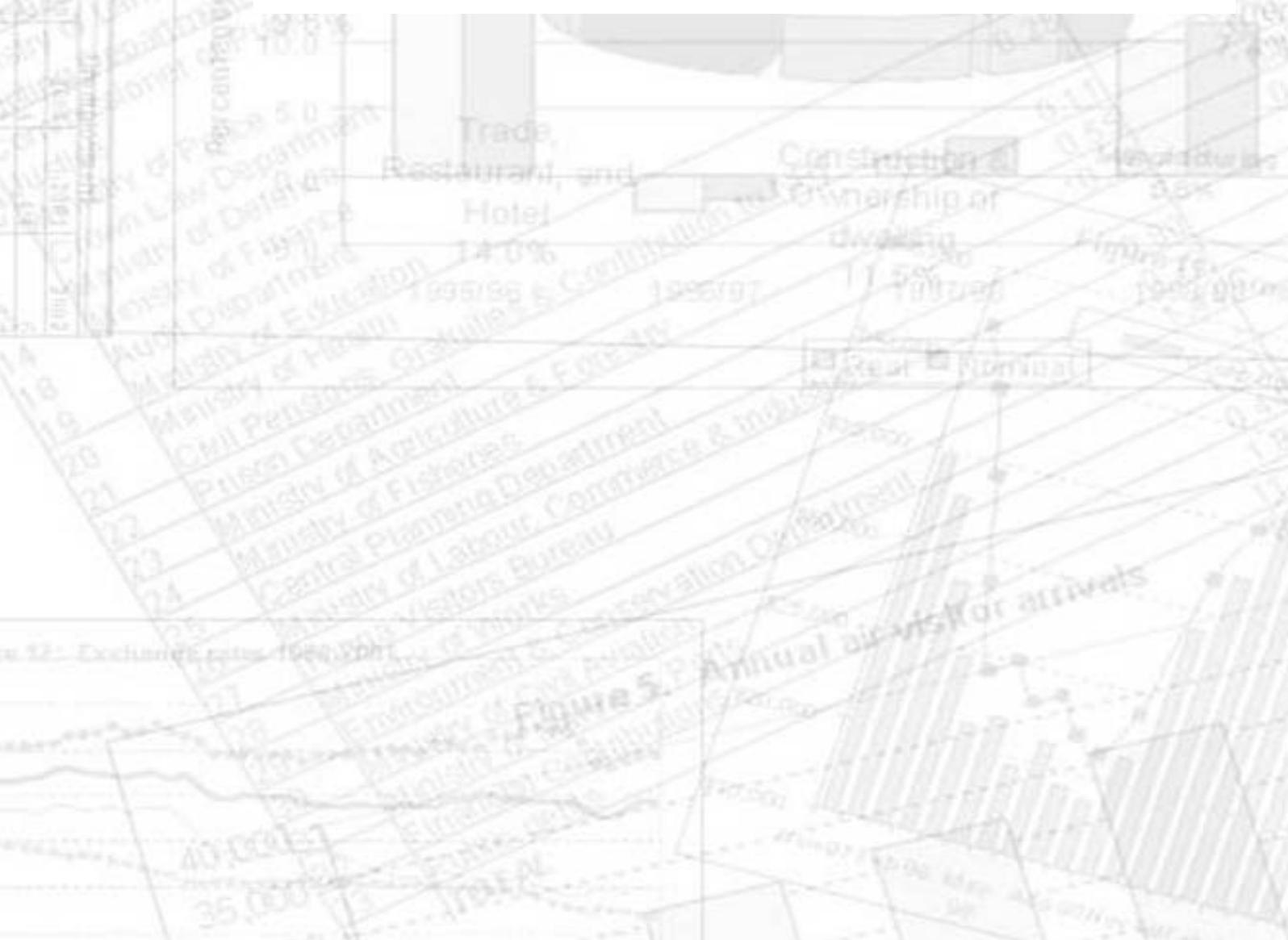


Figure 2. Sectoral Contribution to Gross Domestic Product  
Constant prices for the year 1999/00



Budget Statement for Year Ending 30<sup>th</sup> June 2008  
*Budget Statement*





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## **1. Introduction**

Twelve months ago, the Government delivered a budget that focused on the Kingdom's economic survival using appropriate fiscal policies. The Kingdom was on target for a prosperous 2007/08 because the Government had put in place the right policy instruments to drive economic growth. However, twelve months later, we are again facing the same situation due to the events of 16 November 2006.

At this time, the people of Tonga are looking to the Government to restore some stability to their lives, not only the people of Nuku'alofa who suffered but all those others on Tongatapu and the outer Islands who also got caught up in the suffering they neither caused nor wanted.

Our traditional values of compassion for those in difficulties were tested last year and were reaffirmed. These values are not just reflected in the Government's core spending but also in its revenue reforms. Compassion for the lowest income earners and fairness for everyone are two of the values reflected in the income tax changes that are being implemented. They reflect what the public said during extensive consultation over revenue reforms in 2006.

This Budget Statement will be pointing to recent progress with business recovery, and outlining the steps being taken to support a strong private sector that can give us all some optimism about the future.

The Government will continue to focus on achieving the goals and objectives of our key policy instrument - the Strategic Development Plan 8 (SDP8). The strategies of SDP8 are absolutely relevant during this difficult period to ensure we look after those in society who are vulnerable when the economy weakens.

Although, total Government spending is being restrained, there are two special spending initiatives that are being funded through targeted revenue initiatives to maintain overall fiscal balance. These are initiatives to support technical training and road maintenance

The Government is determined to maintain a balanced budget in order to lay the platform for sustained economic growth.

## **2. Economic Outlook**

The challenges over the last two years have been addressed effectively by implementing appropriate monetary and fiscal policies. These measures have ensured that the Government can meet its obligations as well as providing core public services. This type of responsible management has ensured that the economy could withstand unexpected shocks.

## **3. International Prospects**

In the past, the Budget Statements have usually drawn people's attention to the external threats Tonga faces from unfavourable developments in the global economy. This year things are different.

At the moment, the international prospects are good. Growth in the major economies remains high. One recurring threat – increased oil prices – has moderated, although there are still risks, especially due to conflict in the middle east and adverse weather patterns in the United States.

The international economy has enjoyed a period of strong growth. There are always risks but that growth is forecast to continue. International inflation is at relatively low levels and this is also expected to continue. Some smaller nations like Tonga have benefited from this favourable international situation. They show what can be achieved through strong private sectors supported by prudent “trade friendly” Government policies.

## **4. Domestic Economy**

The Tongan domestic economy has proved its underlying strength by recovering from last year’s problems. This is thanks mainly to a combination of courageous and committed private sector businesses, strong friends in the international community, and effective Government action in bringing everything together.

The resilience shown by our business community also gives us confidence that they can make a successful transition into the global trading environment.

## **5. Government Policy Priorities**

This year we face a new set of challenges, especially those caused by the events of last year. The significant damages experienced by the business community has threatened our fiscal position and forced the Government to reprioritise spending given the reduction in revenue collection.

In an emergency situation, facing urgent and unexpected new challenges with reduced revenue, the Government had to revise our key priorities from SDP8 accordingly:

- Highest priority – to uphold law and order & support political reform;
- Second priority – to treat productive sectors equally with the social sectors; and
- Third priority – undertake investment in infrastructure.

The key foundations for these priorities are macroeconomic stability, environmental sustainability and disaster risk reduction. They must not be weakened and need the same urgent action as the priorities.

Through the Ministers responsible for these priority areas, Government will be announcing the details of the reform programme: in particular the growth strategy for development of the productive sectors, and social sector initiatives.

## **6. Successful Revenue Reform Programme Nearing Completion**

In 2003/04 taxes on international trade provided 53 percent of Government revenue leaving only 47 percent to be raised from domestic sources. It is estimated in the year ended 30 June 2007, at least 63 percent of Government revenues will be from domestic taxes on incomes, general goods and services (CT), and excise goods (alcohol and tobacco).

Revenue reform encompassing fundamental change to the main tax types used in the Kingdom, is in its third and final stage. Once this process is complete with the passage and implementation of customs and excise legislation, and the Income Tax Bill, it is expected that domestic taxes will account for almost 90 percent of Government revenues, with only around 10 percent being raised from border taxes.

This is a significant achievement and represents real progress towards modernising the tax system in the Kingdom. From a strategic perspective it prepares the way for Tongan-based businesses to compete on an equal footing with foreign-based businesses without the artificial disincentives and commercial distortions arising from over-reliance on trade taxes.

For the payment of the tax by internet banking, the suppliers of the Revenue Management System are currently working to add a facility for on-line filing of tax returns and payment of tax by Internet banking. It is anticipated that this facility will be available for taxpayers during 2008. Not only will online filing save time for taxpayers by that will free up staff of the Revenue Services Department for other more valuable tasks.

Further work will be undertaken as part of the 2007/08 revenue reform policy work program.

## **7. Revenue Reform Measures**

The Government expects that revenue bills tabled in the Legislative Assembly in 2006, will be approved in 2007 and these will strengthen the foundations for stable economic growth as well as supporting private sector development. These include the Customs, Excise and Income Tax Bills.

## **8. Donor Assistance**

At least \$15 million in projects have been approved by the Government and donors to be implemented in the next financial year. Our major donor partners consisting of Australia, New Zealand, European Union and Japan continue to support the community projects at the grassroots level. Our local communities are able to realise their aspirations through the support of these donor friends.

This Budget will continue to ensure that all donor projects focus on alleviating poverty and improving the quality of life for our regional and rural communities by actively engaging communities and civil society.

## **9. Moving Forward**

The favourable international conditions, plus the domestic recovery suggest that future prospects are good. The success of other small countries shows Tonga what can be done. There are emerging economies, particularly in Asia which have been enjoying much faster growth than countries we think of as most developed. This is a lesson to Tonga to be more active in trade promotion: building on the existing traditional markets but also developing new trading relationships.

This market development overseas is being supported at home by continuing revenue reforms, and reduction of regulations that add unnecessary costs and delays to Tongan businesses.

## 10. Conclusion

The economy can only move forward if we have a strong private sector so it is critical that we play our part to provide support and interventions that encourage growth and recovery for the affected businesses.

Our forward plans will look at how to rebuild the damaged business district as well as improving the infrastructure so that businesses have a strong platform to operate from.

The Government wants to re-emphasise its commitment to maintaining sound fiscal policies that sustain the financial requirements of public services and at the same time promote macro stability and economic growth. The challenges before us are formidable, but we are determined to implement the right policies to maintain macroeconomic stability.

Protecting core services for the public, promoting fairness and opportunity, staying united and motivated by shared national goals, strengthening our international links, giving people certainty through consistent policies and staying on track with reforms, making sure that the private sector can borrow and expand without threat to the economy – these are stable foundations for going forward from where we are today.



Budget Statement for Year Ending 30<sup>th</sup> June 2008

## Budget Paper No 1:

*Review of the Tongan Economy & Outlook 2007/08*



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## 1.0 OVERVIEW

Budget Paper Number 1 describes the Kingdom's economic environment and the likely economic development within the major industries.

The domestic economy is expected to return to positive growth in 2007/08 following a softening of economic activities in 2006/07, which was largely attributed to two major events.

The first event was the wage settlement of 2005 which led to the large civil servant wage increases and its associated consequents, that is a reduction in public employment and significant reductions in government purchases of goods and services. These contributed to the softening of economic activity in 2006/07.

The second was the civil disorder in Nuku'alofa on 16 November 2006. This led to the destruction of shops, offices, plant and equipment, and stocks of goods for sale. Tourists spending in Tonga fell, with some tourists canceling their existing travel arrangements and others planning to travel elsewhere. This affected efforts to strengthen the tourism industry and overall economic activity in the Kingdom.

Both these major events affected the flow of remittances and tourism earnings.

The Government of Tonga has successfully steered the economy through each crisis. The wage settlement was honoured in full while maintaining macroeconomic stability through a responsible fiscal policy. Following the civil unrest of 16 November 2006, the Government facilitated reconstruction and recovery efforts and ensured and supported the restoration of business confidence. As a result, the economy is forecast to strengthen in 2007/08.

Furthermore, the resumption of economic growth is expected to be accompanied by moderate inflation as the recent falls in inflation to about 4 % are consolidated and maintained. This has been achieved through responsible fiscal and monetary policies that have adapted to changing economic conditions.

## 2.0 GLOBAL ECONOMIC DEVELOPMENTS

The International Monetary Funds (IMF) latest World Economic Outlook release in April 2007, reported that the global economy expanded vigorously in 2006, growing by 5.4 % which was a 0.25 % point higher than projected in the previous report for September 2006. In the United States, expansion slowed in the face of headwinds from a sharp downturn in the housing market, but oil price declines since August helped prop up consumer spending. In Europe, growth accelerated to its fastest pace in six years as domestic demand strengthened. In Japan, activity regained traction toward the end of 2006 after a soft patch mid year. Among emerging markets and developing countries, rapid growth was experienced by China and India, while momentum was sustained across other regions as countries benefited from high commodity prices and continued supportive financial conditions. China's growth rate reached 10.7 % in 2006, driven by large investments and export growth. This was followed closely by continued economic growth that reached 9.2 % in India.

Strong growth and rising oil prices in the first half of 2006 raised concerns about inflation, but pressures moderated in the second half, dampened by tightened monetary policy and a turnaround in the oil market. The oil price decreases from August 2006 largely reflected some easing of security tensions in the Middle East, improved demand balance for oil and favorable weather conditions in the second half of 2006.

Inflation in the advanced economies dropped quite sharply after the summer as fuel costs fell.

The expectations of continued solid economic growth and fading inflation concerns contributed to buoyant global financial market conditions from the second half of 2006.

