Board of Directors

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Performance Evaluation Report
Strengthening Public Financial Management Program (Tonga) (Grant 0359)

The attached report is circulated at the request of the Director General, Independent Evaluation Department.

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Performance Evaluation Report

Tonga: Strengthening Public Financial Management Program

Independent Evaluation ADB

Raising development impact through evaluation

Performance Evaluation Report
December 2017

Tonga: Strengthening Public Financial Management Program

Reference Number: PPE: TON 2017-15
Project Number: 46385-001
Grant Number: 0359
Independent Evaluation: PE-799

Independent Evaluation ADB

NOTES

(i) In this report, "$" refers to US dollars.
(ii) The fiscal year (FY) of the government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2016 ends on 30 June 2016.
(iii) For an explanation of rating descriptions used in Asian Development Bank evaluation reports, see Asian Development Bank. 2016. *Guidelines for the Evaluation of Public Sector Operations.* Manila.

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Abbreviations

ADB	–	Asian Development Bank
DMF	–	design and monitoring framework
FY	–	fiscal year
GDP	–	gross domestic product
IMF	–	International Monetary Fund
JPRM	–	Joint Policy Reform Matrix
MFNP	–	Ministry of Finance and National Planning
PEFA	–	Public Expenditure and Financial Accountability
PSE	–	public sector enterprise
TA	–	technical assistance
TCC	–	Tonga Communications Corporation
TSDF	–	Tonga Strategic Development Framework

Currency Equivalents

Currency Unit–pa'anga (T$)

		At Appraisal (August 2013)	At Program Completion (January 2014)	At Evaluation (Mar 2017)
T$1.00	=	$0.55	$0.54	$0.45
$1.00	=	T$1.81	T$1.82	T$2.24

Contents

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IED Senior Evaluation Specialist Benjamin Graham and Principal Evaluation Specialist Joanne Asquith commented on the report and Royston A.C. Brockman peer-reviewed it. The report was prepared under the overall guidance of Marvin Taylor-Dormond, Director General, IED; Veronique Salze-Lozac'h, Deputy Director General, IED; and Nathan Subramaniam, Director, Sector and Project Division, IED.

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IED retains full responsibility for this report.

Basic Data

Grant No. 0359-TON: Strengthening Public Financial Management Program

Key Program Data ($ million)	Per ADB Grant Documents	Actual
Total program cost	4.50	4.50
ADB grant	4.50	4.50
Local currency cost	0	0
Other grant financing	0	0
Grant amount cancelled		0

Key Dates	Expected	Actual
Appraisal		11–16 July 2013
Grant negotiations		19 July 2013
Board approval		24 September 2013
Grant agreement		5 November 2013
Grant effectiveness	5 February 2014	15 November 2013
First disbursement		2 December 2013
Grant closing	31 December 2013	24 January 2014

Borrower	Kingdom of Tonga
Executing Agency	Ministry of Finance and National Planning

Mission Data

Type of Mission	No. of Missions	No. of Person-Days
Pre-Fact finding	1	10
Fact-Finding	1	20
Appraisal	1	4
Program completion review*	-	56
Independent evaluation	1	8

ADB = Asian Development Bank.
*Desk-based and consultations in country.

Executive Summary

This program performance evaluation report assesses the performance and highlight lessons learned from the Strengthening Public Financial Management Program in Tonga. The evaluation will support the ongoing corporate evaluation of the policy-based lending of the Asian Development Bank (ADB).

Both the targeted program outcome and impact were not met. The program's reform measures were insufficient in achieving fiscal soundness. Greater efforts are still needed to attain a favorable fiscal position and in enhancing private sector participation in the economy. Building a sound fiscal position could involve pursuing far-reaching measures to help stabilize public sector wage bill, enhance revenue generation, and increase the scale of private sector participation. As such, deeper and continued structural reform measures than what had been previously implemented are essential. On the whole, the program is assessed less than successful.

As inputs to future operations in the country, the evaluation suggests that measures to address the public sector wage bill issue need to be closely monitored. Also, ADB could assist the government in assessing options that would be technically feasible and politically justifiable. Special attention should be given to initiatives to stabilize the wage bill, building up fiscal buffer, and expenditure management. Likewise, continued engagement is needed to sustain reform momentum. Capacity building measures need to be given greater impetus in future operations.

Background

Tonga's economy experienced sluggish growth during 2003–2012, with gross domestic product (GDP) averaging about 1.1%. This was due to a combination of the country's small economic base, its vulnerability to natural disasters, and its dependence on remittances. The economy contracted in fiscal year (FY) 2013, although it has been on the rebound since. The fiscal balance has been another persistent problem. Tonga's fiscal balance averaged about -1.5% from 2003 to 2012, and the government has been running a fiscal deficit since FY2008. Two factors that drive this trend—the government's participation in economic activities through public sector enterprises, and the government's role as Tonga's largest employer.

Helping Tonga achieve a sustainable fiscal balance was a component of Economic and Public Sector Reform Program, which was ADB's first program of assistance for Tonga in 2002. While many components of the 2002 program were successful, the program failed to improve Tonga's fiscal balance or the quality of its public services. The Economic Support Program which was ADB's second program of assistance for Tonga was prepared in 2009, just as Tonga was beginning to feel the effects of the 2008–2009 global economic crisis. Two of this program's projected outputs pertained to improving Tonga's fiscal health in the face of the global crisis: (i) providing budgetary support to protect basic social services expenditures, and (ii) maintaining fiscal responsibility. Outputs delivered did not result in the achievement of the envisaged outcome of timely and effective response to the global economic crisis. The economy remained sluggish, unable to overcome the prolonged effects of the global economic crisis and its own structural weaknesses. These conditions provided the impetus for a political consensus on further reforms to proceed, with measures aimed at strengthening revenue mobilization, public financial management and fostering public sector enterprise reforms.

Thus, a third policy support program—the Strengthening Public Financial Management Program—was formulated in 2013 to help put the economy back on track. The program was approved on 24 September 2013 and became effective on 15 November 2013. The expected impact was achieving fiscal stability. The expected outcome was attaining a sustainable fiscal position. This was reflected in the structure of the policy matrix, which set out 10 policy actions to be achieved. The program was built around three related expected outputs: (i) strengthened public financial management, (ii) strengthened fiscal policy, and (iii) improved implementation of structural reforms. In view of the nature and extent of these conditions, policy-based grant financing was considered the appropriate instrument to employ in addressing these issues.

The program focused on three reform areas: fiscal policy, public financial management, and structural reforms. A compelling ground for ADB's support for fiscal policy reforms was the need for Tonga to boost tax revenues and create fiscal space. Support for public financial management reforms was driven by the need to strengthen budget processes at agency and sector levels, and to ensure a stronger link between government policy, planning, and budgeting. Support for structural reforms was driven by the need to strengthen investor confidence, create a more business-friendly economic environment, diversify the economic base, and foster more private sector participation in Tonga's economy.

Overall Assessment

On the whole, the program contributed to easing fiscal pressure through a quick and much-needed infusion of budgetary support. Government ownership of the program was strong, and the program established itself as an important part of the national economic agenda. The program also supported efforts to broaden coordination of reforms with other development partners.

However, the program failed to adequately address a number of lingering problems. The government's fiscal position has remained precarious. Also, the program could have performed better in providing support for expenditure management, particularly vis-à-vis the public sector wage bill, and in deepening private sector involvement in the economy.

Program reform measures failed to result in Tonga achieving a favorable fiscal position. Looking ahead, much more needs to be done to address Tonga's fiscal soundness and improve the environment for private business—critical factors in ensuring the sustainability of ongoing and future reform measures. Overall, the program is assessed less than successful on the basis that both the envisaged program outcome and impact were not achieved.

While the program was in line with the development priorities of both the government and ADB, the program had several design deficiencies, such as a weak results chain (i.e., how program activities lead to outputs, and outputs lead to outcome and impact). The output targets and policy actions, as configured, were unlikely to result in the impact (fiscal stability) and outcome (sustainable fiscal position) over the relatively short time frame of the program.

A major underlying assumption in the program's design was that the wage bill could be restrained in the medium term to help achieve a more stable fiscal position. This proved to be unrealistic, as political economy considerations made it difficult for the government to rein in public sector wages. The risk of this happening should have been factored into the program design, especially in the formulation of the outcome and impact statements and indicators. This was a clear oversight in the program design.

Also, the policy actions were made few and narrowly focused to take into consideration the government's capacity constraints. Of the 10 policy actions, seven were one-off measures that required further action for the expected outcome and impact to be achieved. In addition, most policy actions were process-focused and administrative in nature.

The short duration of the program failed to account for the time lag that tends to occur when implementing policy actions. Reform measures pertaining to public sector enterprises in particular tend to involve substantial time lag because of political sensitivities and the inherent complexity of privatization and corporate governance reform. The risk of time lag should have been accounted for during program design and highlighted in the risk assessment. Thus, the program is assessed less than relevant.

The intended outcome of a sustainable fiscal position was not achieved. The fiscal balance (excluding grants) has remained in deficit post-project—in fact the deficit worsened in 2015. Of the three targeted outcome performance indicators, one was met and one was partially met.

But the most important indicator—maintaining a sustainable fiscal outturn over FY2014–FY2016—was not met.

In terms of outputs, only three out of six indicators were achieved. Furthermore, these did not deliver the targeted outcome—the targeted outputs, as configured, could not have resulted in a sustainable fiscal position. Delivery of other outputs and reform measures, beyond what the program had envisaged, was needed. Hence, the program is assessed less than effective. For output 1 which concerned strengthening of public financial management, the indicators were approved programs that were defined for key ministries and a review of the national procurement policy. These important inputs and processes were achieved. However, it was not clear how these alone could have resulted in a strengthened public financial management.

For output 2—strengthened fiscal policy—the program supported the Cabinet's submission to the Parliament of two tax legislations. This was achieved. However, the desired results may not materialize until many years after program completion. Take the Seabed Minerals Act of 2014, for instance. Since seabed mining is prospective by nature, it will require a relatively long gestation period before tax revenues from this act materialize. This should have been properly considered during program design.

The final output—improved structural reform to enhance private sector participation in the economy—represented a major portion of the program. Of the three performance targets related to this output, two were partially achieved while the third was not met. One target that was partially met involved the liquidation and/or rationalization of two state-owned enterprises; however, in reality one of those enterprises—Tonga Investment Limited—simply saw its assets and ownership transferred to other public sector enterprise. More successful was the completion of a concession agreement for a private entity to take over operations of the International Dateline Hotel (albeit this occurred 3 years past the target date). The other target that was partially met concerned the passage of legislation to improve the regulatory environment. The amendment to the Registration of Business Names Act was completed, but the Receivership Bill still awaits approval. The target that was not met was the reform and restructuring of the Tonga Communications Corporation, which did not push through. On the whole, measures intended to enhance private sector participation were partially achieved.

Program benefits could only start to materialize toward the end of the grant period, some of which were dependent on the extent and nature of the proposed policy actions such as tax legislations. Over time, increases in domestic revenue and higher returns from more efficient public enterprises could gradually reduce future development financing needs. However, these types of benefits are often diffused and more distant, extending well beyond the program period. The program supported a single-tranche operation, which ensured that policy actions were completed before grant effectiveness. The program did not experience any delay. The grant financing was tied to budget support and, as such, it was not related to any estimation of adjustment costs of reforms. The program is assessed efficient in its use of resources.

A sustainable fiscal position was not achieved, as Tonga's fiscal deficit persists and it continues to rely on development partner financing for budget support. It is unlikely that underlying issues (particularly relating to the public wage bill) will be addressed in the medium term, and therefore it is expected that the fiscal deficit will linger. Government measures to restrain wage increases have been arbitrary, short-term, and largely ineffective because of political economy factors. In the future Tonga will have to carefully consider a more sustainable and politically justifiable means of controlling expenditures. The Cabinet approved in 2016 a new remuneration framework. Despite the approval, this condition is likely to linger over the medium term since the public sector's size relative to the economy will continue to be large, as the case in most small states. ADB could have provided more help in this direction through the program.

In terms of structural reform, deeper structural reform measures will be needed in the future to spur private sector involvement in the economy. Alternative models of public–private partnerships should be explored to provide public services and utilities. Such arrangements could be more conducive to privatization and attracting outside investment.

