate for the purposes of this operation.

#### Relationship to CPF

The proposed operation addresses all four of the focus areas articulated in the World Bank Group's Regional Partnership Framework for nine Pacific Island countries, including the Kingdom of Tonga. These areas are: first, fully exploiting the available economic opportunities (including in fisheries, agriculture, and tourism); second, enhancing access to employment opportunities (including by broadening opportunities for labor mobility and improving education outcomes); third, protecting incomes and livelihoods (including through strengthening resilience to disasters and climate change, and addressing non-communicable diseases); and fourth, strengthening the enablers of growth and opportunities (macro-economic management, infrastructure and addressing knowledge gaps). The proposed operation contributes to the first theme by supporting increased access to finance for Micro, Small & Medium Enterprises (MSMEs) in the three target sectors (fisheries, agriculture, and tourism) to help firms overcome short-term liquidity constraints and lay the foundations for a sustainable economic recovery. The reform program addresses the second focus area by supporting measures to protect existing employment and promote a sustainable and inclusive economy recovery. The operation contributes to the third focus areas by: (i) supporting rapidly disbursing crisis-responsive social protection payments to help mitigate the negative impacts of the dual shocks on vulnerable households, their livelihoods and their schooling decisions; and (ii) establishing a new institution to lead housing sector resilience and introducing an event-specific housing recovery strategy that promotes the principles of building back better, sustainability and preventative risk reduction. Finally, the program supports the fourth focus area by introducing international arbitration legislation that will enhance the business climate and encourage higher foreign trade and investment.

Actions supported by this DPO are also closely linked to the IDA19 special themes and WBG COVID-19 Crisis Response Approach Paper. The operation supports actions related to the themes of "Climate Change" and "Gender and Development" and the cross-cutting issues of "Disability" and "Human Capital". These actions address the areas of enhancing resilience to climate change and natural hazards, supporting and reinforcing households' investments to build human capital, promoting and protecting disability-inclusive development, and improving women's access to finance. Finally, the operation directly addresses a key priority to mitigate gender inequalities and close gender gaps—namely, low access to finance for female entrepreneurs—which is a priority in the East Asia & Pacific Gender Action Plan and the Bank's Gender Strategy 2016-2023. The operation supports measures that are critical to the immediate relief and restructuring phases of the crisis response and address three of the four pillars of the WBG Approach – namely the social response, the economic response, and the strengthening of policies, institutions, and investments. The proposed operation builds on and complements the ongoing programmatic DPO series, as well as several investment projects and technical assistance activities. The proposed operation also complements the Bank's broader macroeconomic policy



dialogue, including the Bank's new Sustainable Development Finance Policy and Tonga's two Performance and Policy Actions for FY21.

### C. Proposed Development Objective(s)

The program development objective is to: (i) assist firms, protect livelihoods and support vulnerable households to enhance human capital; and (ii) lay the foundations for growth and sustainable economic recovery.

#### Key Results

##### ***Pillar 1— Assist firms, protect livelihoods and support poor and vulnerable households to enhance human capital***

**Prior Action #1.** To support livelihoods and household investments in human capital, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which provides school fee relief and targeted crisis-responsive social protection payments drawing on newly developed social registries and using new electronic payment methods. *Results:* (i) 100 percent of DWS, SWSE and CCT beneficiary households (FY20); (ii) 50 percent of SWSE beneficiaries (FY21); over 5,800 female students and over 6,300 male students benefit from school fee relief (FY20)

**Prior Action #2.** To support firms to retain workers at risk of unemployment or furlough, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which establishes an institutional mechanism for the payment of wage subsidies to workers affected by the crisis.

*Results:* Over 5,000 workers receive wage subsidy (FY20)

**Prior Action #3.** To support recovery in key economic sectors and business, the Recipient, through its Cabinet, has approved an Economic and Social Stimulus Package which establishes an institutional mechanism for the provision of financial assistance to formal and informal businesses affected by the crisis.