In the foreign exchange market, the US dollar has weakened, mainly against the euro and pound sterling. The yen has also depreciated further, in part because prospects for continued low interest rates have encouraged capital outflows, although it recovered in early 2007. The Chinese *renminbi* has declined modestly in real effective terms despite a mild acceleration in its rate of appreciation against the US\$ dollar. The US current account deficit rose to 6.5 % of GDP in 2006, although the non-oil trade deficit declined as a % of GDP as exports accelerated. Surpluses in Japan, China, and Middle Eastern oil-exporting countries increased further.

The outlook for the global economy is expected to grow moderately to 4.9 % in 2007 and 2008. This is 0.5 % slower than in 2006 and will help to contain inflationary pressures in the major economies. The growth in the US is expected to come down from 3.3 % in 2006 to 2.2 % this year, although the economy should gather some momentum during the course of the year as drag from the housing sectors dissipates. Emerging markets and developing countries are expected to continue to grow strongly, albeit at a somewhat slower pace than in 2006. These economies will continue to draw support from benign global financial conditions and commodity prices that remain high notwithstanding recent declines. China's economic growth is projected to continue through 2007 and 2008, albeit a little below the torrid pace in 2006, while India's economy should also continue to grow rapidly.

The moderate growth projected for the global economy is surrounded by a number of risks. Particular uncertainties include the potential for a sharper slowdown in the US if the housing sector continues to deteriorate; the risk of a retrenchment from risky assets if financial market volatility were to rise from historically low levels; the risk that inflation pressures could revive as output gaps continue to close, particularly in the event of another spike in oil prices; and the low probability but high cost risk of disorderly unwinding of large global imbalances.

### 3.0 REGIONAL ECONOMIC ISSUES

The 2007 Report on Economic and Social Survey of Asia and the Pacific 2007<sup>1</sup>, reported that the region economies grew at 7.9 % in 2006, up from 7.6% in 2005. The continuing buoyancy of external demand remained a source of growth for many countries. The impressive economic performance was against the backdrop of a riskier global environment. Oil prices hit a record high in the middle of 2006, while stock markets plummeted across the Asia-Pacific region, raising fears of a downturn. Global imbalances steadily widened, with the current account balance of the United States of America deteriorating by a further \$100 billion in 2006, increasing the possibility of an abrupt depreciation of the United States dollar. The sharp appreciation of major currencies in the region against the United States dollar made it difficult to keep exchange rates competitive while addressing inflationary pressure.

Despite high and volatile oil prices in 2006, developing economies in the Asia-Pacific region kept inflation under control at 4.3%, similar to that of the previous year. Developing countries in the region continued to add to their sizeable foreign exchange reserves, which had reached an unprecedented \$2.5 trillion at the end of 2006. The large increase in reserves points to continuing efforts to push down the region's currencies by official intervention. Current account balances deteriorated across the region in 2006, mainly a result of rising oil imports.

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<sup>1</sup> Report prepared by UN-ESCAP

Strong exports in many countries offset some of the effects of rising oil prices. The region's exports grew at an impressive 18%, benefiting from healthy global demand.

Specifically, the Pacific Island economies recorded robust growth in 2006. The Pacific economies grew by 3.1 % in 2006, picking up from 2.5% growth in 2005.<sup>2</sup> Growth is however forecast to slow down in 2007. High growth in 2006 was mainly due to strong growth in services sectors, particular tourism in most small island countries.

## **4.0 KEY DEVELOPMENTS IN THE DOMESTIC ECONOMY**

This section discusses the general conditions of economic growth in 2006/07.

### **4.1 Civil Disorder of 16 November 2006**

The civil disorder of 16 November 2006 has directly and indirectly reduced economic activity. Retail and wholesale businesses were largely affected as the following examples illustrate.

According to surveys by the Ministry of Labour, Commerce and Industries, 153 businesses were directly affected and a further 107 businesses were indirectly affected by the civil unrest. An estimated cost of \$112 million was reported for the affected businesses due to the civil disorder of 16 November 2006.

The affected businesses estimated that 678 jobs were affected although this figure has been revised down reflecting the resilience of the private sector and willingness on the part of employers and employees to be flexible over hours of work and pay levels.

The destruction had indirect flow-on effects by reducing economic activity in the Commerce, Hotels and Restaurants industry due to the businesses that ceased trading. However, it also reduced employment and incomes caused by tourist cancellations. These indirect effects have also reduced economic activity in other industries, such as Transport and Communications, Financial and Real Estate Services and Manufacturing.

Following the destruction, the Government has announced that it will rebuild a new Nuku'alofa into a more modern capital.

With the assistance of NZAID and AusAID, the Government has established the Business Recovery Facility (BRF) directed at affected businesses to assist short term recovery which is vital to ensuring short and longer term recovery of the Tongan economy. With the implementation of the BRF and other policy measures of government, it is expected many of the affected businesses would partially recover in 2007/08. New business entrants may also enter the market to replace those who have ceased trading.

### **4.2 Public sector wage settlement and redundancy**

The wage settlement and associated redundancy program have created financial challenges in the last two years.

The year 2006/07 was the first full year for the pay settlement. It also saw the payment of \$10 million (40 % of the wage increase for 2005/06) that was deferred until 2006/07. These large payments required a reduction in the number of civil servants. This led to the program of

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<sup>2</sup> Figures based on Asian Development Outlook (ADO) 2007

voluntary redundancy payments which reduced the government's workforce by almost 20 per cent.

In addition to that, there is an indirect effect that will further reduce economic activity in 2006/07. The pressure on government expenditure from the overall increase in wage payments will have reduced Government spending on operations and purchases of goods and services from the business sector. As the Government is forced to spend less on goods and services relative to wages and salaries it will have certain implications on other industries, such as manufacturing, transport and communications, financial and real estate services.

### **4.3 Primary Production**

Secondary data indicate that primary production has fallen over the last few years and this trend is expected to continue into the next financial year. Provisional estimates for 2006/07, suggest that primary production is expected to decline and is likely to continue into 2007/08.

Squash is one of the main agricultural exports. It is highly dependent on a narrow and variable "window" in the Japanese market. Over the past five years, market shortages had boosted prices to Tongan exporters. Since then, Tongan squash export prices and volumes have both suffered because Tonga's production increased well beyond previous levels at the same time as the market contracted due to extended seasons for exporters in other countries.

The change in squash exports is the major factor affecting the trend in primary production. The movements in the market price for squash has caused some farmers to diversify into other crops.

The overall growth for the agricultural industry is projected to weaken, which is likely to affect the real GDP growth rate in 2007/08. The Tongan economy has been relying on agricultural products for many decades. Despite the relatively weak performance of this sector, it still remains the highest contributor of a single industry to real GDP, comprising about 30 % of total real GDP and an average of about 60 % of total exports.

The ratification of Tonga's membership in various trade agreements should provide market access for potential new exports, including agricultural products.

### **4.4 Remittances**

Provisional data suggests that remittances may have declined in 2006/07. A plausible explanation for this is that one of the key sources of remittance information, the ANZ bank was affected by the social disorder of 16 November 2006. Other remittance reporting agencies, however, indicate that the underlying trend for remittances continues to remain stable.

The continuing migration of Tongans overseas will contribute to future remittances. The NZ Recognized Seasonal Employment work-scheme is about to start with employment opportunities for Pacific Islanders growing at 5 % each year. This new scheme is expected to contribute to growth in remittances.

### **4.5 Tourism**

The contribution of tourism to the economy has varied in recent years. In 2006/07, preliminary data suggests that arrival numbers and tourist receipts declined compared to 2005/06. The relatively weak performance of the tourism sector was exacerbated by the civil disorder of 16 November, resulting in a recorded reduction in tourism receipts. Other tourist facilities and attractions were destroyed during the civil disorder of 16 November and unfortunately, the

negative publicity will likely persist for some time. The general negative publicity and social disorder in neighbouring island countries will also continue to affect efforts to attract tourists to Tonga.

The Ministry of Tourism is undertaking a vigorous promotion campaign and is projected to increase significantly with a rise in arrivals of about 10 % in 2007/08.

There are currently discussions with interested parties relating to potential development that could increase the future earnings from tourism. There are discussions with interested airline providers to provide direct Nadi-Vava'u scheduled flights which would further boost the inflow of tourists. There are other proposed investment projects which are currently on the pipeline, including major tourism development plan for Vava'u, where construction is expected to commence after 2007.

These proposed projects, should they be implemented quickly, would be encouraging to the development of the economy as tourism is a relatively labor-intensive industry and, therefore, can make a significant contribution to employment. This is of obvious importance in Tonga where about half of the population is under the age of 20 and where there are growing numbers of youth unemployed with limited employment opportunities.

## **5.0 COMPOSITION OF ECONOMIC GROWTH BY INDUSTRY**

### **5.1 Agriculture**

General indicators show that the performance of the agricultural sector has been below expectation since 2003/04. This performance can be partially attributed to the low volume of squash exports caused by volatile market prices.

The inception of the new Korean market for baby squash may partially offset the decline in the Japanese market. There are other agricultural products that are likely to contribute positively to the sector like Tahitian vanilla, root crops and taro leaves. However, the lower than expected performance of the squash industry is likely to outweigh any of the positive contributions from other agricultural export produce.

Partial estimates indicate that vanilla exports are likely to increase in 2006/07, despite the falling prices in the last two years. Vanilla for Tonga has been affected by fierce competition in this industry with new comers into the world market such as Indonesia and Vanuatu.

Provisional data also suggest that root crop exports improved in 2006/07. The high risks and lower price in the squash industry has caused farmers to grow root crops such as cassava, yams and taro. These crops have lower returns compared to squash but it has less risk. The target markets for these root crops are Tongan communities in New Zealand, Australia and the US markets.

### **5.2 Fishing**

Preliminary data indicated that activity in the fishing industry is expected to continue to perform below expectation. The projected decline in yield from the industry is attributed to various reasons such as the depletion of fish stock (a general trend in the Pacific region according to various studies), harsh weather conditions, lack of new technology, lack of cargo space in airlines to export fish to markets and lack of accessibility to credit. Provisional indicators for 2006/07, however, projects that the decline in the fishing industry will slow

down with the absence of new activity adding to the decline in current activities.

According to official data released by the Statistics Department, the total volume of fish exported throughout 2006 fluctuated with the total volume for the year recording a fall. The total quantity of marine resource exported for 2006 fell despite the increase in its value. Other fresh fish like snapper, and tuna has increased but their impact on the industry is insignificant.

Latest data indicate a fall in the export of seaweed due to poor market conditions, poor weather and harvesting techniques.

### **5.3 Manufacturing**

Activity in this industry has been broadly unchanged for the last five years following growth in the last decade. Like many other countries in the Pacific region, manufacturing in Tonga is being challenged by its remoteness from raw materials, its relatively small market and the attractiveness of manufactures from other countries.

The Government is working to improve the environment for manufacturing and other businesses. The Implementation of Regulatory Reform (IRR) for private sector development project funded by the World Bank is designed to improve the regulatory environment in Tonga to attract potential investors and also to strengthen the confidence of the existing investors. The project aims to deal with those regulatory issues that the private sector perceived as an impediment for business development and simultaneously endeavoring to provide an environment that is favorable for investors.

Based on provisional information, the outlook for manufacturing is not encouraging. However, there are other works in progress by the government which will provide opportunities for investors. In addition to the regulatory reform, the ratification of Tonga's membership in various free trade agreements will provide some market access for Tonga's manufacturers. Other Regional Trade Agreements like PICTA and EPA will provide market access in Europe, other ACP members and neighboring countries.

### **5.4 Construction**

Provisional estimates suggest that the construction industry is expected to strengthen in 2007/08, following limited performance in 2006/07.

The performance of the industry in 2006/07 is explained by the completion of several major donor funded projects such as the WAKA cyclone rehabilitation project and phase 1 of the health sector support project. In addition, maintaining appropriate credit growth also contributed to the limited growth of the industry. It is expected, however, that with NRBT policy of lifting credit ceiling, housing loans should increase. It is also expected that the reconstruction of Nuku'alofa will commence with a very small contribution in this financial year that will grow in subsequent years.

Despite the restraint growth rate estimated for 2006/07, encouraging progress by the industry is projected for 2007/08. This reflects robust activities in some areas, such as tourism development, renovation work by the LDS, phase two of the Vaiola Hospital development and the Nuku'alofa reconstruction efforts.

## **5.5 Commerce, Restaurants and Hotels**

The tourism industry continues to play an important role in generating foreign exchange earnings and creating employment. Provisional estimates show that arrivals, both by air and sea for 2006/07 may decline as a result of the civil disorder of 16 November 2006.

The projected weakening of the tourism industry, combined with the estimated fall in consumer spending (partially resulting from the redundancy exercise in 2006) will significantly affect the performance of the commerce, restaurants and hotel industry for 2007/08.

However, this may change as a result of higher activity in the transport and communication industry.

## **5.6 Transport and Communication**

Provisional estimates suggest that the sector is experiencing high levels of activity. Air Pacific has extended their flights to Tonga by two flights per week while Air New Zealand brings in a bigger aircraft with higher capacity. These will contribute positively to other sector of the economy particularly the tourism industry. This potential capacity is affected by the total number of arrivals into the Kingdom. As indicated in earlier sections, the implication of continued weakening of the tourism industry may present a concern for airline industry. However, the effort put in place by the Ministry of Tourism may alleviate such pressures.

Partial estimates suggest that the other components of sea transport and communications will continue to be encouraging in 2006/07 and is expected to continue into 2007/08. Some of the planned activities in this sector includes: effort to replace the “Olovaha Vessel” which will result in an improved services through more frequent and greater freight capacity for the outer islands.