Regarding institutional sustainability, technical and managerial capacity within the government remains thin. The lack of capacity has made it difficult the government to implement successive reform agendas over the years, especially given time constraints and the complex nature of those reforms—particularly legislative reforms.

In terms of reform durability, the government's strong commitment to reform has continued. However, political economy factors may lead to the reversal of reform policies. The magnitude of political economy issues such as the size of public sector and political volatility, vulnerability to natural disasters, and reliance on remittances, continue to pose high risks. These could undermine reform resilience and the extent to which momentum that was achieved under the program could continue. Stakeholders' support would need further strengthening to advance the Receivership Bill and the rationalization of Tonga Communications Corporation. The program is assessed less than likely sustainable.

The program helped to continue the momentum of the reform process in Tonga, even during a period of economic downturn. However, limited progress was made with long-standing weaknesses of private sector participation in the economy and enhancing of fiscal space. The targeted impact did not materialize. The program's development impact is assessed less than satisfactory.

More work could have been devoted during preparation, in terms of formulating a sound program design. Thus, ADB's performance is assessed less than satisfactory. Government's strong ownership to the program helped bolster the credibility of the reform measures that were undertaken. It coordinated well with other development partners via the Joint Policy Reform Matrix process, in terms of identifying and monitoring priority reform areas and actions. Hence, the performance of the borrower and the executing agency is assessed satisfactory.

Key Issues

Deficiencies in program design. The program's design and monitoring framework was of poor quality. During program formulation, more attention should have been devoted in setting up the logical linkages between policy actions and program outputs, outcome and impact. Given the program's limited time frame, some performance targets were overly ambitious and should have been more conservatively formulated. To create fiscal space, the program focused mainly on revenue-generating policy actions—namely, the approval of two bills; it should have targeted expenditures as well.

Insufficient risk assessment. The program lacked a well-prepared risk assessment highlighting key factors that might undermine the program. The public wage bill in particular was a major fiscal risk factor that was not given proper consideration during program preparation. The program's targeted outcome implicitly hinged on public sector wages remaining stable; that did not happen. Another risk that was overlooked during project preparation was the possible delay or deferment of legislation and other output targets. Ultimately the Receivership Bill, scheduled for approval in 2015, was deferred for at least 2 years. Outputs related to increased private sector participation in public sector enterprises were also delayed.

Lack of vigorous measures to enhance private sector participation. Results of privatization measures under the program were mixed. Given the lengthy amount of time required to establish a conducive business environment and reform public sector enterprises, the program should have called for a more aggressive approach to enhancing private sector involvement in the economy. The degree to which privatization is supported and attainable could have been adequately assessed and discussed with the government, including technical and political feasibilities of the full range of options.

Key Lessons

In small island economies, fiscal consolidation measures should take into account the size of the public sector. The share of the public sector in small island economies tends to be large because of the small economic base and because areas for alternative employment are often limited. In the future, the role and magnitude of the public sector in small island economies must be more carefully considered in program design. In such economies, even small and/or sporadic wage increases for civil servants can put tremendous pressure on recurrent fiscal expenditures, making it difficult to manage these expenditures. In future ADB programs, a more thorough assessment of risk on the expenditure side must be carried out in small island economies.

Short-duration programs should consider time lags for policy actions. Programs with short time frames should more carefully consider the time lag that tends to occur after implementing policy actions. Because of these time lags, performance targets such as improved debt-to-GDP ratios, increased revenue mobilization, sustainable fiscal outturn, and improved public expenditure and financial accountability (PEFA) ratings can be difficult to achieve for short-duration programs, even with up-front delivery of vital reforms. When designing programs, performance indicators need to be realistically formulated, taking into consideration the focus, timing, and extent of the policy reforms to be implemented.

Follow-Up Actions

As inputs to future operations in the country, the evaluation suggests the following:

Measures to address the public sector wage bill issue need to be closely monitored. Government is now embarking on a comprehensive civil service reform, including a new remuneration framework. ADB should continue to monitor developments in these areas in view of the political-economy implications. In particular, ADB could assist the government in assessing options other than restraining wage increases. A more realistic approach that would be technically feasible and politically justifiable should be explored.

Fiscal consolidation measures will need focused attention and monitoring. ADB should continue to monitor developments related to fiscal consolidation, especially on the expenditure side. Special attention should be given to initiatives to stabilize the wage bill, building up fiscal buffer, and expenditure management.

Continued engagement is needed to sustain reform momentum. ADB should continue to engage the government and development partners on business regulation, public sector remuneration, and public financial management, with an emphasis on capacity building. This will require continuous engagement with the government, through advice and guidance via technical assistance, and support that could be linked to the success of reforms. Reinforcing reforms in these areas through advice, guidance, and technical assistance may help facilitate future investments, and enhance the country's economic growth prospects. ADB could also re-assess its mix of instruments to ensure greater development results in Tonga. In particular, ADB may consider the use of wholly grant support in its operation in view of Tonga's precarious fiscal position and external debt vulnerability.

CHAPTER 1

Introduction

A. Evaluation Purpose and Process

1. The Strengthening Public Financial Management Program was designed to support the Government of Tonga to restore medium-term fiscal sustainability, continue reform efforts, and spur private sector development. It focused on three areas: (i) strengthening public financial management by improving budgeting and procurement processes, (ii) strengthening fiscal policy through tax reforms aimed at mobilizing domestic resources and broadening the tax base, and (iii) structural reforms geared toward improving private sector business activity to boost economic growth. Specifically, the program was designed to put Tonga's economy back on track at a time when it was still suffering from lingering effects of the 2008–2009 global economic crisis.

2. The program was included in the 2017 work program of the Independent Evaluation Department in order to provide inputs to the corporate evaluation on policy-based lending of the Asian Development Bank (ADB). This program performance evaluation report was undertaken about 2.5 years after the program's 2014 completion. This allowed sufficient time for the outputs and outcome to be reassessed, and for conclusions to be drawn regarding sustainability and impacts. Following ADB's evaluation guidelines,[1] the report assesses the performance of the program and highlights lessons learned.

3. The program completion report rated the program *successful*, *highly relevant*, *effective*, *efficient*, and *sustainable.*[2] It noted that the program was implemented as designed, and suggested that program-driven measures have helped put Tonga on a more sustainable fiscal path while enhancing the enabling environment for private sector development.

B. Summary of Expected Impact, Outcome, and Outputs

4. According to the program's design and monitoring framework (DMF) in the report and recommendation of the President, the envisaged impact was achieving fiscal stability.[3] The expected outcome was attaining a sustainable fiscal position. The program was structured around three related outputs. The first pertained to strengthening public financial management. This was to involve defining programs for key ministries and reflecting these in the 2014 budget for program budgeting purposes. Also, a review of national procurement policy and procedures was to be completed by 31 July 2013.

5. The second output concerned strengthening fiscal policy and was to involve submission for cabinet approval of new tax regimes for presumptive small and medium-sized enterprise and extractive industries. The third was improved implementation of

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[1] ADB. 2016. *Guidelines for the Evaluation of Public Sector Operations*. Manila.

[2] ADB. 2014. *Completion Report: Strengthening Public Financial Management Program in Tonga*. Manila.

[3] ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Kingdom of Tonga for Strengthening Public Financial Management Program*. Manila.

structural reform. This was to be undertaken through liquidation of one public sector enterprise (PSE)—Tonga Investment Limited; adoption of a reform and restructuring plan for Tonga Telecommunications Corporation (TCC); and improvement of regulatory environment, including submission of Receivership Bill and amendment to the Registration of Business Names Act of 2002. The DMF indicates the targeted and achieved impact, outcome, and output indicators. (Appendix 1).

6. The program's envisaged outcome was reflected in the structure of the policy matrix, which set out 10 policy actions to be achieved. Two of these actions were related to public financial management, two were related to fiscal policy, and six were related to structural reforms. All policy actions were defined as single-tranche actions (Appendix 2).

CHAPTER 2

Design and Implementation

A. Rationale

7. From 2003 to 2012, Tonga's fiscal balance averaged about -1.5%, while economic growth was sluggish. A small economic base, vulnerability to natural disasters, and an overdependence on remittances were all part of the problem. The fragile fiscal balance was of particular concern given the government's exposure to economic activities through public sector enterprises and its role as Tonga's largest employer. ADB's first program support for Tonga, in 2002, had also targeted the fiscal balance.[4] Its second program assistance was prepared in 2009, just as the effects of the 2008–2009 global economic crisis were beginning to put additional pressure on Tonga's fiscal position. The government began running a deficit in fiscal year (FY) 2008. Components of the 2009 ADB program assistance included budgetary support to protect basic social services expenditures, and maintenance of fiscal responsibility.[5]

8. Tonga's economy remained vulnerable during the time of program preparation in 2012–2013 as negative effects of the global economic crisis lingered. During the fiscal year (FY)[6] 2010 to FY2012, annual gross domestic product (GDP) growth averaged 2.6%, driven primarily by major public infrastructure projects that had been initiated to mitigate the effects of the global economic crisis. However, GDP grew only 0.9% in FY2012, and in FY2013 Tonga's GDP growth plummeted to -3.1%. The sharp contraction followed the completion of the aforementioned infrastructure projects, exacerbated by weaknesses in tourism and remittance inflows.[7]

9. Credit to the private sector declined, on the average, by -7.5% during the period FY2011–FY2013. This was attributed to a combination of reduced remittance receipts that constrained domestic demand and consumer spending, cuts in government purchases of goods and services, delays in business tax reimbursements, and increases in taxes and business license fees. Also, foreign direct investment, as a proportion of GDP, dropped from 1.6% in FY2011 to -0.3% in FY2012. These affected both revenue generation and private sector participation in the economy.

10. Despite the economic deceleration, Tonga's fiscal position improved during the program preparation period. The fiscal deficit dropped from 7.4% of GDP in FY2011 to 1.3% of GDP in FY2013, largely because of a decrease in capital expenditure spending (para. 7). This fiscal position was not precarious at this level and could still be considered

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4 ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Kingdom of Tonga for Economic and Public Sector Reform Program.* Manila.

5 ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to the Kingdom of Tonga for the Economic Support Program.* Manila.

6 Fiscal year (FY) in Tonga runs from 1 July to 30 June.

7 International Monetary Fund (IMF). 2013. *Tonga: 2013 Article IV Consultation*. Washington, DC, International Monetary Fund. 2014. *Tonga: 2014 Article IV Consultation*. Washington, DC, and International Monetary Fund. 2016. *Tonga: 2016 Article IV Consultation*. Washington, DC.

sustainable during that time, given appropriate cost of borrowings, stock of debt, and GDP growth rates. However, total public debt as percentage of GDP was on the rise from 43.6% of GDP in FY2011 to 51.4% of GDP in FY2013. Combined with the sluggish economy, this presented a risk to Tonga's fiscal balance. Although the 2013 International Monetary Fund (IMF)–World Bank Debt Sustainability Analysis rated Tonga's risk of debt distress as "moderate," it noted that public debt repayments were projected to increase—yet another factor that threatened to place strain on the government's budget.[8]

11. The government adopted a "no new loan" policy[9] (including concessional borrowings) in June 2011 in light of its vulnerability to external debt and its need to regain some fiscal space.[10] Given this context, the program was formulated to provide budget support to the government at the time of prolonged effects of the global economic crisis to Tonga's economy. Efforts to assist the government's medium-term fiscal framework (MTFF) and the multi-year Joint Policy Reform Matrix (JPRM) with development partners, designed to underpin budget support, were also envisaged under the program (paras. 21–22). On the whole, the program was geared toward leveraging reforms in fiscal policy and in public financial management areas, which both the government and ADB considered vital. In the country's development context, these mutually-related reform fronts could not be addressed separately.

12. However, actions on both fiscal and public financial management could have more likelihood of being realized if these would include structural reforms to spur private sector activity. In particular, PSE reforms would have to continue being carried out. In combination with efforts to improve reforms for private sector development, the program was aimed at putting the economy back to the path of recovery over the medium-term. The government acknowledged that reforms on these areas provided the appropriate direction toward this goal. Also, it was understood that political consensus had to be maintained in carrying out these reforms.

