

Figure 2. Sectoral Contribution to Gross Domestic Product, at constant prices for the year 1999/00



Fig 1: Construction Annual Growth Rates during the period 1996/97-1999/2000

Budget Statement for Year Ending 30<sup>th</sup> June 2005

*Budget Statement*



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## **1. Introduction**

In this year's Budget statement, I outline the next steps in our continuing reforms, and announce new targeted measures. Both consistency and focus must be applied to overcome global uncertainty and local difficulties, and to achieve our vision – our long-term social and economic goals. The setting for this year's budget is that our challenges have multiplied, but our people's needs have also continued to increase: the needs of our young people, our elders, families on very low incomes – and especially our people on the outer islands. We cannot, and will not, ignore those needs. We are making a concerted effort, through our policies and expenditures, to address these needs and we will enlist the support of our development partners in this endeavour.

## **2. Government's long term vision**

So, at the outset, I would like remind you of the government's vision for the future of the people of this Kingdom.

It is the government's vision that, through the reform program steady progress will be made so that the people of Tonga will enjoy a high overall quality of life, with a high standard of living throughout the Kingdom. We will respect the options of both present and future generations through an adaptive culture, with high values. Our social and economic development structure will feature individual fulfilment, gender equity, political stability and a stable economic and financial environment.

This vision guides the government's macroeconomic policies and budget priorities.

## **3. Budget setting**

### **i. Global Challenges**

The climate of uncertainty, which formed the background to the preparation of the budget last year, has unfortunately continued into this year. Despite the declaration of the end of the official period of hostilities between the coalition forces and Iraq, fighting has continued, while the spectre of terrorism continues to place a cloud of apprehension over the financial and commodity markets. While the impact of SARS has been fortuitously blunted, political instability in the Middle East has resulted in the price of crude oil reaching record levels in the middle of May.

This changing and challenging global policy environment must be considered carefully. It has far reaching implications for our assumptions about future economic growth. Our relative physical isolation of the past has been reduced by the impact of globalisation. Today, policy decisions taken in far away places can have a dramatic effect on our domestic economy.

The global challenges come in many forms. The issue of terrorism and the related issue of border security within a framework of international and regional cooperation must be given high priority. Our defence personnel are serving in the regional peace keeping forces in the Solomon Islands and may soon be deployed in Iraq. Our international obligations under the various United Nations resolutions must be maintained. These are not without cost, and must be financed from the national budget.

The issue of our dependence on remittances must also be considered carefully. Remittances are our largest source of overseas earnings and far outweigh our earnings from commodity exports, tourism and other activities. The growth of remittances has been dramatic in recent years but this should not be taken for granted. As time passes, the strength of relationships between Tongans in Tonga and those overseas are expected to weaken and with it the strength of remittances.

The dependence of the export sector on squash exports was drastically exposed last year when the prices of squash to growers fell to record lows. Some growers failed to receive any proceeds from their exports. Nationally, our total export receipts were pulled down by the lowered returns to this one industry. The sudden decline of fish catches also shows the vulnerability of the fishing industry to forces largely beyond its control. More recently, the financial difficulties faced by the national airline, Royal Tongan Airlines, echoed similar experiences in many other countries.

## **ii. Local Difficulties**

It will be necessary to make short term sacrifices as we nurture our limited resources, if we are to build a fair and prosperous future for our young people of today.

The demographic structure of our society is changing and therefore our policy must be flexible to address these changes. Young people below the age of 21 comprise the majority of our total population. More young people are searching for work today than ever before. More young people are dropping out of school. More people are facing economic hardship in the outer islands. The rate of crime is increasing very rapidly. Drug abuse is also increasing. These are real issues on which we must focus.

A recent survey indicated that internal migration is causing economic hardship for those left behind in the outer islands. Furthermore, about a quarter of households surveyed were deemed to have weekly income below a notional benchmark for basic needs.

These are all factors which must be taken into account in the design of the budget, difficult though they are.

However, the government cannot resolve all the many economic and financial challenges facing the Kingdom in one step.

The government promises only to deliver steady progress and improvement on a step by step and year by year basis. It would be unrealistic to promise that which we cannot deliver.

## **4. Budget Theme**

To pursue our vision in this setting, the theme of the budget for 2004/05 is to “achieve sustainable growth with social equity”. To achieve sustainable growth we must maintain a sound and stable financial environment with low inflation, adequate international reserves, and a sustainable overall budget position. In order to achieve these conditions we must continue with the economic and public sector reform we first embarked on in 2001, including the tax and public enterprise reforms. We must also reform the structure of our economy in order to create more jobs for our young people, and at the same time develop a flexible economy which can adapt rapidly to a changing global economic environment. With a strong flexible economy, we will be more able to address the needs of all the people of Tonga, especially the poor. The government is acutely aware of the economic hardship faced by certain sections of the community, particularly in the outer islands.

## **5. Economic Factors**

I am now going to review in more detail the economic factors in this year’s budget setting.

### **i. International economic situation**

According to the International Monetary Fund, the global recovery has strengthened with global GDP growth averaging 6% at an annualized rate during the second half of 2003. This growth has continued into early 2004. This overall growth level masks wide regional differences. Growth is

most rapid in Asia, especially China, and the United States. Growth in the European Union countries is not so strong with weak consumption growth. The IMF forecasts that growth in the G7 countries will increase from 2.2% in 2003 to 3.5% in 2004, which is well above the trend rate of 2.5%.

Of Tonga's main trading partners, the New Zealand economy continued its strong growth through the second half of 2003 and into early 2004. The current growth phase has averaged 3.7% over five years since 1999, which has been above the long run average. Strong growth in export markets led to strong domestic demand with strong growth in consumption and income. The Australian economy also grew rapidly over the second half of 2003, with GDP expanding at an annualized rate of 5.5%. This growth was based on strong domestic demand, with a strong increase in the rate of consumer spending. Export growth was also strong. The Japanese economy has been more promising than it has been for some time. Japan's GDP increased by 1.6% in the December quarter of 2003 reflecting strong growth in business investment and exports.

## **ii. Domestic economic situation**

It is estimated that the economy grew by 2.9% in 2002/03, higher than the budget projection of 1.9%. This reflects strong activity in the agriculture, tourism, construction, transportation and communication sectors. However, poor performance in the agriculture sector in 2003, with low prices for squash exports, low fish catch rates and lower value added in the transportation, power and telecommunications sectors have caused our GDP estimates for 2003/04 to be lowered to 1.6% from our projection of 2.6% last year.

## **iii. Outlook for 2004/05**

The outlook for 2004/05 is for GDP to grow by 2.8% with agriculture growth projected to form the foundation of a return to faster growth. This projection depends to a large extent on stability and impacts from the external market and the effectiveness of the government's fiscal and monetary policy. The global economy is projected to grow by 4.6% in 2004 and by 4.4% in 2005. This will play a significant role in Tonga's performance in the medium term.

Imports continue to show a strong upward trend, based primarily on strong remittance growth, while exports overall show a slight upward trend. At the same time the government's financial position remains under pressure due to high expenditure commitments.

The current high rate of inflation is expected to stabilize around the 10% mark, although it is too early in the economic cycle to forecast any significant reduction in the current high rate. The external position is stronger than in previous years reflecting the disbursement of concessional external loans and the anticipated growth in remittances as the global economy strengthens. The gross official foreign reserves are projected to remain at current levels.

# **6. Macroeconomic management**

The Government's monetary and fiscal policies will continue to be directed to the twin goals of long-term economic strength and medium-term economic stability.

## **i. Monetary policy**

The two main policy objectives with regard to monetary policy are maintaining an internationally competitive level of inflation and secondly, maintaining the level of the gross official international reserves at a comfortable level, at between 3 to 4 months of import cover. Monetary policy has succeeded in achieving one of its two main targets, by maintaining the gross official international reserves at between 3 to 4 months of import cover. On the other hand, more needs to be done to bring about a low and sustainable level of inflation.

The rate of inflation has continued to be under upward pressure, rising from 10.7% in 2002/03 to an average of 11.6% by December 2003. This has been attributable to imported inflation, coupled with sharp increases in tax rates for imported alcohol and tobacco products. At the same time, the continued deficit position of the government's budget has added to overall aggregate demand, with added upward pressure on domestic demand, although this later eased as credit growth stabilized in the second half of 2003. It is expected that the level of inflation will stabilize at this level for 2004/05, although there is a risk that this assumption could be undermined with the price of crude oil reaching record levels by mid-May 2004. If the price of crude oil continues to rise, then it is expected that the rate of inflation will also rise for 2004/05.

The level of gross official foreign reserves improved in December 2004 and it is expected that this comfortable level will be maintained in 2004/05. The improvement was due in part to the drawdown by the government on its overseas lines of credit, as well as commercial banks seeking to finance the purchase of pa'anga to finance their lending operations.

The value of the pa'anga against the value of the US dollar appreciated during the first 9 months of 2003/04, while the value of the pa'anga against the Australian and New Zealand dollars declined during the same period. These changes have been caused by the movements of capital and investor sentiment, factors which are essentially beyond the influence of government policy. The cost of paying for most of our imports has continued to increase and has contributed to the higher rate of inflation.

On the other hand, the lower exchange rate favours those sectors that rely on the exports of goods and services, which receive higher income.

Monetary policy has been maintained at a tight level in recent months in order to conserve the level of the foreign reserves. This will continue until such time as the gross official foreign reserves have increased to more comfortable levels.

## **ii. National Reserve Bank of Tonga**

As part of strengthening the financial sector, the government will be tabling legislation to revise the Financial Institutions Act. This will enable the National Reserve Bank of Tonga to enhance its supervisory role over financial institutions and ensure that a high level of confidence is maintained by investors and depositors. The government is also considering amendments to the NRBT Act to strengthen its balance sheet and its operational authority so that it can react more effectively to potentially rapid changes in the financial environment.

## **iii. Tonga Development Bank**

The Tonga Development Bank has performed above expectations in recent years. Through prudent lending policies, a focus on the productive side of the economy, and local knowledge and understanding of Tonga's development needs, the TDB makes a special economic contribution. To enable the TDB to increase its services to those sectors of the community who require special support, the government proposes to increase its capital contribution to the Bank in 2004/05. Furthermore, the government is studying other ways to build on the strengths of this local institution without weakening the commercial disciplines that are the key to the continuing success of the Bank and its business customers.

## **iv. Export credit guarantee scheme**

In light of the recent challenges faced by the export sector, the government is considering the option of supporting our export industries by initiating an export credit guarantee scheme. It is expected that the scheme should provide assistance to exporters by guaranteeing receipts of their

export proceeds against certain repayment risks. The government will seek the assistance of experts to develop the legal and operational framework for such a scheme.

## 7. Fiscal policy

The government has formulated a fiscally responsible budget for 2004/05 within the context which I have just outlined. As summarized in Table 1, the 2004/05 budget is based on an overall operating surplus of \$3.6 million. In addition, \$14.3 million will be invested in capital expenditure projects, primarily associated with the final phase of the Cyclone Waka infrastructure restoration in Vava'u and the Niua and continuation of the health services improvement program, in particular, commencing construction of the new Vaiola Hospital. The financing of the -\$10.6 million overall budget balance will be achieved in cooperation with our development partners, based on external concessional loan financing of \$5.5 million net and domestic financing through a \$3 million drawdown in government cash balances and a net \$2 million bond issue.

The full details of the revenue and expenditure components underpinning the budget aggregate figures are presented in Budget Statement Paper 2.

Table 1: Budget Balance (\$ millions)

	Preliminary Outturn 2002/03	Original Estimate 2003/04	Revised Estimate 2003/04	Budget Estimate 2004/05
<b>Total Revenue (1)</b>	<b>99.3</b>	<b>124.9</b>	<b>102.1</b>	<b>117.7</b>
Tax revenue	80.7	83.1	83.6	88.2
Other Revenue	15.7	26.7	15.5	23.8
Grants (in cash)	2.9	15.1	3.0	5.7
<b>Total Operating Expenditure (2)</b>	<b>92.9</b>	<b>114.6</b>	<b>102.3</b>	<b>114.1</b>
<b>Operating Balance (1-2)</b>	<b>6.4</b>	<b>10.3</b>	<b>-0.2</b>	<b>3.6</b>
Net acquisition of nonfinancial assets (3)	8.0	17.3	2.8	14.3
Net Acquisition of Financial assets for Purposes (4)	9.5	-0.4	-0.4	-0.1
<b>Overall Balance (1-2-3-4)</b>	<b>-11.1</b>	<b>-6.6</b>	<b>-2.6</b>	<b>-10.6</b>
<b>Acquisition of Financial Assets (A)</b>	<b>0.0</b>	<b>0.0</b>	<b>-10.0</b>	<b>3.0</b>
Net changes in Government cash balances and investments*	0.0	0.0	-10.0	3.0
<b>Acquisition of Financial Liabilities</b>	<b>11.1</b>	<b>6.6</b>	<b>12.6</b>	<b>7.6</b>
<i>Net Domestic</i>	5.4	0.7	0.0	2.1
<i>Net Overseas</i>	5.7	5.9	12.6	5.5

\* The net changes in government cash balances for 2004/05 includes a \$2m ADB loan balance disbursed in 2003/04

(A+B= Overall Balance)

## 8. Reform priorities

I have made it clear that Tonga faces a rapidly changing global economy, and special local needs. Our macroeconomic policies will contribute to medium-term stability. But, for Tonga to succeed in achieving the vision for a more stable and prosperous future for our future generations, then we must continue the structural reforms we have started. Our economy must be able to provide new jobs for the 2,000 or so school leavers each year. To be able to do that our economy must be adaptable and dynamic. It also means that the present structure of the economy must be strengthened and made more robust. That is why the economic and public sector reforms are important.

One aim of the reforms is to make the public sector more efficient. This will improve the provision of basic services to the public, and reduce the level of taxation that the government

needs to pay for the provision of these resources. The reduction in taxation will free up resources in the private sector for new investment, which in turn will create new employment opportunities for school leavers.

A second aim is to make public policies more effective, especially where they affect private sector performance. In practice this means that we must reform the direction and magnitude of the government's interventions in the economy to focus on the things that the government does best – delivering basic public services, strengthening community institutions, pooling and managing community knowledge and community risks, building the foundations for private sector activities, and leaving the private sector to make commercial judgements and bear commercial risks.

### **i. Agriculture sector**

The agriculture sector has suffered its share of set backs in the past 12 months. It is clear that our high dependence on volatile returns from squash exports can be a constraint, in that when the squash market is affected by low prices, the performance of the whole export sector is seriously affected. In order to diversify the base of the export sector, the government has initiated the trials of domestic production of various types of vegetables for the export markets. This will be accelerated during the new financial year. The government is also actively seeking the assistance of donors to assist with the development of the agriculture sector through an enhanced policy environment and the development of small and medium agricultural enterprises.

### **ii. Fisheries sector**

The government is considering new options to support the fisheries sector in the wake of the recent low catch rates during the current financial year. The experts cannot tell us when the tuna will return, but the government can and will work with the fisheries sector to help improve and sustain the viability of the industry in these difficult times. The joint initiatives being considered include the issue of the declaration of the EEZ, exploring bilateral arrangements to expand the area of ocean available to the fishing industry, and re-assessing Government's policy interventions to ensure that they serve to support the industry.

### **iii. Tourism sector**

The government will continue to increase its level of support to the tourism industry. At present the key challenge is the discontinuation of the domestic air service by Royal Tongan Airlines. The approach by the government is to seek private sector interests who wish to perform the provision of this service. This is a key change from the previous policy of maintaining a government-owned air service. At the same time, the government will consider options for attracting new investment into the sector. The performance of the industry in 2003/04 has been a factor in the growth of the economy.

### **iv. Building on success**

I have had to talk about a number of difficulties that we face. Realism demands this. But we must not ignore or neglect the successes that Tongan people are achieving – often quietly and without attracting a lot of attention. These include the communities making progress at local level with addressing and solving some of our social challenges; the businesses making steady progress with sound commercial practices; the members of our religious and voluntary sector that are making a special contribution to that vision I summarised earlier. The government wants to help build on these community institutions and to pool community knowledge where this is compatible with commercial considerations – and most of these people are prepared to share their

knowledge. If we can recognise, strengthen and spread these proven local successes, then we can accelerate the improvements that are needed.

## **v. Public sector**

The reform of the public sector is an ongoing exercise. The first component of the reform is in the management of the government's finances.

### ▪ *Financial management*

Following the coming into effect of the Public Finance Management Act of 2002, the Ministry of Finance is continuing the introduction of modern methods of financial management. It is anticipated that during 2004/05 all government departments and ministries will be connected directly to the Ministry of Finance computer system to improve the management by ministries of their votes. New changes will also be brought into operation to make the payment of wages and salaries more efficient. This year we moved to integrate public enterprise funding requests into the annual budget process, and we will continue to integrate and strengthen the financial management processes for putting our policies into action. We will work with experts to improve the management of the government's financial balance sheet, to ensure that our borrowing and on-lending are soundly-based in terms of individual loans and the overall position.

### ▪ *Public service*

As of the 1<sup>st</sup> of July of 2004, heads of departments will be placed on contracts with associated performance indicators. This is intended to make the heads more accountable and responsible for the activities and outputs of their ministries, especially in relation to the resources made available to them through the budget estimates. The heads of departments will be required to accept more responsibility in terms of financial management as greater authorities will be delegated to them from the Ministry of Finance.

### ▪ *Public enterprises*

The programme for the reform of public enterprises will continue. Progress to date has been slowed by the need to deal with the financial implications of the termination of the services undertaken by Royal Tongan Airlines. Once this delay has been overcome, it is anticipated that other activities such as privatization of Sea Star Fishing Company Limited, Tonga Investment Limited and Leiola Duty Free Tonga Limited will be implemented. Furthermore it is expected that the corporatisation of the Post Office and the Printing Departments, which were delayed by legal and other issues, will be effective from 1 January 2005. The government will continue with the policy of progressive divestment of shares in public enterprises undertaking non-core government functions and the corporatisation of trading activities of ministries and departments such as the Talamahu Market Authority, and the Chronicle newspaper.

## **9. Social development policies**

### • **Youth**

The challenges posed by the issues of youth must be addressed effectively and urgently. There are increasing indicators of problems associated with unemployed youth, such as rising petty crimes, increasing teenage pregnancies, and increased drug related offences. This situation is exacerbated by internal migration with the bulk of the population of Tonga concentrated in the greater Nuku'alofa area. To address these challenges, the government will be considering new policy initiatives on training for young school leavers and dropouts as a matter of priority. The government has sought the support of bilateral and multilateral donors to initiate pilot projects, which if successful will form the foundation for a nation wide programme to provide new skills

learning opportunities for the youth of today. Some of the options to be explored include possible apprenticeship programmes, and enhanced counselling services for young people leaving school.

- **Urban development**

The standard of services provided for greater Nuku'alofa area is a matter of concern to the government, and it is reviewing new policy options to address the issue of sanitation, drainage, roading, waste disposal, and other services. This is expected to be a large undertaking and the government has sought the assistance of donors.

- **Economic hardship**

The government will be accelerating the implementation of policies which provide for the basic needs those who face economic hardship, and those who live in rural areas. In addition to the many projects funded by donors, the government, at the macro-economic level, is also implementing policies aimed at improving the services provided by ministries and departments and also at reducing taxes on imported goods. The implementation of projects for the health and education ministries in the outer islands will do much to alleviate hardship in these areas. At the same time the government will be reviewing options which will focus on specific groups, such as senior citizens.

## 10. Sectoral Spending Priorities

This budget continues to give priority to spending in law and order, education, health, and basic infrastructure. The allocations for operations and maintenance in these ministries are increased from last year. These are needed to ensure that they are better able to serve the public through the effective provision of government services, particularly to the outer islands.

- **Health**

The government is committed to provide quality health services through a programme of modernization of its services to meet current and potentially new demands from the public. The Ministry of Health has been allocated \$36.2 million in 2004/05 comprising of funds from the Tonga government and from foreign aid donors. A portion of this expenditure is for the construction of a new hospital with part to be financed by a loan from the World Bank and the balance from a grant from the Government of Japan. The allocation from the Tonga government funds is \$13.3 million with:

- \$1.1 million for the first phase of the reconstruction of Vaiola Hospital
- \$1.1 million for preventative health care and
- \$7.4 million curative health care.

- **Education**

Education continues to account for a large share of total expenditure with \$16.3 million allocated in 2004/05. The focus of government's efforts is to improve the quality of education at all levels. The major allocations for 2004/05 include:

- \$7.3 million for the provision of primary school services
- \$4.1 million for secondary school services
- \$700,000 for subsidy to non-government schools
- \$700,000 for scholarships for students at USP

- **Tourism**

Tourism is one of the key priority sectors for economic growth. The government is committed to undertaking joint marketing exercises with wholesalers support in New Zealand, Australia and the West Coast of the United States. The government is also continuing its endeavours to work with the private sector to expand investment in the tourism sector. The government has commissioned a review of enhancing the resources available for marketing which will form the framework for financing future investment activity.

- **Agriculture**

The economy is predominantly agriculture based and it is important that the government gives priority to food and income security through the diversification of the agricultural product base. The major allocations for 2004/05 include:

- \$0.9 million for food security, safety and nutrition
- \$0.5 million for livestock production and import substitution
- \$0.2 million for forestry services

The government has commissioned a review of the domestic agriculture sector in order to formulate a long term policy framework. The review will focus on new policy directions and strategies.

- **Fisheries**

The fisheries sector is one of the three key priority sectors for government intervention to provide new employment opportunities as well as foreign exchange income. The major allocation for 2004/05 includes:

- \$179,000 for research and development
- \$100,000 for the administration of access and compliance

## 11. Tax changes

On 1 April 2005, the government plans to abolish the following taxes:

- Port and service tax (presently at 20%)
- Sales tax (presently at 5%)
- Fuel sales tax

They will be replaced by the Tonga Consumption Tax, levied at 15% of the value of goods and services. This tax would be collected primarily at the import stage and, with larger businesses, at the point of sale of imported or locally produced goods and services. Coupled to this would be a reworking of individual and corporate income tax to provide a fairer system with generally lower rates of tax and the abolition of Ports and Services Tax.

This is in line with the government's intention to ensure that the tax burden is spread as widely and fairly as possible, whilst maintaining simplicity.

The government will be tabling before the Legislative Assembly a revised Income Tax Bill to update the current act. At the same time the government is also updating the Customs and Excise Act, for tabling at a later date.

## 12. Conclusion

The budget lays the foundation for achieving the government's long term vision for the people of this Kingdom. This vision can only be achieved through patient hard work and sacrifice. The government must work together with the people of this Kingdom to secure a prosperous and fair future for the youth of today. It is only through a partnership of trust and mutual respect that the many of the challenges facing Tonga today can be overcome.

The government of Tonga is grateful to the people of Tonga for their trust and continued patience and to its overseas development partners for their continued assistance.

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S.T.T 'Utoikamanu

Minister of Finance

1<sup>st</sup> June 2004

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Budget Paper No. 1: *Review of the Tonga Economy & Outlook 2003/04*

Budget Paper No. 2: *Fiscal Outlook*

Budget Paper No. 3: *Regional Development*

Statistical Appendix



Figure 2. Sectoral Contribution to Gross Domestic Product, at constant prices for the year 1999/00



Budget Statement for Year Ending 30<sup>th</sup> June 2005

**Budget Paper No 1: *Review of the Tongan Economy & Outlook 2004/05***



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## 1.0 Introduction

This Budget Paper No.1 is set out to address two main issues. First, to provide an overview of the country's economic performance for 2003/04 financial year. Second, to discuss the macroeconomic framework within which the government's approved fiscal policies for 2004/05 form a basis for sustainable economic growth and improves the well being of Tongans as outlined in the Strategic Development Plan Seven.

The 2004/05 Budget will continue to re-enforce the underpinning principles of program budgeting by encouraging program managers to manage efficiently and operate a programme that is more transparent and affordable by the government. The budget also highlights the third year of economic reform. This is expected to provide a more efficient government performance and improve the macroeconomic environment suitable for developing private sector activities. Furthermore, new initiatives have been implemented by the government to target improvements in economic growth by making funds available for specific projects in the agriculture, fisheries and tourism sectors.