## **5.7 Other Industries**

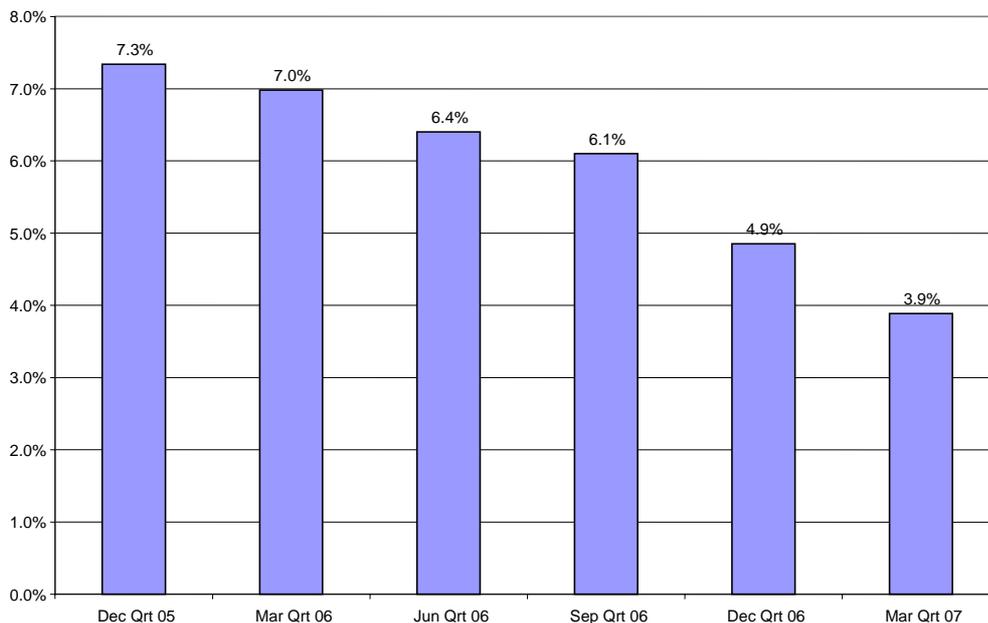
Preliminary data shows that the performance of the Finance and Real Estate Industry continues to be encouraging.

While preliminary data shows encouraging signs, the Government Services sector was affected by the decline in the civil servant numbers following the voluntary redundancy program in June 2006. Provisional data suggests that for 2007/08 positive performance will be recorded for some sectors such as Government Services, Finance and Real Estate and Entertainment and Private Services.

## **5.8 Domestic Price Development**

Data shows that the overall inflation rate was recorded at 3.9 % at the end of March 2007 (Figure 1). The decrease in level of inflation is largely due to fall in domestic prices. In the year to March 2007, the level of inflation for imported goods is very similar to the domestic level of inflation as well as the all items inflation rate. Domestic inflation had previously been higher than imported inflation. Inflation has continued on a downward spiral since December 2005.

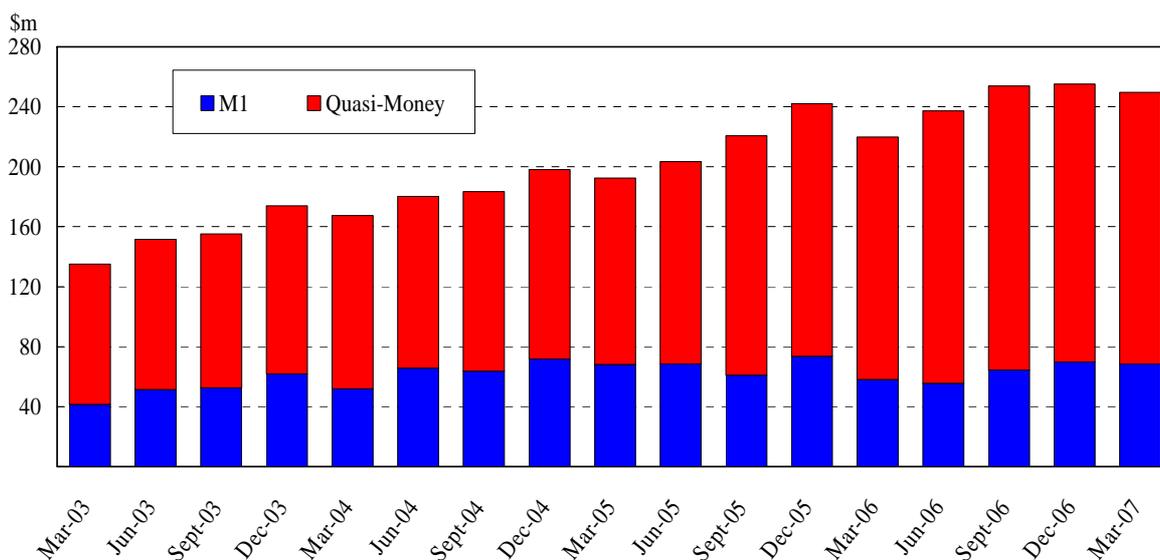
**Figure 1: Quarterly inflation rate (% , end period)**



## 6.0 MONEY SUPPLY

The money supply measure, M2, totaled \$237.3 million at end June 2006, compared to \$203.5 million at end June 2005 (Figure 2). This represented growth of 16.6 %, an increase from the 12.9 % growth recorded in the year-ended June 2005.

**Figure 2: Component of Money Supply for March 2003 to March 2007**



Source: National Reserve Bank of Tonga.

The growth in money supply in 2005/06 reflected an increase in quasi-money of \$46.9 million which more than offset a fall in M1 by \$13.1 million. Within M1, currency in circulation increased by \$2.2 million although demand deposits fell by \$15.3 million. The growth in quasi-

money reflected increases in time deposits of \$23.1 million, saving deposits of \$20.1 million and foreign currency deposits of \$3.7 million.

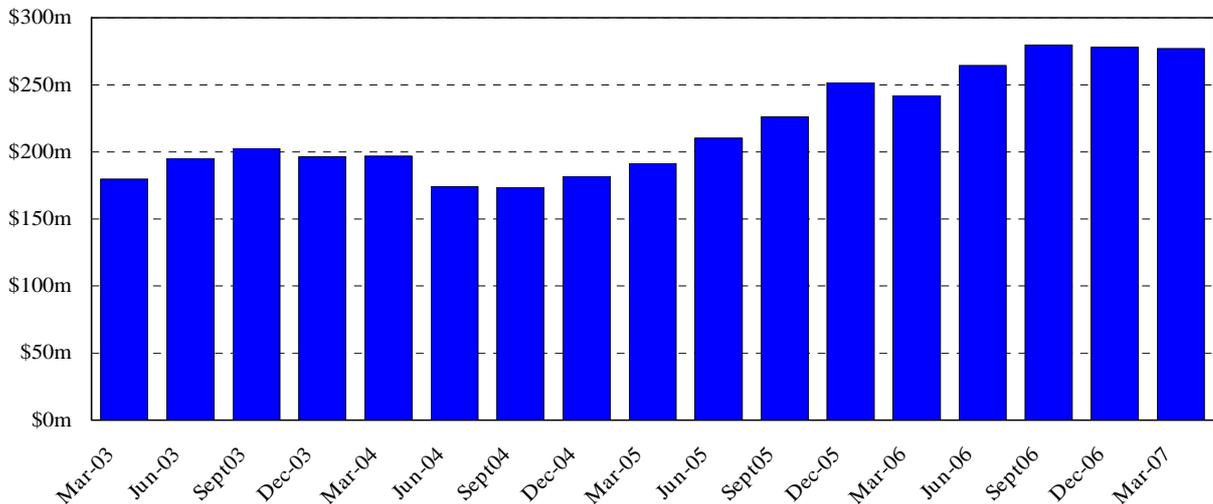
In the first nine months of the 2006/07 financial year, M2 increased to \$249.6 million, a 5.2 % increase from the level at the end of June 2006. This increase largely reflected growth in M1, particularly demand deposits which rose by 35.4 %.

## 6.1 Domestic Credit

Estimates show that the year-ended June 2006, the net domestic credit (net of government deposits) extended by the banking system increased by \$54.2 million to \$264.5 million (Figure 3). This represented an increase of 25.8 % compared with a 20.9 % increase in 2004/05. The rise in the level of net domestic credit was largely due to an increase in private sector credit. Total credit extended to the private sector increased by 22.6 % to \$278 million, reflecting an increase in lending to the household and business sectors. At the end of June 2006, the government was a net lender to the banking system, with a net balance of \$18.9 million compared to a net lending position of \$25.2 million in June 2005.

The data also shows that in the nine months-ended March 2007, net domestic credit extended by the banking system increased by \$12.6 million to \$277 million. Growth was largely attributed to an increase in business sector credit of 11.2 %, the largest contributor to private sector credit growth during the review period. Growth in business sector credit reflects increase in lending for wholesale & retail and other services. Household credit rose by less than 1 % in the first nine months of the 2006/07 financial year mainly through lending to housing.

**Figure 3: Domestic Credit Level for March 2003 to March 2007**



Source: National Reserve Bank of Tonga.

In June 2006 household credit was the largest contributor to private sector credit growth with a year-ended growth of 22.4 %. The trend after November with the credit ceiling and after the events of 16 November 2006, showed business credit surpassing household credit with household credit growth falling to 1 % in November and declining further reaching a record low of negative 6.1 % year-ended growth in January 2007. It recovered slowly through the months to a growth of negative 1.5 % in March 2007, whereas business credit growth rose from 16.5 % in November 2006 to 18.6 % in March 2007.

In February 2007, the Reserve Bank officially announced the suspension of credit ceilings on individual banks. The suspension of credit ceilings was to allow banks to consider lending for the recovery of those who were affected by the civil disorder in November 2006. In addition, the Reserve Bank reduced the Statutory Required Reserves ratio by 2.5 % to 10 % effective April 2007. This added T\$6.2 million into the banking system. The Reserve Bank is mindful of its objective in fostering balanced economic development and the important role of the banks in funding the rebuilding of Nuku'alofa.

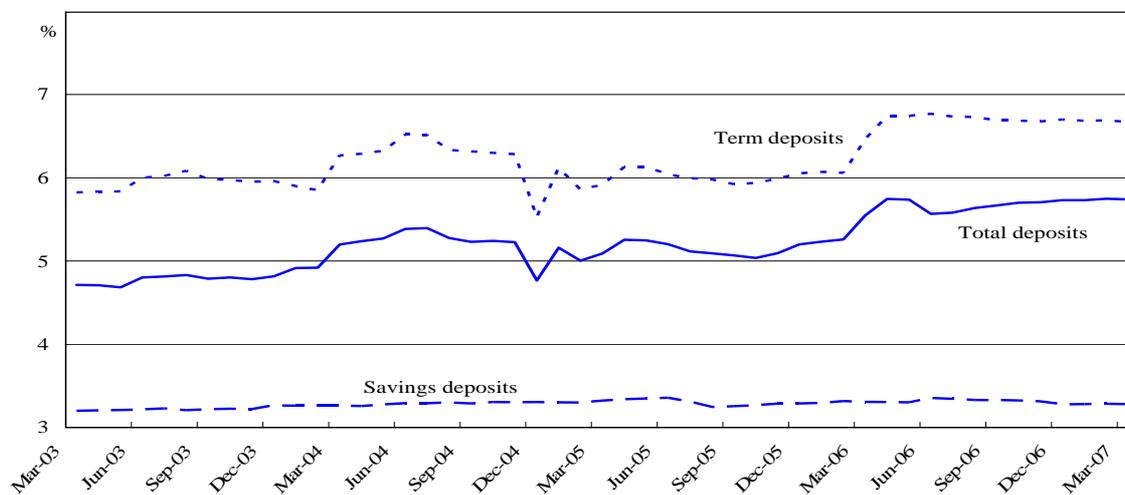
## 6.2 Deposits with the Banking System

In 2005/06, total deposits with the banking system increased by 16.7 % to \$237.3 million. The expansion in private sector deposits of \$39.8 million was underpinned by increases in time deposits and saving deposits. Furthermore, government deposits increased by \$1.2 million to \$11.1 million while 'other' deposits fell by \$7 million over the year.

In the first nine months of the 2006/07 financial year, total deposits with the banking system showed a further increase of \$7.8 million to \$245.1 million. This growth reflected increases in public enterprise deposits by \$35.3 million and non-monetary financial institution deposits by \$1.6 million while government deposits fell by \$6.4 million and private sector deposits fell by \$22.7 million.

## 6.3 Interest Rates

Figure 4: Weighted Deposit Interest Rates: March 2003 to March 2007



Source: National Reserve Bank of Tonga.

Nominal interest rates on savings deposits published by the banks were unchanged in the 2005/06 financial year (Figure 4). However, weighted average deposit rates have followed an upward trend as reflected by the Reserve Bank's deposits indicator rate. This is indicated by an increase in the weighted average interest rate paid on term deposits, from 6.04 % at the end of June 2005 to 6.77 % at the end of June 2006. Since July 2006, term deposit interest rates have been flat. However, over the same period the weighted average interest rate on both term and savings deposits increased from 5.58 % to 5.74 % at the end of March 2007, reflecting a move towards more term deposits.

Figure 5: Banking System - Weighted Lending Rate



Source: National Reserve Bank of Tonga.

Lending interest rates published by the banks increased in 2005/06, with the Reserve Bank's lending indicator rate at 12.29 % at the end of June 2006, representing an increase from the 11.54 % at the end of June 2005 (Figure 5). The lending indicator rate was 12.22 % at the end of March 2007.