1. Fiscal Policy Reforms

13. Restoring fiscal space was considered crucial to the economy in order to enable priority spending and protect capital investment outlays. This was to require fiscal consolidation—i.e., ensuring prudent management of public finances. During program formulation in late 2012 and early 2013, there was limited scope to increase fiscal space. Although total revenue (as a percentage of GDP) increased during this period, it was outstripped by increases in current expenditures.[11]

14. On the expenditure side, the share of wages and salaries of government operating costs was about 52% in FY2013. The government attempted to restrain the public sector wage bill through freeze hiring on civil service recruitment, which was in effect since 2010. Vacant posts were cut back and centralized under the Ministry of Finance and National Planning (MFNP) and within-year reallocation of resources to casual employment was restricted. These measures were adopted to meet the target of reducing the wage bill to about 45% of government expenditure so as to avoid a squeeze on nonwage expenditures.

[8] The IMF estimated repayments as percentage of GDP to be about 0.9% in FY2013, 1.8% in FY2014, 2% in FY2015, and 2.1% in FY2016.
[9] The government also introduced a policy of using domestic borrowing only for the purposes of in-year cash management.
[10] This was later amended to allow concessional borrowing.
[11] Total revenue as a percentage of GDP increased from 18% in FY2012 to 19.6% in FY2013. Current expenditure (as a percentage of GDP) increased from 23.5% to 24.9% during the same period.

15. Revenue priorities were focused on implementing tax reform and modernization programs. These included measures aimed at rationalizing tax exemptions through application of non-discretionary, fair and transparent policy guidance, and implementation of simplified tax procedures. However, there was still scope for further tax policy reforms to remove leakages, reduce distortions, and improve tax administration.[12] For instance, improvements in tax regime could include new legislative bases for tax collection. A compelling basis for ADB's support for reform efforts was the need to boost tax revenues and the government's initiative to improve value-for-money in public expenditure.

2. Public Financial Management Reforms

16. Tonga's public financial management system was based on a set of generally well-established expenditure control procedures covering wages and salaries, non-salary items, and procurement. Since 2014, Tonga has consistently performed well above the regional average, particularly for economic management, structural policies, and public sector management and institutions. However, there were still areas for improvement especially on enhancing budget credibility at the agency level, proper costing of sector-specific plans, and presentation of budgetary impacts of policy changes.[13] The government's 4 Year Tonga Strategic Development Framework for 2011–2014 highlighted the need for ensuring a stronger link between policy, planning, and budgeting.[14]

17. Given the context of fiscal difficulties, a multi-year JPRM with development partners was launched in 2011 to reflect shared reform priorities. The process was part of a synchronized, medium-term, programmatic dialogue aimed at improving coordination between the government and its development partners in identifying key binding constraints. Areas identified were budget support, policy design, monitoring and financing. Likewise, the MTFF was developed in 2013 in consultation with the IMF, to help provide the basis for assessing whether the government has the necessary fiscal space to carry out reforms. ADB support was therefore needed to help strengthen the public financial management system through support for capacity and performance improvements.

3. Structural Reforms

18. Tonga's economy traditionally has been highly dependent on remittances (20% of GDP on average during FY2011–FY2014) and tourism (9% of GDP on average over the same period). By contrast, foreign direct investment averaged only about 1.3% of GDP during that period. Private sector development has been stymied by a narrow production base, lack of diversification, and remote geography. Tonga did receive a relatively favorable business-environment rating in the World Bank's Doing Business 2013 report, where it ranked 62 out of 185 global economies. However, the IMF noted that Tonga would need an even more favorable business environment to overcome its locational disadvantage and small size. Judicious deregulation (e.g., easing ancillary licenses) and enhanced policy coordination to nurture a business-friendly environment were considered important (footnote 7).

19. Against this backdrop, the government pursued reforms to improve its business environment and strengthen investor confidence. A key focus was on restructuring and

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[12] Cotton, Jenkins, and Mullins. 2011: *Revenue Policy and Administration Review*. Aide-Mémoire, International Monetary Fund. Pacific Financial Technical Assistance Center.

[13] Public Expenditure and Financial Accountability (PEFA). 2010. *Public Financial Management Performance Report for the Kingdom of Tonga. Final Report*. Washington, DC.

[14] Kingdom of Tonga. 2011. *Tonga Strategic Development Framework (2011–2014)*. Nuku'alofa.

liquidating selected public sector enterprises (PSEs). At the time of program preparation, Tonga's portfolio comprised 18 PSEs. On average these PSEs recorded a modest 5.2% return on equity and a 3.2% return on assets annually during FY2002–FY2012. The former figure was well below the government's 10% target for return on equity, and well below the return required to compensate the government for its portfolio's risk-adjusted cost of capital. Six of the 18 PSEs accounted for 90% of total assets and drove the portfolio returns. The contribution to GDP of all PSEs was about 6% in 2012, reflecting the low productivity of their assets.[15]

20. Tonga's Public Enterprise Act was amended in 2010 to require PSEs to operate profitably. It also required PSEs to restructure their boards to promote greater transparency and accountability. Business licensing and permit processes were streamlined to spur greater private sector investment (para. 60). However, PSE reforms could not be carried out apart from fiscal reforms. These were interconnected and needed to be properly paced and sequenced over a longer time frame to help strengthen the regulatory environment and enhance investment. ADB's support for PSE reform was therefore appropriate in view of the primary need to build up fiscal space and consolidate reforms that could accelerate restructuring and privatization, promote better corporate governance, and improve the commercial and legal framework for PSEs.

B. Time, Cost, Financing, and Implementation Arrangements

21. ADB provided a grant financed from its Special Fund resources of $4.50 million for a stand-alone policy-based program, which contributed to Tonga's FY2014 national budget. Total government financing needs for its fiscal reform program were estimated at $17.2 million for FY2014, $15.7 million for FY2015, and $12.9 million for FY2016 (footnote 3). The program was a joint undertaking with other development partners to help support JPRM initiatives.

22. For FY2014, it was expected that other development partners would fill up the balance of Tonga's financing needs for fiscal reform. The Government of Australia agreed to provide $5.0 million. The European Union agreed to provide $3.5 million, and the World Bank was to provide $5.0 million. The World Bank supported common areas in line with JPRM initiatives, such as public financial management, fiscal policy, and improving Tonga's business-enabling environment. The World Bank also targeted distinct policy areas such as increasing taxes on cigarettes and soft drinks, updating the electricity tariff structure, improving the policy framework for foreign investment, and centralizing procurement tasks.[16]

23. The program was prepared during pre-fact finding (1–6 October 2012), fact-finding (27 May–1 June 2013), and appraisal (11–16 July 2013) missions. It was built on the results and lessons learned from the earlier ADB-financed Economic Support Program, which was completed on 30 June 2011 (footnote 5). The program was approved on 24 September 2013 under a "no objection" procedure and became effective

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[15] ADB. 2014. *Finding Balance 2014: Benchmarking the Performance of State-Owned Enterprises in Island Countries*. Manila.

[16] The World Bank's implementation completion results report assessed the results of its two programmatic economic reform development policy operations for 2013 and 2014. The report indicated that the program was overambitious in a number of areas—in particular reforms linked to simplification of taxes on small-medium-sized enterprises, foreign investment, the International Dateline Hotel and the Tonga Communications Corporation. Also, reform actions were not always strongly linked, in terms of sequencing and related links to the outcome indicators. Four outcome indicators were dropped while six were revised. Based on these revised indicators, the report's overall assessment was still satisfactory. Available: http://documents.worldbank.org/curated/en/779741499445987778/pdf/ICR00004159-06122017.pdf.

on 15 November 2013. The grant was disbursed in a single tranche on 2 December 2013. Local currency generated from the grant was directed to the government's bank account with the National Bank of Tonga to support the FY2014 budget.

24. The implementation period was envisaged for 1 year. The original grant closing date was 31 December 2013, but was closed almost a month later. The Ministry of Finance and National Planning (MFNP) was the executing agency and had overall responsibility for the program. Implementing agencies included the MFNP; the Ministry of Public Enterprises; the Ministry of Commerce, Tourism and Labor; and the Ministry of Revenue and Customs. The MFNP, through its Budget Support Management Committee (BSMC), was responsible for program administration, disbursements, and maintenance of all program records.

C. Technical Assistance

25. There was no technical assistance (TA) associated with the program, but program implementation was supported by an ADB capacity development TA project that was ongoing at that time.[17]

D. Procurement and Consultants

26. The proceeds of the grant were disbursed in line with ADB's simplification of disbursement procedures and related requirements for policy-based grants. The proceeds were utilized to finance the foreign exchange cost of items produced and procured in ADB member countries, excluding items included in a list of ineligible items and imports. There were no consultants hired specifically for the program. However, advisors from regional TA projects[18] were mobilized to help in implementing the JPRM along with technical support from the World Bank and the Government of Australia.

E. Safeguard Arrangements and Gender Action Plan

27. The program was category C for potential environmental impacts and risks, which meant that an environmental management plan and resettlement action were not required. Program activities were confined to policy reforms, and the independent evaluation mission determined that there were no involuntary resettlement or environmental issues that resulted from program activities. Tonga's population consists mainly of Tongans, an ethnically homogeneous Polynesian people. Thus, the program did not affect any distinct or vulnerable group of indigenous peoples. Also, there were no indications that women were disproportionately affected.

F. Design Changes

28. There were no changes made to the original program design during program implementation. Likewise, policy actions and outputs during the program period did not deviate from what were originally envisaged.

[17] ADB. 2011. *Technical Assistance for Implementing Strategic Economic Management*. Manila.
[18] ADB. 2009. *Technical Assistance for Pacific Economic Management*. Manila (subproject 2); ADB. 2006. *Technical Assistance for the Private Sector Development Initiative*.

G. Grant Covenants, Monitoring, and Reporting Arrangements

29. The policy matrix comprised 10 policy actions to be implemented under the program. Six of those actions were process-oriented and administrative in nature, and required preparation of procurement review reports, budget documents, and/or reform and restructuring plans for PSEs. The other four policy actions required submission of draft laws to Parliament (Appendix 2). Two of the policy actions were related to public financial management, two were related to fiscal policy, and six were related to structural reforms. All the 10 policy actions were generally relevant in terms of their links to targeted outputs; however, their links to the targeted program outcome (sustainable fiscal position) was less strong. In the area of institutional dimension, four policy actions resulted in the submission of draft laws to Parliament, although one proposed law has been delayed significantly. The policy actions pertaining to PSE rationalization had mixed results because of procedural delays and political economy considerations. In terms of additionality, ADB's support in terms of providing TA and policy dialogue was reflected in the policy actions, especially those pertaining to legislative actions. However, ADB's value addition was low in government functions that were process-oriented in character, such as budgetary framework and procurement processes. Measurability could be difficult to determine due to lagged effects of some policy actions and lack of appropriate metrics in assessing processes. In terms of efficacy, all policy actions were completed. The single-tranche operation ensured that these were to be accomplished prior to grant effectiveness.

30. In terms of the depth of policy actions (i.e., the extent to which a given policy action triggers concrete institutional or policy change), seven out of the 10 policy actions are rated medium depth, while the other three are rated low depth. "Medium depth" implies that follow-up actions or results (e.g., submission of draft legislation to Congress, reaching a target or benchmarks, or organizational changes) are likely required for a given policy to have a significant and/or far-reaching effect. Three of the 10 policy actions are rated low depth, which means that these actions by themselves did not bring about meaningful changes or reforms (such as concrete action plans or strategies). None of the 10 policy actions were rated high depth (meaning that the actions on their own could trigger long-lasting changes in the institutional or policy environment). Appendix 2 provides additional information on the depth of specific policy actions.

31. The grant agreement included 14 covenants, 11 of which focused on the use of grant proceeds, grant effectiveness, and implementation.[19] The remaining covenants involved program monitoring and review (Appendix 3). A program performance monitoring system was set up that included a database on the status of policy actions.

[19] These covenants did not directly relate to any specific policy action.

CHAPTER 3

Performance Assessment

32. The evaluation criteria focused on the program's performance and development results rather than on the performance of the executing agency and ADB. The Independent Evaluation Department's guidelines identify four core criteria: (i) relevance of the program to the government and ADB development strategies and relevance of the design to achieve program objectives, (ii) effectiveness of program outputs and outcome, (iii) efficiency of the program's utilization of resources, and (iv) sustainability of the program outputs and outcome (footnote 1). Noncore assessments were undertaken on the program's development impact and the performance of ADB and the borrower.

A. Relevance

33. While the program's envisaged impact, outcome, and outputs were in line with government's development strategies and ADB's country strategies, the program was plagued by design deficiencies (paras. 38–40 and 42–43). In particular, the linkage between the program outputs (and the specific output components and policy actions) and the intended outcome and impact was weak.