The Paper consists of Section 2 that presents the performance of the global economy. Section 3 brings to light the latest developments in the domestic economy. Section 4 presents factors behind the increasing inflation rate. Section 5 reviews developments in monetary policy, and the outlook for interest rates is in Section 6. External sector performances are outlined in section 7. Section 8 discusses the trends in Exchange Rate and the economic outlook for 2004/05 and the medium term is addressed in Section 9.

## 2.0 Global Economy

The global economy has illustrated stronger recovery than anticipated in the beginning of 2004. The IMF has therefore revised upward its baseline forecast significantly, with global GDP growth in 2004 and 2005 now projected at about 4.5%. With global trade rising rapidly, buoyant financial markets, and the U.S. economy rebounding from the poor performance in the previous two years, the balance of risks has improved significantly.

Growth in the world economy has strengthened and broadened in the second half of 2003 with industrial production picking up sharply, accompanied by a strong rebound in global trade, as well as strengthening confidence and investment growth, which are essential to sustain the recovery. The IMF has estimated global growth to average around 6.0%. The projection for 2004 is expected to remain solid due to continued strengthening in consumption in the United States, and the rebound from the slowdown related to Severe Acute Respiratory Syndrome (SARS) in Asia. In the euro area, the recovery remains subdued, as household consumption remains weak and some key forward-looking indicators have fallen back. In Japan, GDP has continued to exceed expectations, with strong external demand-notably from China-accompanied by rising investment and latterly a pick up in consumption. Looking forward, Japan's GDP growth is projected at 3.4% in 2004. The emerging market and developing countries have also seen a rebound in activity, with GDP growth projections for 2004 marked up to varying extents in most regions. The growth momentum has been particularly strong in emerging Asia, where GDP growth is projected to remain at 7.2 % in 2004.

Despite the global recovery proceeding well above expectation at the beginning of 2004, significant challenges and risks remain an underlying concern particularly with the large U.S. current account deficit, which influences the medium-term fiscal outlook in many industrial and emerging market economies and eventually transition to higher interest rates. Further, the

geographical risks of another terrorist attack and fluctuations in oil prices have become increasing concerns.

Domestic demand with respect to consumption and investment is generally strongest among the industrial countries which have the largest current account deficit. The growth of domestic demand among the emerging Asia countries has picked up substantially with the regional current account surplus remaining very large. The exports supported by the rebound in the information technology (IT) sector and the depreciation of exchange rates have produced large current account surpluses in Asia.

Exchange market developments have been dominated by a further decline in the U.S. dollar, driven primarily by concerns over the sustainability of the U.S. current account deficit. Notwithstanding some rebounds since late February, the U.S. dollar has depreciated by 3.2% in trade-weighted terms since the Group of Seven (G-7) statement of exchange rate issues of September 2003—a cumulative decline of 16.5% from its peak in February 2002.

Commodity prices, in particular the price of oil, have risen markedly due to the rapid increase in global recovery combined with currency developments. Oil prices have risen from US\$26.5 a barrel in September 2003 to US\$34 a barrel in mid April 2004 and over US\$40 in mid May 2004. A significant portion of this increase appears to reflect the depreciation of the U.S. dollar as well as higher-than-expected demand, particularly in the United States and China, relatively low inventories, earlier delays in restoring Iraq's oil production, OPEC announcements of prospective production cuts, and sizeable speculative activity. The futures markets suggest that oil prices will average about US\$32.50 a barrel for 2004 as a whole, about US\$8 higher than assumed in macroeconomic projections.

Inflation remains subdued in the advanced countries with consumer price inflation averages 1.8% in 2003. Despite rising commodity prices it is projected to remain moderate in 2004. This will reflect continued excess capacity, weak labour markets, and limited producer pricing power in the face of strong domestic and global competition. For the emerging market and developing countries the level of inflation is now close to single digits in every major region. Even so, concerns about deflation have moderated, reflecting growing confidence that the recovery will be sustained.

The forecast assumes that monetary policy in the United States is tightened moderately with interest rates beginning to rise in the second half of 2004. Monetary policy in the euro area remains broadly unchanged this year, and that quantitative easing in Japan continues. Fiscal policies are expected to be expansionary in the United States and Italy, and neutral or mildly contractionary elsewhere.

## **2.1. Regional Economies**

The Asian Development Bank (ADB) reported in its Asian Development Outlook 2004 that Pacific Island Countries (PICs) demonstrated an overall good economic performance during 2003 as represented by an aggregate weighted growth rate of 2.7%. This is supported by real growth rates among PICs ranging from 0.1% in Micronesia to 5.0% in Fiji and in Samoa. The favourable economic performances were attributed to the high international prices for exporting primary commodities.

The uncertainties caused by the Iraq war conflict as well as other geographical unrest raised the prices of oil, gold and copper process which benefited Papua New Guinea and Solomon Islands' primary production. The tourism sector across the Pacific picked up in 2003 and has stimulated the services sector and investment in infrastructure, particularly in the Fiji Islands. In line with faster economic growth and increase in domestic demand, labor market conditions generally improved and inflation accelerated to an average 7.4% in the PICs.

Fiscal outcomes varied considerably among countries in the region. In Papua New Guinea, revenue collection was on target, but expenditure restraint was required to minimize the need for domestic borrowing and the consequent pressure on interest rates. The fiscal deficit exceeded the budget in the Fiji Islands, due to higher expenditures and a failure to realize planned asset sales, despite strong revenue collection. External accounts showed substantial variation in 2003. While export was generally positive, import growth was erratic; currency trends and earnings from tourism determined disparate outcomes in the accumulation of international reserves.

Political uncertainty and poor governance continued to hamper growth in several countries. A gradual move toward freer trade in the PICs occurred with the entry into force in April 2003 of the Pacific Islands Countries Trade Agreement, signed by 14 members and covering a 10-year implementation period. The main policy focus at the national level in the majority of countries was on maintaining macroeconomic stability through sound fiscal management as a key condition to encourage private investment and economic growth. Efforts to consolidate gains from implementation of economic and public sector reforms varied in intensity and effectiveness.

Based on further improvements in the tourism sector and continued strong commodity prices, economic growth is expected to continue at a relatively fast pace by 2.9% in 2004 and by 2.4% in 2005. Inflation however is projected to slow down to 5.6% but then increase to 6.0% over this period. These trends are essentially determined by projections from Papua New Guinea, by far the largest economy in the Pacific. While expected medium-term growth and inflation rates represent improvements from the trends of the last few years, creating jobs in the formal sector will remain a major concern, as almost all economies are unlikely to be able to absorb the net increase in labor market entrants, with high youth urban unemployment leading to potential social unrest. Aside from adverse external shocks, the main risk to the growth forecasts rests with the evolution of the internal political conditions and the capacity of local institutions to build up a climate of stability to boost business confidence.

Table 1: Forum Island Countries, GDP growth and inflation

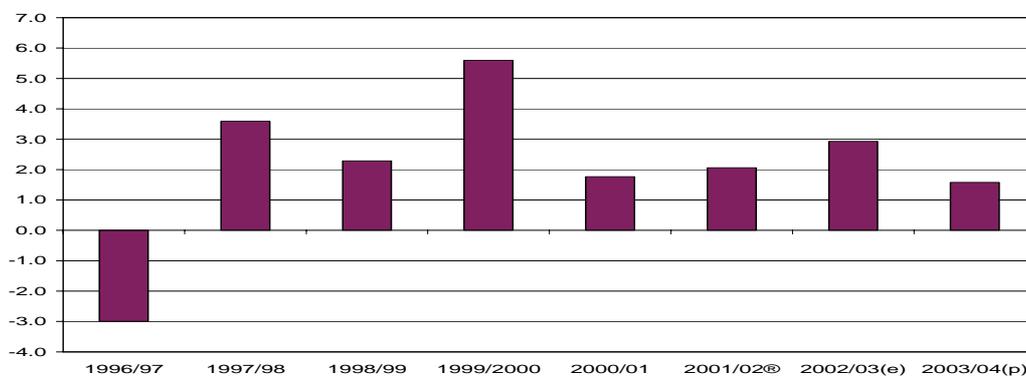
Countries	GDP Growth (% per year)					Inflation (% per year)		Inflation (% per year)	
	2000	2001	2002	2003	2004	2002	2003 (f)	2004 (f)	
				(f)	(f)				
Cook Islands	7.9	5.1	0.3	1.5	2.7	2.9	3.9	3.4	2.0
FSM	4.4	1.1	0.8	2.4	1.5	2.2	0	1.5	0.5
Fiji	-3.2	4.3	4.4	5.1	3.9	3.0	0.9	3	3
Kiribati	0.2	1.5	2.8	2.5	1.8	1.5	5.1	Na	Na
Tuvalu	3	4	2	2	1.8	3	2.6	3	Na
Vanuatu	2.7	-2.7	-0.3	1.3	2.1	2.6	2	2.5	2-2.5
PNG	-1.2	-3.4	-0.5	1	2.8	1.7	11.8	9	8.7
Republic of Marshall Islands	0.7	2.1	4	3	2	3	2	2.5	2-3
Samoa	6.9	6.2	1.3	3.6	4	Na	5.5	3.5	3
Solomon Island	-13.3	-10.1	-4	2	4	Na	9	8	6-7

(Asian Development Bank  
 Outlook 2004)

### 3.0 Domestic Economy

The latest official estimates of Gross Domestic Product (GDP), at 2000/01 constant prices, stood at \$297.7 million for 2002/03, representing real economic growth of 2.9% compared to an estimated 1.9% in last year’s Budget Statement. The revision reflects strengthening activity in the agriculture, tourism, construction and transportation and communication sectors. Likewise, based on new information collected by the Statistics Department on manufacturing and communication industries, the growth rates for 2000/01 and 2001/02 have been revised up slightly to 1.8% and 2.1% respectively. However, on the basis of currently available economic data, the Ministry of Finance has revised down its projection for 2003/04 from 2.6% to 1.6% and projected a growth rate in 2004/05 of approximately 2.8%. The GDP growth pattern, in constant prices, is depicted in Figure 1 and presented in Table 2 of the appendices.

Figure 1: Constant Gross Domestic Product Growth Rate (2000/01 prices<sup>1</sup>)



(e): estimate by Ministry of Finance

(p): projection by Ministry of Finance

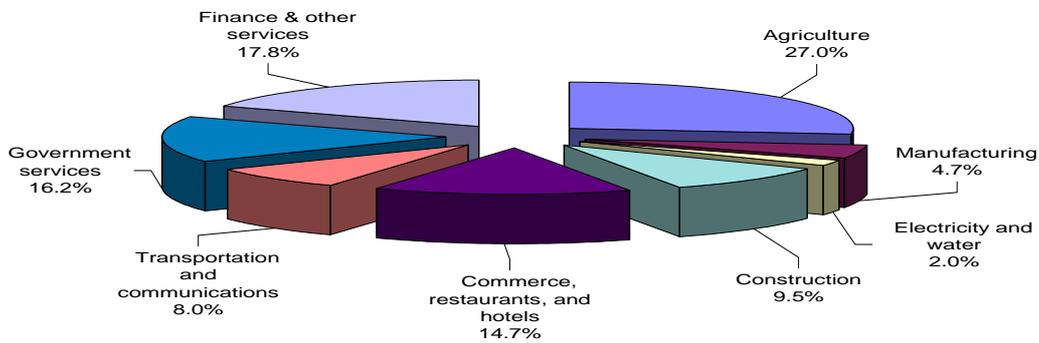
Indicators suggested that economic activities were more subdued in 2003/04 due to a combination of factors. These included unfavorable price conditions for squash exports, low fish catch rates, difficulties faced by wholesale, retail trade and manufacturing operators, and the adverse impacts of financial difficulties experienced by some enterprises in transportation, power and telecommunications. The growth in GDP was primarily supported by tourism and key agricultural activities such as vanilla and coffee.

#### 3.1. Real Sector Developments

The structural composition of the economy has not changed significantly in the last five years. The agriculture, fisheries and forestry sector remains the highest contributor to economic activity at 27.0% of GDP, followed by: government administration and community services (16.2%); commerce, restaurants and hotels (14.7%); finance and other services (17.8%); construction (9.5%); transportation and communication (8.0%); and manufacturing (4.7%). These sectoral contributions to GDP for fiscal year 2002/03 are depicted in the pie chart below.

<sup>1</sup> The estimates are the first in the rebased series, with the base year used for deriving constant price estimates of GDP having been updated from 1995-96 to 2000-01. The revisions to growth rates for earlier years associated with the latest estimates are due to a combination of two factors: the use of more recent price weights, reflecting current conditions more closely than did the previous estimates based on 1995-96; and the introduction of new data sources. However, the overall revisions are relatively minor – the average absolute revision to annual growth rates is less than 0.4% points.

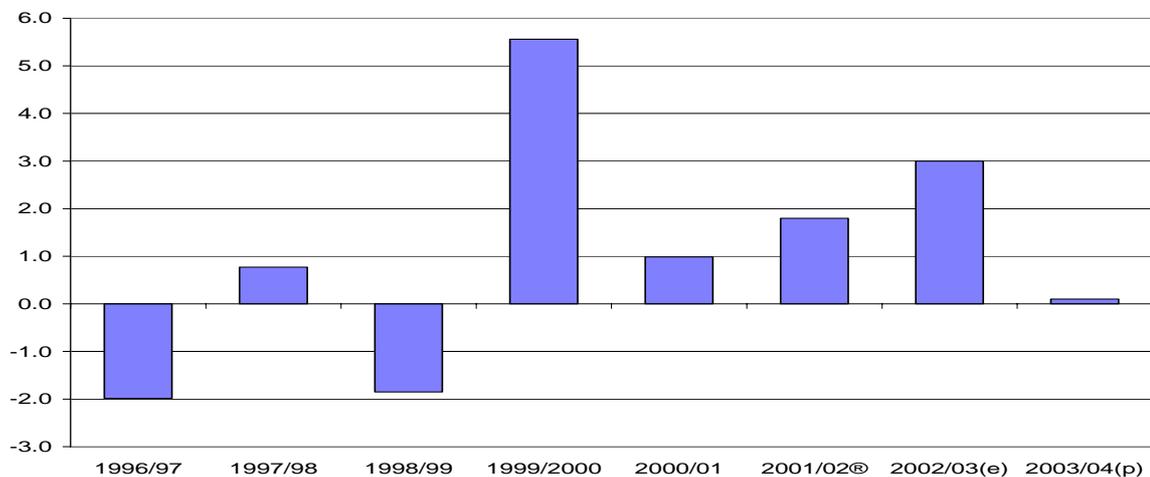
Figure 2: Sectoral Contribution to Real GDP at factor cost for the year 2002/03



### 3.2. Agriculture

The agriculture sector registered an estimated growth rate of 3.0% in 2002/03, representing a 1.2% increase from the 2001/02 growth rate. The improvement is due to a significant increase in the exports of squash as well as marking the revival of the vanilla industry. The performance in 2003/04 is anticipated to be more subdued due to lower international prices in the squash industry and the fisheries' sector slow recovery from the *el nino* phenomenon. The value-added performance of the agriculture sector over the last seven years and projection for 2003/04 is illustrated in Figure 3.

Figure 3: Agriculture Real Growth Rates for 1996/97 to 2003/04



Although squash export production increased from 18,162 metric tonnes (mt.) in 2002/03 to 22,657 mt. in 2003/04, due to increased international competition, the average price dropped significantly from 71 cents per kilo to 23 cents per kg and some growers failed to receive any proceeds from their exports. This, coupled with a significant drop in demand for Tonga Development Bank loans, from squash farmers, is anticipated to adversely influence the production prospect for 2004.

Despite the poor prices received from the squash harvest of 2003 and its dampening effect on the agriculture sector and the economy, there are a number of developments which are expected to assist in efforts to diversify the sector, improve its contribution to GDP and provide new employment opportunities.

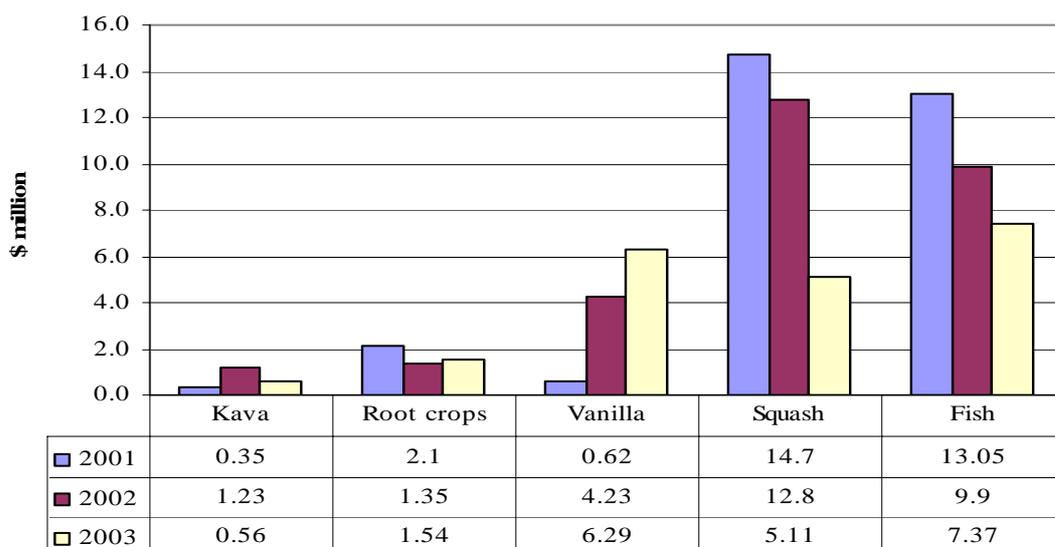


First, as world vanilla prices continue to soar, old plantations in Tonga are being brought back into production and new plantings made. This is reflected in the significant increase in exports in 2003/04 which reached 22.2 mt. earning around \$6.1 million as compared to \$5.1 million in 2002/03. The highest volume of vanilla exported from Tonga was 44.0 mt. in 1998/99. If similar volumes of vanilla exports can be achieved once again and current market prices maintained, then a favorable out-turn from the agriculture sector could be expected over the medium term with associated spill-over effects to other sectors of the economy. Furthermore, the impact of a severe hurricane in Madagascar, one of the world's major vanilla growing countries, has caused a shortage of vanilla supply internationally, which may contribute to further increases in vanilla prices in 2004. The Ministry of Agriculture has also indicated that buyer enquiries have increased significantly prior to the commencement of the harvesting season in July.

Secondly, arising from the 2003 Pacific Islands Forum, the New Zealand government agreed to fund additional resources to resolve the problems of access into the New Zealand and Australian markets associated with fruit fly infestations experienced in many island groups. Accordingly, the High Temperature Forced Air facility at Fua'amotu Airport has been recommissioned by the Agricultural Ministries of both New Zealand and Tonga. Seven countries have been made acceptable for entry into New Zealand after treatment and others are to be added during 2004. Growers are now organizing planting of vegetables for exports to New Zealand and American Samoa.

Thirdly, in 2003 six tonnes of local coffee were roasted and sold in Tonga with a retail value of \$150,000. The 2004 harvest is estimated to be eight to ten tonnes with a value of \$200,000 to \$250,000 of which \$100,000 will come from exports primarily to the People's Republic of China, as well as to Samoa and New Zealand. A plant tissue culture laboratory, which is in its fourth year of production, has generated export earnings for 2003 of approximately \$100,000, mostly to New Zealand. It is anticipated that this will triple in 2004 as Australia and new plant varieties are added to the export market. The laboratory will also be used in a large organized taro growing venture and offers opportunities to Tongan agriculture to improve the export potential of coconut, banana, pawpaw, cut flower, breadfruit, chillies, egg plant, mango and foliage varieties.

Figure 4: Principal Exports of Agricultural Products



(a) Value for 2001 was computed using an average price of \$106; 2002 unit price of 71 cents, 2003 unit price of 23 cents.

(b): fish exports statistics were taken from NRBT survey on major fishing companies.

Fourthly, increased agricultural based exports are anticipated in a number of markets. The European Union has been instrumental in reopening the market for kava in Europe and export is expected to pick up in the medium term. Coconuts are continuing to be exported to both New Zealand and Australia and there are also new efforts to add value by extracting and refining the oil for use in cosmetics. In addition, the first shipments of Japanese taro “satoima” are being made to Japan in the first half of 2004 with the total acreage of this new crop now exceeding two hundred acres.

Finally, exports of root crops and customary goods such as mats and tapa cloth to relatives overseas are now recognized as being the origin of a large portion of remittances. In all, agriculture’s prospect for 2004/05 offers strong potential for increased exports and providing of employment opportunities.



### **3.3. Fisheries**

Activity in the fishing industry continued to suffer with catch rates yet to recover after end of the *El Nino* phenomenon in 2002/03. This has seriously impacted on some companies which have sustained large debts. The volume of fish exported in 2002/03 declined to 987.6 mt. from 1,506.9 mt in 2001/02. The total value of fish exports in 2002/03 stood at \$7.2 million. For the first six months of 2003/04, the available statistics indicate a marginal improvement in the catch rates with exports totaling 707 mt. compared to 643 mt. in the corresponding period for 2002/03 and 344 mt. in the second half of 2002/03.

The fishing industry is vulnerable to the weather conditions and its performance constrained by both the availability of domestic capital for investment and the high transportation cost, especially airfreight for fresh fish exports. These issues have been the focus of the Ministry of Fisheries in reviewing its current foreign investment policies as well as streamlining government administrative procedures to encourage private sector activities in the industry. The Ministry is also seeking ways to provide the appropriate infrastructure and financial assistance to further strengthen the industry.

The Ministry of Fisheries in conjunction with MAFF and the Tonga National Youth Congress has established a training programme for future young farmers emphasizing commercial farming not only in agriculture but fisheries as well (farming limu). The Ministry will also conduct a survey on sea cucumber in May 2004 to decide if the market will open again for public. This reaped significant earnings in the past.

### **3.4. Manufacturing**

Growth in manufacturing activities in 2002/03 is estimated at 2.0% compared to 3.3% recorded in 2001/02. Despite the industry registering positive growth over the last three years, there are signs that the growth rate of the industry is weakening.

Indicators for this industry are based on quarterly surveys conducted by the Statistics Department on all manufacturing business in Tonga. The surveys indicated that production in nominal terms increased by 26.5% in 1999, -2.8% in 2000, 7.0% in 2001 and 2.7% in 2002.

The government’s licensing register shows that during the 2001-2003 period, 65 manufacturers were in operation of which: 28 were food and drink manufacturers including bakery, sausages, ice & fish, noodles, biscuit, coconut milk, tongo, chips and other agricultural products; 5 ice-cream and ice block manufacturers; and the remainder, classified as other manufacturers such as fibre glass boat, wire, gas, water, spirits and beer, furniture, paints, block making, kava powder, tobacco and processing aloe vera etc. During this period, 23 businesses closed down. Most of these enterprises were supplying import substitution products but due to the small domestic

market it was difficult to realize the economies of scale needed to compete against foreign producers.