## 7.0 EXTERNAL SECTOR DEVELOPMENT

### 7.1 Exports

According to estimates based on the overseas exchange transactions (OET) reported by the Reserve Bank and commercial banks, the total value of exports fell by \$0.7 million to \$30.4 million in 2005/06, largely reflecting lower receipts from agricultural exports, particularly squash.

During the first eight months of the 2006/07 financial year, export earnings amounted to \$18.8 million compared with \$19.2 million a year earlier. The fall in export receipts largely reflected lower proceeds from squash exports in the 2006 season.

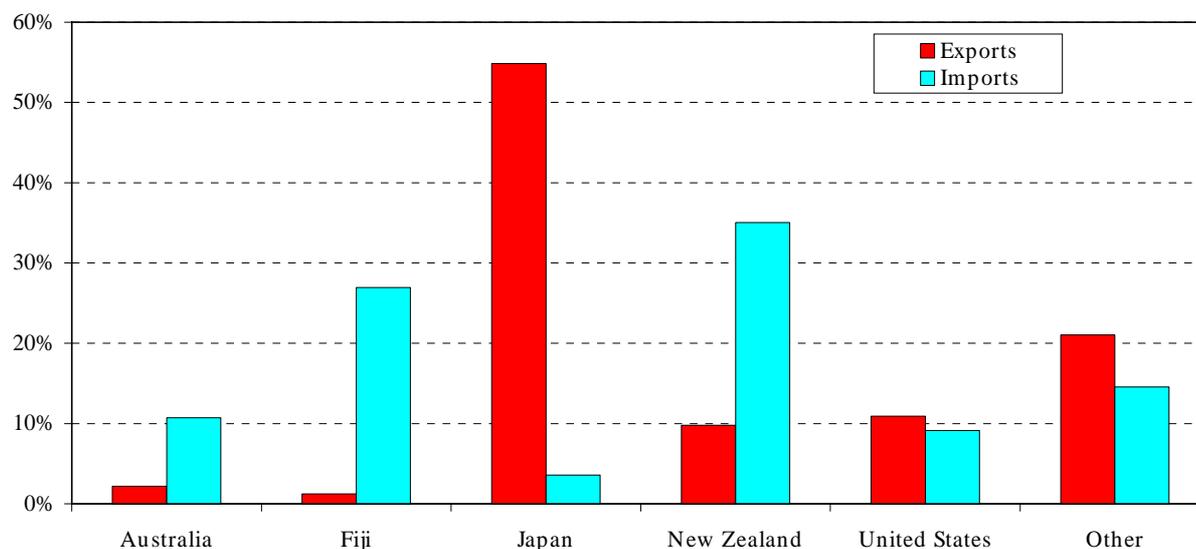
Japan remains the largest destination for Tonga's exports, totaling 54.8 % of the total, mainly squash and fish, followed by other countries (21.0 %) and United States (10.9 %). It is anticipated that squash, vanilla, coffee, root crops, kava, fish and seaweed will remain Tonga's major sources of export income.

### 7.2 Imports

During 2005/06, the value of imports (OET based) rose by \$32.2 million to \$236.3 million, underpinned by firm growth in remittances and growth in business and household credit. During the first eight months of 2006/07, import payments were \$138.8 million, compared with \$158.2 million in the same period last year. The imposition of credit ceilings on banks' lending to the private sector contributed to the decline in import payments early in the period. The impact of the civil disorder on 16 November 2006 was also reflected on the decline in import payments when most of the businesses in the central business district were affected.

New Zealand continued to be Tonga's largest supplier of imports (35.0 %), followed by Fiji (27.0 %), and other countries (14.6 %). This is displayed in Figure 6.

**Figure 6: Direction of Trade for 2005/06**



Source: Department of Statistics.

### 7.3 Balance of Payments

The balance of trade (OET based) recorded a deficit of \$205.9 million in 2005/06 compared with \$173.1 million in 2004/05 (Table 1). Deterioration in the merchandise trade deficit more than offset improvements in the balances on services and investment income, resulting in a current account deficit of \$37.1 million in 2005/06 compared with a deficit of \$11.1 million in 2004/05. The increase in net capital inflow to \$43.6 million in the year-ended June 2006 more than offset the current account deficit and net unrecorded outflows of \$5.3 million, resulting in a balance of payments surplus of \$1.1 million. This compared to a deficit of \$7.6 million in the previous year.

**Table 1: Balance of Payment for 2003/04 to 2006/07(OET Basis)**

	2003/ 04	2004/ 05	2005/ 06	2006/ 07 first 8 months
Balance of Trade	-140.8	-173.1	-205.9	-120.0
Services Balance	5.9	-19.3	-15.6	-18.4
Investment Income Balance	-0.8	3.1	5.7	3.0
Transfers Balance	162.5	178.1	178.8	102.3
Current Account Balance	15.7	-11.1	-37.1	-33.1
Capital and Financial Balance	75.6	24.2	43.6	33.8
Other Items Net	-38.5	-20.7	-5.3	0.3
Overall balance	52.8	-7.6	1.1	1.0

Source: National Reserve Bank of Tonga.

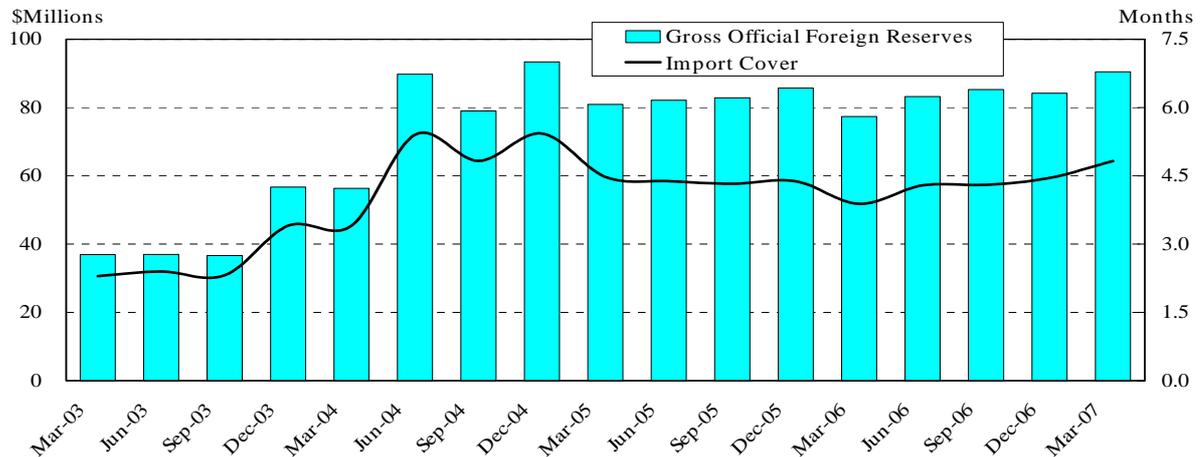
In the first eight months of 2006/07 financial year, the balance of payments recorded an overall external surplus of \$1.0 million. The current account deficit of \$33.1 million and net unrecorded inflow of \$0.3 million were offset by the improvement in net capital inflow of \$33.8 million.

### 7.4 Gross Official Foreign Reserves

During 2005/06, the level of gross official external reserves ranged from \$77.4 million to a peak of \$87.2 million at the end of January 2006, equivalent to 4.5 months of imports. At the

end of June 2006, the total level of gross official foreign reserves was \$83.2 million, equivalent to 4.3 months of imports (refer to Figure 7). This compared with \$82.1 million at the end of June 2005, equivalent to 4.4 months of imports.

**Figure 7: Gross Official Foreign Reserves**



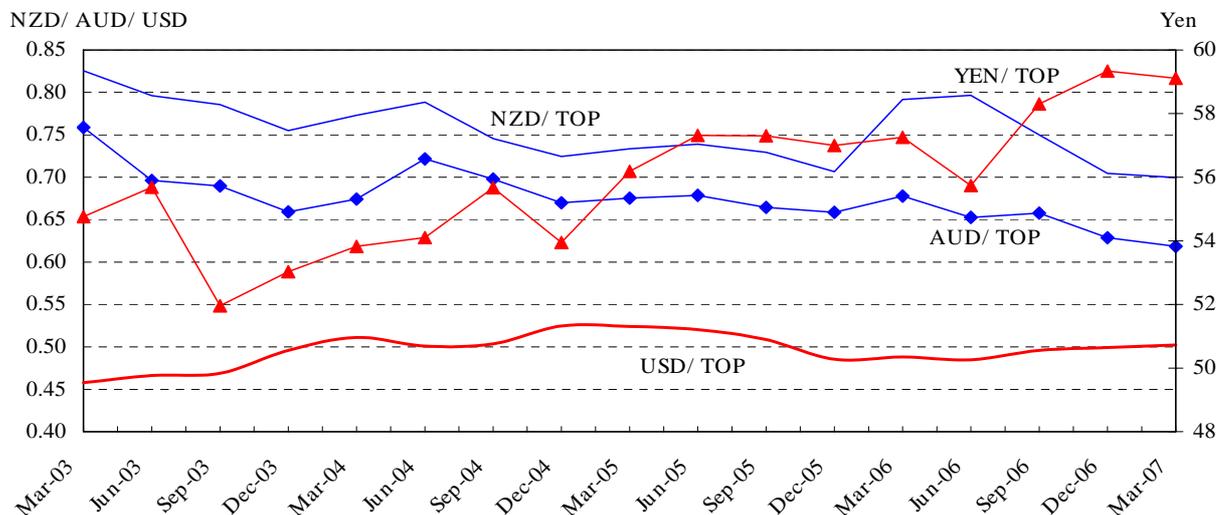
Source: National Reserve Bank of Tonga.

At the end of March 2007, gross official foreign reserves amounted to \$90.4 million, equivalent to 4.7 months of imports, mainly due to deferment of large oil payments to the following month. This was above the level of external reserves of \$77.4 million, equivalent to 3.9 months of imports a year earlier.

## 8.0 EXCHANGE RATES

In 2005/06, the pa'anga depreciated against the United States dollar by 6.8 %, the Australian dollar by 3.8 % and the Japanese yen by 2.7 %. In contrast, the pa'anga appreciated against the New Zealand dollar by 7.8 % (Figure 8).

**Figure 8: Exchange Rate**



Source: National Reserve Bank of Tonga.

During the first nine months of 2006/07, the pa'anga depreciated against the Australian dollar by 5.3 % and against the New Zealand dollar by 12.2 %. However, it appreciated against the United States dollar by 3.6 % and the Japanese yen by 6.0 %, reflecting the weakened of the United States dollar. The fall in the Tongan pa'anga against the Australian dollar and the New Zealand dollar reflects the strengthening of the Australian dollar and the New Zealand dollar against the United States dollar during this period.

## 9.0 IMPROVING THE REGULATORY ENVIRONMENT

The Government of Tonga has created a Task Force for Implementation of Regulatory Reform for private sector development. This was approved by Cabinet on 25<sup>th</sup> January 2006 with four working groups, namely: Starting a Business; Licenses, Permits and Inspections; Immigration; and Fishing Industry being established. The WB is the financier for the project and a Consultant has been assigned by the WB to assist Tonga on this work

The initiative for the project came from a general understanding in both the public and the private sectors that the existing regulatory environment was one of the main factors impeding development of the private sector in Tonga. This coincided with the World Bank's inclusion of several Pacific Island countries, including Tonga, in its annual *Doing Business* survey. This survey showed that although Tonga compared reasonably well with other PI countries in most criteria, it performed well below OECD averages.

The goals for the project can be described in four broad categories:

1. Addressing specific regulatory reform issues, finding appropriate solutions, implementing them and then monitoring the results.
2. Ensuring that there is a high degree of community consultation and public participation in the regulatory reform process.
3. Improving the efficiency and effectiveness of the Task Force, the Working Groups and the Secretariat.
4. Embedding processes so that the project, as much as possible, becomes sustainable.

Since its inception, the main achievement was the engagement of both the private and the public sectors in working to resolve regulatory reform issues.

**Budget Statement for Year Ending 30<sup>th</sup> June 2008**  
**Budget Paper 2: *Fiscal Outlook***

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





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## 1.0 OVERVIEW

The civil unrest of 16 November 2006 has had a significant impact on the state of the economy. Revenue collection fell due to the decline in business activity and extra Government spending was needed to deal with damages to commercial buildings and property. This comes on top of the redundancies last year which were necessary to prevent unsustainable budget deficits from severely damaging the economy. The last installment of the public service pay increase was made at the beginning of 2006/07, and redundancy packages including accrued pension entitlements and various allowances were also paid using aid monies provided for this purpose, but also running down the reserves that had been built up to handle economic threats coming from international events such as oil price shocks.

As a result, the fiscal context for the 2007/08 budget was constraint in several respects: falling revenue, unbudgeted extra expenditure, and lowered reserves. While wage expenditures will fall in 2007/08 due to the absence of any arrears payment, they will continue to be at a relatively high level that presents an ongoing fiscal challenge, and wages are also a relatively high proportion of total spending which creates an additional operational challenge. The Government is determined to defeat both challenges.

These fiscal constraints require Government to continue its policies of prudent economic management, while also continuing its tax reforms to modernize revenue collection and make it fairer for everyone.

One of the key challenges is to minimise dependence on foreign aid and avoid spending so much money on public servants pay that there is not enough money left over to pay essential operating expenses. Public expenditure reforms as part of wider public sector reforms are now needed to improve services and rebalance public service wages and Government operating expenditures.

### 1.1 Fiscal Policies in 2007/08

Fiscal policies will be aligned to the national strategies on Strategic Development Plan 8 (SDP8). The following policies will be implemented to maintain macroeconomic stability:

- Completion of the revenue reform program;
- Reconstruction of Nuku'alofa;
- Implementing pro-poor policies; and
- Continuing the public sector reform program.