34. Strategically, the program was consistent with the Tonga Strategic Development Framework (TSDF) for 2011–2014. The key objectives of the TSDF were improving Tonga's macroeconomic environment and fiscal management; ensuring a more coordinated government approach with development partners; achieving a more efficient and effective government; and ensuring sustainable and accountable PSEs, if necessary by moving them into the private sector (footnote 14). The government continues to strive toward improving macroeconomic management and stability; creating public–private partnerships; strengthening business-enabling environment; and improving access to overseas trade, employment, and foreign investment, as articulated in the TSDF II, 2015–2025.[20] Hence, the program remains aligned with Tonga's current national economic strategies.

35. The program was in line with ADB's Pacific Approach (2010–2014),[21] which served as the country partnership strategy for Tonga.[22] The Pacific Approach aimed to support sustained, resilient, and improved standards of living. The program remains aligned with ADB's country business plan for Tonga for 2017–2019, the focus of which mirrors the TSDF II. The program is also aligned with ADB's Pacific Approach (2016–2020),[23] which calls for ADB operations to focus on reducing costs of doing business, managing risks from economic shocks, and supporting private sector growth and investment.

36. The program was prepared during a period of economic sluggishness for Tonga brought about by the prolonged effects of the global economic crisis of 2008–2009 and structural weaknesses—e.g., the small size of the economy and limited private sector

[20] Kingdom of Tonga. 2015. *Tonga Strategic Development Framework II (2015–2025)*. Nuku'alofa.
[21] ADB. 2009. *ADB's Pacific Approach, 2010–2014*. Manila.
[22] Memorandum approved by the Vice-President-in-Charge, Operations 2, on 1 July 2011, paragraph 2b.
[23] ADB. 2016. *Pacific Approach, 2016–2020*. Manila.

participation (paras. 7–10). In particular, the government had been running a fiscal deficit since FY2008. These circumstances provided the impetus for a political consensus to advance reforms through measures aimed at strengthening revenue mobilization, improving public financial management, and accelerating PSE reforms.

37. The government sought to speed up these reforms by implementing the program. Government's solid ownership and firm commitment and the program's place in the national reform agenda that underpinned the reform process, were well entrenched. Given the nature and breadth of these circumstances, policy-based grant financing was the appropriate instrument to employ in addressing these issues since it provided an opportunity to leverage reforms before transfer of resources. The program's thrust was on gradually establishing building blocks for future reforms.

38. A lack of coherence in the logic of the program was one factor that detracted from the program's relevance. The results chain (i.e., how program activities lead to outputs, and outputs lead to outcome and impact) was not well-articulated. For example, the single indicator for the intended impact of achieving fiscal stability was debt-to-GDP ratio, which seemed narrow. More importantly, the envisaged outcome (sustainable fiscal position) depended heavily on direct measures on expenditure cuts or control that could have helped in bringing down the deficit which was a crucial element in putting a country into a sound fiscal footing (para. 39). This was a clear omission in program design.

39. A major underlying assumption in the program's design was that the wage bill (para. 14) could be restrained in the medium term to increase the likelihood of achieving the outcome. This proved unrealistic, as political economy considerations made it difficult for the government to rein in public service wage hikes (para. 68). The inflated wage bill was a major fiscal risk that should have been factored into program design—particularly in the formulation of the outcome and impact statements and indicators.

40. Some of the performance indicators in the DMF were poorly defined, overly ambitious, and/or failed to take into consideration the cause and effect mechanisms of policy reforms (i.e., how the targeted policy actions could be translated into activities, outputs, outcome, and eventually impact). Performance indicators also would have benefited from more realistic time frames, and more careful risk assessment. For example, achieving a financing gap (excluding grants and concessional loans) of 3.3% of GDP for FY2014–FY2016—a little more than 2 years after grant effectiveness—was not a realistic target. Ultimately the fiscal gap remained relatively unchanged. This outcome indicator remained relatively unchanged from 6.9% of GDP in FY2013 to 6.7% of GDP in FY2016 (footnote 7). The impact indicator proved unrealistic as well (para. 74).

41. Policy actions in the program design generally mirrored conditions related to Tonga's fiscal position and the state of public financial management and PSEs. These policy actions were made few and narrowly focused, to take into account the government's thin institutional capacity. Of the 10 policy actions, 7 were one-off measures that required further action for the expected outcome and impact to be achieved (para. 30). Although a few of these laid the groundwork for pertinent legislation (i.e., the Small Business Tax and the Seabed Minerals Act of 2014), and were easily enacted within a short period, the attendant implementing rules, guidelines, and institutional arrangements required additional time to set up.

42. Also, it will take years beyond program completion for the desired effects of several policy reform actions to be realized. For instance, some PSE reforms did not yield

near-term results because of political sensitivities and/or the inherent complexity of privatization and corporate governance (para. 59). The reform process had its own unique gestation period which made it difficult to immediately realize the targeted outcome. PSE reforms tend to happen slowly, even in developed countries. This should have been considered during the design of the program and in the risk assessment. Other policy actions were process-focused and administrative in nature (para. 29) and amply handled by the government bureaucracy. However, some difficulties were encountered in undertaking simultaneous reform measures due to capacity constraints—a common problem in economies dominated by government bureaucracy.

43. Stringent performance targets pertaining to macroeconomic performance should have been avoided in small island economies. In retrospect, one of the targeted outcome indicators could have been formulated in a different way. The fiscal situation was still stable despite a 1.3% fiscal deficit (para. 10). There was no economic case for stating a stringent policy rule to be achieved at a specific time (i.e., no later than FY2016), particularly in a small island country that is highly vulnerable to risk. It would have been desirable to have this indicator year after year if tax revenues move with economic development while expenditure growth remains stable. However, this proved to be not the case in Tonga. Thus, the outcome indicator appeared to be stringent. The indicator could have been made flexible and allowed to fluctuate within a certain band or limit or perhaps to cover 3 fiscal year period instead of an annual basis. This would have meant that a more relevant and flexible outcome indicator could have been defined. On these bases, the program is assessed less than relevant.

B. Effectiveness

44. The intended outcome of a sustainable fiscal position was not achieved. The fiscal balance (excluding grants) has remained in deficit even after program completion (Table 1). Of the three targeted outcome performance indicators, one was met, and one was partially met, and one was not met. The target that was achieved was the one on increased revenue mobilization. The target that was partially achieved was on improved public expenditure and financial accountability (PEFA) rating. The most important indicator—maintaining a sustainable fiscal outturn over FY2014–FY2016—was not met (paras. 47–51).

45. In terms of outputs, although three out of six indicators were met, these did not deliver the targeted outcome. Taken together, the targeted outputs—strengthened public financial management (PFM), strengthened fiscal policy, and improved structural reform—could not have resulted in a sustainable fiscal position. For example, for output 1 which concerned strengthening PFM, the indicators were the approval of programs for key ministries to facilitate budget programming, and the completion of a review of the national procurement policy. While these were important, it was not clear how these alone could have resulted in strengthened PFM (paras. 52–61).

46. Attaining the envisaged outcome of a sustainable fiscal position required both expenditure cuts or freeze and revenue increases. The program focused mainly on the revenue side—namely, policy actions to ensure the passage of two pieces of legislation (Appendix 2)—while paying insufficient attention to expenditures. The program is assessed less than effective.

1. Program Outcome

47. The program did not achieve its envisaged outcome. The fiscal deficit (excluding grants and concessional loans) averaged about 6.8% of GDP annually during FY2014–FY2016 (Table 1). This fiscal gap exceeded the program's performance target (a deficit less than 3.3% of GDP by FY2016). When grants are included in revenues, the government registered a fiscal surplus in FY2014, but this became a deficit of 1.1% of GDP in FY2015, rising to a projected deficit of 3.1% of GDP in FY2016. Cost-of-living-allowance adjustments led to public wage increases of approximately 5% in both FY2014 and FY2015, which placed additional pressure on the government's precarious fiscal position. The government has recently developed a set of medium-term fiscal targets. Among those targets: domestic revenue should amount to more than 22% of GDP; the ratio of employees' compensation to domestic revenue should be less than 53%, and should move toward 50% over time; and the external debt-to-GDP ratio should be less than 50%. However, the government acknowledges that it might have mixed success meeting these targets year in and year out.[24]

48. The targeted outcome was implicitly based on the assumption that the public wage bill— about 51.3% of recurrent expenditures in FY2013—would not rise in the medium term. That this turned out to be unrealistic is perhaps not surprising given the difficulty of quickly reducing the size of the public sector by shifting employment to the private sector.

49. The IMF has estimated that over the medium term, Tonga would need to run a surplus of 1% of GDP to achieve fiscal sustainability. To achieve that surplus, Tonga would have to reduce external public debt to 40% of GDP while keeping domestic public debt at around 10% of GDP.[25] The IMF projected that Tonga would be able to meet these targets in FY2021 at the earliest. Several reasons are behind this—foremost among them the public wage bill, which continues to be a large fiscal risk for the government. The government needs to come up with a more systematic approach to managing public service remuneration.

Table 1: Economic and Fiscal Outlook, FY2011–FY2016

Item	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015[e]	FY 2016[f]	FY 2017[f]
Real GDP (% change)	2.7	0.9	(3.1)	2.1	3.7	3.1	2.3
Total revenue excl grants (% of GDP)	19.5	18.0	19.6	20.0	21.4	23.7	24.1
Total expenditure (% of GDP)*	33.7	30.2	26.5	25.7	29.3	30.4	29.1
Overall fiscal balance incl grants (% of GDP)	(7.4)	(2.8)	(1.3)	1.7	(1.1)	(3.1)	(1.7)
Overall fiscal balance excl grants (% of GDP)	(14.2)	(12.2)	(6.9)	(5.7)	(7.9)	(6.7)	(5.0)
External public debt (% of GDP)	36.0	41.8	45.3	42.1	44.2	43.1	42.4
Debt service ratio (% of GDP)	1.2	1.4	1.7	1.7	1.8	1.7	1.6

e = estimated, f = forecast, FY = fiscal year, GDP = gross domestic product,
*including net lending.
Sources: International Monetary Fund. 2016. *Tonga: Article IV Consultation. IMF Country Report No. 16/178. June 2016.*

[24] Government of Tonga Fiscal Strategy. Available at: http://www.finance.gov.to/sites/default/files/PR_GoT_Fiscal_Strategy_02Mar2017.pdf. Ministry of Finance and National Planning. Nuku'alofa.

[25] IMF. 2015. *Tonga: 2015 Article IV Consultation-Staff Report.* April 2015. IMF Country Report No. 15/107.Washington, DC.

50. There were improvements on the revenue side, as total revenues excluding grants increased from 18% of GDP in FY2012 to 23.7% of GDP in FY2016. This was largely driven by increases in excise and customs revenues, which were outside the program's scope of policy actions, although they could be considered part of the JPRM efforts. Domestic revenues from sales and consumption taxes increased by about 5% each year from FY2013 to FY2016.[26] Revenue increases were attributed to improved revenue collection efficiency and new and/or increased excise taxes on unhealthy foods, alcohol, tobacco, and gasoline, among other items (para. 67).

51. The program compared the 2010 PEFA ratings for five items with self assessment ratings prepared by the MFNP in 2014 (the most recent external PEFA assessment has yet to be undertaken).[27] Results from the self assessment showed improvements in three out of five items, including a jump from "C" to "A" in (i) classification of budget and (ii) oversight of aggregate fiscal risks from other public sector entities, and a jump from "C" to "B" in (iii) composition of expenditure outturn compared to original approved budget (Table 2). Although the external PEFA assessment that will validate these improvements is still pending, these gains represent a step toward improving the credibility, comprehensiveness, and transparency of the budget. However, the 2014 PEFA self-assessment noted that there was no improvement for (iv) multiyear perspective in fiscal planning, expenditure policy, and budgeting. In addition, the self-assessment's rating on (v) transparency, competition, and complaints mechanisms in procurement declined from a "C+" to a "D". Based on these PEFA ratings, results of the targeted improvements were mixed for the items analyzed. The government is implementing its Public Financial Management Reform Roadmap, 2014/2015–2018/2019, to close gaps identified in both assessments through the JPRM and development partner TA.[28]

Table 2: Comparison of Selected Indicators under the 2010 External PEFA Ratings and 2014 PEFA Self-Assessment Review

Items	Overall Rating (2010)	Self Assessment (2014)
A. Credibility of the budget		
2. Composition of expenditure outturn compared to original approved budget	C	B
B. Comprehensiveness and transparency		
5. Classification of the budget	C	A
9. Oversight of aggregate fiscal risk from other public sector entities	C	A
C. Budget cycle		
C.1. Policy-based budgeting		
12. Multiyear perspective in fiscal planning, expenditure policy, and budgeting	C	C
C.2. Predictability and control in budget execution		
19. Transparency, competition, and complaints mechanisms in procurement	C+	D

Source: Tonga's Public Financial Management Reform Roadmap, 2014/2015–2018/2019; PEFA website https://pefa.org/country/tonga

[26] Taxes on income and profits remained flat during the same period. However, nontax revenue increased from 2.5% of GDP in FY2013 to 4.4% of GDP in FY2016.