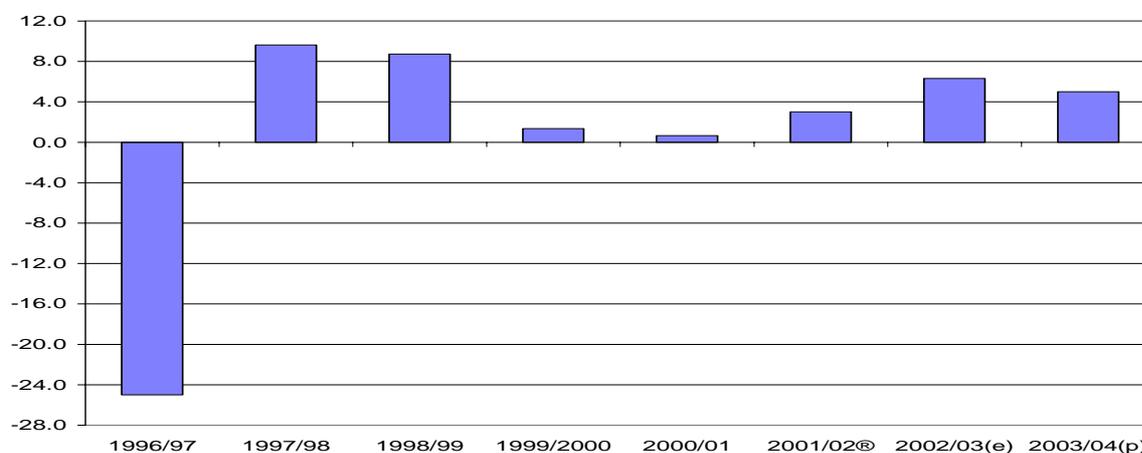
The government, in its second year of the Economic and Public Sector Reform Program, continues to address these impediments and attempts to identify a roadmap to encourage private sector investment. It is anticipated that the tax reform proposed for next financial year will be most beneficial to this sector, in particular lowering the costs of production. In addition, the government has also put in place short term training in business administration, managerial training, bookkeeping for small businesses, and a variety of vocational training in an effort to upgrade the skills levels to meet demand from the private sector and improve productivity. Other government initiatives include the proposal to establish a second site for the Small Industry Center which is a necessary infrastructure for starting a new business.

The performance of the industry in 2003/04 continues to weaken with an estimated growth rate of 1.0%. However the tax reform commencing in 2004/05, in addition to the various reform initiatives by the government, is projected to support a growth rate of between 2% and 3%.

### 3.5. Construction

Real GDP growth rate for the industry in 2002/03 is estimated at 6.3%, which is 2.3% points higher than the estimate released in last year's Budget Statement, and contributed 0.5% to the overall growth. The high growth rate is in line with the continued assistance from Tonga's donor partners including the completion of a number of projects such as the AusAID electrification projects in the Ha'apai group, the FIFA Goal at the soccer academy, phase one of Janfull International Dateline hotel, the Fund Management business complex and the Faua wharf project. Figure 5 depicts the growth rate trend of the construction industry since 1996/97.

Figure 5: Real GDP Growth Rates for Construction Industry, for year 1996/97-2003/04(p)



(e): official estimates from Statistics Department

(p): projection by Ministry of Finance

A continued strengthening is projected for the construction industry over 2003/04 and 2004/05, reflecting major projects currently underway in Tonga. These include WAKA (World Bank, AusAid, EU funding), Health project (AusAid, World Bank), Tonga High School (People's Republic of China), EU projects in Vava'u (fisheries market and wharf, agricultural and tourism roads, education and health offices), solar electrification (AusAid), church constructions, relocation project at the Queen Salote wharf, and extension to the Faua wharf project.

The increase in volume of imported construction materials is consistent with the increase in construction activities, where imports of cement and dressed timber in 2002/03 increased by 15.0% and 41.0% respectively. Housing loans from the commercial banks at the end of 2002/03

also increased to \$41.7 million, representing a 22.6% increase on the 2001/02 level. Latest statistics for housing loans show a total of \$45.5 million in outstanding loans, as at the end of January 2004, which is 9.1% and 21.7% higher than level in June 2003 and January 2003 respectively. Housing loans from the commercial banks is normally utilized for residential construction in addition to fund flows in from private remittances.

The growth rate for 2003/04 is estimated at 5.0% and projected to rise between 8% and 10% in 2004/05. This reflects the commencement of the World Bank Health Sector Support Project (estimated at \$6 million) and the completion of the new Tonga High School (\$7.0 million).

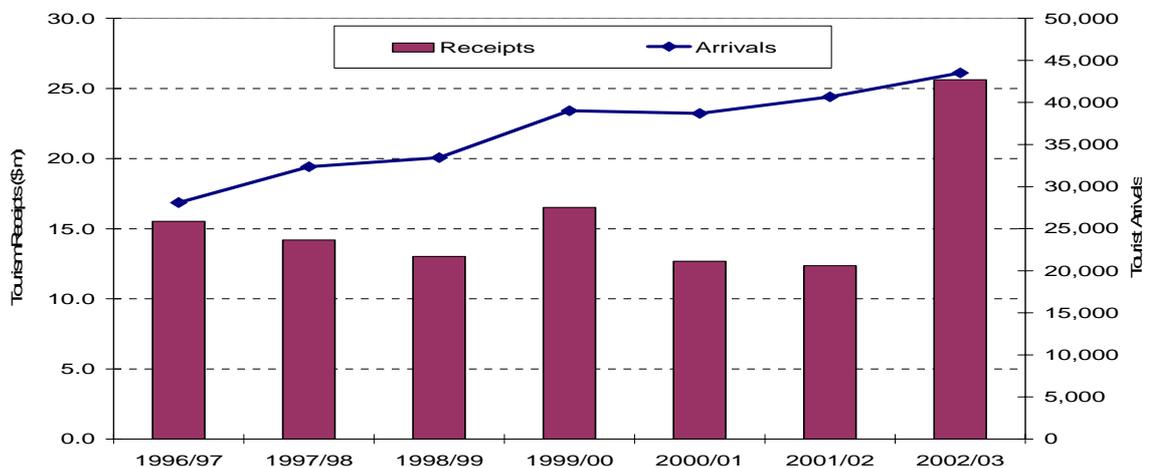
### 3.6. Tourism

The estimated growth rate in tourism activities, classified together with commerce, hotel and restaurants, is 3.5% in 2002/03 compared to the 5.0% growth recorded in 2001/02. The 1.5% decline is related to the weakening in the wholesale and retail industry.

Tourism is still considered an important sector for development and one that has had a significant impact on the local economy through the creation of employment opportunities and the generation of income, particularly in the outer islands and rural areas through the demand for handicrafts, taxis, guesthouse and tourist attractions as well as increased foreign exchange earnings. It also offers an opportunity for diversification from agricultural-based production.

The tourist arrivals in the first half of 2003/04 totaled to 22,300 which represents an increase of 6.9% from the total number of arrivals in the same period 2002/03. This reached the high level obtained in 1999 due to the millennium celebration. Foreign receipts have also increased to \$16.5 million from the \$12.4 million received in same period 2002/03. The declining value of the exchange rate has aided the increase in tourist receipts.

Figure 6: Number of Tourist Arrivals & Tourism Receipts for the year 1996/97-2002/03



The government together with its donor partners continues its effort to develop the industry to realize its full potential. Two projects are ongoing with NZAID funding, the “*Community Based-Tourism*” focusing training on ‘Eua and Vava’u to improve the quality of handicrafts for tourist souvenir. The second project “*Tonga Tourism Project*” is funded by AusAID which concentrates on coordinating and managing tourism activities in Tonga, setting minimum standards to raise the quality of hotel and tourist facilities, beautification and clean-up campaigns, training programmes on tourism and hospitality, and assisting in marketing of tourism overseas. The completion of the first phase in upgrading of the Janful International Dateline Hotel to a three star level hotel provides a promising prospect for attracting up market visitors. It is projected that

in 2004/05 tourism will continue to increase contributing positively to foreign exchange earnings and the growth of the economy.

### **3.7. Wholesale, Retail and Distribution**

Indicators for the wholesale, retail and distribution sector suggest it has not performed as well as some of the other sectors. The weakening in the sector is due to the declining value of pa'anga resulting in higher costs of imported goods, shipping and government fees and charges, together with the continued expansion of the informal markets, which undermined the demand for the products of the operators in the formal sector.

The overall imports, commonly used as the indicator for activities in this sector, totaled \$195.1 million in 2002/03, representing an increase of 25.9% on 2001/02. The nominal growth rate for the sector is estimated to be around 20%. In determining the real (volume) changes in imports, the impact of inflation as well as the effects of the exchange rate need to be taken into account. The exchange rate has deteriorated against the New Zealand dollar and the Australian dollar. Given that the majority of imports come from New Zealand and Australia, the total imports for 2002/03 recorded a modest increase of 2.2% and 9.6% respectively after adjusting for exchange rate movements.

The commerce, restaurants and hotels industry is expected to record a growth rate of 2.5% in 2003/04 and in the order of 3.0% in 2004/05 as the tourism, and wholesale and retail strengthen due to the tax reform.

### **3.8. Transportation and Communication**

The transportation and communication sector consists of three major activities, namely communication, air transport and sea transport. In the latest national accounts, the Statistics Department estimated that the sector grew in real terms by 10.8% in 2002/03, in contrast to the negative growth rate of 2.0% in 2001/02. The improvement was due to an increase in value added performance of the communication sector as well as the expansion by Royal Tongan Airline of its international services through the leasing of a Boeing 757 aircraft from Royal Brunei Airlines.

Over the last two years, competition in the communication industry has been tight with the most visible impact seen through the significant reductions in the cost of telecommunication services. It is anticipated that the reduction in cost will encourage a greater demand for such services while at the same time, the limited size of the domestic market imposed constraints on the contribution of the sector to overall economic growth. It is estimated that communication sector will continue to add positive value in 2003/04.

The operation of the domestic airlines has improved competition in the airlines industry, and benefited some sectors of the economy such as tourism, agriculture and fisheries with the increased transportation in and out of Tonga. However, the benefits have come with significant costs, not only from the financial pressure on the government's fiscal position but the spillover effects on the rest of the economy.

The performance of the shipping sector on the other hand has relied mainly on the level of activity in the external sector's trading with overseas market. Despite the significant increase in imports, there is an indication of slowdown in shipping services in the current financial year.

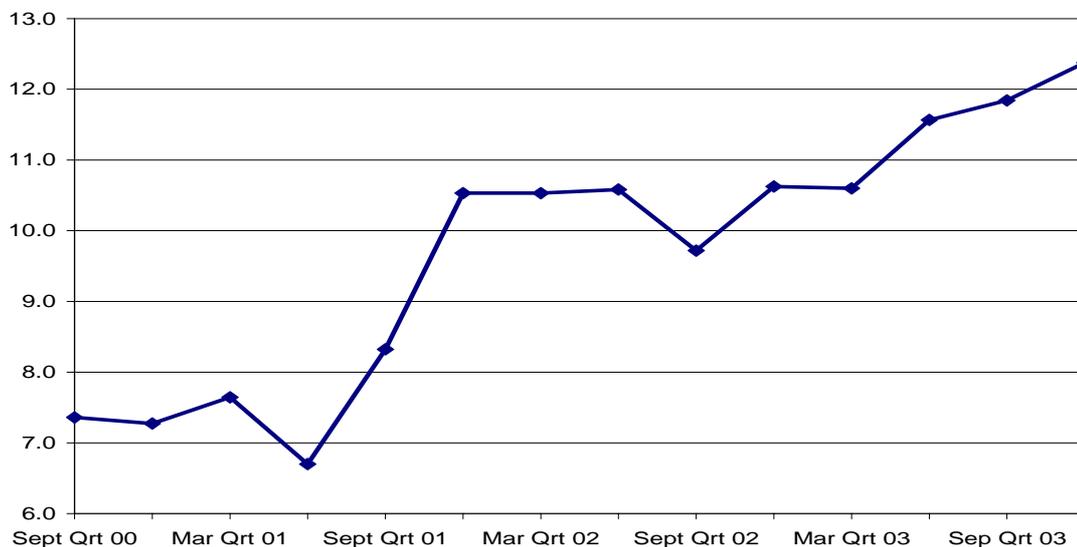
The overall performance of the industry in 2003/04 is estimated at a negative growth rate of 0.5% with negative growth in the transportation sector outweighing the positive contribution from communications sector. Real growth in 2004/05 is projected in the order of 1.0%.

## 4.0 Domestic Price Developments

Inflation has continued to accelerate in 2003 posing significant problems in all sectors of the economy. In particular, it has had significant impact on low income earners and the import intensive sectors such as wholesale and retail and manufacturing. The average inflation rate has risen from 10.7% in 2002/03 to about 11.7% in December 2003.

A number of factors have contributed to the high inflation. The increase has been primarily driven by imported inflation and the sharp increase in electricity and tariff rates for imports of alcohol and tobacco products. Furthermore, the limited response of the supply side of the economy to high budget deficits and the rapid expansion of broad money have intensified pressure on domestic inflation. Annual imported inflation rose to 17.9% at the end of December 2003 compared to 12.0% recorded in December 2002. Domestic inflation on the other hand declined to 0.7% compared to 13.5% in December 2002.

Figure 7: Average annual inflation rates for all items for September Qrt 2000 to December Qrt 2003



The breakdown of CPI by major groups for December 2003 shows that the increasing price level is attributable to a 23.1% increase in tobacco, alcohol & kava goods (on a year to year comparison), 12.6% increased in transportation (fuel) and household operations, and a 9.6% increase in the food group.

A concerted effort between fiscal and monetary policy is needed to bring down inflation to a sustainable level. Inflation is anticipated to be more subdued in 2004/05 due to the steady appreciation of the pa'anga against the basket since late 2003.

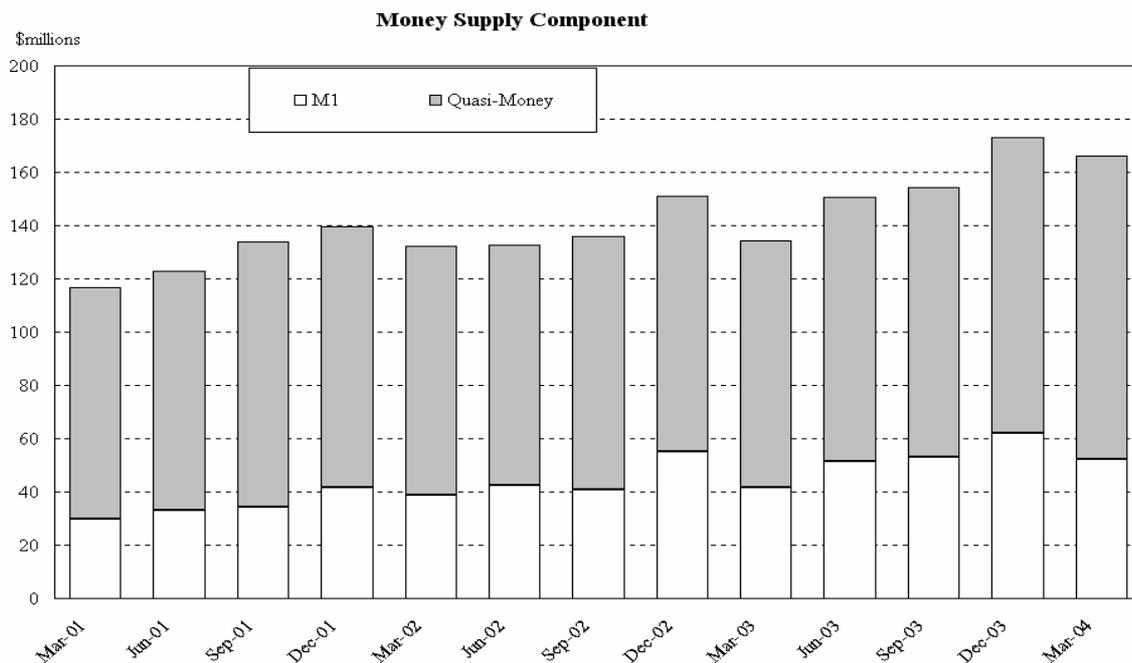
## 5.0 Monetary Policy & Development

### 5.1 Money Supply

During 2002/03, the broad money supply M2 reached \$150.5 million compared to \$132.7 million in 2001/02. This represented a growth rate of 13.4%, an increase from the 7.8% growth rate recorded for the previous year.

The growth in money supply during the year was reflected by increases in both M1 and quasi-money, by \$9.3 million and \$8.6 million, respectively. The two components of M1, currency in

circulation and demand deposits, both increased by \$1.0 million and \$8.3 million, respectively. The growth in quasi-money was a result of an increase in foreign currency deposits by \$8.4 million.



During the first nine months of the 2003/04 financial year, money supply reached \$166.2 million, a 10.5 % increase from the level at the end of June 2003. This increase reflected a growth in quasi-money especially time deposits which rose by 34.4 %.

## 5.2. Domestic Credit

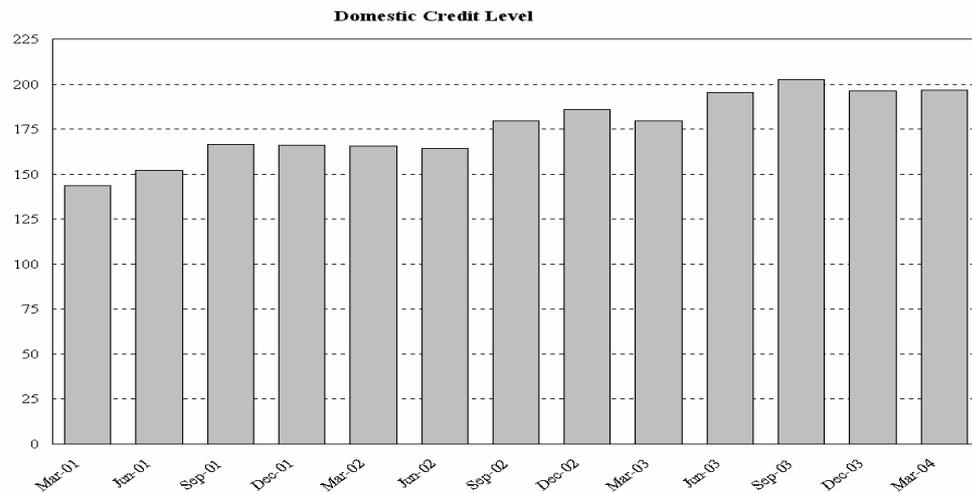
During the year ended June 2003, the net domestic credit (net of government deposits) extended by the banking system rose by \$30.8 million to \$195.2 million. This represented an annual growth of 18.8 % compared with the 8.2 % increase in 2001/02. The higher level of net domestic credit was a result of increases in private, government and non-financial public enterprise credit. Private sector credit increased by \$20.6 million to \$183.2 million while net credit to Government rose by \$8.0 million to -\$0.5 million. At the same time, credit to the non-financial public enterprises rose by \$2.3 million to \$12.5 million. Credit to the private sector was mainly directed to 'other services' and housing.

During the nine months ended March 2004, domestic credit increased by \$1.6 million to \$196.8 million, a 0.8 % growth from the end of June 2003. This modest growth was attributable to a huge improvement in the government position largely reflecting the disbursement of the second tranche of the ADB loan. Credit to the private sector rose by 8.5 %.

## 5.3. Bank Lending

During 2002/03, loans and advances from the commercial banks to the private sector increased by \$13.4 million to \$138.5 million. Loans to industry and housing sectors increased by \$10.3 million and \$7.7 million to \$71.3 million and \$41.7 million, respectively. On the other hand, loans to the agricultural sector declined by \$1.8 million to \$7.9 million.

During the nine months ended March 2004 loans and advances from the commercial banks to the private sector increased further by \$16.2 million from the end of June 2003. This increase reflected increases in lending to other personal purposes by \$7.2 million, industrial sector by \$5.3 million and housing sector by \$3.7 million.



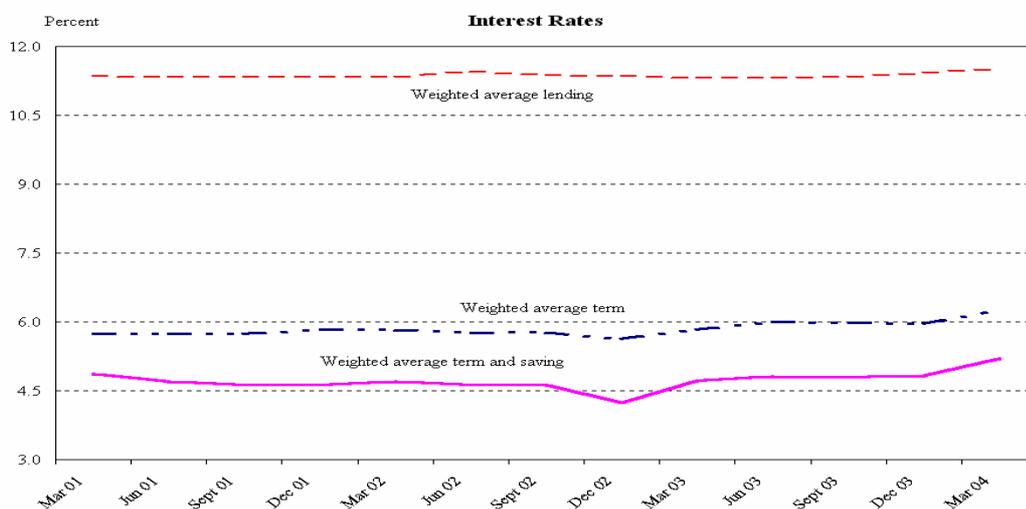
#### 5.4. Deposits with the Banking System

During 2002/03, total deposits with the banking system showed a substantial increase of \$14.0 million to \$148.2 million. The rise was a result of higher private sector and 'others' deposits. Private sector deposits increased by \$13.7 million to \$128.3 million. This increase was due to increases in foreign currency deposits by \$8.4 million, demand deposits by \$3.8 million and time deposits by \$1.0 million. 'Others' deposits also rose by \$6.0 million to a level of \$13.9 million while government deposits declined by \$5.7 million to \$6.0 million.

During the first nine months of the 2003/04 financial year, total deposits with the banking system showed a further increase of \$17.8 million to \$166.1 million at the end of March 2004. This growth reflected increases in private sector deposits by \$19.1 million and government deposits by \$2.2 million.

#### 5.5. Interest Rates

The nominal published annual interest rates on term and savings deposits reported by commercial banks remained unchanged during the 2003/04 financial year. However weighted average deposit rates have followed a slow upward trend as reflected by the Reserve Bank's deposits indicator. This is indicated by the weighted average interest rate paid on deposits, at 4.81 % at the end of June 2003, was slightly higher compared with 4.62 % at the end of June 2002, and 4.70 % at the end of June 2001. Since the end of June 2003, the weighted average interest rate on term and saving deposit slowly climbed to 5.21 % at the end of March 2004.



On the other hand lending interest rates in Tonga gradually declined, with the Reserve Bank's lending indicator rate at 11.31 % at the end of June 2003, was slightly lower compared with 11.45 % at the end of June 2002 and 11.34 % at the end of June 2001. Since the end of June 2003, the lending indicator rate slowly increased to 11.43 % at the end of March 2004.

## 6.0 External Sector Development

### 6.1. Exports

According to estimates based on the overseas exchange transactions (oet) collected by the NRBT and commercial banks, total export receipts during 2002/03 at \$38.6 million, were 0.5 % lower than in the previous year. Export receipts were led by squash, fish and other marine products.

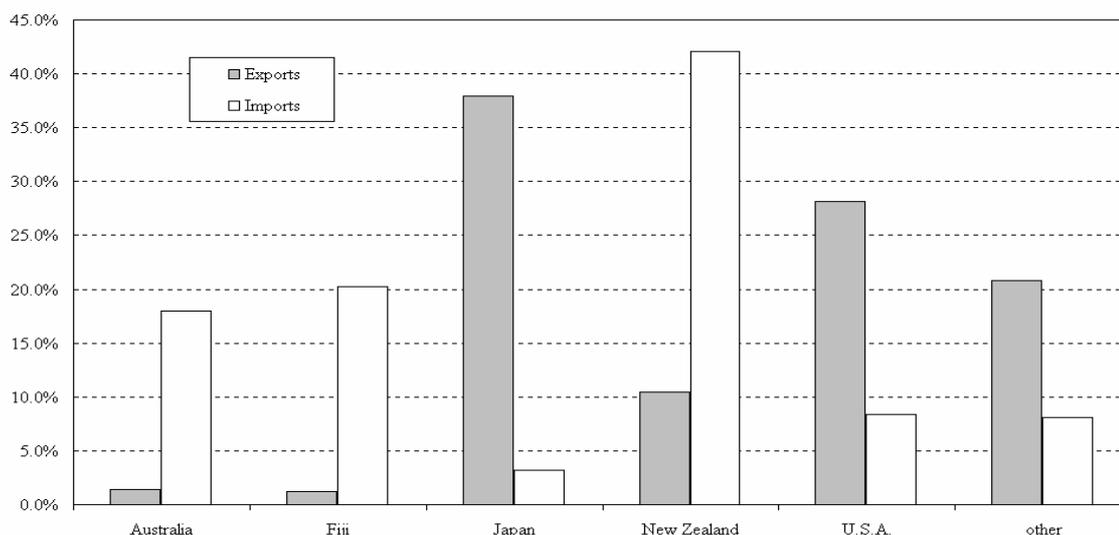
During the first eight months of the 2003/04 financial year, exports earnings were recorded at \$18.6 million compared with \$29.2 million during the same period last year. This decline largely reflected lower squash export proceeds received during the 2003/04 season.