Government has had to reprioritize its goals in SDP8 in light of 16 November 2006. The immediate priorities and most urgent reforms in the short-term are:

- Social stability through law and order and political reform;
- Productive sectors to be treated equally with the social sectors; and
- Investment in infrastructure.

The remainder (macroeconomic stability, and environmental sustainability and disaster risk reduction) remain as foundations that must not be weakened.

The Government hosted the first Joint Synchronized Country Strategy Mission to Tonga on the 26<sup>th</sup> of March – 3<sup>rd</sup> of April 2007 whereby Government re-emphasized to development partners

Tonga's priorities and the need for future programs of assistance to be aligned with these priorities.

Development partners and Government agreed that post-16 November 2006, assistance would continue to be guided by SDP8 with the main focus on the reconstruction of urban infrastructure, business recovery, and improved fiscal governance. Ongoing liaison with the development partners on development proposals from line ministries led to the proposed forward aid program for 2007/08.

Development estimates for 2007/08 are confined to proposals that have confirmed funding and those which have a high probability of attracting funds during the budget period. Development assistance is divided into two components, namely, cash grants and in-kind assistance. Grants are regarded as official external cash coming in through the Government system and are being disbursed by Treasury while in-kind assistance are official external assistance disbursed through other means.

The total cash grant for 2007/08 is budgeted at \$54.8 million while total in-kind grants amounts to \$46.2 million. Most of the assistance was provided by bilateral and multilateral organizations including AusAID, NZAID, ADB, World Bank, EU, Commonwealth Secretariat, Japan, People's Republic of China, and Pacific Regional Organizations.

## 2.0 OVERALL FISCAL BALANCE 2007/08

Table 1 below is calculated using an international standard, the Government Financial Statistics (GFS) basis, and shows actual policy decisions and outturns. On this basis, the budget estimates for 2007/08 show an estimated deficit of \$4.4 million in 2007/08 resulting from total revenues and grants of \$217.0 million compared to \$221.4 million in expenditure.

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

	Preliminary Actual 2005/06	Original Estimate 2006/07	Preliminary Outturn 2006/07	Budget Estimate 2007/08
<b>Total revenue and grants</b>	<b>158,153,437</b>	<b>184,544,460</b>	<b>172,445,807</b>	<b>216,986,549</b>
Tax revenue	125,895,108	137,066,623	125,764,336	127,057,293
Other revenue	22,372,541	18,037,467	20,735,125	35,151,936
Grants (in cash)	9,885,788	29,440,369	25,946,346	54,777,321
<b>Total expenditure and lending minus repayments</b>	<b>180,644,661</b>	<b>194,631,200</b>	<b>165,180,887</b>	<b>221,388,726</b>
Total expenditure	181,877,832	194,948,503	166,031,222	221,368,730
Wages and salaries	99,399,829	85,459,515	78,913,778	75,430,965
Other current expenditures	67,138,016	84,891,977	75,491,457	133,700,384
Capital expenditure	15,339,987	24,597,011	11,625,987	12,237,381
Total lending minus repayments	-1,233,171	-317,303	-850,335	19,996
<b>Overall deficit/surplus</b>	<b>-22,491,224</b>	<b>-10,086,740</b>	<b>7,264,920</b>	<b>-4,402,177</b>

While collection of revenue is projected to increase in 2007/08, it will not be sufficient to cover budgeted expenditure which will increase at a faster rate. However this increase is being matched to the availability of funding from extra external grants and concessional loans, which reflect donor support for reconstruction and recovery. To achieve better domestic

balance, and avoid recourse to domestic borrowing which is being used by businesses to fund their recovery, the Government will finance the deficit through a combination of overseas concessional loans, roll-over of domestic bonds and sales of Government shares in some public enterprises.

### 3.0 2007/08 REVENUE AND GRANTS

Government expects to collect \$217.0 million from revenues and grants in 2007/08. This is 25.9% higher than the \$172.4 million estimated outturn for 2006/07. The significant increase for 2007/08 is associated with a rise in expected grants from abroad of \$54.8 million.

The major factors attributed to the revenue projection for 2007/08 is a moderate pick up in economic activities, turn around from the temporary slowdown in imports after 16 November 2006 and efficiency gains through the improved compliance and monitoring by Revenue Services which will continue to improve in 2007/08.

Table 2 sets out the detailed components of revenues and grants estimated at the aggregate GFS level for the past two years and the allocated budget for 2007/08.

**Table 2: Estimated Revenues and Grants (\$) for 2007/08 Budget**

	Preliminary Actual 2005/06	Original Estimate 2006/07	Preliminary Outturn 2006/07	Budget Estimate 2007/08
<b>Total Revenue and Grants</b>	<b>158,153,437</b>	<b>184,544,460</b>	<b>172,445,807</b>	<b>216,986,549</b>
<i>Current revenue</i>				
<b>Tax revenue</b>	<b>125,895,108</b>	<b>137,066,623</b>	<b>125,764,336</b>	<b>127,057,293</b>
Taxes on income and profits	26,868,111	26,898,039	25,193,963	20,000,000
Taxes on property	45,850	48,814	86,110	93,588
<i>Domestic taxes on goods and services</i>	<i>54,643,398</i>	<i>61,654,540</i>	<i>51,485,869</i>	<i>57,121,402</i>
Consumption tax	52,757,304	59,075,545	49,276,362	55,000,000
Other taxes	1,886,094	2,578,995	2,209,507	2,121,402
<i>Taxes on international trade and transactions</i>	<i>43,609,527</i>	<i>47,690,078</i>	<i>48,884,891</i>	<i>49,342,302</i>
Customs duties	43,549,896	47,655,432	48,835,515	49,305,969
Other import charges	59,632	34,646	49,376	36,333
Other taxes	728,221	775,152	113,503	500,001
<b>Nontax revenue</b>	<b>22,372,070</b>	<b>18,026,465</b>	<b>20,703,125</b>	<b>35,150,934</b>
Entrepreneurial and property income	5,628,428	3,374,705	6,358,190	7,699,811
Administrative fees and charges	12,959,777	13,776,347	12,550,627	26,555,757
<i>of which: revolving funds</i>	<i>4,904,580</i>	<i>7,431,049</i>	<i>3,478,879</i>	<i>19,981,459</i>
Fines and forfeits	298,748	306,367	270,355	328,078
Other nontax revenue	3,485,116	569,046	1,523,953	567,288
<b>Subtotal current revenue</b>	<b>148,267,178</b>	<b>155,093,089</b>	<b>146,467,461</b>	<b>162,208,227</b>
<b>Capital revenue</b>	<b>472</b>	<b>11,002</b>	<b>32,000</b>	<b>1,002</b>
Subtotal revenue	148,267,649	155,104,091	146,499,461	162,209,229
<i>Grants (in cash)</i>				
From abroad	9,885,788	29,440,367	25,946,346	54,777,319
From other levels of national government	-	2	-	2
<b>Total Grants (in cash)</b>	<b>9,885,788</b>	<b>29,440,369</b>	<b>25,946,346</b>	<b>54,777,321</b>

### 3.1 Current Revenues

The total current revenue for 2007/08 is estimated at \$162.2 million which makes up 74.7% of the estimated revenue available to Government. This is 10.7% higher than the 2006/07 estimated outturn. Most of the tax components of current revenues are projected to increase in the 2007/08 budget compared to the previous year with the exception of income tax which decreases by 20.6%.

Tax revenue is estimated at \$127.1 million which is a 1% increase from the estimated outturn in 2006/07. The increase in tax revenue is attributed to a 1% rise in customs duty collection and 11.6% from Consumption Tax. The improvement is attributed to better compliance and monitoring efforts by Customs and Revenue Services.

In 2007/08, revenues from income and profits are expected to decrease by 20.6%; revenues from property and other taxes will remain the same as of 2006/07 while domestic revenues on goods and services increased by 10.9%; and taxes on international trade also went up by 1%. Government also expects to collect \$7.7 million from dividends, up 22.2% from last year.

Domestic taxes continue to contribute significantly to tax revenue with an estimated \$57.1 million in 2007/08 compared to \$51.5 million in 2006/07. The largest component of domestic taxes is Consumption Tax, which recorded the highest revenue per item at \$55.0 million. Other domestic taxes decreased by 4.5% from the estimated outturn of \$2.2 million in 2006/07.

## 4.0 TAX EXPENDITURE

This section outlines the Government's operation of tax expenditure and concessional charges for 2007/08 as well as an estimate of revenue forgone from concessions during the 2006/07 financial year. There are three main areas where Government offers concessions and they consist of development licenses, fuel concession and development projects. These concessions are intended to promote investment in the Kingdom.

Both tax expenditure and concessions have been valued on the conceptual basis of public sector revenue forgone. In many cases this is difficult to determine or forecast and so must be approximated. The revenue forgone is estimated by applying the appropriate tariff rate for the class of activity or asset concerned to the current volume of these activities or assets.

Total Government tax expenditure in 2006/07 is estimated at \$12.5 million representing an increase of 20.4% from the \$10.4 million recorded in 2005/06. This increase comprised of 25.9% in fuel concession and 44% for development projects. Development license duty exemptions recorded a fall of around 50%. The following table shows the major tax expenditures by type in 2006/07:

**Table 3: Total Tax Expenditures by Type for 2006/07**

Tax Expenditure by type	2003/04	2004/05	2005/06	Eight Months to February 2007		Extrapolated for 2006/07
	\$m	\$m	\$m	\$m	% of total	\$m
Development License	2.98	5.66	0.87	0.27	3.2%	0.4
Development Projects	1.67	1.34	1.25	1.17	14.0%	1.8
Fuel	3.54	6.74	8.26	6.90	82.8%	10.4
<b>Total Tax Expenditure</b>	<b>8.19</b>	<b>13.74</b>	<b>10.38</b>	<b>8.34</b>	<b>100.0%</b>	<b>12.5</b>

### 4.1 Industrial Development Incentives

The Industrial Development Incentives (IDI) was established in 1978 to encourage private sector activities in Tonga. The main IDIs are tax holidays, exemption of customs duties on imported capital goods for up to two years and access to duty drawback on imported inputs used in producing exports. The Government decided to suspend the IDI legislation from 1<sup>st</sup>

July 2006 and to repeal it by 1<sup>st</sup> January 2007. With the delay in the passage of other tax reform bills, this is yet to materialize. The permanent closure of this scheme will commence when the new Customs Bill becomes effective in the 2007/08 financial year.

Tax expenditure for development licenses was \$0.4 million in 2006/07 which was less than half the amount issued in the previous year. The 2007/08 budget has included an estimate of \$500,000 for industrial development related projects.

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

The Government continued to provide a fuel concession subsidy for the fishing industry in recognition of its potential particularly generating foreign reserves and employment opportunities. The initiative was granted to lower the cost of production and encourage fishing companies to increase productivity. With the drop in catch rates and increase in fuel prices, the concession scheme had been increasingly important to the fishing companies. Furthermore, the industry has continuously pressured the Government to remove import duties imposed on all fishing inputs. A fuel concession committee monitored this concession.

The estimated total fuel concession recorded for the eight months ending February 2007 amounted to \$0.4 million.

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

The Government continued to subsidize the supply of electricity by exempting fuel from customs duty to reduce costs to consumers. The total value of fuel concession issued during the first eight months ending February 2007 amounts to \$6.5 million and this is projected to reach over \$10 million at the end of the 2006/07 financial year.

## **4.4 National Development Projects**

The Government of Tonga continues to receive assistance from donor countries in support of a variety of social and economic development projects. These projects ranged from poverty eradication, climate change initiatives, humanitarian aid, gender equality, solar electrification of the outer islands (renewable energy), water systems to the rural areas of Tongatapu and the construction of the new Vaiola hospital. The Government also makes a contribution to these projects in the form of exemptions for duties and taxes on the project materials and supplies.

The total concession provided by the Government during the eight months to February 2007 amounted to approximately \$1.17 million. This is expected to reach \$1.8 million at the end of the financial year. Projects such as the Tonga Solid Waste Management, Japanese grassroots project, rural areas water projects, European Union projects and the solar electrification project for the Niuaus are covered under this scheme. The 2007/08 budget has made an allowance of \$2.0 million in recognition of the importance of these projects.

## **5.0 REVENUE REFORM**

The impetus for the revenue reform programme that commenced in 2002 is the necessity for the Kingdom to end its heavy reliance on taxes on international trade as a main source of government revenue. Trade taxes cannot support the burden of demands on government for

expenditure without adversely affecting the development of commerce in the Kingdom that has consequences for economic progress. The aim of the new tax system is to spread the burden of tax across a broader range of economic activity and support the level of government spending without distorting patterns of trade and commerce. Significant progress has been made with the introduction of Consumption tax, and abolition of Port and Services Tax. It is estimated in the year ended 30 June 2007, 63% of government revenues will be from incomes tax, Consumption Tax (CT), and a 16% increase in excise tax (alcohol and tobacco) from what was collected in 2003/04. It is also a system compatible with the Kingdom's international obligations to members of the global trading community on a multilateral and bi-lateral basis. This represents progress towards preparing the Kingdom's economy for trade liberalization and participation in PICTA and PACER.

The third stage of the revenue reform programme – customs and excise duty, and income tax - was meant to take effect on 1<sup>st</sup> January and 1<sup>st</sup> July 2007. The enabling legislation was introduced in 2006 but the final stages of the Legislative process were delayed and will be progressed in the current session.

Revenue Reform encompassing fundamental change to the main tax types employed in the Kingdom, is in its third and final stage. Once this process is complete with the passage and implementation of customs and excise legislation, and the income tax bill, it is expected that domestic taxes will account for almost 90% of government revenues, with only around 10% being raised from border taxes.