[27] Results of the 2014 self assessment can be found in Tonga's Public Financial Management Reform Roadmap, 2014/2015–2018/2019. PEFA is a multi-agency partnership program sponsored by the World Bank, the International Monetary Fund, the European Commission, the United Kingdom's Department for International Development, the French Ministry of Foreign Affairs, and the Royal Norwegian Ministry.

[28] Public Financial Management Reform Roadmap, 2014/2015–2018/2019. Ministry of Finance and National Planning. Kingdom of Tonga. Nuku'alofa.

2. Program Outputs

52. **Output 1: Strengthened public financial management.** There were two performance targets: (i) programs defined for key ministries and reflected in the 2014 budget to facilitate program budgeting, and (ii) review of the national procurement policy and procedures. The performance indicators and policy actions related to this output were accomplished (Appendix 1). Meeting these targets contributed to improved public financial management as the targets provided a basis for program budgeting and better alignment between expenditures and policy priorities. The FY2014 budget incorporated program objectives and results, and strengthened links between ministry and agency plans and funding commitments. In particular, internal controls were put in place for budgetary transfers which were monitored by the MFNP to ensure compliance with the regulations.

53. The MFNP also designed and implemented a 3-year rolling medium-term budgeting framework which was integrated with the corporate planning process. This is to ensure that ministries', departments', and agencies' corporate plans and budgets are internally consistent, and thus provide a better picture between the outputs of these institutions and available resources. In the medium term, the government indicated its plan to create a tracking system to identify prospective costs at the program and subprogram levels, as well as to provide information on the forthcoming costs of other high priority objectives associated with the National Development Strategy.

54. A review of the government's procurement policies and procedures was completed in July 2013 with support primarily from the Government of Australia. The final report was approved by the Cabinet in August 2013. It was aimed at strengthening the government procurement system through a regulatory framework review, staff capacity improvements, improved public access to procurement information, an appropriate complaints system, and improved transparency and accountability.[29] One of the direct results of the action plan was the establishment of a Central Procurement Unit in the MFNP, which now oversees all public procurement while providing capacity building for procurement officers in line ministries to improve compliance with procurement best practice standards. Despite improvements brought about by the new process, the government has continued to encounter difficulties implementing procurement reforms, especially in cascading the revised procedures to line agencies, which continue to lack procurement capacity and familiarity with procurement regulations. Notwithstanding these difficulties, the MFNP indicated that compliance with formal procurement processes has improved by 10% between FY2014 and FY2015.[30] Given that it takes a long time to firmly embed procurement process reforms in the bureaucracy, it may still be too early to clearly ascertain whether the new system could deliver better value for money and free up resources.

55. **Output 2: Strengthened fiscal policy.** The performance target pertaining to the approval of two new tax regimes is achieved. The small business tax regime (i.e., Small Business Tax) was approved by Parliament in 2013 and was implemented from 1 January 2014. This tax regime for small businesses (not companies) is directed toward business entities with an annual turnover of less than $100,000 to allow them to pay an up-front lump-sum tax instead of submitting full tax returns.[31] These changes have

[29] Areas needing attention were low capacity within procurement units of various ministries and inadequate staffing.

[30] World Bank, 2016. *Strengthening Public Financial Management Reform in Pacific Island Countries*. Washington, DC.

[31] Before the passage of this Act, businesses were taxed at 10% for chargeable income between

simplified tax filing procedures and reduced record keeping requirements for small businesses. The changes have also resulted in reduced administrative costs for the Ministry of Revenue and Customs, and have improved tax compliance and increased formal registrations of small businesses.[32]

56. The passage and approval of the Seabed Minerals Act on 1 January 2014 could facilitate investments in mineral resources and help ensure equitable sharing of benefits from prospective deep-sea mining activities that are currently at exploration stage. The act is essentially a tax that combines royalties, a corporate income tax, and a resource rent tax.[33] Both of these new taxes could potentially broaden the tax base and increase compliance. While there are still no significant underwater mining operations, a few seabed explorations are underway. Nonetheless, it will require a long time—well beyond the program's short duration—for tax revenues from this act to materialize. This should have been properly considered during program design.

57. **Output 3: Improved structural reform implementation.** This output, which represented a substantial proportion of the program, had three performance indicators (Appendix 1). Two of the output targets were partially achieved while the third was not achieved.

58. The first target under this output involved the liquidation and rationalization of state-owned enterprises. Under the program, the Tonga Investment Limited was liquidated in 2015 and its remaining assets were transferred to Tonga Asset Managers and Associates Limited, which effectively inherited its management and operations.[34] In addition, Home Gas, the retail arm of Tonga Investment Limited, was sold to Tonga Power Limited in March 2013. Both of these transactions simply represented a transfer of assets and ownership between PSEs. However, there is probability that these transactions could pave the way for eventual privatization. A third transaction was more successful: the concession agreement for the International Dateline Hotel, previously a PSE, was concluded with the International Tanoa Group in FY2016. While this was way past the target date of 31 July 2013, the hotel is now the largest operating hotel in Tonga and is expected to benefit from the anticipated tourism expansion.[35] On the whole, the performance target was partly achieved.

59. The second target under this output was a reform and restructuring package for the Tonga Communications Corporation (TCC). The package was approved by the cabinet in August 2013. After considering several options, including privatization, restructuring, and the implementation of a management contract, the Cabinet agreed to the privatization of between 49% and 51% of the government's shares in TCC. The Ministry of Public Enterprises was directed to engage a transaction agent to lead the privatization process. However, progress has been stalled due to concerns raised by TCC management and its employees' union regarding the absence of a consultative process. This envisaged

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$7,400-$30,000, and 20% on the chargeable income of $30,001 and above. The new tax regime is divided into four rates as follows: (i) turnover $0–$10,000 at $100 flat; (ii) turnover $10,001–$30,000 at $250 flat; (iii) turnover $30,001–$50,000 at $500 flat; and (iv) turnover $50,001–$100,000 at 2%.

[32] Government of Tonga. Ministry of Finance and National Planning. 2014. *Budget Statement. 2014/2015. Nuka'alofa; IMF. 2014. Tonga. 2014 Article IV Consultation—Staff Report*. Washington, DC.

[33] Royalties are payments made by the mining company to the government at a range of 2%–4% ad valorem for minerals, and around 10% for oil. Corporate income tax remains at the current level of 25%, while the rent resource tax is applied to companies with excess profits above the required rate of return.

[34] Tonga Asset Managers and Associates Limited was established as a public sector enterprise in 2011. It consolidates and manages government assets by exploring new commercial and business opportunities.

[35] Occupancy rate was estimated at 39% in April 2017.

output indicator is therefore assessed *not achieved*. The status of recent PSE reforms in Tonga is summarized in Box 1.

Box 1: Public Sector Enterprise Reforms in Tonga

Tonga has 15 active public sector enterprises (PSEs) involved in a range of commercial activities, including utilities, transport, banking, and communications. In 2014, these PSEs represented 19%–23% of the country's total capital stock and contributed roughly 7% of GDP. PSE profits exceeded government transfers during 2010–2014, with the PSE portfolio yielding a net surplus of $19 million (an annual average of 0.9% of GDP). Since 2009, Tonga has been implementing a broad-based PSE reform program, including the removal of ministers from PSE boards; adopting objective performance targets supported by improved transparency and accountability; contracting out noncore activities; and merging small, nonprofitable PSEs to achieve economies of scale.

PSEs are also required to provide services to communities on noncommercial terms through community service obligations (CSOs). These CSOs are budgeted and provided for by the government rather than cross-subsidies to PSEs. This CSO framework is expected to increase transparency, provide incentives for PSEs to focus on achieving commercial return, and allow the government to choose from range of CSO suppliers, thus enhancing value for money. Most of these reforms have affected all PSEs in Tonga (i.e., Tonga Airports, Tonga Power, Tonga Ports, and Tonga Water Board), and have also produced sharp improvements in return on assets. Tonga Water Board, which has seen the most rapid improvements in terms of productivity, was able to realize improved collections.

The adoption of a PSE divestment and ownership policy in 2015 has led to a privatization and reform pipeline, with high-level reform strategies being laid out for each PSE. As a result of these reforms from 2009–2015, Tonga now has one of the Pacific's best-performing public enterprise portfolios. It is expected that reforms in governance and the ownership structure of individual public enterprises, along with improvements in service delivery arrangements, will further improve portfolio performance.

Sources: ADB. 2016. *Finding Balance 2016: Benchmarking the Performance of State-Owned Enterprises in Island Countries*. Manila and IED evaluation.

60. The third target under this output concerned the passage of legislation to improve the regulatory environment. The amendment to the Registration of Business Names Act was approved by Parliament in 2013, and its implementing rules and regulations approved a year after. These amendments have reduced compliance costs by simplifying and speeding up the registration process through electronic registration of new businesses. The new online registry system, which covers registration of companies, business licenses, and business-name registration, was launched in December 2014. The system provides businesses with the opportunity to apply only for the above, and to carry out searches on the online registry. To date, this has resulted in the registration of about 2,000 companies, 4,000 business licenses, and 1,000 business names.[36] However, there are still areas for improvement such as the need to install new modules that would generate better business data reporting and classification. The registry also needs to be connected to the Ministry of Revenue for tax purposes.

61. The passage of the Receivership Bill, which is expected to enhance the business regulatory framework, has progressed but at a slower pace.[37] It was approved at the House Committee level in September 2015. However, its approval was deferred by the Privy Council in November 2015 and has been stalled for 2 years. The main issues for the

[36] Filling up of forms is now much faster, taking about 3–4 minutes to complete four pages.

[37] Specifically, the Bill is aimed at providing protection to both creditors and businesses, reduce uncertainty on legal entitlements, and prevent early exit of businesses with short-term financial problems.

deferment were the need for further review on land ownership as well as the power of the receivers and the courts in executing receivership matters. Land ownership has always been a sensitive issue, so this should have been anticipated. The output indicator is assessed partly achieved.

C. Efficiency

62. ADB supported the program with a grant of about $4.5 million. In estimating the grant amount, factors that were taken into account included budget support from other development partners, the government's financing requirements and commitment to pursue its reform agenda, and the scope of the proposed policy actions. However, the grant was tied to budget support and, as such, was not related to any estimation of adjustment costs of reforms.

63. Some benefits from this type of program could only materialize toward the end of the grant period (or well beyond the grant period), as they were dependent on proposed policy actions such as tax legislation being passed first. Over time, increases in domestic revenue and higher returns from more efficient public enterprises could reduce future development financing needs. A good example is the Seabed Minerals Act of 2014. A few extractive activities to be covered by the act, such as seabed mining, are prospective in nature and will require a relatively long gestation period before economic rent can be collected.

64. The program supported a single-tranche operation, which meant that policy actions were accomplished before grant effectiveness. In compliance with the grant financing requirements, full proceeds of the program were used to support the budget. In terms of process efficiency, the program did not encounter any delays, and the actual grant became effective earlier than expected. Timely disbursement enabled the government to moderate deficit spending pressure in the FY2014 budget. Thus, the program is assessed efficient in the use of resources.

D. Sustainability

65. A sustainable fiscal position was not achieved, and it is unlikely that underlying issues affecting fiscal sustainability, particularly relating to the public wage bill, will be addressed in the medium term (paras. 47-49). Building a sound fiscal position will require far-reaching measures that could help reduce or stabilize the public wage bill, enhance revenue generation, and increase private sector participation.