Japan is the largest market for Tonga's exports, absorbing 37.9 % of the total, mainly squash and fish, followed by the United States (including Hawaii) (28.2 %) and New Zealand (10.6 %). The government is seeking to further diversify exports into areas such as deep-sea fishing (particularly tuna), pearl farming and agricultural products such as peanuts, sweet corn, taro, coffee, nonu leaves, kava and Tahitian vanilla. Through the Kingdom of Tonga and the People's Republic of China Cooperation Program on the Vegetables Demonstration, Tonga may start exporting more vegetables to American Samoa and other foreign markets.

### 6.2. Imports

During 2002/03, merchandise imports (OET based) payments at \$163.0 million rose by 21.9 % since the end of 2001/02. This increase in payments was largely underpinned by higher payments for consumption goods followed by intermediate goods such as fuel, crude and other chemicals and capital goods.

Direction of Trade for 2002/03



During the first eight months of 2003/04, import payments were \$116.2 million compared with a \$110.7 million during the same time last year. This largely reflected imports of consumer goods, fuel, construction materials and capital equipment. New Zealand continued to be Tonga's largest supplier (42.1 %), followed by Fiji (20.3 %), Australia (18.0 %) and the United States (8.4 %).

### 6.3. Balance of Payments

The overall balance of payments (OET basis) recorded a deficit of \$2.6 million in 2002/03, compared with a surplus of \$13.8 million in 2001/02.

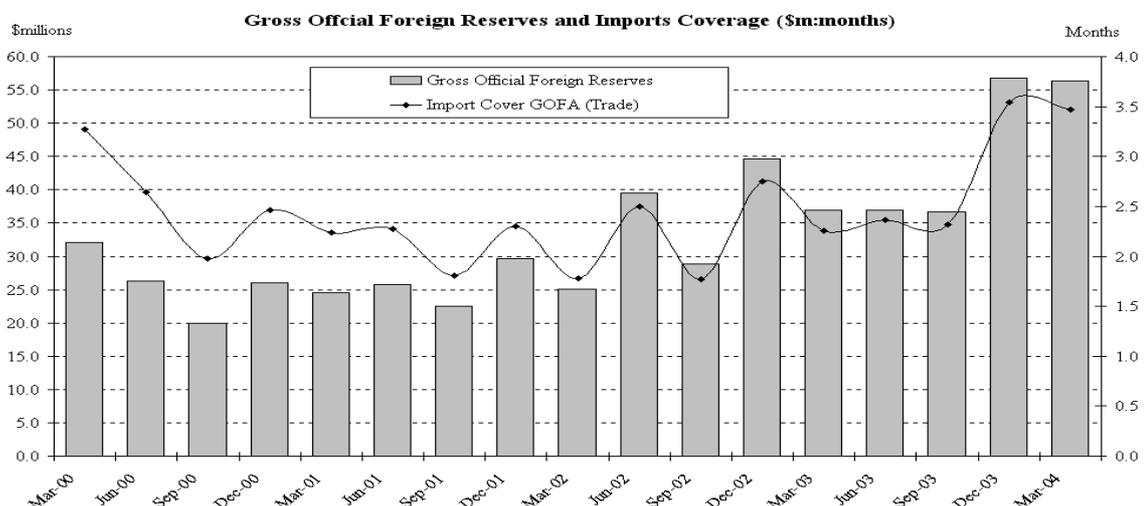
The balance of trade recorded a deficit of \$124.4 million compared with \$94.9 million last year attributed to higher import payments, which reached \$163.0 million in 2002/03, 21.9 % higher than the previous year. At the same time, total exports slightly fell by \$0.2 million (0.5 %). Exports receipts were led by squash, fish and other marine products and vanilla. The services balance also recorded a deficit of \$11.9 million. The higher net transfer inflow of \$128.9 million (11.1%) was not enough to finance the deficits in the trade, services and investment income accounts. Accordingly, the current account recorded a deficit of \$10.7 million, a significant change from the \$15.8 million surplus of the previous year. Due to lower official outflows in the 2002/03 year, the capital account recorded a surplus of \$17.4 million, a 10.2 % increase from the \$15.8 million surplus recorded last year. According to the OET data, some net outflow of \$14.3 million was unaccounted for during the year.

**Balance of Payments for 1999/00 to 2002/03(OET Basis)**

	2000/01	2001/02	2002/03	2003/04 first eight months
Balance of Trade	-96.7	-94.9	-124.4	-97.7
Services Balance	-17.2	-4.2	-11.9	-0.2
Investment Income Balance	-2.2	-1.2	-3.3	-0.4
Transfers Balance	89.9	116.0	128.9	102.8
Current Account Balance	-26.2	15.8	-10.7	4.6
Capital and Financial Balance	6.2	15.8	17.4	22.3
Other Items Net	19.5	-17.8	-9.3	-9.5
Overall balance	-0.4	13.8	-2.6	17.4

During the first eight months of 2003/04 financial year, the balance of payments recorded an overall external surplus of \$17.4 million. The improvement in the overall external position is a combination of a favourable current account surplus of \$4.6 million and a net capital account inflow of \$22.3 million (largely reflecting the disbursement of the second tranche of the ADB loan) which offset an unrecorded net outflow of \$9.5 million.

### 6.4. Gross Official Foreign Reserves



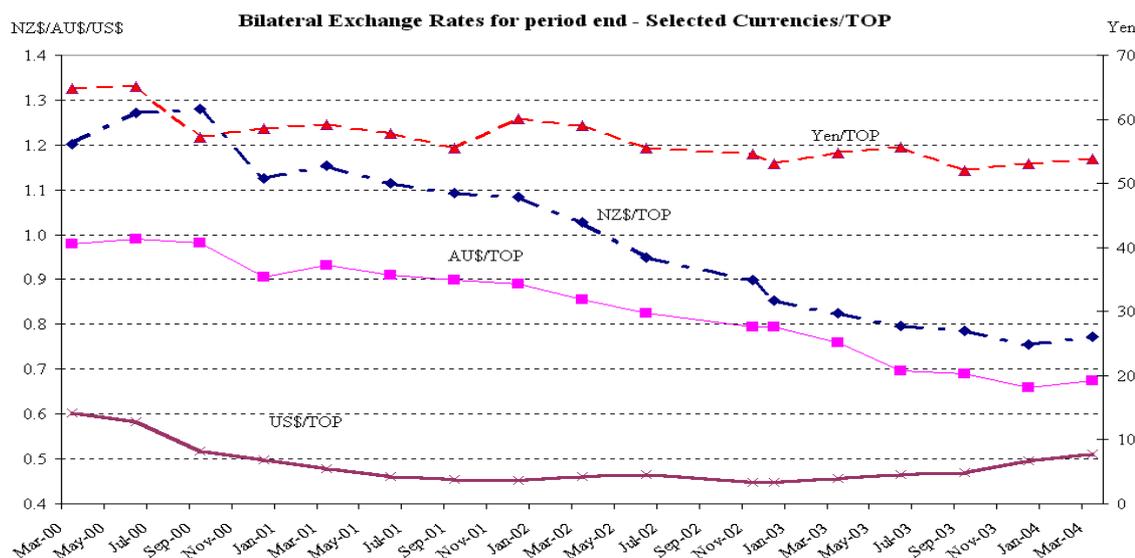
The gross official foreign reserves declined to \$36.9 million at the end of June 2003 compared with \$39.6 million in the previous year. At the end of June 2003, the level of official foreign reserves was equivalent to 2.4 months of imports. The decline in the gross official reserves mainly reflected higher payments for imports of goods and services.

At the end of March 2004, the gross official foreign reserves reached \$56.3 million compared with \$36.9 million at the end of March 2003. At the same time the level of gross official foreign reserves was equivalent to 2.3 months of imports at the end of March 2003, compared with 3.5 months of imports at the end of March 2004. The increase in the gross official reserves largely reflected the disbursement of the second tranche of the Government's loan from the ADB.

## 7.0 Exchange Rates

During the 2002/03 financial year, the pa'anga weakened against most of the currencies of Tonga's major trading partners. The pa'anga depreciated against the New Zealand dollar by 16.2%, the Australian dollar by 15.8% and the Fijian dollar by 12.8%. On the other hand, it appreciated against the US dollar by 0.3 % and the Japanese Yen by 0.4%.

During the nine months ended March 2004, the pa'anga depreciated by 3.1% against the Australian dollar, Japanese yen by 3.3% and the New Zealand dollar by 2.9%. However it appreciated against the United States dollar by 9.6% and the Fijian dollar by 1.6%.



## 8.0 Economic Outlook for 2004/05

The economic outlook for 2004/05 and the medium term depends to a large extent on continued strengthening in the external markets and the effective implementation of the Government's economic reform programme (EPSRP). The International Monetary Fund has predicted a more stable global economy through 2004/05 as major advanced economies recover rapidly from the economic downturn in 2001/02. Nevertheless, there is still concern over the instability of oil prices and the impact of possible terrorist attacks.

It is projected that growth will accelerate in the order of 2.8% in 2004/05. Agriculture and fisheries will register a modest strengthening as fishing expands and the supplies of vanilla, squash, coffee, root crops, and kava respond to better opportunities in regional and global markets. Construction is expected to expand rapidly as a result of externally funded projects and a greater government capacity to fund capital expenditure. Minimal growth in the dominant

government services sub-sector will constrain overall tertiary sector growth, but commerce, restaurants and hotels, entertainment, and private services are projected to edge up as remittance flows continue and tourism expands. The Government plans to market the country as a unique and safe tourist destination but it will need to secure adequate air services.

The strengthening of public financial management, tax policy reform, and public service and public enterprise reform should result in better budgetary outcomes, an improved strategic allocation of public resources, and more effective public service delivery. On the expenditure side, wages and salaries are budgeted to increase by 9.2% from the 2003/04 level, to allow for some pay increases in the context of a continued recruitment freeze. Priority in spending is to be given to law and order, education, health, and basic infrastructure. The major risks in this scenario are a push for public service wage increases and greater demands on the budget from an unreformed public enterprise sector. The inflation rate is projected to moderate at around current levels on the assumption of continued exchange rate stability. The current account is expected to improve as export growth accelerates and remittances maintain their current level, but no major improvement in the overall balance of payments is likely, unless foreign investment grows significantly. Foreign reserves are projected to stay in the vicinity of 3 months of import cover.

Economic growth in the forecast range would create some employment opportunities for young entrants to the labor force, but the high level of youth unemployment and an associated rise in crime will probably continue to be major social issues.



Budget Statement for Year Ending 30<sup>th</sup> June 2005

**Budget Paper 2: *Fiscal Outlook***



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## 1.0 Introduction

Budget Paper No.2 discusses four elements of the budget. Firstly, an overview is presented of the estimated budget balance and proposed financing for the 2004/05 financial year and the last two years. Secondly, the individual components of the proposed budget estimates for 2004/05, based on a Government Finance Statistics (GFS)<sup>2</sup> presentation, are analyzed in detail. Thirdly, the estimated outturn figures for 2003/04 are discussed. Finally, summary tables of the estimated receipts and budget appropriations proposed by the government for each line ministry are provided, together with a reconciliation of the figures to the GFS presentation. The actual details of the appropriations are contained in the separate document: “*The Program Budget Estimates*”.

## 2.0 Overall Balance

The budget estimates for 2004/05 and the two previous years are presented in Table 1, based on the high level GFS economic classifications of revenues and expenditures. The table highlights an estimated operating surplus of \$3.6 million in 2004/05 arising from total revenues of \$117.8 million minus the operating expenditures of \$114.2 million. In addition, the government plans to acquire two types of assets:

- firstly, \$14.3 million in fixed assets primarily infrastructure restoration and the building of a new hospital (refer section 6.2); and
- secondly, financial assets through the provision of loans to public enterprises, as part of the government's public enterprise reform program. Approximately \$1.3 million in loans to public enterprises will be required in 2004/05. Also, based on current outstanding loans that public entities have with government, it is estimated that approximately \$1.37 million in loan repayments should be received by government in 2004/05 (the figure in the table is negative as it is a loan repayment flowing back into government), so the net acquisition of financial assets is -\$0.08 million.

The overall fiscal balance is therefore a deficit of \$10.6 million and represents the additional financing required to fully fund the government's policy agenda for 2004/05. As discussed in Section 8, the government proposes to finance the deficit through a combination of overseas concessional loans, domestic bond issues and a drawdown on the government's cash reserves.

An analysis of the individual revenue and expenditure components are discussed in sections 3 and 6 respectively. A fully expanded GFS presentation is provided in Appendix 17.

**Table 1: Overall Fiscal Balance (\$)**

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<sup>2</sup> The GFS system of classifying government transactions is used in many countries and enables an assessment of the overall performance and financial positions of the general government as well as ready international comparison. The Government of Tonga introduced the presentation of the budget on a GFS basis in the 2003/04 Budget. The budget figures are currently prepared on a cash basis.

	<b>Preliminary Outturn 2002/03</b>	<b>Original Estimate 2003/04</b>	<b>Revised Estimate 2003/04</b>	<b>Budget Estimate 2004/05</b>
<b>Revenue (1)</b>	<b>99,287,567</b>	<b>124,954,354</b>	<b>102,180,102</b>	<b>117,756,038</b>
Tax revenue	80,746,110	83,110,350	83,680,100	88,228,565
Grants (in cash)	2,870,148	15,124,425	3,000,002	5,700,587
Other Revenue	15,671,309	26,719,579	15,500,000	23,826,886
<b>Operating Expenditure (2)</b>				
Compensation of employees	49,080,267	54,970,414	46,197,162	53,889,576
Purchase of goods and services	32,097,693	40,236,947	31,500,000	42,713,901
Interest	2,316,019	3,405,564	3,405,564	2,735,000
Subsidies	3,117,567	6,900,002	11,900,000	5,900,004
Grants	1,443,283	1,261,100	1,261,100	1,121,100
Social Benefits	2,628,554	4,871,707	4,871,707	4,988,003
Other operating expenditure	2,307,357	2,981,532	3,200,000	2,834,017
<b>Total Operating Expenditure</b>	<b>92,990,740</b>	<b>114,627,266</b>	<b>102,335,533</b>	<b>114,181,601</b>
<b>Operating Balance (1-2)</b>	<b>6,296,827</b>	<b>10,327,088</b>	<b>-155,431</b>	<b>3,574,437</b>
Total net acquisition of nonfinancial (fixed) assets	8,001,814	17,336,320	2,800,000	14,301,031
Acquisition of fixed capital assets	7,600,000	17,139,567	2,700,000	14,057,598
Purchases of land and intangible assets	401,814	196,753	100,000	243,433
<b>Net Borrowing Requirement (1-2-3)</b>	<b>-1,704,987</b>	<b>-7,009,232</b>	<b>-2,955,431</b>	<b>-10,726,594</b>
Total net acquisition of financial assets for policy purposes (4)	9,550,363	-423,591	-423,591	-77,624
<i>Domestic</i>				
Lending by Government	9,550,363	1,300,001	1,300,001	1,300,001
Repayments to Government	0	-1,723,593	-1,723,593	-1,377,626
Overseas	0	0	0	0
<b>Overall Fiscal Balance (1-2-3-4)</b>	<b>-11,255,350</b>	<b>-6,585,641</b>	<b>-2,531,840</b>	<b>-10,648,970</b>

### 3.0 2004/05 Revenue and Grants

The total revenue and grants to be received by government in 2004/05 is estimated to be \$117.8 million, which is a 15.2% or \$15.6 million increase on the \$102.2 million estimated outturn for 2003/04. This increase is associated with additional estimated tax revenues of \$4.5 million, other revenues of \$8.3 million and grant revenues of \$2.7 million. Table 2 sets out the detailed components of revenue and grants estimates and the variation between the two years.

#### 3.1 Current Revenues

The total current revenues estimates of just over \$110.6 million, accounts for almost 93.9% of the total estimated revenues available to the Government in 2004/05. As forecasted in last year's budget, due to the implementation of the new taxation regime from April 2005, the composition of current tax revenues in 2004/05 will change over the next few years, with an increasing proportion of tax revenue coming from the introduction of the consumption tax.

Of the estimated 16.6 million total of sales and consumption tax for 2004/05, consumption tax is estimated to generate around \$10.2 million and sales tax \$6.4 million. The two main components of the \$3.6 million estimate for other taxes, are excise taxes (\$2.0 million) and the various license taxes (\$1.6 million). In total, domestic taxes on goods and services are estimated to be just under 23.0 percent of total tax revenue in 2004/05, as compared to 14 percent in 2003/04.

**Table 2: Estimated Revenues and Grants (\$)**

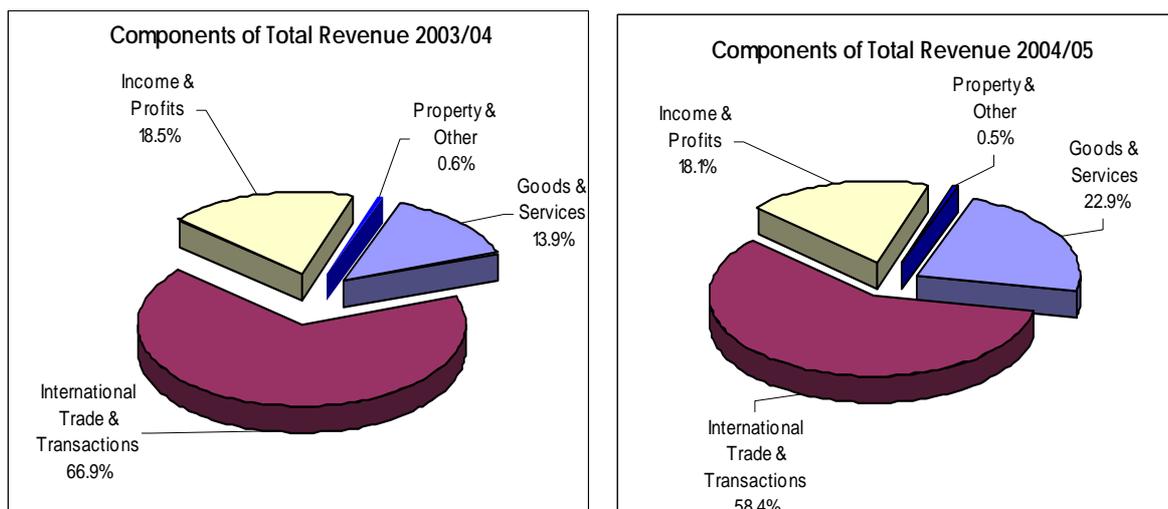
	Preliminary Outturn 2002/03	Original Estimate 2003/04	Estimated Outturn 2003/04	Budget Estimate 2004/05
<b>Total Revenue and Grants</b>	<b>99,287,567</b>	<b>124,954,354</b>	<b>102,180,102</b>	<b>117,756,038</b>
<b>Tax revenue</b>	<b>80,746,110</b>	<b>83,110,350</b>	<b>83,680,100</b>	<b>88,228,565</b>
Taxes on income and profits	15,527,122	14,000,000	15,500,000	16,000,000
Taxes on property	52,725	81,000	81,000	51,573
Domestic taxes on goods and services	10,933,399	11,649,100	11,649,100	20,185,734
Sales tax / Consumption tax	8,066,246	8,500,000	8,500,000	16,602,412
Other taxes	2,867,153	3,149,100	3,149,100	3,583,322
Taxes on international trade and transactions	53,779,654	56,930,250	56,000,000	51,541,258
Customs duties	27,951,304	28,500,603	29,000,000	30,000,000
Other import charges	25,828,350	28,429,647	27,000,000	21,541,258
Other taxes	453,210	450,000	450,000	450,000
<b>Nontax revenue</b>	<b>15,651,254</b>	<b>25,328,578</b>	<b>15,500,000</b>	<b>22,342,587</b>
Entrepreneurial and property income	2,941,160	6,908,013	3,500,000	4,680,899
Administrative fees and charges	11,522,478	17,720,364	11,400,000	16,874,100
<i>of which: revolving funds</i>	<i>3,511,798</i>	<i>7,159,490</i>	<i>3,100,000</i>	<i>6,804,448</i>
Fines and forfeits	336,299	165,000	300,000	201,887
Other nontax revenue	851,317	535,201	300,000	585,701
<b>Subtotal current revenue</b>	<b>96,397,364</b>	<b>108,438,928</b>	<b>99,180,100</b>	<b>110,571,152</b>
<b>Capital revenue</b>	<b>20,055</b>	<b>1,391,001</b>	<b>0</b>	<b>1,484,299</b>
<b>Subtotal revenue</b>	<b>96,417,419</b>	<b>109,829,929</b>	<b>99,180,100</b>	<b>112,055,451</b>
<i>Grants (in cash)</i>				
From abroad	2,870,148	15,124,423	3,000,000	5,700,585
From other levels of national government	0	2	2	2
<b>Grants (in cash)</b>	<b>2,870,148</b>	<b>15,124,425</b>	<b>3,000,002</b>	<b>5,700,587</b>

Conversely, the level of receipts from taxes on international trade and transactions are estimated to decline in 2004/05 to \$51.5 million from \$56.0 million in 2003/04. This is associated with the simplification of the taxation arrangements. Overall, the level of revenue from taxes on international trade and transactions as a proportion of total current taxes, is estimated to decline from 66.9% in 2003/04 to 58.4% in 2004/05. The remaining proportion of tax revenues is made up of taxes on income and profit (18.1%) and a negligible proportion from property tax.

The following pie charts depict the change in composition of total tax revenues between 2003/04 and 2004/05 arising from the introduction of the consumption tax and the sales and customs tax amendments as discussed above.

Non tax revenues in 2004/05 are estimated to increase by \$6.8 million to \$22.3 million. The main component behind this is a \$5.5 million increase in administrative fees and charges, of which the revolving fund income component is 67.6%. The latter refers to income collected by agencies which they can retain for program expenditures, rather than return to the government consolidated revenue. Therefore, if the revenue is not collected, the associated expenditure does not proceed.

Of the estimated \$110.6 million in total current revenues for 2004/05, tax revenues comprise almost 80.0% and non tax revenues 20.2%. This compares to 85.0% and 15.0% respectively in 2003/04.



### 3.2 Grants

As noted in the introduction, a change in the budget presentation for 2004/05 relates to refining the estimation of grant revenues and expenditures. In past budgets these estimates have included both secured grants, that is where a grant agreement had been signed, and unsecured grants for which donor funding is yet to be identified and/or secured. Appropriations were made to the expenditure line items of relevant programs, based on the total level of both secured and unsecured grants. Although the Ministry of Finance did not release funds for expenditure until the relevant grant was actually secured, as the majority of the estimated grant funding was never realized, this approach tended to significantly overstate in equal proportions, both the revenue and expenditures estimates in the budget.

On the expenditure side, the monitoring and reporting of budget execution for those programs where grant revenues were not secured tended to be skewed as actual expenditure continues to appear low relative to the program appropriations. Therefore, grant revenue estimates for 2004/05 are based on donor cash grants that have either been secured through an agreement or are in the pipeline with a high probability that monies will be received in 2004/05. The \$5.7 million estimate is primarily associated with bilateral grant funding from the European Union, New Zealand and Australia together with some funding from UN agencies and the South Pacific Regional Environmental Program. In addition, an estimated \$29.0 million aid-in-kind is anticipated.