*Results:* Over 600 formal firms and over 1,500 informal firms benefit from direct financial assistance (FY20)

##### ***Pillar 2 — Lay the foundations for growth and sustainable economic recovery***

**Prior Action #4.** To facilitate increased access to microcredit for MSMEs, the Recipient, through its Cabinet, has approved the expansion and extension of the Government Development Loan scheme.

*Results:* Over 600 MSMEs (25 percent female borrowers) (FY21)

**Prior Action #5.** To support climate and disaster-resilient housing reconstruction, the Recipient, through its Cabinet, has approved: (i) the establishment of the Housing Sector Resilience Office; and (ii) an event-specific Tropical Cyclone Harold housing recovery strategy.

*Results:* 75 percent of houses rebuilt (FY21)

**Prior Action #6.** To encourage foreign trade and investment, the Recipient, through its Cabinet, has approved an International Arbitration Bill.

*Results:* A framework is established and brought into force (FY22)

### D. Concept Description

This DPO is designed to reinforce and strengthen the foundations for the achievement of key national outcomes under the Tonga Strategic Development Framework 2015-2025 (TSDF II). The operation supports National Outcomes one to six as outlined above. Pillar 1 supports the government's sustainable and inclusive development priorities and reinforce the development of a knowledge-based economy. Pillar 2 supports key initiatives to enhance resilience to climate change and natural hazards and lay the foundations for a sustainable economic recovery. The supported outcomes are consistent with the comparative advantage of development policy programming, while other outcomes are being



supported by investment operations and with technical assistance from the WBG and other development partner programs.

The reform program will directly support poverty reduction and shared prosperity. The first pillar will contribute to these objectives by supporting key crisis-response measures to maintain livelihoods of the poorest and most vulnerable, while also reinforce household investments in human capital through which these groups can achieve greater economic independence and resilience. This pillar also supports the establishment of new institutional mechanisms to deliver financial assistance for firms to retain workers and support business continuity in both the formal and informal sectors—measures that provide critical income protection to vulnerable workers and informal firms. The second pillar supports legislative reform that will enhance foreign investor certainty in contract dispute resolution, encouraging greater foreign investment and trade. Vulnerable households are expected to disproportionately benefit from the institutional and policy reforms to strengthen housing sector resilience and reconstruction, given their higher exposure to the direct impacts of extreme weather events (e.g. because they tend to live in poorer quality housing). Finally, the action supporting improved access to finance for MSMEs in the tourism, agriculture, fisheries and education sectors is designed to catalyze the economic recovery, support livelihoods and retain and create jobs in sectors in which a high proportion of vulnerable households earn a living. This stand-alone DPO is closely aligned with the ongoing programmatic DPO series, with the two operations jointly designed to support Tonga to address the three phases of crisis response to the dual shocks.

## **E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects**

### Poverty and Social Impacts

Extreme poverty is rare but there are significant levels of material deprivation, particularly in rural areas. The policy actions supported under Pillar 1 are likely to result in a progressive distribution of benefits, supporting the welfare of poor and vulnerable households through the dual shocks. The actions supported under Pillar 1 will also deliver progressive distributional effects by supporting households to invest in human capital. The policy actions supported in Pillar 2 will support poor and vulnerable households to maintain their livelihoods and improve the resilience of their housing. The extension and expansion of the government microfinance program is expected to support increased access to finance for female entrepreneurs, thus addressing a key gender inequality that is material to women’s economic participation.

### Environmental, Forests, and Other Natural Resource Aspects

Policy actions supported under the operation that relate to social protection, school fee relief, support to firms and workers, international arbitration and enhanced access to microcredit are not expected to have a significant impact on the environment. The action to establish the Housing Sector Resilience Office and implement a TC Harold housing recovery strategy is expected to yield climate co-benefits due to its positive impact on the nation’s resilience to the impacts of climate change and disasters. Tonga has a well-established environmental impact assessment process administered by the ministry responsible for the environment and climate change.

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**APPROVAL**

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**Approved By**

Country Director:	Michel Kerf	29-Sep-2020
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