Revenue reform measures and work programme for 2007/08 are explained in more detail below.

## 5.1 Income Tax Bill 2006

- **Personal Income tax rates and thresholds.** With effect from the income year commencing 1 July 2007 the rates of tax applying to personal income will be as follows:

For so much income as does not exceed \$7,400	Nil
For so much income as exceeds \$7,401 but does not exceed \$30,000	10 %
Income exceeding \$30,000	20 %

- **Vocational training levy.** In addition to the above rates of personal income tax, a vocational training levy of 1% will be imposed. This levy will be incorporated into PAYE tables and collected simultaneously with PAYE but the moneys raised will be accounted for in a separate fund and applied to vocational training purposes.
- **Abolition of personal exemptions.** Personal exemptions for dependent relatives, expenses for the education of dependent relatives, charitable donations, superannuation contributions, life insurance policy premiums and loan repayments will be abolished.
- **Introduction of tax credits for certain personal expenses.** A tax credit of 10% of eligible expenditure will be allowed as an end-of-year-claim in respect of certain personal expenditure. The tax credits will be a maximum of \$750 for charitable donations to education and charitable organizations.

- **Business tax.** With effect from income years ending on or after 1 July 2007 the rate of tax applying to resident and non-resident companies will be 25%. This enacts the Government's commitment to remove the discrimination against non-resident companies which removes a significant barrier to foreign direct investment.
- **Commercial farmers and fishermen.** After wide consultation with the public, the Government was urged that commercial farmers and fishermen are included in the tax system on the same basis as other business people, but mechanisms need to be found to avoid penalizing the subsistence farmer or fisherman. Work on this recommendation will be part of the revenue policy work programme in 2007/08.
- **Industry Development Incentives.** These have been superseded by elements of the revenue reforms aimed at promoting a business friendly climate such as accelerated depreciation allowances, removal of customs duty from intermediate business inputs and capital goods are to be abolished.

## 5.2 Consumption Tax Act (CT)

The Consumption Tax Act will be amended to extend the period for submitting returns and payments from 15 to 28 days. This measure has been in response to feedback from taxpayers about the difficulty they experience in complying with the 15 day return time. There is no impact on government revenues.

## 5.3 Customs Duty

In line with the introduction of the new tax system based on fairness and equitable distribution of tax, the Government has decided on the following to meet Tonga obligations of accession to the WTO, complementing the move towards equalizing excise rates on locally made and imported excise goods. Therefore, government has decided the following:

- Customs Duty will be subject to a ceiling of 20% commencing on 1<sup>st</sup> July 2007.
- The implementation of the PC trade.
- Capital goods will be free of tax on importation.
- Customs duty on business inputs will be progressively abolished over three years commencing 1 July 2007.

## 5.4 Stamp Duties

The Ministry is considering reviewing the imposition of stamp duty.

## 5.5 Online Filing and Payment of Tax

Work is underway with the suppliers of the Revenue Management System to add a facility for on-line filing of tax returns, and payment of tax by Internet banking. It is hoped that this facility will be available for taxpayers during 2008. Not only will online filing save time for taxpayers but that will free up staff of the Revenue Services Department for other more valuable tasks.

Discussions between the National Reserve Bank, the Revenue Services Department and the major banks represented in Tonga foreshadowed the possibility of offering Internet banking to

extend to tax payment. This facility would provide an additional level of service to taxpayers, improve the security of payments, and reduce the need for Revenue Services staff to be involved in such transactions.

Further work will be undertaken as part of the 2007/08 revenue reform policy work programme.

## **5.6 Policy Rationale**

### ***5.6.1 Import duties and associated indirect taxes***

Custom Tariff Schedule that was expected to implement in January this year has been delayed pending passage of the empowering legislation. This is an important reform as it implements Tonga's obligations under various free trade agreements. Prior to the adoption of the Customs Tariff Schedule, the Revenue Services Department will carry out improvements to tax administration, including the full deployment of PC-Trade as the computerized system for managing and monitoring imports and duty.

### ***5.6.2 Business competitiveness***

Application of Customs Duty to goods that by their nature are likely to be used with other goods or consumed in a manufacturing process, distorts the pattern of commerce and trade. These goods include capital goods used in investment and intermediate inputs that are purchased by business. Taxation of these business inputs results in an increase in production costs in Tonga compared with other countries that relieve their manufacturers and processors of this tax burden.

Such input taxes may cascade, producing highly variable effective tax rates between industries and even within a single industry. Input taxes reduce the effective rate of protection provided by a nominal final-good tariff and may remain unrelieved in the cost of export goods (unless this tax burden is otherwise removed) hampering competitiveness in overseas markets.

It is desirable to relieve resident processors and manufacturers of such costs wherever possible as a competitiveness and trade-enhancing measure. The measures are included as part of the Revenue Reform package such as:

- Capital goods for business use will be free of tax on importation;
- Customs Duty on non-fuel intermediate inputs will be progressively abolished over three years commencing 1 July 2007.

### ***5.6.3 Making up the lost revenue by Excise Tax***

The revenue that will be lost by reducing custom duties will be replaced by tariffs and reforming import duties affecting business inputs will need to be replaced by implementing selective indirect taxes.

To simplify the administration of selective indirect taxes a new statute will take over all the relevant provisions of the Customs and Excise Act and condense them into one law applying tax to the four product categories affected. Although the Excise Tax Act will be new legislation, it is not a new tax because it absorbs the taxes that were previously administered under different legislation.

Excise Tax will apply to imports and domestic manufactures of alcohol beverages, tobacco products, petroleum fuels and motor vehicles.

## 5.7 Income Tax

The Income Tax Bill to reform personal and business income tax currently before the House will come into effect in 2007/08. In addition, the Government is introducing a new vocational training levy (VTL) of 1% that will be collected as income tax but earmarked for providing financial assistance to technical and vocational training schools.

## 6.0 EXPENDITURE AND NET LENDING FOR 2007/08

The aggregate level of expenditure and net lending in 2007/08 is budgeted at \$221.4 million which is an increase of 34.0% from 2006/07. The increase is associated with an additional \$54.7 million current expenditure and \$0.6 million additional capital expenditure in 2007/08. Table 4 provides a breakdown of all expenditures and net lending items into their component categories and highlights the variation between the two years.

### 6.1 Current Expenditure

The Government's overall current expenditure for 2007/08 is estimated at \$209.1 million, up by 35.4% from \$154.4 million last year.

**Table 4: Estimated Expenditures & Net Lending for 2007/08 Budget (\$)**

	Preliminary Actual 2005/06	Original Estimate 2006/07	Preliminary Outturn 2006/07	Budget Estimate 2007/08
<i>Expenditure and lending minus repayments</i>	180,644,661	194,631,200	165,180,887	221,388,726
<i>Current expenditure</i>	166,537,845	170,351,492	154,405,235	209,131,349
Wages and salaries	99,399,829	85,459,515	78,913,778	75,430,965
Employer contributions	3,798,687	4,561,019	3,854,581	4,368,111
Other purchases of goods and services	47,632,577	56,722,745	48,635,586	89,100,616
Interest payments	3,304,547	3,395,038	3,395,037	3,781,252
Additional expenditures	2,177,889	1,678,298	2,048,844	1,678,298
<i>Subsidies and other current transfers</i>	10,224,315	18,534,877	17,557,409	34,772,107
Subsidies to non-financial public enterprises	266,077	1,001	3,737	1,001
Subsidies to financial institutions	4,803	100,003	-	250,003
Subsidies to other enterprises	-	2,825,003	3,483,262	2,825,004
Transfers to non-profit institutions	3,895,336	8,624,144	6,564,018	24,987,106
Transfers to households	4,745,891	5,543,622	6,016,040	5,346,972
Transfers abroad	1,312,209	1,441,104	1,490,352	1,362,021
<i>Capital expenditure</i>	15,339,987	24,597,011	11,625,987	12,237,381
Acquisition of fixed capital assets	14,266,121	23,177,367	11,112,968	11,678,367
Purchases of land and intangible assets	132,413	238,116	174,001	197,515
Capital transfers	941,454	1,181,528	339,018	361,499
<b>Subtotal expenditure</b>	<b>181,877,832</b>	<b>194,948,503</b>	<b>166,031,222</b>	<b>221,368,730</b>
<i>Lending minus repayments</i>				
To non-financial public enterprises (net)	(466,663)	152,031	(381,000)	489,996
To financial institutions (net)	(766,508)	(469,334)	(469,334)	(470,001)
Abroad	-	-	-	1
<b>Subtotal lending minus repayments</b>	<b>(1,233,171)</b>	<b>(317,303)</b>	<b>(850,335)</b>	<b>19,996</b>

The total wages and salaries for 2007/08 amounted to \$75.4 million. This is \$3.5 million less than the previous year. The major cuts in the 2007/08 budget are wages (47.9%) and the public sector reform program (51.8%) reflecting the completion of the 40% arrears paid in the previous financial year. The duty allowance is also reduced by 50%. The most notable change in the wages and salary subgroup for 2007/08 is for salaries of established staff positions which is estimated at \$61.4 million.

Expenditure on purchases of goods and services is budgeted to increase by \$40.5 million to \$89.1 million in 2007/08. The significant change in the projected estimate in 2007/08 is due to the increase in the allocation for technical assistance. Technical assistance is funded by donor

partners with \$14 million from the European Union, \$7.4 million under the revolving fund activities and \$3.1 million from the People's Republic of China. Other items in this group that increased included construction material and supplies (up by \$5.0 million), technical equipment and supplies (up by \$2.4 million), medical drugs (up by \$1.5million) and loan guarantees and forum conference (\$1.5 million).

On the other hand, other items which showed a fall in allocation included overseas and domestic travel (13%), telecommunications charges (15%), fuel (22%), and electricity (12%).

Total subsidies and transfers of \$34.8 million estimated for 2007/08 is up by 98% from the previous year's \$17.6 million. The increase is due to transfers to non-profit institutions (\$25 million), other enterprises (\$2.8 million) and transfers to households (\$5.3 million). The subsidies provided to non-profit institutions included an increase in Government subsidies to non-Government schools from \$100 to \$200 per student and assistance to the recovery progress of private sector activities affected by the civil unrest of 16 November.

## 6.2 Capital Expenditure

The total capital expenditure for the 2007/08 budget is estimated at \$12.2 million, the majority of which will be funded through grants and loans from the development partners of \$9.1 million and \$2.1 million from Government. The major donors for construction includes the People's Republic of China (\$2.9 million), Australia (\$1.5 million), New Zealand (\$1.3 million), European Union (\$1.1 million) and Japan (\$0.5 million). This doesn't include the proposed loans from People's Republic of China and the Asian Development Bank to finance the reconstruction.

Government funded capital projects for 2007/08 will be for the constructing of the new Vaiola Hospital (\$1.5 million) and new Prisons complex (\$0.5 million). A list of all capital expenditure breakdowns by Ministry is reported in Appendix 2 under "*Program Budget Estimates 2007/08*".

## 7.0 ESTIMATED OUTTURN 2006/07

The 2006/07 financial year has presented the Government with bigger challenges for 2007/08 in addition to the financial constraints imposed by the 2005/06 salary settlement.

The Government's overall fiscal position (on a GFS basis) in 2006/07 is estimated at a surplus of \$7.2 million. The surplus is made up of total revenues and grants of \$172.4 million against total expenditure and net lending of \$165.2 million. The significant turn around in the fiscal outturn, compared to the budgeted \$10.1 deficit, is attributed to donor assistance received for the reconstruction of Nuku'alofa and for other projects under implementation. This has helped Government to strengthen its cash reserves.

The total revenue and grant estimated outturn for 2006/07 stood at \$172.4 million which is 6.6% lower than the budgeted estimate.

The total expenditure for 2006/07 is estimated at \$165.2 million, representing a decrease of 8.5% from 2005/06. This fall reflects the reduction in the number of public civil servants as

well as prudent financial management.

The Government received \$8.3 million in disbursements from the World Bank for the completion of the WAKA and health projects. The Government also made public debt repayment for external loans of \$5.4 million, resulting in net external financing of \$2.9 million. The Government also repaid matured bonds (net) at \$1.7 million and increased its cash reserves at the banking sector by \$8.5 million.

## 8.0 FINANCING TRANSACTIONS FOR 2007/08

Net financing transactions measure the manner in which the overall fiscal budget deficit is financed, or a budget surplus is utilized. Table 5 outlines the financing transactions components of the 2007/08 budget and the preceding years.

As highlighted earlier in Table 1, the overall fiscal balance for 2007/08 is a deficit of \$4.4 million. This will be met through a combination of domestic and external financing. In relation to external financing, the Government is expected to receive disbursements of approximately \$6.6 million from the World Bank in 2007/08. This is a combination of loan disbursements and cash grants assistance to the TESP project under the Ministry of Education (\$5.1 million), Health project (\$0.2 million), and Ministry of Transportation (\$0.2 million). The 2007/08 budget also includes provisions for Government's commitment to public debt repayment of about \$6.9 million, resulting in a net external financing of \$1.3 million.