### 4.0 Tax Expenditure

Generally government fiscal policy objectives are achieved through expenditure programs. A less obvious option is the provision of tax credits, tax exemptions, deferrals or concessional tax treatment to an organisation or type of transaction the government seeks to encourage. To the extent that direct government expenditure can be used as substitutes for these tax relief mechanisms to implement government policies, these tax relief mechanisms have become known as 'tax expenditures'.

While direct government expenditure is closely monitored and reviewed (generally annually in the budget process), tax relief is generally only considered closely at the time the legislation providing the relief is passed by the legislature. Recognizing that tax relief can be used to achieve the same objectives as direct expenditures it is important to ensure that this tool of fiscal policy is subject to regular budgetary control procedures.

Tax expenditures can take three main forms:

- i. exempting certain taxpayers from a tax, such as fuel concession for fishing industry and electricity generation;
- ii. applying a lower rate of tax, a rebate or deduction, to certain taxpayers; or
- iii. deferring the time for payment by certain taxpayers of a tax liability.

Likewise, concessions on user charges and fees can take two main forms:

- i. exempting certain users from a charge generally applied to the community for government goods and services or exempting certain sections from a fee generally applied to the community; or
- ii. imposing on certain sections of the community a charge lower than that applied to the general community for government goods and services, or imposing fees lower than the general fee.

#### **4.1 Industrial Development Incentives**

The Industrial Development Incentives (IDI) was established in 1978 with the objective to encourage private sector activities in Tonga, particularly infant entrepreneurship, by providing exemptions on customs and excise and port services tax. A review by the Ministry of Finance, with assistance from AusAid, clearly demonstrates that the tax expenditures provided under the IDI Act are cost ineffective. One report indicated that a survey of tourism facilities benefiting from IDI Act concessions concluded that not one of the facilities had complied with the IDI license conditions, resulting in the provision of a significant amount in tax exemptions for virtually no benefit to the Tongan tourism industry. It is proposed that the act be repealed and incentives to inventors will be provided through deductions for accelerated depreciation and investment allowances under the new Income Tax Assessment Act.

#### **4.2 Fuel Concession for Fishing Industries**

In recognition of the potential that the fishing industry contributes to the overall gross domestic product of the economy, in February 2000 the government approved fuel concessions to fish exporters, to be monitored by a fuel concession committee, chaired by the Secretary for Fisheries. The initiative was granted to lower cost of production and encourages fishing companies to increase production.

The total fuel issued under the concession totaled to 3,621 metric litres (mt.) in 2002/03 compared to 2,939 mt. issued in 2001/02. This represented \$1.52 million of revenue foregone to the government. For the nine months ending March 2004, fuel concession for fishing amounted to \$0.69 million with only 1,653 mt of fuel issued. The decline reflects the weakening of the fishing industry due to the *el nino* phenomenon and overall lower fish stock in the region.

#### **4.3 Fuel for Generation of Electricity**

The government also subsidizes the production of electricity by exempting taxes on fuel in order to lower cost and ultimately, prices for consumers. Tax expenditure on fuel for the generation of electricity was estimated at \$4.31 million in 2002/03, posting an increase of about \$1.0 million from the exemption in 2001/02. Due to significant increases in the international price of fuel, total fuel issued for generation of electricity declined to 7,180 mt. in the nine months ending March 2004 compared to 8,486 mt. in the same period 2003. Total revenue foregone for this period equaled \$2.85 million.

#### **4.4 National Project**

The Government of Tonga continues to receive assistance from donor countries in support of a variety of social and economic projects ranging from water, environment, humanitarian, and

electricity projects. In recognition of the need to reduce project costs to ensure the maximum benefit is delivered to all Tongans, the government provides an exemption of duties and taxes on the project supplies. In 2003/04 the concession provided by the government on the various donor projects amounted to over \$1.67 million. This is estimated to increase in 2004/05 to around \$2.0 million, associated with a higher level of donor project activity.

#### **4.5 Other Projects**

Government provides tax concessions to projects that are considered national interest and of significant economic benefit, as approved by the Privy Council. At the end of April of the 2003/04, the concession granted for such projects amounted to \$2.28 million. A similar tax concession level is expected in 2004/05.

### **5.0 Tax Reform**

The government's proposed changes to the tax system were outlined in details in the Budget Statement 2003/04. This was intended to brief the public on various components of the tax reform in particular tax rates, new government policies and procedures, administrations and the proposed tax structures. This section aims to update the public with the latest progress and the various components of the tax reform that need to be in place before the implementation date, 1 April 2005.

#### **5.1 Tax Policy**

Weaknesses in the legislative basis for tax administration in the Kingdom of Tonga have been evident for some time. The government's tax policy reform initiatives seek to redress this situation by creating a sound and uniform legal foundation for tax and custom administration, based on three key pieces of legislation enacted by the Legislative Assembly: the Revenue Services Administration Act (RSAA), November 2002; Consumption Tax Act (CTA), November 2003; and the RSAA Regulations, November 2003. Two other Bills, the Income Tax Act and Custom & Excise Act are currently with the Law Committee to be tabled before the Legislative Assembly in 2004.

##### ***Revenue Services Administration Act***

The Revenue Services Administration Act (RSAA) received the Royal Assent on 23 December 2002. The regulations to the RSAA were approved by Privy Council in August 2003. The provisions of the RSAA will come into force on 1 June 2004.

The RSAA provides for a common set of administration rules applicable to income tax, sales tax, and customs tax and will also apply to the consumption tax discussed below. The RSAA makes important changes to the existing rules, in particular, relating to: objections and appeals; taxation rulings; Taxpayer Identification Number (TIN); penalties; and recovery of taxes.

##### ***Consumption Tax Act***

The Consumption Tax Act – or CTA – is based on the international model for value added taxes, carefully modified to suit Tonga's particular situation and circumstances. The consumption tax is designed as a broad based tax imposed at a single rate of 15.0% on domestic consumption and imports, with few exceptions. Subject to a small trader exemption, all persons engaged in the production and distribution of goods and services domestically are required to register for consumption tax. A high registration threshold of \$100,000 is imposed to limit the number of taxpayers who will be required to register for consumption tax. Taxpayers may voluntarily apply to register for consumption tax if they are below the threshold. It is estimated that approximately 200 taxpayers (compulsory and voluntary) will register for consumption tax in Tonga. The consumption tax is part of the total tax reform package which aims to stimulate the growth of the

private sector and to spread the tax burden as fairly and widely as possible by shifting the emphasis of taxes from 'trade taxes' (Ports and Services Taxes and Import Duties) to a limited domestic consumption tax.

### ***Income Tax Act***

Changes to the current income tax provisions were recommended as part of the Government's Tax Reform program. The present act is to be replaced by a new income tax assessment act. The draft income tax bill is written in plain language so that it can be read and understood by any person who needs to refer to it. The proposed date of commencement of the Act is 1 July 2005. The major changes proposed in the Income Tax Bill, 2003 are summarized below.

- **Corporate Income Tax**

A single corporate rate of tax of 20% will apply to companies, partnerships and some trusts. Credit for export sales and special deductions for tourism development activities will be removed and replaced with specific deductions for accelerated depreciation and investment allowances, such as a write off of pre-commencement expenditure over 4 years, targeted at developing the business sector generally. A minimum income tax (MIT) of 1% of turnover will be imposed for all companies and large businesses, including those in a loss situation.

Finally, all business in Tonga will require registration of a Tax Identification Number (TIN), similar to current Tax File Number (TFN) arrangements. This will be an important component of strengthening the IRD's and Custom's computerisation and monitoring of business activities, coupled with the introduction of income tax self assessment arrangements.

- **Individual Income Tax**

Progressive tax rates will be introduced, with the highest marginal rate for individuals' equivalent to the corporate tax rate of 20%. The tax free threshold for individuals will be increased to \$5 000 to equate with a reasonable minimum level of income for survival (it represents the average level of deductions for personal expenditure items such as housing interest etc). A system of final withholding through PAYE has already been introduced for individual salary and wage earners. The system means that taxpayers are not required to furnish a return to the Chief Commissioner of Revenue, unless earning other income.

- **Public Awareness**

The Revenue Services Department have already commenced a public awareness program based around ongoing liaison with the Chamber of Commerce, circulation of a Bulletin to the general public and businesses and outer island visits. Television, radio and village awareness initiatives will also be undertaken.

## **5.2 Tax administration**

The Government cannot emphasize enough the importance of strengthening its tax administration capacity. Establishing an effective tax and customs administration will be critical to the implementation of the tax policy reform and achieving the tax revenue estimates. Consequently, the government is redressing the current weaknesses in the systems through a Tax Modernization Programme and a Custom Reform Modernisation Programme.

### ***(i) Tax Modernization Programme***

The tax modernization programme comprises a number of phases. The first is the reorganisation of the Inland Revenue Department into two distinct service divisions: a Large Business Division (LBD) and a Small Business Division (SBD). The latter will have responsibility for

implementation of the corporate tax reform with the power to implement the reorganization and new procedures with the Inland Revenue.

Secondly, a Taxpayer Identification Number (TIN) will be compulsory for all businesses with a threshold of \$100,000 turnover. This will also be available on a voluntary basis to any business below the threshold.

Thirdly, the New Zealand government is providing financial support for acquiring a computer system which will increase the efficiency and productivity of the department in handling tax administration.

The fourth area of tax modernization is the capacity development of Revenue Service Department staffs and promoting a public education program.

#### ***(ii) Custom Reform and Modernization Programme***

There are five main elements to the Customs reforms. Firstly, Customs entry processing operations will be computerized to improve clearance times, compliance, management information and the quality of statistical data. The computerization project is on schedule with all preparatory work undertaken and the specification confirmed. A contract is being prepared and the test phase is the next step which is imminent.

Secondly, the Customs and Excise Act and Regulations are being revised. Customs authorities worldwide rarely, if ever, get the opportunity to re-build their legislation on a foundation of modern Customs principles and in plain, simple language. This is an ambitious undertaking. The Customs Bill 2004 has been prepared and should be ready for consultation with stakeholders in the near future before being drawn up as a legislative proposal for Parliament. Regulations will then be drafted and similarly subjected to a process of consultation with stakeholders before it, in turn, undergoes the necessary legal processes.

The third element is that of raising the technical competence of officers and the business community. Officers have been trained in commercial law principles underlying international trade. In view of difficulties with valuations at the barrier, Customs has brought forward the implementation of the World Trade Organisation's Customs Import Valuation System from 1 August to 3 May 2004. Customs officers, statistical officers and the import community have been fully trained in these principles and issued with a manual to enable all to participate in the valuation process on the basis of a clear set of rules. This development is about three months ahead of schedule and will be followed by similar processes in other areas when the necessary laws are passed and implemented.

Fourthly, there has been frequent consultation with stakeholders through weekly meetings, ad hoc gatherings and in the course of training of the business community in valuation. In most of these consultations written material has been provided and questions invited and answered. This level of consultation will continue.

Finally, an important aim of the reforms is to write and implement comprehensive procedure manuals on every facet of Customs operations. These manuals will be available to officers with a public edition also being available to stakeholders. The business community will thus be empowered in the discharge of its new self-assessment responsibilities, to expect and require that Customs procedures conform to the manual. To further this goal, an internal audit unit will be monitoring adherence to the manual internally in the national interest. A procedures manual on valuation has been prepared and is awaiting the resolution of some legal issues before implementation, once again ahead of time.

## 6.0 Expenditure and Net Lending

The aggregate level of expenditure and net lending in 2004/05 is estimated to total \$128.4 million as compared to an estimated outturn for 2003/04 of \$104.7 million. The increase is primarily associated with an additional \$12.7 million current expenditure and \$10.6 million additional capital expenditure in 2004/05. The main expenditure categories, as a proportion of total expenditure in 2004/05, are: salary and wages, comprising just under 40.0%; goods and services at 33.7%; subsidies, 9.7%; and capital of 11.2%. Table 3 provides a breakdown of all expenditures and net lending items into their component categories and highlights the variation between the two years.

**Table 3: 2004/05 Estimated Expenditure and Net Lending (\$)**

	Preliminary Outturn 2002/03	Original Estimate 2003/04	Estimated Outturn 2003/04	Budget Estimate 2004/05
<b>Total expenditure and net lending</b>	<b>110,542,917</b>	<b>131,539,995</b>	<b>104,711,942</b>	<b>128,405,007</b>
<b>Total Current expenditure</b>	<b>92,415,715</b>	<b>113,766,255</b>	<b>100,735,533</b>	<b>113,480,594</b>
Wages and salaries	44,274,256	52,921,245	44,200,000	51,314,617
Employer contributions	1,498,735	2,049,169	1,997,162	2,574,959
Other purchases of goods and services	32,097,693	40,236,947	31,500,000	42,713,901
Interest payments	2,316,019	3,405,564	3,405,564	2,735,000
Additional expenditures	3,307,276	1,600,000	8,200,000	1,678,297
Subsidies and transfers	8,921,736	13,553,330	11,432,807	12,463,820
Subsidies to non-financial public enterprises	2,401,883	3,200,000	2,000,000	3,200,000
Subsidies to financial institutions	95,592	1,600,001	100,000	700,002
Subsidies to other enterprises	620,092	2,100,001	3,200,000	2,000,002
Transfers to non-profit institutions	1,732,332	2,120,521	1,600,000	2,133,010
Transfers to households	2,628,554	3,271,707	3,271,707	3,309,706
Transfers abroad	1,443,283	1,261,100	1,261,100	1,121,100
<b>Capital expenditure</b>	<b>8,576,839</b>	<b>18,197,331</b>	<b>4,400,000</b>	<b>15,002,038</b>
Acquisition of fixed capital assets	7,600,000	17,139,567	2,700,000	14,057,598
Purchases of land and intangible assets	401,814	196,753	100,000	243,433
Capital transfers	575,025	861,011	1,600,000	701,007
<b>Subtotal expenditure</b>	<b>100,992,554</b>	<b>131,963,586</b>	<b>105,135,533</b>	<b>128,482,632</b>
<b>Net Lending</b>	<b>9,550,363</b>	<b>-423,592</b>	<b>-423,592</b>	<b>-77,625</b>
Domestic	9,550,363	-423,592	-423,592	-77,625
To non-financial public enterprises (net)	10,720,000	849,849	849,849	829,114
To financial institutions (net)	-1,169,637	-1,273,441	-1,273,441	-906,739
Foreign	0	0	0	0

### 6.1 Current Expenditure

The total wages and salaries expenditure of \$51.3 million is a \$7.1 million increase on the estimated outturn for 2003/04. However, the majority of this increase is associated with the Public Sector Reform Program (\$2.7 million) and a \$2.0 million provision for redundancy packages. Whilst the latter was included in the original 2003/04 budget estimates, no expenditure against this item is estimated in the 2003/04 outturn. In addition, the salaries component of this expenditure category actually decreases by around \$400,000 reflecting the Government's continued commitment to containing growth in the total wages, as well as the "right-sizing" of the public sector. The current freeze on additional staffing and advertising of non-essential vacant posts will continue in 2004/05, together with expenditure cuts in allowances (23.0%) and temporary and wages staff (8.0%). In addition, the government is committed to funding any salary adjustment from savings within the overall wages and salaries budget.

The \$11.2 million growth in expenditure in other purchases of goods and services, is primarily associated with the reallocation of funding to priority areas such as culture and youth services (\$300,000), research (\$200,000), agricultural supplies (\$520,000) and medical supplies and

overseas treatments (\$530,000). In addition, the contingency reserve provision has been increased to just under \$5.5 million, and a new \$3.5 million provision made for government loan guarantees. Expenditure reductions have been made in areas such as overseas travel (15.2%), office supplies and printing (21.1%), hospitality (20.4%), fuel (33.1%) and technical equipment and supplies (33.5%).

## **6.2 Capital Expenditure**

The total capital expenditure for the 2004/05 budget is estimated at \$15.0 million, the majority of which will be funded through grants and loans from development partners. As in the 2003/04 Budget, the most significant components of the Government's capital expenditure program for the 2004/05 fiscal year relate to finalization of the Tropical Cyclone Waka infrastructure restoration works in Vava'u and the Niuas, and Phase III of the health sector support project, including commencing construction of the new Vailoa Hospital. Other capital expenditures relate to funding for building renovations (\$0.54 million), the purchase of new equipment (\$0.53 million) and machinery (\$0.45 million) and other capital expenditure (\$0.1 million).

## **7.0 Estimated Outturn 2003/04**

The estimated outturn for 2003/04 is an overall deficit of \$2.5 million compared to the original budget estimate of \$6.5 million associated with both lower total revenues and total expenditures than originally budgeted.

On the revenue side, a large component of the lower than budgeted outturn figures were associated with the over-estimation of grant revenues, as discussed earlier in section 2.2. Although tax collections were in-line with the budget estimates, total revenue collections were 9.7% less than budget, primarily associated with a large reduction in non tax revenues. Most of this was associated with the revolving fund arrangements which enable agencies to retain certain receipts for funding their own operations. However, if the receipts are not realized, then the expenditure cannot occur.

On the expenditure side, the majority of the under expenditures can also be attributed to the unrealized grant revenues, particularly in capital and other expenditures (primarily goods and services). The 16.5% under expenditure in wages and salaries arose from the government's freeze on the filling of non-essential vacant positions as part of the public sector "right sizing" initiative.

Finally, the \$16.9 million in external financing disbursements received from the World Bank and ADB, were \$6.7 million higher than budgeted. As the government made a public debt repayment of \$4.3 million, the net level of external financing was \$12.6 million as compared to the original budget estimate of \$5.8 million. The lower overall deficit of \$2.5 million meant that the difference between the deficit and the net external financing resulted in a \$10 million increase in the government's cash balances.

## **8.0 Financing Transactions**

Net financing transactions measure the manner in which the overall fiscal budget deficit is financed, or a budget surplus is utilized. Table 4 outlines the financing transactions components of the 2004/05 budget and the preceding years.

As highlighted earlier in Table 1, the overall fiscal balance for 2004/05 is a deficit of \$10.6 million. This will be met through a combination of external and domestic financing. In relation to external financing, based on a concessional loan agreement negotiated with the World Bank, disbursements of approximately \$10.1 million will be received in 2004/05. As noted earlier, this financing is primarily for the Cyclone Waka restoration projects and Phase III of the health

improvement program. The 2004/05 budget also includes a provision for government to make a public debt repayment of about \$4.7 million. Therefore the net external financing is \$5.5 million.

**Table 4: Estimated Financing transactions (\$)**

	<b>Preliminary Outturn 2002/03</b>	<b>Original Estimate 2003/04</b>	<b>Estimated Outturn 2003/04</b>	<b>Budget Estimate 2004/05</b>
<b>Total financing</b>	<b>11,255,350</b>	<b>6,585,641</b>	<b>2,531,840</b>	<b>10,648,970</b>
External financing	5,700,000	5,874,567	12,568,142	5,513,478
Disbursements	9,400,000	10,206,425	16,900,000	10,185,478
Repayments	3,700,000	4,331,858	4,331,858	4,672,000
Domestic financing	9,800,000	0	10	2,085,500
of which: Bonds	9,300,000	9,000,000	9,000,000	7,085,500
Tonga Trust Fund	50,000	10	10	9
Net Changes in Government Investment / Bank Balance	1,000,000	711,064	-10,036,312	1,049,960
Treasury Deposit at NRBT	-5,300,000			
ADB Economic & Public Sector Reform Program				2,000,023

On the domestic front, the government intends undertake just over \$7.0 million in bond issues in 2004/05 with the purpose of financing a \$5.0 million rollover of bonds, scheduled to mature in 2004/05, as well as contributing \$2.0 million towards financing the budget deficit. In addition, the government will drawdown approximately \$1.0 million of its own cash balances plus utilise the \$2.0 million ADB funding received as a concessional loan in 2003/04, (and included in Table 4 under the \$16.9 million disbursement for that year), which in effect has been rolled over to 2004/05. The loan is for the government's Economic and Public Sector Reform Program.

## 9.0 Public Debt

Data on public and publicly guaranteed debt is maintained using the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS).

At the end of April 2004, provisional data indicates that the total public debt outstanding amounted to \$189.2 million, with external debt amounting to \$157.3 million and domestic debt amounting to \$31.9 million.

The total external government debt outstanding is projected to increase to \$161.4 million in 2003/04. Total external disbursements are projected to be \$9.2 million by the end of 2003/04. Principal repayments for 2003/04 are projected to be about \$3.9 million. During the same period, interest payments are estimated at \$1.5 million.

The total domestic government debt outstanding is expected to be unchanged in 2003/04 with loan raising limited to the amount necessary to finance the rollover of maturing bonds. Interest payments on domestic debt in 2003/04 are estimated at \$1.3 million.

The total amount of loans guaranteed by the government at the end of April 2004 amounted to \$27 million, of which \$7.7 million was for foreign lenders to public enterprises. All of the guarantees were for public enterprises with the exception of \$2 million for the Squash Export Council. Of the public enterprises, about \$5 million of the loan guarantees are for Royal Tongan Airlines, which the government has decided to liquidate.

Attached in the annex are statements of loans to Local Statutory Boards and other organizations, government external debt, domestic debt, and guaranteed loans made by the government.

During 2003/04 the following loans were entered into by the Government pursuant to section 25 of the Public Finance Management Act. Table 5 is provided pursuant to section 25(3) of the Act.

The government has assessed the overall debt profile and determined that the level of debt is sustainable. It is estimated that the net present value of debt is about 25 percent of GDP which is consistent with the “debt stress” thresholds for countries similar in structure to Tonga. However, it has been noted that unless economic performance improves relative to the last ten years, the net present value of debt would rise to about 45 percent of GDP in the next 20 years. It is further noted that debt sustainability is highly susceptible to exchange rate shocks. It is considered crucial that the reform efforts are accelerated to minimize the likelihood of the debt burden becoming a source of instability.

**Table 5: Government Loans during financial year 2003/04**

Lender	Date	Purpose	Interest rate	Term	Amount
Public bond issue	31 July 2003	Refinance maturing bonds	6.5%	3 years	\$1,000,000
Public bond issue	31 October 2003	Refinance maturing bonds	6.5%	3 years	\$1,000,000
Public bond issue	13 April 2004	Refinance maturing bonds	6.75%	5 years	\$5,000,000
World Bank	23 September 2003	Health sector support project	0.75%	50 years	\$22,000,000 (SDR 8.0 million)

## 10.0 Public Enterprise Reform

Public Enterprises represent a very significant part of Tonga’s economy and public sector. Using balance sheet values, assets total \$186 million and Government’s net investment (including loans) is approximately \$110.0 million, as set out in Table 6. Financing this represents a substantial commitment; especially as Government’s public debt at June 2003 was approximately \$188.6 million so the investment is equivalent to 58.0% of public debt.

**Table 6: Public enterprise overall investment**

Public Enterprises - Overall Investment	
	\$ million
Capital contributed by government	72.28
Donor contributions	18.99
Revaluation of assets	12.83
Net result of profitable operations (profits less dividends)	21.91
Losses	(50.75)
Net equity	75.27
Loans	34.74
Total investment	110.01

It is important for the Government’s financial health that public enterprises are financially successful as their profits are needed to provide funds to service their capital – either loans or equity - provided by Government. The overall results in the recent past have been negative.

At June 2003, the Government had also guaranteed borrowing by public enterprises totaling \$26.2 million. Of this, Government may have to pay for \$13.6 million, much of which has now crystallized as losses.

The actual cash returns to Government in terms of interest and dividends can only be described as modest. The interest due on the loans outstanding at June 2003 totaled \$1.8 million. However, only \$0.9 million will be received as the balance relates to insolvent enterprises. In terms of dividends, the sum declared as dividends for the 2002/03 totaled \$1.1 million. A

detailed analysis of public enterprise accounts shows that the amount actually paid was \$54,000 as two public enterprises declared dividends but did not actually pay them.

It is important that a target rate of return on shareholders funds be set with 10% suggested as a minimum benchmark. This means that with over \$75.0 million invested, earnings should be targeted to be at least \$7.5 million. In addition, interest should be expected to be paid although neither will be achievable without elimination of the major loss-making public enterprises.