66. Tonga's risk of debt distress remains moderate, with public debt projected to be about 48.2% of GDP in FY2017. The government's debt policy limits concessional borrowing and prohibits external commercial borrowings. While this is prudent, it fosters dependence on grant assistance and creates enormous pressure to increase revenues and restrain current expenditure.

67. Improvements in tax collection, decreased exemptions, and increased and/or new excise taxes starting in FY2015 are expected to improve the share of total revenue to GDP to around 24% by FY2017 (para. 50). However, the fiscal deficit is expected to persist, largely because the cost-of-living allowance for public sector employees was increased in FY2014 and FY2015.

68. The government was unable to restrain wage increases because of political economy factors, but ultimately restraining wages is a short-term fix. Tonga needs a

more sustainable way to control expenditures that is both feasible and politically justifiable. The Cabinet in 2016 approved a new remuneration framework aimed at laying the foundation for performance-related pay by ensuring that similar jobs receive similar pay across the public service spectrum. Over time, this is expected to generate cost savings by stabilizing automatic salary progressions and universal pay settlements. Despite this, the public wage bill is likely to remain high over the medium term since the public sector's size relative to the economy will remain large, as is the case in most small states.

69. ADB approved hybrid financing ($3 million grant and $3 million loan) for subprogram 1 of a programmatic approach,[38] with supplementary cofinancing from development partners amounting to $7.8 million. Subprogram 2 was approved on 29 May 2017.[39] An additional subprogram from ADB is scheduled for approval in 2018. Both approved subprograms have the same intended outcome: improved fiscal position and business environment. This highlights the fact that Tonga's fiscal position remains strained and more work is needed to address it.

70. Institutional capacity remains thin in terms of technical and managerial resources. This has been compounded by the need to implement successive reform agendas through the years and the complex nature of those reforms, particularly legislative actions. This has created a real risk of overstretching government staff—a risk that has been exacerbated by heavy staff turnover within the bureaucracy, which could impede all aspects of future reform programs.

71. The privatization measures under the program had mixed results (paras. 57-59), which strongly suggests that deeper structural reform measures are needed to spur private sector participation in the economy. In small island economies, the degree to which privatization is supported and attainable should be adequately assessed and a full range of alternatives, such as public–private partnerships, discussed with the government. Such arrangements could be much more attractive to outside investors.

72. Results of targeted improvements in PEFA ratings were likewise mixed (para. 51). Additional measures are needed to increase the likelihood that initial gains in public financial management are sustained and improved upon. Such measures might focus on providing clearer guidelines and regulations in areas such as procurement and expenditure policy and budgeting.

73. The government has shown and continues to exhibit a strong commitment to the reform measures supported by the program. However, policy reversals are possible because of political economy factors. Other key risks include political volatility, vulnerability to natural disasters, and the economy's reliance on remittances.[40] These could undermine reform resilience and thwart momentum for reform built up by the program. On the whole, program sustainability, in terms of sustaining outcome and outputs, is assessed less than likely sustainable.

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[38] ADB. 2016. *Kingdom of Tonga: Building Macroeconomic Resilience Program (Subprogram 1).* Manila.

[39] ADB. 2017. *Kingdom of Tonga: Building Macroeconomic Resilience Program (Subprogram 2).* Manila.

[40] Tonga had experienced civil service strike in the past because of failure to come up with acceptable remuneration and hiring measures.

CHAPTER 4

Other Assessments

A. Development Impact

74. The DMF indicated that the targeted impact was achieving fiscal stability. This was to be measured by the achievement of a medium-term external debt-to-GDP ratio of 35% by FY2017 (from a baseline of 40.3% in FY2013). Recent data indicate that the envisaged impact was unlikely to be met. IMF's estimates for public external debt were 43.1% of GDP in FY2016 and 42.4% of GDP in FY2017, largely driven by debt servicing of loans contracted in the late 2000s. In retrospect, the impact performance target formulated during program preparation should have been more realistic. Contribution, instead of achievement or attribution, could have been a more realistic approach in formulating the program's intended impact.

75. The program created a more conducive environment for reform and enhanced the government's capacity to formulate policy and manage the reform process. Reforms initiated under the program helped improve the business climate, and the government is moving ahead with reforms to promote private sector activity and improve fiscal management in coordination with ADB and other development partners. However, political-economy considerations, especially in the case of the Receivership Bill, entailed broader and lengthier consultations with stakeholders during program implementation.

76. The program helped sustain the government's momentum to reform even in a period of economic downturn. Progress was made in ensuring that key legislations were passed (paras. 55–56). Reform partnerships with development partners have remained strong via the JPRM. Indeed, the value of open dialogue between the government and its development partners has proven to be one of the most important elements of the program. However, these strengths were offset by weaknesses such as the program's limited success in promoting private sector participation and its failure to enhance fiscal space. Therefore, the program's development impact is assessed *less than satisfactory*.

B. ADB Performance

77. ADB conducted regular visits and follow-up meetings through the joint ADB–World Bank liaison office, and was also active through the JPRM. The stakeholders interviewed indicated that they were satisfied with ADB's performance and appreciated the support provided during program implementation.

78. However, the program suffered from weaknesses in program design and preparation. Several performance indicators in the DMF were poorly defined and/or unrealistic. Fact-finding and appraisal missions were undertaken on a limited scale. More time could have been spent on diagnostics and dialogue at the appraisal and design stages. The grant was negotiated on 19 July 2013, 3 days after the appraisal mission, and approved just 2 months later (para. 23). More time could have been spent on diagnostics and dialogue at the appraisal and design stages. This could have resulted in

the program design not taking into careful account the linkages between policy actions, outputs, outcome, and impact.

79. ADB identified three key risks during program preparation: (i) political consensus needed to mount fiscal and state-owned enterprise management reforms proves more difficult to achieve than anticipated given elections in 2014; (ii) staff turnover leaves insufficient qualified personnel to manage implementation of program elements; and (iii) given a high degree of vulnerability to shocks, fiscal outcomes could diverge from what is anticipated in the budget (footnote 3). However, it overlooked the fiscal risks inherent in a large public sector, and the risk of intermittent pressure for wage increases. Although a program completion report was prepared, it was based on desk review and in-country consultations; a program completion mission was not fielded. Such a mission might have enabled ADB to better assess the adequacy of program design and results post-project. Thus, ADB's performance is assessed less than satisfactory.

C. Borrower and Executing Agency Performance

80. Despite the difficult institutional environment, MFNP staff coordinated well with ADB staff in reviewing the program's progress and in implementing reform measures. The institutional arrangement through the MFNP's Budget Support Management Committee allowed the program to move ahead. There were no major changes in the implementation arrangements during program implementation, indicating that the original arrangements were satisfactory.

81. The government's solid ownership of the program helped bolster the credibility of the reforms. All policy actions in the policy matrix were complied with, including the grant covenants. Likewise, the government coordinated well with other development partners in identifying and monitoring priority reform areas and actions via the JPRM. The performance of the borrower and the executing agency is assessed satisfactory.

CHAPTER 5

Overall Assessment, Issues, and Lessons

A. Overall Assessment

82. On the whole, the program contributed to easing fiscal pressure by providing quick and much needed budget support. Government ownership of the program was strong, and the program was well integrated into the national agenda. The program also supported efforts to broaden coordination of reforms with other development partners. However, the program failed to adequately address a number of lingering problems. The government's fiscal position has remained precarious. Also, the program could have performed better in providing support for expenditure management, particularly vis-à-vis the public wage bill, and in deepening private sector involvement in the economy.

83. Neither the envisaged program outcome nor the impact were achieved. Program reform measures failed to result in Tonga achieving a favorable fiscal position. Looking ahead, much more needs to be done to address Tonga's fiscal soundness and improve the environment for private business—critical factors in ensuring the sustainability of ongoing and future reform measures. Overall, the program is assessed less than successful (Table 3).

84. The program's components and policy actions largely reflected conditions on the ground related to Tonga's fiscal position, PSEs, and public financial management. The program also conformed with the development strategies of both the government and ADB. However, the program had design deficiencies. The link between outputs (and the specific performance indicators and policy actions) and the intended outcome and impact was weak. Achieving the targeted outcome would have required a longer project duration and additional direct measures on the expenditure side that were not tackled under the program. These could have brought down the deficit and improved the fiscal situation (paras. 33–43). Thus, the program is assessed less than relevant.

85. The intended outcome of a sustainable fiscal position was not achieved. The fiscal balance (excluding grants) has remained in deficit even after program completion. Of the three outcome performance targets, one was met, one was partially met, and one was not met. The target on increased revenue mobilization was achieved, while the target on improved PEFA ratings was partially achieved. However, the most important performance target—maintaining a sustainable fiscal outturn—was not met (paras. 47–51).

86. In terms of outputs, although three out of six indicators were achieved, these did not deliver the targeted outcome. The targeted outputs, as configured, could not have resulted in a sustainable fiscal position. Delivery of other outputs and reform measures, beyond what the program had envisaged, was needed. (paras. 52–61). The program is assessed less than effective.

87. The program supported a single-tranche operation, which ensured that policy actions were completed before grant effectiveness. There were no implementation delays. The grant financing was tied to budget support and, as such, it was not related to any estimation of adjustment costs of reforms (paras. 62–64). Thus, the program is assessed efficient in its use of resources.

88. A sustainable fiscal position was not achieved, as Tonga's fiscal deficit persists and it continues to rely on development partner financing for budget support. It is unlikely that underlying issues (particularly relating to the public wage bill) will be addressed in the medium term. Building a sound fiscal position will likely require far-reaching measures to help reduce or stabilize public sector wage bill, enhance revenue generation, and increase private sector participation in the economy (paras. 65–73). Thus, the program is assessed less than likely sustainable.

Table 3: Overall Assessment of Program Performance

Evaluation Criteria	PCR	PPER	Key Reasons for Disagreements and Comments
Relevance	Highly relevant	Less than relevant	Deficiencies in design reduced program relevance.
Effectiveness	Effective	Less than effective	The outcome of sustainable fiscal position was not achieved. Achievement of outputs was mixed and did not result in the envisaged outcome.
Efficiency	Efficient	Efficient	
Sustainability	Likely sustainable	Less than likely sustainable	Underlying issues related to fiscal sustainability are not likely to be addressed in the medium term. Institutional capacity remains thin and a risk of policy reversal remains because of political-economy issues. Increasing private sector participation in the economy has to be prioritized.
Overall assessment	**Successful**	**Less than successful**	
Preliminary assessment of impact	Not rated	Less than satisfactory	Envisaged impact on fiscal stability was unlikely to be met. Limited progress was made to improve private sector participation or enhance fiscal space—two long-standing weaknesses.
Borrower and executing agency	Satisfactory	Satisfactory	
Performance of ADB	Satisfactory	Less than satisfactory	Inadequate program formulation, especially risk assessment.

ADB = Asian Development Bank, PCR = program completion report, PPER = program performance evaluation report.
Source: ADB Independent Evaluation Department.

B. Issues

89. **Deficiencies in program design.** The program's design and monitoring framework was of poor quality. More attention could have been devoted during program formulation in setting up the logical linkages between policy actions and program outputs, outcome and impact. Some of the performance targets were ambitious and could have been conservatively formulated, taking into consideration the program's

limited timeframe for implementing reforms. In improving the fiscal space, the program could have involved direct expenditure measures as well, instead of largely dependent on the enactment of revenue policy actions that involved the approval of two bills.

90. **Insufficient risk assessment.** A carefully-prepared risk assessment could have pinpointed key factors that could undermine the program. The public sector wage bill has been a major fiscal risk which was not given due consideration during program preparation. The Development Policy Letter from the Government of Tonga during program preparation indicated that the government remained fully committed to maintaining the wage bill at an affordable level. However, the program design focused mainly on the completion of revenue policy actions. It was implicitly based on the assumption that restraining the wage bill could be maintained over the medium term to increase the likelihood of achieving a more stable fiscal position. This proved to be unrealistic since it was difficult to control public service wage hikes due to political economy considerations. The share of public sector in the economy remains large, and a case for considering its size and better risk assessment in any future reform program would have to be undertaken. Other risks that could have been considered was the possibility that implementation of legislative initiatives could be deferred as what happened in the case of the Receivership Bill and the time necessary to ensure increased private sector participation in PSEs.