**Table 5: Estimated Financing transactions (\$million)**

	Preliminary Actual 2005/06	Original Estimate 2006/07	Preliminary Outturn 2006/07	Budget Estimate 2007/08
<b>Total Financing</b>	<b>22,491,224</b>	<b>10,086,740</b>	<b>-7,264,920</b>	<b>4,402,177</b>
<b>External financing</b>	<b>9,657,391</b>	<b>6,542,503</b>	<b>2,900,000</b>	<b>1,324,025</b>
Disbursements	14,526,263	13,203,250	8,300,000	8,224,029
Repayments	4,868,871	6,660,747	5,400,000	6,900,004
<b>Domestic Financing</b>	<b>12,833,833</b>	<b>3,544,237</b>	<b>-10,164,920</b>	<b>3,078,152</b>
Bonds Issued / Domestic Loan	6,365,000	6,183,001	6,000,000	6,340,000
Principal Repayment of Matured Bonds/Loan	7,793,011	8,071,458	7,700,000	6,340,000
<b>Subtotal domestic bond financing</b>	<b>-1,428,011</b>	<b>-1,888,457</b>	<b>-1,700,000</b>	<b>0</b>
Others: Treasury Deposit at NRBT				0
ADB Economic & Public Sector Reform Program	0	2,003,034	0	0
Sales of shares				3,078,152
Net Changes in Government Cash Balances and Investment	14,261,845	3,429,660	-8,464,920	0

As for domestic financing, the Government intends to roll over \$6.3 million of matured bonds and sales of shares (\$3.1 million). The total domestic net financing amounted to \$3.1 million.

## 9.0 PUBLIC DEBT

At the end of April 2007, provisional data indicates that the total public debt outstanding amounted to \$192 million, with external debt standing at \$164.7 million and domestic debt at \$27.2 million.

The total external Government debt outstanding is projected to be \$166 million at the end of 2006/07 compared to \$165.6 million recorded in 2005/06. The total external disbursement for 2006/07 is projected at \$8.3 million mainly for the WAKA and Health projects. The fund for the WAKA project is expected to be fully disbursed by the end of this financial year. Principal public debt repayment for 2006/07 is estimated at \$6.2 million with interest payments estimated at \$1.6 million.

The total domestic Government debt outstanding is projected at \$27.2 million in 2006/07 compared to \$26.6 million in 2005/06. Principal repayment for 2006/07 is estimated at \$7.7 million. The total Government bonds issued remains unchanged with loans limited to the amount necessary to finance the roll-over of mature bonds. Interest payments on domestic debt are estimated at \$1.7 million.

Total loans guaranteed by Government are projected at \$11.3 million in 2006/07 compared to \$13.6 million in 2005/06. The repayment on the squash grower's facility loan was due to commence in the current financial year however a request for deferment of payment had been lodged.

The total loans on-lent by Government to public enterprises is estimated at \$28.7 million in 2006/07, compared to \$27.3 million in 2005/06. Projections for 2007/08 included final disbursements for the refurbishment of Janfull International Dateline Hotel.

Details of the Government debt are attached as annexes as well as reporting of statements for loans to local Statutory Boards and other organisations, external debt, domestic debt, and guaranteed loans made by the Government (as at 30 April 2007).

During 2006/07 the following loans were entered into by the Government pursuant to section 25 of the Public Finance Management Act (Table 6).

**Table 6: Government Loans during financial year 2006/07**

Lender	Date	Purpose	Interest rate	Term	Amount
Public bond issue	31 <sup>st</sup> July 2006	Refinance maturing bonds	8.0%	3 years	\$1,000,000
Public bond issue	2 <sup>nd</sup> August 2006	Refinance maturing bonds	8.0%	3 years	\$2,000,000
Public bond issue	30 <sup>th</sup> August 2006	Refinance maturing bonds	7.5%	2 years	\$1,000,000
Public bond issue	30 <sup>th</sup> August 2006	Refinance maturing bonds	10.0%	5 years	\$1,000,000
Public bond issue	31 <sup>st</sup> October 2006	Refinance maturing bonds	10.0%	5 years	\$1,000,000
Public bond issue	28 <sup>th</sup> June 2007	Refinance maturing bonds	To be determined on maturity date	To be determined on maturity date	\$183,000

As a result of 16 November 2006, the Government has made a request for a concessional loan from the Republic of China to assist in the reconstruction of Nuku'alofa. The Government will monitor all revenue to ensure its debt levels over the medium to long term are sustainable for the current and future generations.

At the end 2006/07, external debt is equivalent to 30.3% of GDP and domestic debt is 5.0%.

## 9.1 Business Recovery Facility

The Government has established the business recovery facility (BRF) to assist businesses affected by the events of 16 November 2006. The New Zealand and Australian Government's have entered into a tri-partite arrangement with the Government of Tonga to provide funding for the facility to provide interest rate subsidies. On behalf of donors, the Government of Tonga will provide the legal underwriting for the credit guarantees for the BRF.

## 10.0 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 and out of the Kingdom'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 2007/08 are prepared on this cash basis.

However, commencing in 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 Tongan administrative structures.

Tables 7 and 8 therefore, present reconciliation between the cash inflow estimates as detailed in the "*Program Budget Estimates 2007/08*" 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 7: 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>152,624,920</b>	
<i>Plus</i> Inflows to other Funds		
Revolving Funds	19,981,459	
Local Community	1,017	
Donor Cash Aid	63,001,342	82,983,818
<b>Total Inflows (as per Program Estimates)</b>	<b>235,608,737</b>	
<i>Less</i> Inflows classified as offsets to expenditure		
Repayments of net lending		980,006
<i>Less</i> Inflows classified as financing transactions		
External Financing	8,224,029	
Domestic Financing	9,418,153	17,642,182
<b>Total Revenues (as per GFS Presentation)</b>	<b>216,986,549</b>	

**Table 8: 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>152,624,920</b>	
<i>Plus</i> Outflows from other funds		
Revolving Funds	19,981,459	
Local Community	1,017	
Donor Cash Aid	63,001,342	82,983,818
<b>Total Inflows (as per Program Estimates)</b>	<b>235,608,737</b>	
<i>Less</i> Inflows classified as offsets to expenditure		
Repayments of net lending		980,006
<i>Less</i> Outflows classified as financing transactions		
External Financing	6,900,004	
Domestic Financing	6,340,001	13,240,005
<b>Total Expenditures (as per GFS Presentation)</b>	<b>221,388,726</b>	

Table 9 provides a breakdown of funds from all sources estimated to be collected by the various Ministries and Departments during the 2007/08 financial year.

Table 10 provides a breakdown of funds appropriated from all sources and for all purposes expected to be available to the various Ministries and Departments in 2007/08 compared to the 2006/07 Budget Estimate.

**Table 9: Funds to be collected and received by Ministry**

Vote	Ministry	Budget Estimate 2006/07	%	Budget Estimate 2007/08	%
01	Palace Office	327,192	0.2	81,202	0.0
02	Legislative Assembly	409,001	0.2	7,003	0.0
03	Prime Minister's Office	1,191,314	0.6	1,260,171	0.5
04	Commissioner of Public Relations	-	0.0	5,322	0.0
05	Audit Department	49,062	0.0	41,976	0.0
06	Ministry of Finance & National Planning	17,718,010	8.6	23,597,936	10.0
07	Ministry of Foreign Affairs	12,686,690	6.1	16,970,369	7.2
08	Tonga Defence Services	491,539	0.2	541,356	0.2
09	Ministry of Lands, Survey, Natural Resources and Environment	507,316	0.2	3,015,316	1.3
10	Ministry of Justice	604,225	0.3	658,909	0.3
11	Ministry of Police, Prisons & Fire Services	1,775,343	0.9	2,518,547	1.1
12	Ministry of Education, Women's Affairs & Culture	16,861,481	8.2	17,012,846	7.2
13	Ministry of Health	8,769,709	4.2	6,733,459	2.9
14	Ministry of Agriculture, Food, Forests & Fisheries	3,040,057	1.5	2,603,931	1.1
15	Ministry of Labour, Commerce and Industries	1,186,013	0.6	1,477,767	0.6
16	Ministry of Tourism	383,102	0.2	1,922,651	0.8
17	Ministry of Works	2,484,469	1.2	8,473,043	3.6
18	Ministry of Transport	1,636,403	0.8	930,748	0.4
19	Ministry of Training, Employment, Youth & Sports	1,080,578	0.5	1,774,928	0.8
20	Crown Law Department	56,020	0.0	179,848	0.1
21	Public Enterprise Division	-	0.0	222,953	0.1
22	Revenue Services Department	135,595,084	65.6	145,578,459	61.8
<b>Total</b>		<b>206,852,609</b>	<b>100.0</b>	<b>235,608,737</b>	<b>100.0</b>

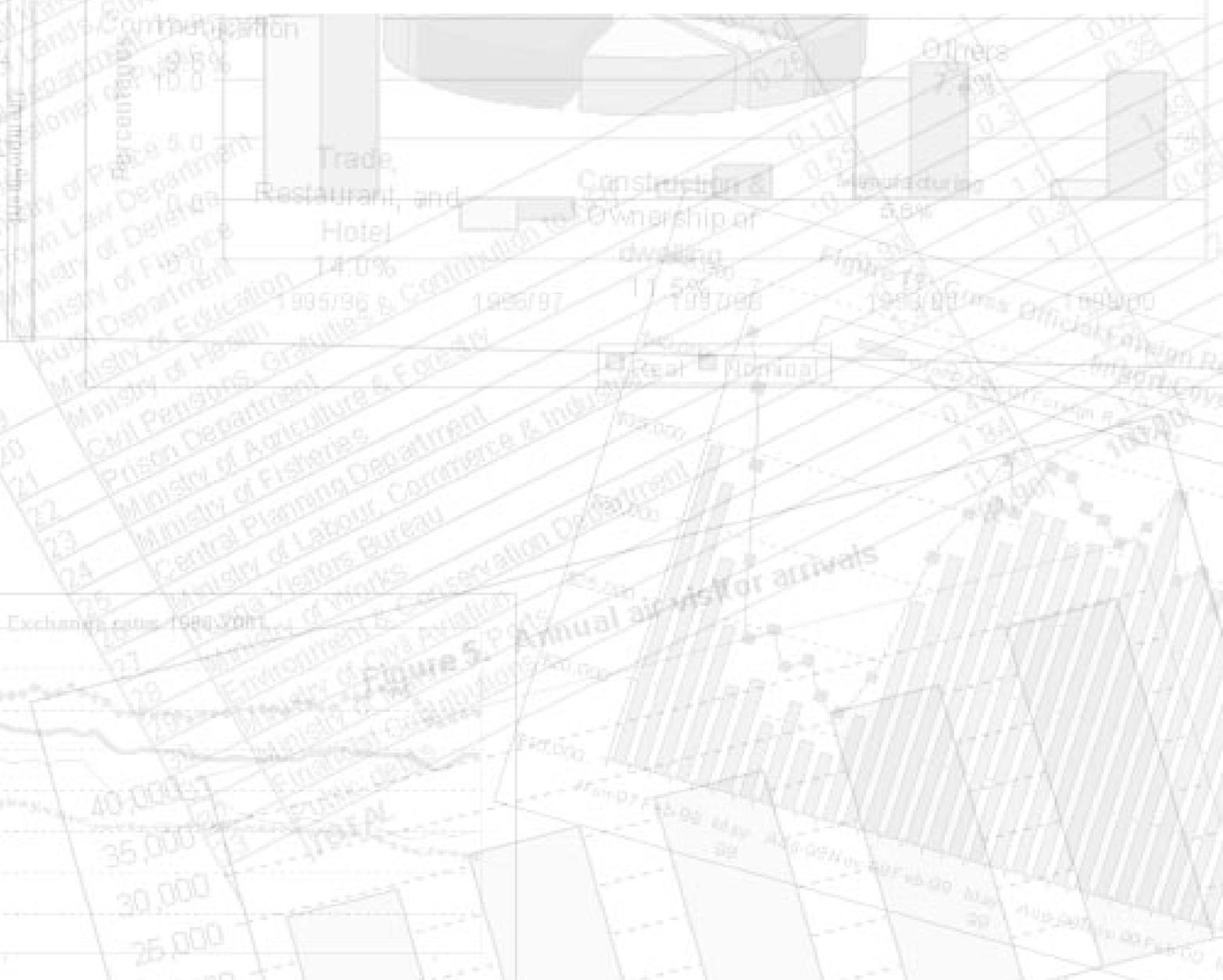
**Table 10: Funds to be appropriated by Ministry**

Vote Ministry	Budget Estimate 2006/07	%	Budget Estimate 2007/08	%
01 Palace Office	5,209,737	2.5	3,408,356	1.4
02 Legislative Assembly	3,350,092	1.6	4,033,082	1.7
03 Prime Minister's Office	5,435,787	2.6	6,261,926	2.7
04 Commissioner of Public Relations	183,743	0.1	183,745	0.1
05 Audit Department	654,868	0.3	736,097	0.3
06 Ministry of Finance & National Planning	62,590,954	29.8	56,732,177	24.1
07 Ministry of Foreign Affairs	18,437,559	8.8	21,821,732	9.3
08 Tonga Defence Services	7,446,627	3.5	7,684,868	3.3
09 Ministry of Lands, Survey, Natural Resources and Environment	2,203,947	1.0	4,640,761	2.0
10 Ministry of Justice	2,087,723	1.0	1,874,763	0.8
11 Ministry of Police, Prisons & Fire Services	8,264,802	3.9	10,148,601	4.3
12 Ministry of Education, Women's Affairs & Culture	38,205,716	18.2	37,381,250	15.9
13 Ministry of Health	28,609,259	13.6	23,988,086	10.2
14 Ministry of Agriculture, Food, Forests & Fisheries	7,686,936	3.7	6,760,328	2.9
15 Ministry of Labour, Commerce and Industries	2,091,738	1.0	2,519,914	1.1
16 Ministry of Tourism	1,526,495	0.7	3,440,301	1.5
17 Ministry of Works	5,711,631	2.7	12,434,244	5.3
18 Ministry of Transport	2,997,428	1.4	2,438,390	1.0
19 Ministry of Training, Employment, Youth & Sports	2,692,859	1.3	3,862,553	1.6
20 Crown Law Department	1,147,352	0.5	1,388,038	0.6
21 Public Enterprise Division	318,474	0.2	577,888	0.2
22 Revenue Services Department	3,428,542	1.6	23,291,640	9.9
<b>Total</b>	<b>210,282,269</b>	<b>100.0</b>	<b>235,608,737</b>	<b>100.0</b>

Budget Statement for Year Ending 30<sup>th</sup> June 2008

**Budget Paper 3: *Regional Development***

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





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## 1.0 Regional and Rural Development Program

“Rural Communities” is defined as all villages in the outer islands and Tongatapu as well as low-lying (swampy) areas in Nuku’alofa such as Popua and Sopa. “Region” refers to the five main regions of Tonga – Tongatapu, ‘Eua, Vava’u, Ha’apai and the Niuas.