Financial results are very mixed but there has been an overall loss for each of the past six years. A few public enterprises have done well. The losses from a few very poor performers – Royal Tongan Airlines, Tonga Electric Power Board, Sea Star Fishing, and Tongan Corporation – have been so large that they dominate.

While some of the losses might be attributed to public policy or social obligations (e.g. Tonga Broadcasting Commission) these account for only a small part. The vast majority of the losses relate to commercial activities. This poor financial performance needs to change if public enterprises are to contribute positively to Government, rather than drain resources that could be better used elsewhere.

The Public Enterprises Act is a first step towards achieving this much needed improvement and contains what are internationally accepted as standard good practices for public enterprise management and accountability. Gaining the benefits of a well performing public enterprise sector, will take time and will require changes in management practices.

### 10.1 Progress on Asset sales announced on 2003/04 Budget Statement

It was announced that Leiola Duty Free Shop, Tonga Investments Ltd and Sea Star Ltd would be prepared for privatization. Efforts are ongoing with updated financial statements with legal papers drafted with assistance from ADB advisers and crown law.

Sea Star Ltd is the only company well in advance where an advertisement for expression of interest with a formal offer of sale released by the Minister of Finance on December 22, 2003. Five bids were received where a short list by an evaluation panel consisting of Ministry of Fisheries, Crown Law, and Ministry of Finance and Asian Development Bank advisers was made. Short listed bidders attended a due diligence followed by a question and answers session with the board of the Sea Star Fishing Company Ltd on 20<sup>th</sup> February 2004. Further, financial information was requested with the submission of final bids expected two weeks after bidders receive audited accounts followed by any necessary negotiations with final sale estimated for late May early June.

### 10.2 Direct budget assistance

To ensure social non commercial policy mandates of public enterprises are achieved, government offers direct budgetary assistance as is summarized in Table 7 below.

**Table 7: Public enterprise subsidies**

	2003/04	2004/05
<b>Subsidies for Niuafu'ou and Niuatoputapu</b>		
Air Travel	100,000	100,000
Sea Travel	132,000	132,000
Banking	40,000	80,000
Total subsidies	272,000	312,000
<b>Other budget assistance</b>		
Air Travel ( <i>Royal Tongan Airlines</i> )	1,000,000	-
Tonga Broadcasting Commission	500,000	-
Tonga Corporation	300,000	480,000
<b>Total Budgetary support</b>	<b>2,072,000</b>	<b>792,000</b>

### **10.2.1 Royal Tongan Airlines**

In April 2004 Royal Tongan Airlines returned the Boeing 757 aircraft it had leased to the lessor due to inability to fulfil financial obligations under the lease agreement. The return of the aircraft resulted in a large number of stranded passengers. As a public service the government agreed to guarantee the payment of fares to other airlines which assisted with uplifting these passengers.

The government, on 14 May 2004, agreed to place the company into liquidation as it was considered that it could not provide continuing financial support without seriously impairing the provision of other public services due to budgetary and other constraints. As of 2003 total Government capital injection stood at \$20.0 million prompting the government to assess the viability of the company through studies carried out by KPMG, International Finance Corporation (IFC), the Royal Commission and AusAid. Although some of these studies are still on going it is apparent that for RTA to have continued operations, it would have required significant levels of capital injection.

### **10.2.2 Tonga Broadcasting Commission**

The Tonga Broadcasting Commission has a significant non commercial element in ensuring public broadcast and has requested government guarantees of \$230,000 on a loan from Tonga Development Bank.

### **10.2.3 Tonga Corporation**

Tonga Corporation has requested assistance of \$480,000 to retire historical debts and to maintain operations.

## **10.3 Corporatisation**

In evaluating the potential for revenue generating activities to be corporatised specific issues on primary function, nature of activity in relation to the Strategic Development Plan objectives, alternatives, regulation requirements, costs and benefits are assessed. For 2004/05 Government has provided funding for the Tonga Post Office and the Government Printing Department to be corporatised given that all issues named above are satisfied.

### **10.3.1 Tonga Post Office**

The target date for corporatisation is January 2005 provided enabling legislation is passed by the Legislative Assembly. Government has again budgeted for a half year support with the remaining half injected as part of the initial funding under a corporatisation.

### **10.3.2 Government Printing Department**

The Government Printing Department was provided with an additional \$400,000 for the purchase of new equipment during the 2003/04 financial year to enable the transition from Government Department to a corporate body in 2004 and full privatization in 2005.

### **10.3.3 Technical assistance**

The Public Enterprise Unit consists of 2 professional staff and a secretarial support worker all working towards achieving the requirements set out in the Public Enterprise Act 2002 and the goals set out in the Reform Program. The unit has received over the years technical assistance from NZAID and most recently ADB advisers. Ongoing efforts are focused in acquiring updated information that will in future permit proper planning. There is an intermediate need to address the problem that donors have limited capacity to respond quickly to requests for assistance which is often the case when an urgent issue arises in a public enterprise. Moreover, it is hoped that

donors will be more prepared to give direct assistance to enterprises that operate in a commercial environment and to support policy and regulatory work of public enterprises.

## 11.0 Alternate Classifications of Financial Transactions

Traditionally, the estimates of receipts and payments in the appropriation bill are predicated on the cash basis of accounting — that is as funds flow into, within, and out of the Kingdom of Tonga’s bank accounts. Receipts are brought to account in the period in which they are received and payments are accounted for when the actual disbursement is made from those bank accounts. The presentation of the Government’s accounts in this form is predominantly concerned with ensuring money is legally able to be spent and is spent on the purpose for which it was provided. That system of classifying the Government’s financial transaction also forms the basis for effective cash planning and management. The Program Budget Estimates are prepared on this cash basis.

However, as noted earlier, commencing with the 2002/03 budget the Government adopted the Government Finance Statistics (GFS) basis as the primary presentation of the budget estimates as set out in Paper 2. The GFS system of classification is designed to facilitate the study of the macro-economic impact of the Government’s financial transactions on the economy and therefore assessments of the sustainability of fiscal policy objectives. It does so by recording separately ‘below the line’ those receipts and payments transactions, such as those associated with raising or repaying loans, that are primarily associated with the actions necessary to finance a shortfall in government revenues.

The GFS system of classification also records inflows to government associated with the repayment of loans made by the government as net lending within the category ‘expenditure and net lending’, rather than as revenue of the government. Furthermore, by bringing together expenditures directed towards like purposes, GFS system of classification also facilitates presentation of information on the total resources devoted by the Government to those purposes and allows international comparisons independently of local administrative structures.

Tables 8 and 9 therefore, present reconciliation between the cash inflow estimates as detailed in the Program Budget Estimates document and the estimates of revenues (inflows) and expenditures (outflows), classified on a GFS basis, as discussed in the preceding sections of this paper.

**Table 8: Reconciliation between Cash Inflows to the Government of Tonga Fund and Revenues as per the Budget Statements**

<b>Inflows to the Government of Tonga Fund</b>		<b>113,323,132</b>
<i>Plus</i> Inflows to other Funds		
Tonga Trust Fund	9	
Revolving Funds	6,804,448	
Local Community	391,000	
Donor Cash Aid	17,886,086	25,081,542
<b>Total Inflows (as per Program Estimates)</b>		<b>138,404,674</b>
<i>Less</i> Inflows classified as offsets to expenditure		
Repayments of net lending		1,377,626
<i>Less</i> Inflows classified as financing transactions		
External Financing	12,185,501	
Domestic Financing	7,085,509	19,271,010
<b>Total Revenues (as per GFS Presentation)</b>		<b>117,756,038</b>

**Table 9: Reconciliation between Appropriations the Government of Tonga Fund and Expenditure as per the Budget Statements**

<b>Outflows from the Government of Tonga Fund</b>		<b>114,373,092</b>
<i>Plus</i> Outflows from other funds		
Tonga Trust Fund	9	
Revolving Funds	6,804,448	
Local Community	391,000	
Donor Cash Aid	17,886,086	25,081,542
<b>Total Inflows (as per Program Estimates)</b>		<b>139,454,634</b>
<i>Less</i> Inflows classified as offsets to expenditure		
Repayments of net lending		1,377,626
<i>Less</i> Outflows classified as financing transactions		
External Financing	4,672,000	
Domestic Financing	5,000,000	9,672,000
<b>Total Expenditures (as per GFS Presentation)</b>		<b>128,405,008</b>

Table 10 provides a breakdown of moneys from all sources estimated to be collected by the various Ministries and Departments. The decrease in total revenues between the two years is primarily associated with the 2004/05 budget only including estimated grant revenues for which funding is primarily secured (as discussed in section 3.2).

**Table 10: Moneys to be collected by Ministry**

Vote	Ministry	Budget Estimate 2003/04	%	Budget Estimate 2004/05	%
01	Palace Office	1	0	2	0.0
03	Prime Minister's Office	1	0	962,898	0.7
04	Ministry of Foreign Affairs	2,089,633	1	685,509	0.5
05	Governor of Ha'apai	800,000	1	4	0.0
06	Governor of Vava'u	2	0	2	0.0
07	Ministry of Lands, Survey Natural Resources	1	0	1,289,637	0.9
08	Printing Department	1,614,810	1	882,934	0.6
10	Ministry of Justice	850,001	1	344,386	0.2
11	Ministry of Police	735,606	1	1,140,345	0.8
13	Defence	1,008,600	1	103,149	0.1
14	Ministry of Finance	100,000	0	21,065,596	15.2
15	Revenue Department	21,591,940	15	87,300,678	63.1
16	Statistics Department	82,042,725	56	11	0.0
18	Audit Department	159,005	0	20,631	0.0
19	Ministry of Education	32,001	0	2,895,036	2.1
20	Ministry of Health	3,818,923	3	6,411,418	4.6
22	Prisons Department	9,364,603	6	164,731	0.1
23	Ministry of Agriculture	160,000	0	4,933,323	3.6
24	Ministry of Fisheries	3,878,080	3	1,280,104	0.9
25	Central Planning Department	1,352,119	1	609,500	0.4
26	Ministry of Labour, Commerce and Industries	1,029,512	1	1,131,849	0.8
27	Tonga Visitor's Bureau	2,100,004	1	460,111	0.3
28	Ministry of Works	412,850	0	2,779,871	2.0
29	Environment Department	7,497,291	5	695,747	0.5
30	Civil Aviation	1,415,670	1	2,646,511	1.9
31	Ministry of Marine and Ports	3,212,504	2.2	600,690	0.4
<b>Total</b>		<b>145,265,882</b>	<b>100.0</b>	<b>138,404,674</b>	<b>100.0</b>

Table 11 provides a breakdown of moneys appropriated from all sources and for all purposes expected to be available to the various Ministries and Departments compared to the 2003/04 Budget. As in Table 10, the decrease in total appropriations between the two years is primarily associated with the 2004/05 budget only including grant related expenditures for which funding is secured (as discussed in section 3.2).

**Table 11: Moneys to be Appropriated by Ministry**

Vote	Ministry	Budget Estimate 2003/04	%	Budget Estimate 2004/05	%
01	Palace Office	1,770,106	1.2	1,635,616	1.2
02	Legislative Assembly	2,070,472	1.4	2,030,471	1.5
03	Prime Minister's Office	4,320,651	2.9	3,338,249	2.4
04	Ministry of Foreign Affairs	5,647,505	3.9	5,169,085	3.7
05	Governor of Ha'apai	122,914	0.1	214,082	0.2
06	Governor of Vava'u	178,629	0.1	285,133	0.2
07	Ministry of Lands, Survey Natural Resources	2,874,628	2.0	2,309,645	1.7
08	Printing Department	768,423	0.5	581,777	0.4
09	Commissioner of Public Relations	125,200	0.1	118,991	0.1
10	Ministry of Justice	3,934,793	2.7	2,029,659	1.5
11	Ministry of Police	4,130,278	2.8	4,348,989	3.1
12	Crown Law Department	918,439	0.6	978,860	0.7
13	Defence	4,314,253	2.9	3,927,912	2.8
14	Ministry of Finance	40,287,991	27.5	46,862,143	33.6
15	Revenue Department	2,910,537	2.0	2,703,187	1.9
16	Statistics Department	634,387	0.4	462,770	0.3
17	Public Service Commission	0	0.3	541,010	0.4
18	Audit Department	460,608	13.0	465,201	0.3
19	Ministry of Education	18,986,038	14.1	18,092,165	13.0
20	Ministry of Health	20,658,784	0.5	19,430,882	13.9
22	Prisons Department	737,743	4.6	859,791	0.6
23	Ministry of Agriculture	6,781,807	1.4	6,905,147	5.0
24	Ministry of Fisheries	2,062,098	1.0	1,731,048	1.2
25	Central Planning Department	1,525,804	1.8	1,077,472	0.8
26	Ministry of Labour, Commerce and Industries	2,594,582	0.9	1,691,479	1.2
27	Tonga Visitor's Bureau	1,387,951	7.7	1,180,692	0.8
28	Ministry of Works	11,272,377	1.3	6,286,412	4.5
29	Environment Department	1,870,763	1.8	1,088,118	0.8
30	Civil Aviation	2,578,006	0.5	2,494,201	1.8
31	Ministry of Marine and Ports	669,678		614,448	
<b>Total</b>		<b>146,595,446</b>	<b>100.0</b>	<b>139,454,634</b>	<b>100.0</b>



Figure 2: Sectoral Contribution to Gross Domestic Product, at constant prices for the year 1999/00



Budget Statement for Year Ending 30<sup>th</sup> June 2005

## Budget Paper No 3: *Regional Development.*



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## REGIONAL AND RURAL DEVELOPMENT

In June 2001, the Government approved the Strategic Development Plan Seven (SDP7) 2001-2004 with the following key themes:

- i. restructuring for higher sustainable economic growth;
- ii ensuring financial stability; and
- iii investing in people.

The SDP7 includes a three year rolling Public Sector Development Program encapsulating the priority development program of Government, divided into eleven Strategic Results Areas, together with three priority sectors for policy development - agriculture, fisheries and tourism.

The focus of the Strategic Results Area eleven is: *Improving access to government services in the outer islands and rural areas*, encompassing five distinct development programs: Ha'apai; Niua; 'Eua; Vava'u; and Rural. This priority area receives the largest share of the SDP7 planned expenditures.

Statement 3 of the Budget Papers therefore presents and an overview of progress in each of these five development programs as well as the intended future directions<sup>3</sup>.

### 9.0 Financial

The Governments of Australia, New Zealand and Japan remain the core donors for regional and rural development. The total financial contribution to rural and regional communities during the year 2003/2004 is estimated at \$4.8 million. Table 1 illustrates the financial contribution to rural and regional communities by donor country.

Table 1: Regional Distribution of Donor Aid 2003/04 (TOP\$)

<i>Donor/Region</i>	'Eua	Ha'apai	Vava'u	Niuafo'ou & Niuatoputapu	Tongatapu	Total
Japan		159,904	320,585		1,946,517	2,427,006
New Zealand	77,229			521,938	196,500	795,667
Australia		1,540,000			58,726	1,598,726
<b>TOTAL</b>	<b>77,229</b>	<b>1,699,904</b>	<b>320,585</b>	<b>521,938</b>	<b>2,201,743</b>	<b>4,821,399</b>
<i>% distribution</i>	2%	35%	7%	11%	45%	100%

### 10.0 Niua Region

#### 10.1. Niua Development Fund (NDF) - TOP\$752,834

The Government of New Zealand (GONZ) continues to be the core donor for the two Niua with a grant in 2003/04 of NZ\$600,000, equivalent to TOP\$752,834 (at 0.7972 exchange rate). The Niuafo'ou Electrification Project and the Niuatoputapu new high school absorbed most of the allocation at TOP\$313,597 and TOP\$250,878 respectively. Of the remaining TOP\$188,359, the

<sup>3</sup> Based on a review of the SDP7 undertaken by the Central Planning Department and reported in February 2004.

Niua Development Committee approved four new projects for submission to the New Zealand Government for funding consideration. The details of these projects are in Table 2 below.

**Table 2: Project approved by the Niua Development Committee in 2003/04 for submission to the Government of New Zealand**

Submission	NDC Status	CD Status	Requested Amount T\$	Status
"Clean" Community Litter Eradication Around Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	6,700	Conveyed to the New Zealand Authorities.
Village Cement Water Tanks for Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.
Kitchens for Niuatoputapu and Niuafou'ou	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.
Weaving halls for Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.

### **2.1.1 Niuafou'ou Electrification (TOP\$313,597)**

This program is aimed at installing lighting system in both the Niua. In 2003, institutional committees were set up for the islands and a rehabilitation program was also implemented at Tafahi and Niuatoputapu solar system. However, due to delays in implementation, the solar electrification project was largely under spent. The only costs incurred (\$33,055) covered visits by Meritech consultant, Gerhard Zieroth and procurement and freighting of some equipment such as batteries, controllers including the freight to Niua.

### **2.1.2 Niuatoputapu New High School (TOP\$250,878)**

The program is aimed at promoting education in the two Niua through construction, upgrading and furnishing of primary and secondary schools. Eighteen new classrooms, three staff quarters and industrial arts tools were funded for Niuatoputapu High School. School resources were also provided for Niuafou'ou High School and one monitoring visit was conducted during 2002/03. Total expenditure on this program in 2003 was \$380,823. The additional expenditure included the cost of constructing three new teachers quarters and other costs originally allocated under the Cyclone Waka schools reinstatement project.

Table 3 below provides a summary of projects expenditures and outputs in 2003 under the Niua Development Funding across the 2002/03 and 2003/04 financial years.

**Table 3: Niuva Development Fund Project Expenditures and Outputs in 2003**

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
Niuatoputapu new high school	380,823	Niuatoputapu	18 classrooms, staff quarters, etc	Ongoing
Niuvafo'ou solar electrification project	33,055	Niuvafo'ou	1 visit by Meritech Consultant	Completed visit but yet to install electrification
Buoy Installation	21,295	Niuvafo'ou	1 buoy and fittings	Yet to deliver to Niuvafo'ou
Tafahi Solar Upgrading	25,996	Tafahi, Niuatoputapu	31 homes were upgraded	Completed
Kava Pounding and Sieving Machines	36,000	Niuvafo'ou & Niuatoputapu	2 Kava Poundings and 2 Sieving Machines	Completed
20% payment for disc plough	1,745	Niuatoputapu	Disc plough	Completed
District high school resources project	17,000	Niuvafo'ou	Library books, science books, mathematical materials, and others	Completed
20% payment for ripper	530	Niuatoputapu	Ripper	Completed
20% payment for slasher	1,099	Niuatoputapu	Slasher	Completed
20% labour cost for drum ovens	1,500	Niuatoputapu	26 Drum ovens	Completed
20% payment for Trailer	1,740	Niuvafo'ou	Trailer	Completed
High School Monitoring Visit	1,155	Niuatoputapu	1 visit	Completed
<b>TOTAL</b>	<b>521,938</b>			

## 11.0 'Eua Region

The achievements for the EDC in 2003 were the completion of funding for the 'Eua Vanilla Curing Shed Phase II: Equipment, the finalization of management issues relating to the 'Eua Water Supply project, and the installation of a new generator at Niu'eiki Hospital.

### 11.1. 'Eua Development Fund (EDF) - TOP\$878,073

The Government of New Zealand continues to be the core donor for 'Eua with a grant in 2003/04 of NZ\$700,000, equivalent of T\$878,073 (at 0.7972 exchange rate). The grant provides funding for community projects under the 'Eua Development Program. In 2003, the upgrading of 'Eua Water Supply was allocated TOP\$627,195 and the remaining TOP\$159,440 was targeted for development projects in 'Eua.

However, in 2003 the 'Eua Development Fund was largely under-spent due mainly to the delays in expediting the formalities and other requirements of the 'Eua Water Supply Project upgrade. Table 4 summarises the project expenditures and outputs for 2003.

**Table 4: 'Eua Development Fund Project Expenditures and Outputs in 2003**

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
Final payment Vanilla Curing Shed project & professional fee	6,082	Angaha	1 Vanilla Shed	Completed
Final payment Upgrading Nafanua Harbour & professional fee	70,931	'Ohonua	Ramp and Steps	Completed
Custom clearance/freight for generator to Hospital	151.90	'Ohonua	1 generator	Completed
Airfare to 'Eua for the NZ Deputy High Commissioner	64	'Eua	1 visit	Completed
<b>TOTAL</b>	<b>77,228.90</b>			

## 12.0 Ha'apai Region

In 2003, Ha'apai witnessed the completion of one of its major planned infrastructural project, namely the Ha'apai Outer Island Electrification Project (HOIEP). In April 2003 and November 2003 His Majesty King Taufa'ahau Tupou IV graciously commissioned the remaining two power stations of Ha'afeva and Nomuka respectively. This was the final construction and installation component of the TOP\$8 million HOIEP which commenced in 2001.

### 12.1. Ha'apai Development Fund (HDF) – T\$250,701

The Government of Australia remains the core donor for the Ha'apai region through both the HOIEP and the Ha'apai Development Fund (HDF) for community development projects throughout the islands of Ha'apai. In 2003 expenditure under the HDF was approximately \$140,000 against an initial allocation of \$233,000. The project expenditures and outputs for the two programs are summarized in Table 5.

**Table 5: Ha'apai Project Expenditures and Outputs in 2003**

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
1. Ha'apai Outer-islands Electrification (1 million per year)	1,400,000	Ha'ano, Nomuka, 'Uiha & Ha'afeva	Establishment of the Power Station at Ha'afeva and Nomuka plus more than 200 connections	Completed
2. Taufa'ahau College Brass Band	20,000	Pangai	Brass Band Instruments	Completed

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
3. Ha'apai High School Laboratory Equipment	20,000	Pangai	Laboratory Equipment	Completed
4. Repairing Governor's Boat	20,000	Pangai	Repairing Governor of Ha'apai's Boat	Completed
5. Kolongatata Village Fence	20,000	Ha'afeva	Village Fence	Ongoing
4. Tungua and Fonoifua Classrooms	60,000	Tungua & Fonoifua	1 classroom each	Ongoing
<b>TOTAL</b>	<b>1,540,000</b>			

### 13.0 Vava'u

The European Union (EU) remains the core donor of funds for development projects for the Vava'u Region. In 2003, approximately \$5.4 million is expected to be spent on two main programmes as follows:

- Phase III of the Vava'u Development Programme, which is financed from the unspent Lome III and Lome IV funds. Projects included in this component includes the Vava'u Development Programme III Project Management Unit (\$702,000), responsible for the overall management of the VDP III Programme; the Vava'u Tourism Roads Phase 1 (\$755,000); Vava'u Tourism Roads Phase II (\$184,500.00; Vava'u Agricultural Roads Programme \$585,956.23 and the construction of the Fisheries Wharf \$739,353.96 and the Fisheries market \$543,750.00
- Direct Budgetary Support for the Social Sectors (Education and Health), which is being financed from the Cotonou funds. An allocation of \$1 million has been programmed for the upgrading, furnishing and equipping of the primary and secondary schools in Vava'u, and \$500,000 for the refurbishment of Ministry of Health Government Quarters, as well as fencing of Prince Ngu Hospital. A sum of \$240,000 has been programmed for Non State Actor activities in the health and education sector. A sum of \$864,325.00 was also approved for disbursement for the rehabilitation of the MV Olovaha under the Emergency (Envelope B) provision of the Cotonou funds for Tonga.

### 14.0 Rural Development Program

'Rural Community' is defined to include all the outer island villages, all villages in Tongatapu, including low-lying areas of Nuku'alofa (Sopu and Popua).

The Rural Development Program projects were funded from the New Zealand's Community Development Fund (NZCDF), the Tonga Community Development Scheme (TCDS) formerly known as ACAS, and Japan's Grant Assistance for Grassroots Projects (GGP).

#### 14.1. New Zealand Small Project Funds

The community development program directly funds assistance for villages and community development activities. Given that the program is community based, communities/villages

identify their respective priorities, as a corporate body. In most cases, project recipients must contribute in cash and in kind to the total project costs.