91. **Lack of vigorous measures to enhance private sector participation.** Privatization measures under the program had mixed results. Given the long gestation periods in establishing a conducive business environment and in deepening of public sector enterprise reforms, a more aggressive approach to enhance private sector involvement in the economy could have been encouraged under the program. The degree to which privatization is supported and attainable could have been adequately assessed and discussed with the government, including technical and political feasibilities of the full range of options.

C. Lessons

92. **In small island economies, fiscal consolidation measures should take into account the size of the public sector.** The role and magnitude of the public sector in a small, island economy and sporadic wage increases for civil servants put pressure on recurrent expenditure. These make it difficult to manage fiscal expenditure over time. A small economic base limits areas for alternative employment opportunities. This could imply that the share of the public sector in the economy would remain large in the longer term. Thus, there is a case for considering the size of the public sector in any future reform program.

93. **Short-duration programs should consider time lags for policy actions.** A program of short timeframe should adequately reflect the time lags that usually occur in implementing policy actions. It would be difficult for a short-duration program, even with up-front delivery of vital reforms, to achieve indicators involving external debt-to-gross domestic product, revenue mobilization, sustainable fiscal outturn, and improvements in Public Expenditure and Financial Accountability ratings due to time lags of these actions. The magnitude of the effects of these policy measures could be difficult to determine. As such, performance indicators would have to be realistically formulated when designing reform programs, taking into consideration the focus, timing and extent of the reform measures to be adopted.

D. Follow-Up Actions

94. As inputs to future operations in Tonga, the evaluation suggests the following:

95. **Measures to address the public sector wage bill issue need to be closely monitored.** Government is now in the process of embarking on a comprehensive civil service reform, including a new remuneration framework. ADB should continue to monitor developments on these areas in view of the political-economy implications. In particular, ADB could assist the government in assessing options other than restraining wage increases. A more realistic approach that would be technically feasible and politically justifiable may have to be explored.

96. **Fiscal consolidation measures will need focused attention and monitoring.** Building a sound and sustainable fiscal position will be a persistent challenge for Tonga. ADB should continue to monitor developments related to fiscal consolidation, especially on the expenditure side. Special attention should be given to initiatives pertaining to stabilization of the wage bill, building up of fiscal buffer, and expenditure management.

97. **Continued engagement is needed to sustain reform momentum.** ADB should continue to leverage its support for reforms through its engagement with the government and development partners in the areas of business regulatory environment, public sector remuneration and performance management., Specifically, capacity-building measures need to be given greater impetus in future operations. This calls for continuous engagement through advice and guidance via TAs, and support that could be linked to the success of reforms. Reinforcing reforms on these areas could facilitate future investment, and enhance the country's economic growth prospects. ADB could also re-assess its mix of instruments to ensure greater development results in Tonga. In particular, ADB may consider the use of wholly grant support in its operation in view of Tonga's precarious fiscal position and external debt vulnerability.

Appendixes

APPENDIX 1: DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Indicators	Assessment	Program Achievements
Impact Fiscal stability is achieved	Government achieves its medium-term external debt-to-GDP target of 35% by FY2017 (FY2013 baseline: 40.3% of GDP)	Not achieved	The IMF estimated that for FY2017, external debt-to-GDP was at 42.4%, 7% higher than the target. This is largely driven by debt servicing to loans contracted in the late 2000s, which puts the debt service ratio to 1.6% of GDP in FY2017. Also, the policy of zero non-concessional borrowing has been relaxed, which could impact the country's debt portfolio.
Outcome Sustainable fiscal position	Revenue mobilization reaches 20% of GDP by FY2016 (FY2013 baseline: 18.2%)	Achieved	Government revenues reached 23.7% of GDP in 2016, compared with 19.6% in 2013, driven by increases in sales taxes and consumption taxes. Nontax revenue also increased from 2.5% of GDP in 2013 to an estimated 3.2% of GDP in 2016.
	Sustainable fiscal outturn maintained over FY2014–FY2016 (FY2013 baseline: overall balance excluding grants and concessionary loans not to exceed a deficit of 3.3% of GDP)	Not achieved	Overall fiscal balance (excluding grants and concessional loans) remained in deficit, averaging about 6.8% of GDP during FY2014–FY2016. This fiscal gap was higher than the program's performance target of a deficit not exceeding 3.3% of GDP.
	Improvements in the PEFA ratings for Tonga (2010 baseline: "C" for composition of expenditure; classification of the budget; oversight of aggregate fiscal risk from other public sector entities; and multiyear perspectives in fiscal planning, expenditure policy and budgeting; and "C+" for competition, value for money, and controls in procurement)	Partly achieved	Results from the self-assessment conducted by the Ministry of Finance and National Planning in 2014 showed slight improvements relative to the 2010 PEFA assessment. In particular, there was jump from "C" to "A" in (i) classification of budget and (ii) oversight of aggregate fiscal risks from other public sector entities; and an increase from "C" to "B" in (iii) composition of expenditure outturn compared to original approved budget. However, there was no improvement for multiyear perspective in fiscal planning and expenditure policy and budgeting. The rating for transparency, competition, and complaints mechanisms in procurement declined from "C+"

Design Summary	Performance Indicators	Assessment	Program Achievements
			to "D." Tonga's Public Financial Management Reform Roadmap, 2014/2015–2018/2019, aims to narrow the gaps identified in both assessments.
Outputs 1. Strengthened public financial management	Programs defined for key ministries and reflected in the 2014 budget to facilitate program budgeting are approved by 31 July 2013	Achieved	The FY2014 budget reflected the link between program goals, objectives, intended outcomes, outputs, and resources over a 3-year rolling period. It also identified the key functions, expected results, and budget envelope for each of the ministries and line agencies.
	A review of the national procurement policy and procedures is completed by 31 July 2013	Achieved	Comprehensive procurement reform was completed in July 2013 with substantial support from the Government of Australia. The resultant Procurement Reform Strategy (Action Plan) was approved by the Cabinet in August 2013. It addresses several issues pertaining to regulatory framework review, staff capacity improvements, public access to procurement information, the complaints system, and ensuring transparency and accountability.
2. Strengthened fiscal policy	New presumptive small and medium-sized enterprise tax regime and extractive industries tax regime submitted for cabinet approval by 31 July 2013	Achieved	The new Small Business Tax and the Seabed Minerals Act were both approved by Parliament in July 2013 and implemented from 1 January 2014. The Seabed Minerals Act could facilitate investments in mineral resources and ensure equitable sharing of benefits from prospective seabed mining activities that are currently at exploration stage.
3. Improved structural reform implementation	One state-owned enterprise, Tonga Investment Limited, is liquidated and rationalization is initiated for another state-owned enterprise by 31 July 2013	Partly achieved	Tonga Investment Limited was liquidated and its remaining assets were transferred to Tonga Asset Managers and Associates Limited. In 2013, Home Gas, a subsidiary of Tonga Investment Limited was sold to Tonga Power Limited. The concession agreement of International Dateline Hotel was completed with the Tanoa Hotel Group. Commercial operations started in FY2016.
	A reform and restructure plan is adopted for	Not achieved	Cabinet approved the TCC's restructuring in August 2013. It

Design Summary	Performance Indicators	Assessment	Program Achievements
	Tonga Telecommunications Corporation by 31 July 2013		agreed to the privatization of about 49 percent and 51 percent of the government's shares in TCC, with the Ministry of Public Enterprise directed to proceed with the engagement of a transaction agent. However, progress has been stalled due to concerns raised by the TCC labor union regarding the absence of a consultative process.
	Government policies to improve the regulatory environment, including submission of the Receivership bill and the amendment to the Registration of Business Names Act, 2002 accomplished by 31 July 2013	Partly achieved	The Receivership Bill was approved at the House committee level in September 2015 but its approval has been deferred by the Privy Council Decision for further consideration. Main issues revolved around land ownership, and the power of the receivers and the courts in executing receivership matters. The Registration of Business Names Act (Amended) was passed in 2013. Its implementing rules and regulations were approved in 2014.

FY = fiscal year; GDP = gross domestic product; IMF = International Monetary Fund; PEFA = Public Expenditure and Financial Accountability; TCC = Tonga Telecommunication Corporation.
Sources: Independent Evaluation Mission and IMF Article IV documents.

APPENDIX 2: DEPTH AND QUALITY OF POLICY ACTIONS

1. This section reviews the depth and quality of the policy actions based on the approaches developed by the World Bank's Independent Evaluation Group and the Inter-American Development Bank's Office of Evaluation and Oversight. The first approach attempts to capture the depth of policy measures, i.e., the extent to which actions are sufficiently critical to trigger, by themselves, an institutional or policy change. Policy measures that are too process-oriented or easily reversible, or that only indicate intentions, have *low depth*; conditions that can have immediate (but not lasting) impact are usually considered of *medium depth*; and conditions that could, by themselves, trigger long-lasting changes in the institutional or policy environment are considered of *high depth*.[1]

2. The review finds that seven out of the 10 policy actions are assessed to be of *medium depth*. This category includes conditions calling for one-off measures that can be expected to have an immediate and possibly significant effect, but that would need to be followed by other measures for this effect to be lasting. Examples are submission of draft legislation to Congress, reaching a target or benchmarks, and organizational changes. Also, three of the 10 policy actions are considered *low depth*, which by themselves, do not bring about meaningful changes such as preparation of action plans and strategies or intentions to reform. None of the policy actions in this program are considered high depth.

3. The second approach examines several criteria for the assessment of the quality of the policy actions based on these characteristics: (i) relevance, (ii) criticality, (iii) additionality, (iv) measurability, and (v) efficacy. *Relevance* is the extent to which policy actions are relevant to objectives and/or outcomes, and whether there are links with actions from both previous and subsequent operations in case of a programmatic series. *Criticality* is the extent to which policy actions have sufficient institutional depth to trigger policy and/or institutional change. Policy actions that are excessively process-oriented, easily reversible, or only indicate intentions should be avoided. *Additionality* is the extent to which policy actions reflect ADB's value added with respect to the borrower's reform agenda. *Measurability* is the extent to which the expected impact of policy actions is measurable. This largely depends on the quality of the monitoring and evaluation framework and the links between results indicators and policy actions. *Efficacy* is the extent to which policy actions become completed as an output for the results chain. This refers mostly to prior actions such as draft laws, decrees, and strategies that require follow-up steps to be completed.[2]

4. Of the 10 policy actions, six were process-oriented and administrative in nature, and required preparation of procurement review reports, budget documents, and/or reform and restructuring plans for public sector enterprises. The other four policy actions required submission of draft laws to Parliament. These four policy actions were generally relevant in terms of their links to targeted outputs; however, their links to the targeted program outcome (sustainable fiscal position) was less strong. Four policy actions had institutional range as they pertained to the submission of draft laws to Parliament, although significant delay has been encountered in one proposed legislation. The policy actions pertaining to rationalization of public sector enterprises had mixed results because of procedural delays and political economy considerations. In terms of additionality, ADB's support in terms of providing technical assistance and policy dialogue was reflected in the policy actions, especially those pertaining to legislative actions. However, ADB's value addition was low in government functions that were process-oriented in character, such as budgetary framework and procurement processes. Measurability could be difficult to determine due to lagged effects of some policy actions and lack of appropriate metrics in assessing processes. In terms of efficacy, all policy actions were completed. The single-tranche operation ensured that these were to be accomplished prior to grant effectiveness.

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[1] IDB, 2015. 2015 Annual Report. *Technical Note: Design and Use of Policy-Based Loans at IDB*. Office of Evaluation and Oversight, Inter-American Development Bank. Washington, DC.