Table 6 provides a list of projects that were approved and implemented under the New Zealand Community Development Fund for 2003. The Government of New Zealand under the community fund contributed a total of TOP\$196,500 in 2003. That is approximately 87% of the total project cost and the remaining 13% (approximately TOP\$29,114) is the contribution of the projects' beneficiaries.

Table 6: Projects Funded from the New Zealand Community Development Fund - 2003

Project Titles	Approved Allocation (T\$)	Village Contributions (T\$)	Project Locations	Project Outputs	Project Status
1. Pelehake Village Water Supply	37,000	2,976	Pelehake Tongatapu	Water pump, pipes and fittings	Ongoing
2. Te'ekiu Village Water Supply	38,150	Labour & Maintenance	Te'ekiu Tongatapu	1 Tank & Tank Stand	Ongoing
3. Uelofea WID Water Cement Tanks	24,336	6,864	Ha'alalo Tongatapu	26x2200 gal cement tanks	Completed
4. Finealafia WID Cement Tanks	23,400	6,600	Hofoa Tongatapu	25x2200 gal cement tanks	Completed
5. 'Amalani WID Cement Tanks	14,976	4,224	Tofoa Tongatapu	16x2200 gal cement tanks	Completed
6. Kolonga Kindergarten Projects	8,338	Maintenance	Kolonga Tongatapu	Desks, Chairs, and Water tank	Completed
7. Pupunga Fetu'u WID Landfill	20,000	5,200	Hala'ovave Tongatapu	20 homes rocks filled	Completed
8. 'Utulelei WID Landfill	14,300	3,250	Hala'ovave Tongatapu	13 homes rocks filled	Completed
9. Tu'anuku Village Water Supply	16,000	Maintenance	Tu'anuku Vava'u	1 Water Pump, Pipes and fittings	Completed
<b>TOTAL</b>	<b>T\$196,500</b>	<b>T\$29,114</b>			

## 14.2. Tonga Community Development Scheme

Table 7 lists the projects that were completed, approved or ongoing under the Tonga Community Development Scheme (TCDS) for 2003. The Government of Australia contributed a total of TOP\$58,726. This is approximately 86% of total project cost and the remaining 14% (approximated at TOP\$9,477) were contributed by the projects' beneficiaries.

The approved allocation for this program was in effect under spent, largely because of the donor's new administrative arrangements for managing the fund. By the end of 2003, this administrative arrangement was still not in place.

**Table 7: Tonga Community Development Scheme**

Project Titles	Approved Allocation (TOP\$)	Village Contributions (TOP\$)	Project Locations	Project Outputs	Project Status
Tekina 'i Moana WID Landfill	50,000	9,477	Sopu Tongatapu	26 homes rocks filled	Completed
St. Joseph College computers	8,726	Maintenance	Sopu Tongatapu	5 computers	Completed
<b>TOTAL</b>	<b>T\$58,726</b>	<b>T\$9,477</b>			

### 14.3. Japan's Grant Assistance for Grassroots Projects (GGP)

Japan's Grant Assistance for Grassroots Projects (GGP) was first underway in 1992. It is a bilateral aid program that provides non-refundable financial assistance to non-government organizations (NGOs), hospitals, primary schools, research institutes and other non-profitable organizations to implement development projects at the grassroots level.

In 2003, the RDU managed and coordinated \$2.4 million in expenditure under GGP. As set out in Table 8, a total of 10 projects were completed during 2003 and 17 projects were still in progress.

**Table 8: Japan's Grant Assistance for Grassroots Projects – 2003**

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
1. Upgrading Nukunuku Water Supply	156,114	Tongatapu	i. One New Water Pump ii. One Water Tank 10,000 litres iii. 270 Water Meters iv. Pipes and Pumping Materials for Renewing Old Water Pipes	Ongoing
2. Upgrading Niutoua Water Supply	71,019	Tongatapu	i. One New Water Pump ii. One Water Tank 10,000 litres iii. 145 Water Meters iv. Pipes and Pumping Materials for Renewing Old Water Pipes	Ongoing
3. Upgrading GPS Te'ekiu	56,279	Tongatapu	i. 2 New Classrooms and ii. 6 Toilet Sets	Completed
4. Upgrading GPS Vaini	72,016	Tongatapu	i. 6 New Classrooms (3 Classrooms x 2 Blocks)	Completed
5. New GPS Hala'ovave	160,000	Tongatapu	i. 6 New Classrooms (3 Classrooms x 2 Blocks) ii. 4 Toilet Units x 2 Blocks iii. 1 x 5000 Gallons Water Tanks iv. Backfilling of the Building Site	Completed
6. Upgrading GPS Ngele'ia	30,156	Tongatapu	i. 4 Toilet Units x 2 Blocks	Completed

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
7. upgrading GPS 'Ata	38,929	Tongatapu	i. 2 New Classrooms	Completed
8. Upgrading Talafo'ou Middle School	67,174	Tongatapu	i. 3 New Classrooms, ii. 4 Units Toilet Block iii. 1 x 5000 Gallons Water Tank	Completed
9. Rehabilitation Food Supply in Vava'u	159,905	Vava'u	i. Planting materials, vegetables, kava, vanilla and root crops ii. Fencing Materials	Completed
10. Upgrading GPS Holonga	40,096	Vava'u	i. One Staff Quarter	Completed
11. Renovation of GPS Koulo	20,356	Ha'apai	i. Improving Classrooms	Completed
12. Construction GPS Hihifo	139,548	Ha'apai	i. 6 New Classrooms (3 Classrooms x 2 Blocks) ii. 4 Units x 2 Blocks iii. 2 x 5000 Gallons Water Tanks	Ongoing
13. Construction Canteen GPS Fanga - Nutrition Project	157,350	Tongatapu	i. 1 Building ii. Workers (Phase I)	Ongoing
14. GPS Hala'ovave - Second Phase	156,521	Tongatapu	i. Backfilling and Grading (Play Ground) ii. 1 New Staff Quarter iii. School Fence	Ongoing
15. Upgrading Tonga Maritime Polytechnic Institute (TMPI)	156,711	Tongatapu	i. 2 New Classrooms and ii. Laboratory	Ongoing
16. Upgrading GPS Ma'ufanga	116,123	Tongatapu	i. 6 New Classrooms ii. 1 New Staff Quarter	Ongoing
17. Upgrading GPS Houma	110,050	Tongatapu	i. 3 New Classrooms ii. 1 Staff Quarter	Ongoing
18. Upgrading GPS Kolovai	126,671	Tongatapu	i. 2 New Classrooms ii. 1 New Staff Quarter iii. 8 Toilet Sets	Ongoing
19. Upgrading GPS Matahau	73,830	Tongatapu	i. 1 New Staff Quarter ii. 6 Toilet Sets	Ongoing
20. Upgrading GPS Fua'amotu	98,267	Tongatapu	i. 2 New Classrooms ii. 1 New Staff Quarter	Ongoing
21. Upgrading GPS Talafo'ou	120,107	Tongatapu	i. 2 New Classrooms ii. 1 New Staff Quarter	Ongoing

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
			iii. 6 Toilet Sets	
22. Upgrading GPS Mu'a	51,988	Tongatapu	i. 1 New Staff Quarter	Ongoing
23. Upgrading GPS Ha'alalo	73,830	Tongatapu	i. 1 New Staff Quarter ii. 6 Toilet Sets	Ongoing
24. Upgrading GPS Nukuleka	15,771	Tongatapu	i. 4 Toilet Sets	Ongoing
25. Upgrading GPS Toloa	15,771	Tongatapu	i. 4 Toilet Sets	Ongoing
26. Upgrading GPS Kanokupolu	21,840	Tongatapu	i. 6 Toilet Sets	Ongoing
27. Upgrading Vava'u High School	120,584	Vava'u	i. 6 New Classrooms	Ongoing
<b>TOTAL</b>	<b>2,427,006</b>			

## Future Directions

This section gives an indication of the direction of the 2003/04 – 2005/06, with a focus on 2003/04. The last two years, 2004/05 and 2005/06, are very much subject for further confirmation.

Based on the February 2003 report on the review of the SDP7, *Improving access to government services in the outer islands and rural areas* (SRA11) receives the largest share of planned expenditure for 2003/04 with \$17.3m or 37.9 percent, encompassing the following planned projects:

the Ha'apai Development Program estimates a total expenditure of \$2.1million with the Ha'apai Outer Islands Electrification as the main infrastructure project for the group, estimated at \$1.4million;

for the Niuas, a total of \$694,000 is estimated for 2003/04 with a major project for upgrading of primary and secondary schools (\$228,000) as well as the Niua Electrification Project (\$285,000), which is expected to be funded by New Zealand;

the 'Eua Development Program estimates a total of \$986,000 for the same period with the 'Eua Water Supply as the main project which is envisaged to be implemented in 2003/04 with an estimate of \$570,000 from New Zealand;

the Vava'u Development Program comes to a total of \$11.1m which is mainly EU assistance towards the Vava'u region; and

the Rural Development Program, an estimate of \$2.4m is made for the same period with two major projects, namely: a Water Program (\$700,000); and a School Construction Program (\$900,000) to be funded by Japan's Grassroots Scheme.

The following table summarises the proposed SRA11 programs and funding requirements for the financial years 2003/04 to 2005/06, together with the programs proposed under the SDP7's three sectoral priority areas namely, agriculture, fisheries and tourism.

**STRATEGIC DEVELOPMENT PLAN SEVEN (SDP7)**  
**Rolling Public Sector Development Program (2003/04 - 2005/06)**

Strategic Result Areas and Action Programs	Development Cost (T\$'000)			Priority	Finance	Leading Agency
	2003/2004	2004/2005	2005/2006			
<b>11. Improving access to government services in outer islands and rural areas</b>	<b>17256</b>	<b>9893</b>	<b>7306</b>			
<b>'Eua Development Program</b>	<b>986</b>	<b>1716</b>	<b>928</b>			
<i>Education Sector</i>	<i>0</i>	<i>118</i>	<i>118</i>			
11.1. Pre-School Program for Villages	0	18	18	P2	Nil	MOE
11.2. 'Eua Government Primary School Construction Program	0	100	100	P2	Nil	MOE
<i>Income and Employment Generation</i>	<i>228</i>	<i>114</i>	<i>342</i>			
11.3. 'Eua Community Development Fund	228	114	342	P2	NZAID	EDC
<i>Regional Local Administration</i>	<i>188</i>	<i>0</i>	<i>10</i>			
11.4. Tourism Project	188	0	0	P2	NZAID	EDC
11.5. Runway Improvements/Extensions for 'Eua Airport	0	0	10	P2	Nil	MCA
<i>Infrastructure Support</i>	<i>570</i>	<i>1484</i>	<i>458</i>			
11.6. Agricultural Roads	0	116	116	P2	Nil	MOW
11.7. 'Eua Water Supply	570	1,368	342	P2	NZAID	TWB
<b>Ha'apai Development Program</b>	<b>2093</b>	<b>880</b>	<b>980</b>			
<i>Education Sector</i>	<i>120</i>	<i>200</i>	<i>300</i>			
11.8. Programs for Upgrading Ha'apai Primary and Secondary Schools	120	200	300	P2	AusAID/Japan	MOE/CPD
<i>Health and Nutrition</i>	<i>0</i>	<i>300</i>	<i>200</i>			
11.9. Rural Sanitation Program	0	200	200	P2	AusAID/Japan	MOH
11.10. Rural Water Supply	0	100	0	P2	AusAID/Japan	MOH/CPD
<i>Income and Employment Generation</i>	<i>20</i>	<i>100</i>	<i>100</i>			
11.11. Fishery Development Program	20	100	100	P2	AusAID	MOH/CPD
<i>Regional Local Administration</i>	<i>100</i>	<i>50</i>	<i>50</i>			
11.12. Strengthening of Ministries & Departments	100	50	50	P2	AusAID	TVB/CPD
<i>Infrastructure Support</i>	<i>1,853</i>	<i>230</i>	<i>330</i>			
11.13. Upgrading of Key Infrastructures: Jetties, Wharves and Roads	100	100	100	P2	AusAID	MMP/MOW
11.14. Ha'apai Outer-Islands Electrification Project	1,427	0	0	P2	AusAID	MMP/MOW
11.15. Village and Agricultural Fencing Program	20	30	30	P2	AusAID	Community
11.16. Renovation of Pilolevu Airport	50	100	100	P2	AusAID	MOW/MCA
11.17. Airstrip for Nomuka Island	0	0	100	P2	Nil	CA
11.18. Ha'apai Development Fund	256				AusAID	
<b>Niua Development Program</b>	<b>694</b>	<b>1661</b>	<b>1139</b>			
<i>Education Sector</i>	<i>228</i>	<i>0</i>	<i>0</i>			
11.19. Program for Upgrading Niua's Primary and Secondary Schools	228	0	0	P2	NZAID	MOE/CPD
<i>Infrastructure Support</i>	<i>466</i>	<i>1661</i>	<i>1139</i>			
11.20. Program for improving water access in the Niuas	10	80	55	P2	NZAID	MOH
11.21. Niua's Electrification Program	285	353	342	P2	NZAID	MLSNR
11.22. Niua Development Fund	171	228	342		NZAID	NDC
11.23. Agricultural Roads' Development Program	0	1000	300	P2	Nil	MOW
11.24. Wharves' Upgrading Program	0	0	100	P2	Nil	MOW/MMP
<b>Vava'u Development Program</b>	<b>11098</b>	<b>3554</b>	<b>2240</b>			
11.25. Education Projects	1000	1000	1000	P2	EU	MOE
11.26. Health Projects	1000	1000	1000	P2	EU	MOH
11.27. Civil Society Projects (Non State Actors)	240	240	240	P2	EU	NGOs
11.28. Tourism Project	188	0	0	P2	NZAID	TVB
11.29. Technical Assistance	560	0	0	P2	EU	MFA
11.30. Evaluation of Microproject Programme III	13	0	0	P2	EU	MFA
11.31. Vava'u Tourism Roads Phase II	185	0	0	P2	EU	MFA
11.32. Vava'u Refuse Initiative	280	0	0	P2	EU	MFA
11.33. Vava'u Agricultural Roads Programme	870	0	0	P2	EU	MFA
11.34. Fisheries Wharf	4436	0	0	P2	EU	MFA
11.35. Fisheries Market	544	326	0	P2	EU	MFA
11.36. Rehabilitation of MV Olovaha	864	0	0	P2	EU	MFA
11.37. Nafanua Harbour	0	988	0	P2	EU	MFA
11.38. VDP III Project Management Unit	918	0	0	P2	EU	MFA

Strategic Result Areas and Action Programs	Development Cost (T\$'000)			Priority	Finance	Leading Agency
	2003/2004	2004/2005	2005/2006			
<b>Rural Development Program</b>	<b>2385</b>	<b>2082</b>	<b>2019</b>			
<i>Water</i>	<i>800</i>	<i>400</i>	<i>400</i>			
11.39. Self - Sustainable Village water metering program	700	200	200	P2	AusAID/NZAID /Japan	MOH
11.40. Household Water Cement Water Tank	100	200	200	P2	AusAID/NZAID /Ger/EU	MOH
<i>Health and Sanitation</i>	<i>30</i>	<i>40</i>	<i>20</i>			
11.41. Upgrading of Community Health Center	30	40	20	P2	Nil	MOH
<i>Education</i>	<i>900</i>	<i>1000</i>	<i>900</i>			
11.42. School Construction Program	900	1,000	900	P2	Japan	MOE/PTA
<i>Infrastructure</i>	<i>655</i>	<i>642</i>	<i>699</i>			
11.43. Landfill program	50	50	50	P2	NZAID	MOW/Community
11.44. Community Development Fund	285	342	399	P2	NZAID	Communities
11.45. Community Development Scheme (CDS)	320	250	250	P2	AusAID	Communities
<b>Priority Sectors for Policy Development</b>	<b>4,162</b>	<b>6,436</b>	<b>2,152</b>			
<b>1. Agriculture</b>	<b>715</b>	<b>2461</b>	<b>690</b>			
1.1. Post Harvest Handling Facilities & agricultural export expansion	0	0	690	P2	EU	MAF
1.2. Forestry Project	285	0	0	P2	NZAID	MAF
1.3. Organic Certification System for Tonga	0	879	0	P2	FAO	MAF
1.4. Development of Food & Agribusiness industry in	0	250	0	P2	Japan	MAF
1.5. Kava Nursery Development Project	412	0	0	P2	STABEX	MAF
1.6. Tahitian's Vanilla Development Program	8	0	0	P2	EU	MAF
1.7. Strengthen Capacity of National Youth Groups towards Food Security and Prosperity	10	225	0	P2	FAO	MAF
1.8. Vava'u Integrated Agricultural Development Program	0	1107	0	P2	EU	MAF
<b>2. Fisheries</b>	<b>2,355</b>	<b>2,616</b>	<b>1,262</b>			
2.1. Tonga Fisheries Project	2355	1343	990	P2	AusAID	MoFisheries
2.2. Developing a small boat tuna longline fishery	0	231	231	P2	Nil	MoFisheries
2.3. Determining Financing Options for Tuna Ventures	0	44	0	P2	Nil	MoFisheries
2.4. Financial Training for Tonga's Fisheries Lending Sector	0	52	41	P2	Nil	MoFisheries
2.5. Establishing Fishing Joint-Venture Assessment Capability	0	113	0	P2	Nil	MoFisheries
2.6. Developing Flying Fish Capture in 'Eua	0	48	0	P2	Nil	MoFisheries
2.7. Study of the Tongatapu market for salted/dried fish products	0	12	0	P2	Nil	MoFisheries
2.8. Development of an aquaculture permit allocation and management system	0	123	0	P2	Nil	MoFisheries
2.9. Development of Fisheries Wharf					EU	MoFisheries
2.10. Pearl Farming Industry Feasibility Study	0	71	0	P2	Nil	MoFisheries
2.11. Establishment of a Pearl Oyster Hatchery in Vava'u	0	579	0	P2	Nil	MoFisheries
<b>3. Tourism</b>	<b>1,092</b>	<b>1,359</b>	<b>200</b>			
3.1. Tonga Tourism Project	862	220	0	P2	AusAID	TVB
3.2. Broaden the tourism facilities base throughout Tonga	10	50	50	P2	Nil	TVB
3.3. Encourage investment in tourism accommodation and other facilities	10	50	50	P2	Nil	TVB
3.4. Raising the standards and level of service within the industry	10	100	100	P2	Nil	TVB
<b>New Project</b>						
Tourism Sector Study	200	0	0	P1	??	TVB
Revival of Tonga's Maritime Heritage - Tonga Maritime Center	0	939	0	P1	??	TVB



Figure 2: Sectoral Contribution to Gross Domestic Product, at constant prices for the year 1999/00



Budget Statement for Year Ending 30<sup>th</sup> June 2005

## Budget Paper No 3: *Regional Development.*



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## REGIONAL AND RURAL DEVELOPMENT

In June 2001, the Government approved the Strategic Development Plan Seven (SDP7) 2001-2004 with the following key themes:

- i. restructuring for higher sustainable economic growth;
- ii ensuring financial stability; and
- iii investing in people.

The SDP7 includes a three year rolling Public Sector Development Program encapsulating the priority development program of Government, divided into eleven Strategic Results Areas, together with three priority sectors for policy development - agriculture, fisheries and tourism.

The focus of the Strategic Results Area eleven is: *Improving access to government services in the outer islands and rural areas*, encompassing five distinct development programs: Ha'apai; Niua; 'Eua; Vava'u; and Rural. This priority area receives the largest share of the SDP7 planned expenditures.

Statement 3 of the Budget Papers therefore presents and an overview of progress in each of these five development programs as well as the intended future directions<sup>4</sup>.

### 15.0 Financial

The Governments of Australia, New Zealand and Japan remain the core donors for regional and rural development. The total financial contribution to rural and regional communities during the year 2003/2004 is estimated at \$4.8 million. Table 1 illustrates the financial contribution to rural and regional communities by donor country.

Table 9: Regional Distribution of Donor Aid 2003/04 (TOP\$)

<i>Donor/Region</i>	'Eua	Ha'apai	Vava'u	Niuafo'ou & Niuatoputapu	Tongatapu	Total
Japan		159,904	320,585		1,946,517	2,427,006
New Zealand	77,229			521,938	196,500	795,667
Australia		1,540,000			58,726	1,598,726
<b>TOTAL</b>	<b>77,229</b>	<b>1,699,904</b>	<b>320,585</b>	<b>521,938</b>	<b>2,201,743</b>	<b>4,821,399</b>
<i>% distribution</i>	2%	35%	7%	11%	45%	100%

### 16.0 Niua Region

#### 16.1. Niua Development Fund (NDF) - TOP\$752,834

The Government of New Zealand (GONZ) continues to be the core donor for the two Niua with a grant in 2003/04 of NZ\$600,000, equivalent to TOP\$752,834 (at 0.7972 exchange rate). The Niuafo'ou Electrification Project and the Niuatoputapu new high school absorbed most of the allocation at TOP\$313,597 and TOP\$250,878 respectively. Of the remaining TOP\$188,359, the

<sup>4</sup> Based on a review of the SDP7 undertaken by the Central Planning Department and reported in February 2004.

Niua Development Committee approved four new projects for submission to the New Zealand Government for funding consideration. The details of these projects are in Table 2 below.

**Table 10: Project approved by the Niua Development Committee in 2003/04 for submission to the Government of New Zealand**

Submission	NDC Status	CD Status	Requested Amount T\$	Status
"Clean" Community Litter Eradication Around Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	6,700	Conveyed to the New Zealand Authorities.
Village Cement Water Tanks for Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.
Kitchens for Niuatoputapu and Niuafou'ou	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.
Weaving halls for Niuatoputapu	Approved by NDC 3/2003 of 14 <sup>th</sup> November 2003	Approved by CD 1984 of 17 December 2003	To be confirmed	Conveyed to the New Zealand Authorities.

### **2.1.1 Niuafou'ou Electrification (TOP\$313,597)**

This program is aimed at installing lighting system in both the Niua. In 2003, institutional committees were set up for the islands and a rehabilitation program was also implemented at Tafahi and Niuatoputapu solar system. However, due to delays in implementation, the solar electrification project was largely under spent. The only costs incurred (\$33,055) covered visits by Meritech consultant, Gerhard Zieroth and procurement and freighting of some equipment such as batteries, controllers including the freight to Niua.

### **2.1.2 Niuatoputapu New High School (TOP\$250,878)**

The program is aimed at promoting education in the two Niua through construction, upgrading and furnishing of primary and secondary schools. Eighteen new classrooms, three staff quarters and industrial arts tools were funded for Niuatoputapu High School. School resources were also provided for Niuafou'ou High School and one monitoring visit was conducted during 2002/03. Total expenditure on this program in 2003 was \$380,823. The additional expenditure included the cost of constructing three new teachers quarters and other costs originally allocated under the Cyclone Waka schools reinstatement project.

Table 3 below provides a summary of projects expenditures and outputs in 2003 under the Niua Development Funding across the 2002/03 and 2003/04 financial years.

**Table 11: Niuva Development Fund Project Expenditures and Outputs in 2003**

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
Niuatoputapu new high school	380,823	Niuatoputapu	18 classrooms, staff quarters, etc	Ongoing
Niuvafo'ou solar electrification project	33,055	Niuvafo'ou	1 visit by Meritech Consultant	Completed visit but yet to install electrification
Buoy Installation	21,295	Niuvafo'ou	1 buoy and fittings	Yet to deliver to Niuvafo'ou
Tafahi Solar Upgrading	25,996	Tafahi, Niuatoputapu	31 homes were upgraded	Completed
Kava Pounding and Sieving Machines	36,000	Niuvafo'ou & Niuatoputapu	2 Kava Poundings and 2 Sieving Machines	Completed
20% payment for disc plough	1,745	Niuatoputapu	Disc plough	Completed
District high school resources project	17,000	Niuvafo'ou	Library books, science books, mathematical materials, and others	Completed
20% payment for ripper	530	Niuatoputapu	Ripper	Completed
20% payment for slasher	1,099	Niuatoputapu	Slasher	Completed
20% labour cost for drum ovens	1,500	Niuatoputapu	26 Drum ovens	Completed
20% payment for Trailer	1,740	Niuvafo'ou	Trailer	Completed
High School Monitoring Visit	1,155	Niuatoputapu	1 visit	Completed
<b>TOTAL</b>	<b>521,938</b>			

## 17.0 'Eua Region

The achievements for the EDC in 2003 were the completion of funding for the 'Eua Vanilla Curing Shed Phase II: Equipment, the finalization of management issues relating to the 'Eua Water Supply project, and the installation of a new generator at Niu'eiki Hospital.

### 17.1. 'Eua Development Fund (EDF) - TOP\$878,073

The Government of New Zealand continues to be the core donor for 'Eua with a grant in 2003/04 of NZ\$700,000, equivalent of T\$878,073 (at 0.7972 exchange rate). The grant provides funding for community projects under the 'Eua Development Program. In 2003, the upgrading of 'Eua Water Supply was allocated TOP\$627,195 and the remaining TOP\$159,440 was targeted for development projects in 'Eua.

However, in 2003 the 'Eua Development Fund was largely under-spent due mainly to the delays in expediting the formalities and other requirements of the 'Eua Water Supply Project upgrade. Table 4 summarises the project expenditures and outputs for 2003.

Table 12: 'Eua Development Fund Project Expenditures and Outputs in 2003

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
Final payment Vanilla Curing Shed project & professional fee	6,082	Angaha	1 Vanilla Shed	Completed
Final payment Upgrading Nafanua Harbour & professional fee	70,931	'Ohonua	Ramp and Steps	Completed
Custom clearance/freight for generator to Hospital	151.90	'Ohonua	1 generator	Completed
Airfare to 'Eua for the NZ Deputy High Commissioner	64	'Eua	1 visit	Completed
<b>TOTAL</b>	<b>77,228.90</b>			

## 18.0 Ha'apai Region

In 2003, Ha'apai witnessed the completion of one of its major planned infrastructural project, namely the Ha'apai Outer Island Electrification Project (HOIEP). In April 2003 and November 2003 His Majesty King Taufa'ahau Tupou IV graciously commissioned the remaining two power stations of Ha'afeva and Nomuka respectively. This was the final construction and installation component of the TOP\$8 million HOIEP which commenced in 2001.

### 18.1. Ha'apai Development Fund (HDF) – T\$250,701

The Government of Australia remains the core donor for the Ha'apai region through both the HOIEP and the Ha'apai Development Fund (HDF) for community development projects throughout the islands of Ha'apai. In 2003 expenditure under the HDF was approximately \$140,000 against an initial allocation of \$233,000. The project expenditures and outputs for the two programs are summarized in Table 5.

Table 13: Ha'apai Project Expenditures and Outputs in 2003

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
1. Ha'apai Outer-islands Electrification (1 million per year)	1,400,000	Ha'ano, Nomuka, 'Uiha & Ha'afeva	Establishment of the Power Station at Ha'afeva and Nomuka plus more than 200 connections	Completed
2. Taufa'ahau College Brass Band	20,000	Pangai	Brass Band Instruments	Completed

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
3. Ha'apai High School Laboratory Equipment	20,000	Pangai	Laboratory Equipment	Completed
4. Repairing Governor's Boat	20,000	Pangai	Repairing Governor of Ha'apai's Boat	Completed
5. Kolongatata Village Fence	20,000	Ha'afeva	Village Fence	Ongoing
4. Tungua and Fonoifua Classrooms	60,000	Tungua & Fonoifua	1 classroom each	Ongoing
<b>TOTAL</b>	<b>1,540,000</b>			

## 19.0 Vava'u

The European Union (EU) remains the core donor of funds for development projects for the Vava'u Region. In 2003, approximately \$5.4 million is expected to be spent on two main programmes as follows:

- Phase III of the Vava'u Development Programme, which is financed from the unspent Lome III and Lome IV funds. Projects included in this component includes the Vava'u Development Programme III Project Management Unit (\$702,000), responsible for the overall management of the VDP III Programme; the Vava'u Tourism Roads Phase 1 (\$755,000); Vava'u Tourism Roads Phase II (\$184,500.00; Vava'u Agricultural Roads Programme \$585,956.23 and the construction of the Fisheries Wharf \$739,353.96 and the Fisheries market \$543,750.00
- Direct Budgetary Support for the Social Sectors (Education and Health), which is being financed from the Cotonou funds. An allocation of \$1 million has been programmed for the upgrading, furnishing and equipping of the primary and secondary schools in Vava'u, and \$500,000 for the refurbishment of Ministry of Health Government Quarters, as well as fencing of Prince Ngu Hospital. A sum of \$240,000 has been programmed for Non State Actor activities in the health and education sector. A sum of \$864,325.00 was also approved for disbursement for the rehabilitation of the MV Olovaha under the Emergency (Envelope B) provision of the Cotonou funds for Tonga.

## 20.0 Rural Development Program

'Rural Community' is defined to include all the outer island villages, all villages in Tongatapu, including low-lying areas of Nuku'alofa (Sopu and Popua).

The Rural Development Program projects were funded from the New Zealand's Community Development Fund (NZCDF), the Tonga Community Development Scheme (TCDS) formerly known as ACAS, and Japan's Grant Assistance for Grassroots Projects (GGP).

### 20.1. New Zealand Small Project Funds

The community development program directly funds assistance for villages and community development activities. Given that the program is community based, communities/villages

identify their respective priorities, as a corporate body. In most cases, project recipients must contribute in cash and in kind to the total project costs.

Table 6 provides a list of projects that were approved and implemented under the New Zealand Community Development Fund for 2003. The Government of New Zealand under the community fund contributed a total of TOP\$196,500 in 2003. That is approximately 87% of the total project cost and the remaining 13% (approximately TOP\$29,114) is the contribution of the projects' beneficiaries.

**Table 14: Projects Funded from the New Zealand Community Development Fund - 2003**

Project Titles	Approved Allocation (T\$)	Village Contributions (T\$)	Project Locations	Project Outputs	Project Status
10. Pelehake Village Water Supply	37,000	2,976	Pelehake Tongatapu	Water pump, pipes and fittings	Ongoing
11. Te'ekiu Village Water Supply	38,150	Labour & Maintenance	Te'ekiu Tongatapu	1 Tank & Tank Stand	Ongoing
12. Uelofea WID Water Cement Tanks	24,336	6,864	Ha'alalo Tongatapu	26x2200 gal cement tanks	Completed
13. Finealafia WID Cement Tanks	23,400	6,600	Hofoa Tongatapu	25x2200 gal cement tanks	Completed
14. 'Amalani WID Cement Tanks	14,976	4,224	Tofoa Tongatapu	16x2200 gal cement tanks	Completed
15. Kolonga Kindergarten Projects	8,338	Maintenance	Kolonga Tongatapu	Desks, Chairs, and Water tank	Completed
16. Pupunga Fetu'u WID Landfill	20,000	5,200	Hala'ovave Tongatapu	20 homes rocks filled	Completed
17. 'Utulelei WID Landfill	14,300	3,250	Hala'ovave Tongatapu	13 homes rocks filled	Completed
18. Tu'anuku Village Water Supply	16,000	Maintenance	Tu'anuku Vava'u	1 Water Pump, Pipes and fittings	Completed
<b>TOTAL</b>	<b>T\$196,500</b>	<b>T\$29,114</b>			

## 20.2. Tonga Community Development Scheme

Table 7 lists the projects that were completed, approved or ongoing under the Tonga Community Development Scheme (TCDS) for 2003. The Government of Australia contributed a total of TOP\$58,726. This is approximately 86% of total project cost and the remaining 14% (approximated at TOP\$9,477) were contributed by the projects' beneficiaries.

The approved allocation for this program was in effect under spent, largely because of the donor's new administrative arrangements for managing the fund. By the end of 2003, this administrative arrangement was still not in place.

Table 15: Tonga Community Development Scheme

Project Titles	Approved Allocation (TOP\$)	Village Contributions (TOP\$)	Project Locations	Project Outputs	Project Status
Tekina 'i Moana WID Landfill	50,000	9,477	Sopu Tongatapu	26 homes rocks filled	Completed
St. Joseph College computers	8,726	Maintenance	Sopu Tongatapu	5 computers	Completed
<b>TOTAL</b>	<b>T\$58,726</b>	<b>T\$9,477</b>			

### 20.3. Japan's Grant Assistance for Grassroots Projects (GGP)

Japan's Grant Assistance for Grassroots Projects (GGP) was first underway in 1992. It is a bilateral aid program that provides non-refundable financial assistance to non-government organizations (NGOs), hospitals, primary schools, research institutes and other non-profitable organizations to implement development projects at the grassroots level.

In 2003, the RDU managed and coordinated \$2.4 million in expenditure under GGP. As set out in Table 8, a total of 10 projects were completed during 2003 and 17 projects were still in progress.

Table 16: Japan's Grant Assistance for Grassroots Projects – 2003

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
28. Upgrading Nukunuku Water Supply	156,114	Tongatapu	iv. One New Water Pump v. One Water Tank 10,000 litres vi. 270 Water Meters iv. Pipes and Pumping Materials for Renewing Old Water Pipes	Ongoing
29. Upgrading Niutoua Water Supply	71,019	Tongatapu	v. One New Water Pump vi. One Water Tank 10,000 litres vii. 145 Water Meters viii. Pipes and Pumping Materials for Renewing Old Water Pipes	Ongoing
30. Upgrading GPS Te'ekiu	56,279	Tongatapu	iv. 2 New Classrooms and v. 6 Toilet Sets	Completed
31. Upgrading GPS Vaini	72,016	Tongatapu	ii. 6 New Classrooms (3 Classrooms x 2 Blocks)	Completed
32. New GPS Hala'ovave	160,000	Tongatapu	v. 6 New Classrooms (3 Classrooms x 2 Blocks) vi. 4 Toilet Units x 2 Blocks vii. 1 x 5000 Gallons Water Tanks viii. Backfilling of the Building Site	Completed
33. Upgrading GPS Ngele'ia	30,156	Tongatapu	ii. 4 Toilet Units x 2 Blocks	Completed

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
34. upgrading GPS 'Ata	38,929	Tongatapu	ii. 2 New Classrooms	Completed
35. Upgrading Talafo'ou Middle School	67,174	Tongatapu	iv. 3 New Classrooms, v. 4 Units Toilet Block vi. 1 x 5000 Gallons Water Tank	Completed
36. Rehabilitation Food Supply in Vava'u	159,905	Vava'u	iii. Planting materials, vegetables, kava, vanilla and root crops iv. Fencing Materials	Completed
37. Upgrading GPS Holonga	40,096	Vava'u	i. One Staff Quarter	Completed
38. Renovation of GPS Koulo	20,356	Ha'apai	ii. Improving Classrooms	Completed
39. Construction GPS Hihifo	139,548	Ha'apai	iv. 6 New Classrooms (3 Classrooms x 2 Blocks) v. 4 Units x 2 Blocks vi. 2 x 5000 Gallons Water Tanks	Ongoing
40. Construction Canteen GPS Fanga - Nutrition Project	157,350	Tongatapu	iii. 1 Building iv. Workers (Phase I)	Ongoing
41. GPS Hala'ovave - Second Phase	156,521	Tongatapu	ii. Backfilling and Grading (Play Ground) ii. 1 New Staff Quarter vi. School Fence	Ongoing
42. Upgrading Tonga Maritime Polytechnic Institute (TMPI)	156,711	Tongatapu	iii. 2 New Classrooms and iv. Laboratory	Ongoing
43. Upgrading GPS Ma'ufanga	116,123	Tongatapu	iii. 6 New Classrooms iv. 1 New Staff Quarter	Ongoing
44. Upgrading GPS Houma	110,050	Tongatapu	iii. 3 New Classrooms iv. 1 Staff Quarter	Ongoing
45. Upgrading GPS Kolovai	126,671	Tongatapu	iv. 2 New Classrooms v. 1 New Staff Quarter vi. 8 Toilet Sets	Ongoing
46. Upgrading GPS Matahau	73,830	Tongatapu	iii. 1 New Staff Quarter iv. 6 Toilet Sets	Ongoing
47. Upgrading GPS Fua'amotu	98,267	Tongatapu	iii. 2 New Classrooms iv. 1 New Staff Quarter	Ongoing
48. Upgrading GPS Talafo'ou	120,107	Tongatapu	iv. 2 New Classrooms v. 1 New Staff Quarter	Ongoing

Project Titles	Approved Allocation (TOP\$)	Project Locations	Project Outputs	Project Status
			vi. 6 Toilet Sets	
49. Upgrading GPS Mu'a	51,988	Tongatapu	i. 1 New Staff Quarter	Ongoing
50. Upgrading GPS Ha'alalo	73,830	Tongatapu	i. 1 New Staff Quarter ii. 6 Toilet Sets	Ongoing
51. Upgrading GPS Nukuleka	15,771	Tongatapu	i. 4 Toilet Sets	Ongoing
52. Upgrading GPS Toloa	15,771	Tongatapu	i. 4 Toilet Sets	Ongoing
53. Upgrading GPS Kanokupolu	21,840	Tongatapu	i. 6 Toilet Sets	Ongoing
54. Upgrading Vava'u High School	120,584	Vava'u	ii. 6 New Classrooms	Ongoing
<b>TOTAL</b>	<b>2,427,006</b>			

## Future Directions

This section gives an indication of the direction of the 2003/04 – 2005/06, with a focus on 2003/04. The last two years, 2004/05 and 2005/06, are very much subject for further confirmation.

Based on the February 2003 report on the review of the SDP7, *Improving access to government services in the outer islands and rural areas* (SRA11) receives the largest share of planned expenditure for 2003/04 with \$17.3m or 37.9 percent, encompassing the following planned projects:

the Ha'apai Development Program estimates a total expenditure of \$2.1million with the Ha'apai Outer Islands Electrification as the main infrastructure project for the group, estimated at \$1.4million;

for the Niuas, a total of \$694,000 is estimated for 2003/04 with a major project for upgrading of primary and secondary schools (\$228,000) as well as the Niua Electrification Project (\$285,000), which is expected to be funded by New Zealand;

the 'Eua Development Program estimates a total of \$986,000 for the same period with the 'Eua Water Supply as the main project which is envisaged to be implemented in 2003/04 with an estimate of \$570,000 from New Zealand;

the Vava'u Development Program comes to a total of \$11.1m which is mainly EU assistance towards the Vava'u region; and

the Rural Development Program, an estimate of \$2.4m is made for the same period with two major projects, namely: a Water Program (\$700,000); and a School Construction Program (\$900,000) to be funded by Japan's Grassroots Scheme.

The following table summarises the proposed SRA11 programs and funding requirements for the financial years 2003/04 to 2005/06, together with the programs proposed under the SDP7's three sectoral priority areas namely, agriculture, fisheries and tourism.

**STRATEGIC DEVELOPMENT PLAN SEVEN (SDP7)**  
**Rolling Public Sector Development Program (2003/04 - 2005/06)**

Strategic Result Areas and Action Programs	Development Cost (T\$'000)			Priority	Finance	Leading Agency
	2003/2004	2004/2005	2005/2006			
<b>11. Improving access to government services in outer islands and rural areas</b>	<b>17256</b>	<b>9893</b>	<b>7306</b>			
<b>'Eua Development Program</b>	<b>986</b>	<b>1716</b>	<b>928</b>			
<i>Education Sector</i>	<i>0</i>	<i>118</i>	<i>118</i>			
11.1. Pre-School Program for Villages	0	18	18	P2	Nil	MOE
11.2. 'Eua Government Primary School Construction Program	0	100	100	P2	Nil	MOE
<i>Income and Employment Generation</i>	<i>228</i>	<i>114</i>	<i>342</i>			
11.3. 'Eua Community Development Fund	228	114	342	P2	NZAID	EDC
<i>Regional Local Administration</i>	<i>188</i>	<i>0</i>	<i>10</i>			
11.4. Tourism Project	188	0	0	P2	NZAID	EDC
11.5. Runway Improvements/Extensions for 'Eua Airport	0	0	10	P2	Nil	MCA
<i>Infrastructure Support</i>	<i>570</i>	<i>1484</i>	<i>458</i>			
11.6. Agricultural Roads	0	116	116	P2	Nil	MOW
11.7. 'Eua Water Supply	570	1,368	342	P2	NZAID	TWB
<b>Ha'apai Development Program</b>	<b>2093</b>	<b>880</b>	<b>980</b>			
<i>Education Sector</i>	<i>120</i>	<i>200</i>	<i>300</i>			
11.8. Programs for Upgrading Ha'apai Primary and Secondary Schools	120	200	300	P2	AusAID/Japan	MOE/CPD
<i>Health and Nutrition</i>	<i>0</i>	<i>300</i>	<i>200</i>			
11.9. Rural Sanitation Program	0	200	200	P2	AusAID/Japan	MOH
11.10. Rural Water Supply	0	100	0	P2	AusAID/Japan	MOH/CPD
<i>Income and Employment Generation</i>	<i>20</i>	<i>100</i>	<i>100</i>			
11.11. Fishery Development Program	20	100	100	P2	AusAID	MOH/CPD
<i>Regional Local Administration</i>	<i>100</i>	<i>50</i>	<i>50</i>			
11.12. Strengthening of Ministries & Departments	100	50	50	P2	AusAID	TVB/CPD
<i>Infrastructure Support</i>	<i>1,853</i>	<i>230</i>	<i>330</i>			
11.13. Upgrading of Key Infrastructures: Jetties, Wharves and Roads	100	100	100	P2	AusAID	MMP/MOW
11.14. Ha'apai Outer-Islands Electrification Project	1,427	0	0	P2	AusAID	MMP/MOW
11.15. Village and Agricultural Fencing Program	20	30	30	P2	AusAID	Community
11.16. Renovation of Pilolevu Airport	50	100	100	P2	AusAID	MOW/MCA
11.17. Airstrip for Nomuka Island	0	0	100	P2	Nil	CA
11.18. Ha'apai Development Fund	256				AusAID	
<b>Niua Development Program</b>	<b>694</b>	<b>1661</b>	<b>1139</b>			
<i>Education Sector</i>	<i>228</i>	<i>0</i>	<i>0</i>			
11.19. Program for Upgrading Niua's Primary and Secondary Schools	228	0	0	P2	NZAID	MOE/CPD
<i>Infrastructure Support</i>	<i>466</i>	<i>1661</i>	<i>1139</i>			
11.20. Program for improving water access in the Niuas	10	80	55	P2	NZAID	MOH
11.21. Niua's Electrification Program	285	353	342	P2	NZAID	MLSNR
11.22. Niua Development Fund	171	228	342		NZAID	NDC
11.23. Agricultural Roads' Development Program	0	1000	300	P2	Nil	MOW
11.24. Wharves' Upgrading Program	0	0	100	P2	Nil	MOW/MMP
<b>Vava'u Development Program</b>	<b>11098</b>	<b>3554</b>	<b>2240</b>			
11.25. Education Projects	1000	1000	1000	P2	EU	MOE
11.26. Health Projects	1000	1000	1000	P2	EU	MOH
11.27. Civil Society Projects (Non State Actors)	240	240	240	P2	EU	NGOs
11.28. Tourism Project	188	0	0	P2	NZAID	TVB
11.29. Technical Assistance	560	0	0	P2	EU	MFA
11.30. Evaluation of Microproject Programme III	13	0	0	P2	EU	MFA
11.31. Vava'u Tourism Roads Phase II	185	0	0	P2	EU	MFA
11.32. Vava'u Refuse Initiative	280	0	0	P2	EU	MFA
11.33. Vava'u Agricultural Roads Programme	870	0	0	P2	EU	MFA
11.34. Fisheries Wharf	4436	0	0	P2	EU	MFA
11.35. Fisheries Market	544	326	0	P2	EU	MFA
11.36. Rehabilitation of MV Olovaha	864	0	0	P2	EU	MFA
11.37. Nafanua Harbour	0	988	0	P2	EU	MFA
11.38. VDP III Project Management Unit	918	0	0	P2	EU	MFA

Strategic Result Areas and Action Programs	Development Cost (T\$'000)			Priority	Finance	Leading Agency
	2003/2004	2004/2005	2005/2006			
<b>Rural Development Program</b>	<b>2385</b>	<b>2082</b>	<b>2019</b>			
<i>Water</i>	<i>800</i>	<i>400</i>	<i>400</i>			
11.39. Self - Sustainable Village water metering program	700	200	200	P2	AusAID/NZAID /Japan	MOH
11.40. Household Water Cement Water Tank	100	200	200	P2	AusAID/NZAID /Ger/EU	MOH
<i>Health and Sanitation</i>	<i>30</i>	<i>40</i>	<i>20</i>			
11.41. Upgrading of Community Health Center	30	40	20	P2	Nil	MOH
<i>Education</i>	<i>900</i>	<i>1000</i>	<i>900</i>			
11.42. School Construction Program	900	1,000	900	P2	Japan	MOE/PTA
<i>Infrastructure</i>	<i>655</i>	<i>642</i>	<i>699</i>			
11.43. Landfill program	50	50	50	P2	NZAID	MOW/Community
11.44. Community Development Fund	285	342	399	P2	NZAID	Communities
11.45. Community Development Scheme (CDS)	320	250	250	P2	AusAID	Communities
<b>Priority Sectors for Policy Development</b>	<b>4,162</b>	<b>6,436</b>	<b>2,152</b>			
<b>1. Agriculture</b>	<b>715</b>	<b>2461</b>	<b>690</b>			
1.1. Post Harvest Handling Facilities & agricultural export expansion	0	0	690	P2	EU	MAF
1.2. Forestry Project	285	0	0	P2	NZAID	MAF
1.3. Organic Certification System for Tonga	0	879	0	P2	FAO	MAF
1.4. Development of Food & Agribusiness industry in	0	250	0	P2	Japan	MAF
1.5. Kava Nursery Development Project	412	0	0	P2	STABEX	MAF
1.6. Tahitian's Vanilla Development Program	8	0	0	P2	EU	MAF
1.7. Strengthen Capacity of National Youth Groups towards Food Security and Prosperity	10	225	0	P2	FAO	MAF
1.8. Vava'u Integrated Agricultural Development Program	0	1107	0	P2	EU	MAF
<b>2. Fisheries</b>	<b>2,355</b>	<b>2,616</b>	<b>1,262</b>			
2.1. Tonga Fisheries Project	2355	1343	990	P2	AusAID	MoFisheries
2.2. Developing a small boat tuna longline fishery	0	231	231	P2	Nil	MoFisheries
2.3. Determining Financing Options for Tuna Ventures	0	44	0	P2	Nil	MoFisheries
2.4. Financial Training for Tonga's Fisheries Lending Sector	0	52	41	P2	Nil	MoFisheries
2.5. Establishing Fishing Joint-Venture Assessment Capability	0	113	0	P2	Nil	MoFisheries
2.6. Developing Flying Fish Capture in 'Eua	0	48	0	P2	Nil	MoFisheries
2.7. Study of the Tongatapu market for salted/dried fish products	0	12	0	P2	Nil	MoFisheries
2.8. Development of an aquaculture permit allocation and management system	0	123	0	P2	Nil	MoFisheries
2.9. Development of Fisheries Wharf					EU	MoFisheries
2.10. Pearl Farming Industry Feasibility Study	0	71	0	P2	Nil	MoFisheries
2.11. Establishment of a Pearl Oyster Hatchery in Vava'u	0	579	0	P2	Nil	MoFisheries
<b>3. Tourism</b>	<b>1,092</b>	<b>1,359</b>	<b>200</b>			
3.1. Tonga Tourism Project	862	220	0	P2	AusAID	TVB
3.2. Broaden the tourism facilities base throughout Tonga	10	50	50	P2	Nil	TVB
3.3. Encourage investment in tourism accommodation and other facilities	10	50	50	P2	Nil	TVB
3.4. Raising the standards and level of service within the industry	10	100	100	P2	Nil	TVB
<b>New Project</b>						
Tourism Sector Study	200	0	0	P1	??	TVB
Revival of Tonga's Maritime Heritage - Tonga Maritime Center	0	939	0	P1	??	TVB