[2] IEG, 2015. *The Quality of Results Frameworks in Development Policy Operations*, IED Learning Product. Independent Evaluation Group, World Bank: Washington, DC.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
1.1 The FY2014 budget prepared by the Ministry of Finance will be aligned with departmental budgets with national and corporate plan programs and provide a basis for program budgeting and better alignment between expenditures and policy priorities.	Medium	The policy action was important in terms of strengthening PFM, specifically program budgeting since it led to improved alignment between expenditures and policy priorities. The FY2014 budget incorporated program objectives and results, and strengthened links between ministry and agency plans and funding commitments. This policy action was also aligned with previous and subsequent thrusts to improve the planning and budgeting processes.	The alignment of the national budget with departmental budgets anchored on national and corporate plan was critical for internally consistent budget. This provided a clear understanding between ministries, departments, and agencies outputs and available resources. The policy action reflected the government's commitment to implement PFM reforms.	Budgetary function that is recurring in nature was of low additionality. Although TA has been provided in preparing budget frameworks, the government had already taken advance actions in undertaking fiscal and budgetary reforms under the medium-term budget framework.	Measuring the impact of this policy action is tied up with the PEFA assessment, which defines several quantitative and qualitative indicators to assess budget credibility, transparency, predictability and control, and reporting.	The policy action was completed. It contributed to better alignment between expenditures, national strategic goals and objectives, and government policy priorities.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
1.2 The Ministry of Finance will undertake a review of the national procurement policy and procedures with a focus on improving transparency, accountability, and value-for-money in the procurement process.	Low	The policy action was pertinent since it led to the adoption of the Procurement Reform Strategy (Action Plan). This plan addressed issues pertaining to strengthening of the government procurement system, including a review of the regulatory framework, staff capacity improvements, public access to procurement information, the complaints system, and ensuring transparency and accountability. This policy action also was in line with previous and subsequent ADB programs.	The policy action was critical in deepening institutional reform and triggering subsequent action plans, such as capacity building for line ministries and the establishment of a central procurement unit in MFNP to oversee all procurement in the public sector. This policy action also reflected MFNP's institutional depth in implementing reforms.	ADB's value addition was low since the Government of Australia took the lead in this process under the JPRM.	The extent to which the quality of review, including the process and performance indicators could be meaningfully assessed poses difficulties in the absence of widely-accepted standards. Measuring improvements in transparency, accountability, and value for money in the procurement process is captured in the PEFA assessments.	The review was completed and paved the way for the next action steps to be institutionalized.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
2.1 Cabinet will submit to Parliament legislation to create a presumptive tax regime for small and medium-sized enterprises to reduce the administrative burden on the Ministry of Revenue and encourage formalization.	Medium	Submission of legislation on small business tax was deemed relevant to achieve desired outcome. Improving revenue generation was in line with previous and subsequent ADB programs.	The policy action was critical in triggering policy and institutional changes through passage and implementation of the presumptive tax. With the passage of the law, there is some level of institutional depth. Also, there was a consensus among various stakeholders.	ADB added value through TA and policy dialogue that contributed to the formulation of this policy action.	The expected result of the policy action can be measured in terms of increased revenue collection, improved compliance, and reduction in time spent on processing tax payments, among other things.	Submission of the legislation was completed and approved by the Cabinet on the same year.
2.2 Cabinet will submit to Parliament legislation establishing an extractive industries tax regime to ensure equitable sharing of benefits from prospective extractive industry activities.	Medium	Submission of legislation to establish natural resources tax was considered toward meeting the desired outcome. Measures to generate revenue were in consonance with previous and subsequent ADB programs.	Criticality was apparent on this policy action since it could facilitate investments in mineral resources extraction by creating an internationally competitive regime for royalties, corporate tax and excess profits.	ADB added value through TA and policy dialogue.	The expected result of this policy action can be measured in terms of increased revenue collection, improved compliance, and reduction in time spent on processing tax payments, among others.	Submission of the legislation was completed and approved by the Cabinet on the same year.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
3.1 The Ministry of Public Enterprises to liquidate Tonga Investment Limited. This will include the sale of its Home Gas retail operations.	Medium	Liquidation of these PSEs was compatible with efforts to improve structural reform implementation. This was also relevant in terms of its links with actions from previous and subsequent ADB programs.	The policy action was crucial to trigger policy and institutional changes. Actual commitment from the Ministry of Public Enterprises contributed to the institutional depth of the policy action to implement reforms.	ADB added value through TA and policy dialogue that contributed to the formulation of this policy action.	The policy action was measurable to capture the scope of changes in view of ADB support. The expected result from this policy action can be measured by the opportunity costs and efficiency gains of the transaction.	Liquidation of Tonga Investment was completed, including the sale of its Home Gas retail operations. It contributed to the achievement of improved structural reform in Tonga.
3.2 The Ministry of Public Enterprises will have prepared a reform and restructuring plan for Tonga Communications Corporation.	Low	Preparing reform and restructuring plan for TCC was appropriate toward meeting the desired outcome.	The policy action was vital in initiating policy and institutional changes. It would likely open opportunities for competition in the telecommunications sector.	ADB added value through TA and policy dialogue that contributed to the formulation of this policy action.	The policy action was measurable. The expected result of reform and restructuring plan for TCC can be measured in terms of its gains from economic, financial and organizational performance relative to when the government was operating the PSE.	Reform and restructuring plan for Tonga Communication Corporation was prepared and Cabinet approved in 2013. However, progress has since been stalled in view of non-endorsement of reforms by the Cabinet. This was attributed to issues on TCC labor union and the lack of consultative process.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
3.3 The Ministry of Public Enterprises will have taken steps towards better PSEs corporate governance including preparation of a skills-based selection and appointment process for directors of PSEs, achieving full compliance by PSEs with the government's community service obligations (Government Policy Obligations) policy, and achieving at least 60% of SOEs publishing 2012 audited accounts.	Medium	Actions toward improving corporate governance, compliance with the government's community service obligations, and disclosure of audited financial statements were pertinent to the desired outcome.	Criticality was on the high side. The policy action is to complete reform processes within the Ministry of Public Enterprises, which is critical to improving implementation of structural reforms.	ADB added value through TA and policy dialogue that contributed to the formulation of this policy action.	The policy action was measurable in terms of compliance with the new corporate governance arrangements and policies, among others.	The policy action was completed which and was in line with Tonga's Public Enterprise Act.
3.4 Cabinet will have approved a plan for private sector participation (i.e., management contract or concession) in the International Dateline Hotel.	Low	Plans for private sector participation in the International Dateline Hotel was considered important in attaining the targeted outcome.	Criticality was on the high side, as this initiated policy and institutional change. Certain degree of consensus among stakeholders were present. Institutional depth was reflected in the government's commitment to implementing the reform.	ADB added value through policy dialogue that contributed to the formulation of this policy action.	The policy action was measurable in terms of the opportunity costs and efficiency gains associated with private operation of the International Dateline Hotel, as opposed to government operation.	This policy action was completed. However, there was a significant delay between the approval of the plan and the closing of a concession agreement with a private sector firm.

Policy Action	Depth of Policy Action	Quality of Policy Action				
		Relevance	Criticality	Additionality	Measurability	Efficacy
3.5 Cabinet will have submitted to Parliament a Receivership Bill to establish a process of identifying and nominating receivers and establishing clear receivership procedures.	Medium	Submission of the Receivership Bill was deemed relevant to improved structural reforms.	Criticality was on the low side as the government and stakeholders lack consensus.	ADB added value through TA and policy dialogue that it provided to the government.	The policy action was measurable in terms of foreign investment received, number of businesses restructured, and tax revenue, among others.	This policy action was completed. However, the Receivership Bill has yet to be approved by Parliament.
3.6 Cabinet will have submitted to Parliament the proposed amendment to the Registration of Business Names Act, which will simplify the process, lower costs, and facilitate electronic registration of business names.	Medium.	Submission of the proposed amendments on the Registration of Business Names Act was deemed to be relevant to the program's objectives. This is also considered relevant considering the links with actions from previous and subsequent ADB programs.	Criticality was on the high side, as this measure constituted both policy change and institutional change. There was a high degree of consensus among stakeholders. Institutional depth was reflected in the government's commitment to implement the reform.	ADB added value through TA and policy dialogue that it provided to the government.	The policy action was measurable in terms of tangible time and cost savings for business, among others.	This policy action was completed, although there were delays in both approval and adoption.

ADB = Asian Development Bank; FY =fiscal year; JPRM = joint policy reform matrix; MFNP = Ministry of Finance and National Planning; PSE = public sector enterprise; TA = technical assistance; TCC = Tonga Communications Corporation

Source: (i) Independent Evaluation Mission based on Independent Evaluation Group; (ii) Inter-American Development Bank (IDB). 2015. 2015 Annual Report. *Technical Note: Design and Use of Policy-Based Loans at IDB*. Office of Evaluation and Oversight, IDB. Washington, DC. and (iii) Independent Evaluation Group (IEG), 2015. *The Quality of Results Frameworks in Development Policy Operations*, IEG Learning Product. Independent Evaluation Group, World Bank: Washington, DC.

APPENDIX 3: STATUS OF COMPLIANCE WITH GRANT COVENANTS

Covenant	Reference in Grant Agreement	Status of Compliance
1. In the carrying out of the Program, the Recipient shall perform, or cause to be performed, all obligations set out in Schedule 3 to this Grant Agreement.	Article IV, Section 4.01	Complied with
2. The Recipient shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible items financed out of the proceeds of the Grant and to record progress of the Program.	Article IV, Section 4.02 (a).	Complied with
3. The Recipient shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) above.	Article IV, Section 4.02 (b).	Complied with
4. As part of the reports and information referred to in Section 6.04 of the Grant regulations, the Recipient shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (a) the Counterpart Funds and the use thereof; and (b) the implementation of the Program, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.	Article IV, Section 4.03.	Complied with
5. The following is specified as an additional condition to the effectiveness of this Grant Agreement for the purposes of Section 9.01(e) of the Grant Regulations: the Recipient shall have met, to ADB's satisfaction, all conditions for the release of the Grant proceeds as set out in Attachment 2 to Schedule 2 to this Grant Agreement.	Article V, Section 5.01	Complied with
6. The Recipient shall be responsible for the coordination and execution of the Program with the various concerned departments and agencies of the Recipient. The Program Executing Agency shall oversee and coordinate the timely implementation of agreed policy, legal and regulatory actions. The Implementing Agencies shall also be responsible for Program administration, disbursements, and maintenance of all Program records. ADB will work through the Recipient's Budget Support Management Committee mechanism to monitor progress, oversee the implementation of the Program, and guide and direct the activities in the Program Executing Agency.	Schedule 3 of Grant agreement	Complied with
7. The Recipient shall (a) use its best endeavors to ensure the critical Program staff will remain in their position on a full-time basis for a reasonable duration to ensure the continuity in the implementation of the Program; and (b) ensure that all Implementing Agencies will be adequately staffed and provided with the necessary financial, technical, and other resources to perform their functions under the Program.	Schedule 3 of Grant agreement	Complied with
8. The Recipient shall (a) ensure that all policy actions adopted under the Program, as set out in the Policy Letter, including the Policy Matrix, continue to be in	Schedule 3 of Grant agreement	Complied with

Covenant	Reference in Grant Agreement	Status of Compliance
effect for the duration of the Program and subsequently; and (b) make submissions to ADB on the completion of actions under the Policy Matrix by reference to the indicators set out therein.		
9. The Recipient shall keep ADB informed of policy discussions with other multilateral or bilateral aid agencies that have implications for the implementation of the Program, and shall provide ADB with an opportunity to comment on any resulting policy proposals. The Recipient shall take ADB's views into consideration before finalizing and implementing any such proposals.	Schedule 3 of Grant agreement	Complied with
10. The Recipient shall ensure that the local currency funds generated by the Grant will be used to finance the costs relating to the implementation of the Program and other activities consistent with the objectives of the Program and will provide the necessary budget appropriation to finance costs relating to the implementation of reforms under the Program.	Schedule 3 of Grant agreement	Complied with
11. The Recipient, the Program Executing Agency, and the Implementing Agencies shall: (a) comply with ADB's Anticorruption Policy (1998, as amended to date) and acknowledge that ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive or coercive practices relating to the Program; and (b) cooperate with any such investigation and extend all necessary assistance for satisfactory completion of such investigation.	Schedule 3 of Grant agreement	Complied with
12. The Recipient and ADB shall undertake ongoing monitoring and regular formal review of Program performance in the lead up to the Board's consideration of the Program. The Recipient, through the Program Executing Agency, shall establish and maintain a Program performance monitoring system that will include a database on the status of policy actions.	Schedule 3 of Grant agreement	Complied with
13. A Program review shall take place at mid-term. The Recipient shall ensure that ADB will have the opportunity to participate in the review.	Schedule 3 of Grant agreement	Complied with through the Budget Support Management Committee process.
14. The Recipient shall monitor the implementation and outcomes of the Program using a set of indicators and targets that has been agreed to between the Recipient and ADB to assess progress towards meeting the objectives of the Program. For each of the agreed indicators, progress shall be measured against a baseline in 2012. The Implementing Agencies shall review the agreed frameworks every three months to determine progress and identify constraints.	Schedule 3 of Grant agreement	Complied with