Rural communities aspire to improve their standard and quality of life through greater employment, income earning and marketing opportunities in order to alleviate hardship or poverty. Underscored by SDP8, priority development areas expressed by communities throughout the Kingdom included improved basic transportation systems, such as better agricultural roads and improved and affordable boat and air services, access to affordable and reliable power, improved reticulated water services, and better access to markets in Tongatapu and overseas.

Amongst Government’s pro-poor strategies in SDP8 is “to implement the donor supported regional and rural development program,” which is intended to provide opportunities for communities to improve their standard and quality of life thus alleviating rural hardship/poverty.

Government’s regional and rural development program (RRDP) is jointly funded by Tonga’s development partners in collaboration with the communities. Responding to the development priorities of the communities to improve their quality of life will remain Government’s priority for 2007/08.

### 1.1 Our Development Partners

The Government of Tonga’s effort to implement its RRDP is supported by the Governments of Australia, New Zealand, Japan and the European Union (EU). Development assistance for community development is distributed between the five regions of the Kingdom to approved development projects. According to the 2006 census preliminary results show that of Tonga’s total population of approximately 101,134, 70 percent reside on Tongatapu, 15 on Vava’u, seven on Ha’apai, five in the two Niuas.

Figure 1: Approximate Aid Distribution by Region 2006/07 & 2007/08

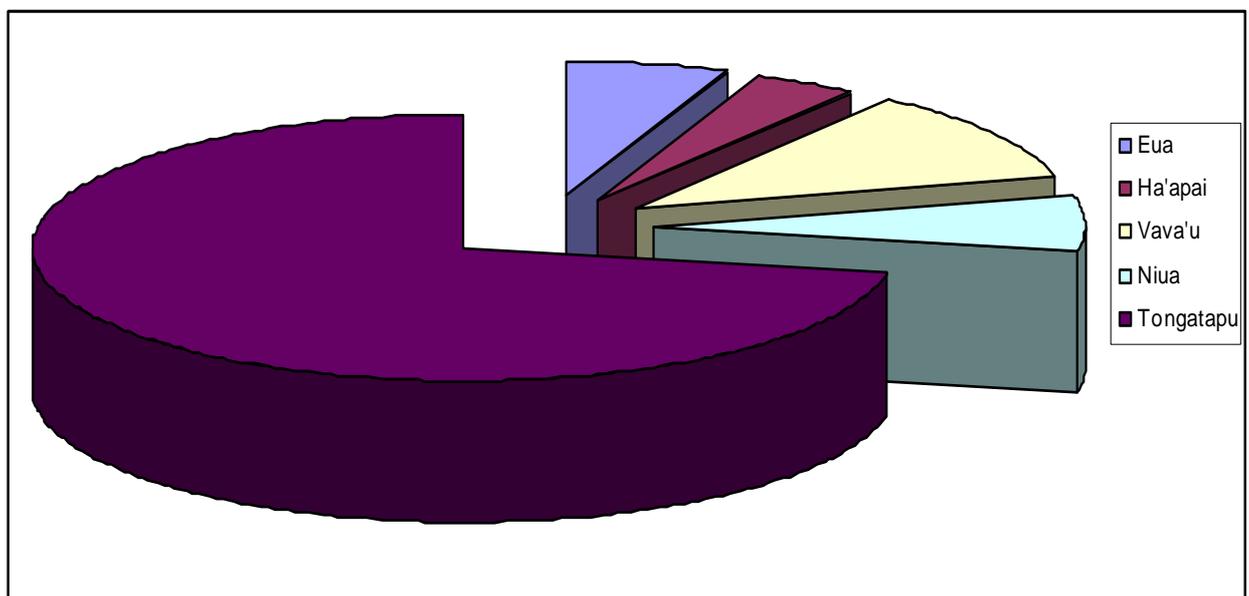


Figure 1 shows the approximate distribution of aid to the various regions in the Kingdom between 2006/2007 & 2007/2008. Although the bulk of development is directed towards Tongatapu, development assistance per head is highest for the two Niuaus.

### **Types of Projects/Assistance Offered by each Development Partner**

Each development partner provides assistance for rural and regional development targeted at specific regions and purposes.

**The Government of Australia** provides assistance under the Tonga Community Development Scheme (TCDS) for Tongatapu and Ha'apai. The TCDS covers both the Australian Community Assistance Scheme (ACAS) which is earmarked for Tongatapu and the Ha'apai Development Fund (HDF) targeted specifically for development in the Ha'apai region.

In addition to these schemes the Government of Australia also offers a special scheme called the Vulnerability Adaptative Initiative (VAI) which makes small grants available for all regions of Tonga, and is for the sole purpose of addressing climate change issues in local communities. This program is only available for three years and 2007/08 is its final round.

The Government of Japan Government through its Grant Assistance for Grassroots projects (GGP) provides financial assistance to non-government government organizations, hospitals, primary schools, research institutes to implement development projects at the grassroots.

**The Government of New Zealand** provides rural and regional development assistance under the Community Development Fund (CDF) which assists development project in the area of youth, agriculture, water and sanitation, income generation and employment creation.

The **European Union** provides rural and regional development assistance for Vava'u and in the past yeas in other islands of Tonga. It funds a variety of projects in the education and health sectors as well as funding community projects through non-government organizations and civil societies.

## **1.2 Management of RRDP**

The overall leading role of management and administration of the RRDP is the responsibility of the Ministry of Finance and National Planning's Budget & Project Management Division. It is also responsible for identifying appropriate and relevant projects through consultations with Government organisations, civil societies and local communities.

At present, staffs of the Division are coordinating and finalizing application of proposals for GGP, TCDS and VAI for 2007/08 and GGP. It is anticipated that the GGP allocation for 2007/08 is likely to be at least equal to the 2006/07 allocation.

To ensure proper monitoring and management, the Government has established five regional committees to provide advice on economic and social development for each region. Table 1 provides details regarding the regional committees.

**Table 1: Regional and Rural Committees Information – 2007/2008**

Name of Region	Core Donor	Secretariat	Hon Chairman of Regional and Rural Development Committees
'Eua	New Zealand	Ministry of Labor, Commerce and Industries	Hon. Minister of Labour, Commerce and Industries
Ha'apai	Australia	Ministry of Health	Hon. Deputy Prime Minister, Minister of Health
Vava'u	European Union	Ministry of Foreign Affairs	Hon. Minister of Foreign Affairs
Niuas	New Zealand	Ministry of Agriculture, Fisheries, Forestry, and Food	Hon. Minister of Agriculture, Fisheries, and Food
Tongatapu & Rural Areas	Australia	Ministry of Finance & National Planning	Hon Minister of Finance and National Planning
	EU		
	Japan (GGP)		

## 2.0 Niua Region

The Government of New Zealand continues to be the core donor for the Niua region with an estimated total allocation of \$1m for 2007/08 for the completion of Niuatoputapu High School. In 2006/07 the Government of Tonga contributed a total of \$40,000 towards the maintenance of Niuafou'ou's wharf which is envisaged to be completed by the end of 2006/07.

### 2.1 Niuafou'ou Solar Electrification

One of the major projects on the island is the solar electrification of the whole island financed by the New Zealand Government. The project which had a total value of \$1,274,585 and included the construction of a new office was successfully completed in October 2006 and is expected to be commissioned on October 31, 2007.

### 2.2 Niuatoputapu New High School

Approximately \$1m has been allocated by the Government of New Zealand for 2007/08, for the completion of Niuatoputapu High School. A recent, site visit was conducted to determine outstanding works required to complete the school. Kramer Engineer Ltd has been recruited for the project and has submitted recommendations that will facilitate the completion of the project. It is also responsible for quality assurance.

### 2.3 Other Projects

In addition to the major projects discussed above, the Niua Development Committee have proposed other development projects which include the Niua Region's Strategic Master Plan, upgrades of road networks and wharves on both islands, upgrade of water reticulation in Niuatoputapu and blasting of Tafahi Channel. Table 2 shows development projects which are ongoing during 2007/08 in the Niua region.

**Table 2: : Niuas' Ongoing Projects for 07/08**

Region	Applicant	Project	Location	Approx amount requested	Status
NTT	Fekau'aki a Fafine Katolika 'a Vaipoa	Mulberry & Pandanus	Vaipoa	7,000	Preparation
NF	Fetu'u Pongipongi Development Group	Vegetable Garden	Esia	5,000	Preparation
NF	Tavake Toto	Kava & Yam Plantation	Esia	10,000	Preparation
NF	Seilose Group	Kava Plantation	Petani	10,000	Preparation
Total Community request for 2007/08				32,000	

### 3.0 'Eua Region

The Government of New Zealand continues to be the core donor for the 'Eua region with a total allocation of approximately \$900,000 for 2007/08.

#### 3.1 'Eua Water Supply Upgrade Project (EWSUP)

To date, expenditure on EWSUP is estimated at \$256,063 with an estimated total cost of \$3.7 million. Since the signing of the contract with the Construction contractor in December 2006, the construction phase (which includes setting up the watersupply network) has started and anticipated to take 12-18 months. To assist with the project's implementation and management process, the 'Eua Water Consumer Committee (EWCC) was established. This committee will also be responsible for reviewing Tonga Water Board's performance over the next four years.

#### 3.2 'Eua Agricultural and Tourism Roads Project

The 'Eua Agricultural and Tourism Roads project was completed in November 2006 and the Government of New Zealand has agreed to upgrade the 10km from basic coral filling to tar sealing. The New Zealand Grant Funding Arrangement has allocated approximately \$1.06m to the Government of Tonga to facilitate the successful completion of this project.

#### 3.3 'Eua Strategic Development Plan

The consultations with the 'Eua community on the development of the 'Eua Strategic Development Plan has been completed. Effort is currently underway to finalise the Plan.

During the consultations on the 'Eua Plan, other projects were identified and are now being processed for funding consideration, which included the upgrading of Kaufana Airport

### 4.0 Ha'apai Region

For 2007/08, the Governments of Australia and Japan remain the major development partners for this region. The HDF proposed projects for the region for 2007/08 are currently being finalised and implementation is anticipated to start by August 2007.

The HDF projects from 2006/07 are expected to be ongoing and completed during 2007/2008. Tables 3 and 4 show details of HDF and VAI projects for 2005/06 and 2006/07 which are currently being implemented.

The Government of Japan through the Grant Assistance for Grassroots Human Security Projects (GGP) is currently funding the construction of 3 staff quarters at Niu'ui Hospital valued at \$162,000.

In 2006/07, the Government of Tonga was committed to assisting the construction of a small wharf for Nomuka Island, with an estimated allocation of T\$70,000, on an understanding that the total cost of construction would be sought from the Government of Germany. The commencement of this project currently awaits a response from the donor partner regarding the co-financing arrangement. The total cost of this project is approximated at \$210,000

**Table 3: : Ha'apai Projects under the HDF and VAI (Government of Australia), 2005/2006**

Project Titles	Project Locations	Approx Grant Total	Approx 10% Contribution	Project Outputs	Status
Komiti Fakakolo Navea	Pangai	54,000	6,000	Purchase of 1 Septic Truck & few equipments	Completed
Nomuka Island Community Youth	Nomuka	50,000	5,600	Purchase of Second-hand MF 265/290 Tractor, Disc Plough, Single Ripper, Trailer and Slasher	Completed
Vai ko Tokomea Youth	Lofanga	32,000	3,500	Purchase of 25ft Longboat & 60hp Outboard Engine	Ongoing
Lataki Sangata Telesia	Ha'ato'u	8,300	900	Plants of vegetable garden & purchase of gardening tools	Ongoing
Kauvai Ha'ano Electricity Cooperative	Ha'ano	65,600	7,300	Purchase of 60hp Diesel Tractor, Trailer, Single Ripper, Slasher and Disc Plough	Completed
Kulupu Tu'a ki Moana	Lofanga	24,000	2,700	Purchase of Fibre Boat & 60hp Outboard Engine	Completed
'Otu Kinekina Cooperative Society	Felemea	29,500	3,300	Purchase of 26ft Longboat & 60hp Mercury Engine	Ongoing
Kulupu Palataisi Garden	Ha'ato'u	7,300	800	Plants of veg. garden with fence & purchase of tools	Ongoing
Komiti Langa Fakalalaka	Haafakahega	20,800	2,300	Construction of 570m town road access with Tar-Sealed	Ongoing
Komiti Fakakolo	Koulo	37,600	4,200	Construction of 1500m agricultural road	Ongoing
Komiti Fakakolo	'Uiha	102,600	12,000	Construction of New Clinic	Ongoing
Niu'ui Hospital Board of Visitors	Hihifo	50,000	5,000	Construction of New Staff Quarter	Ongoing
Ha'apai Youth Congress	Pangai	16,000	In kind	Training & plant vegetable	Ongoing
		<b>\$497,710</b>	<b>\$53,600</b>		
<b>VAI PROJECTS:</b>					
Kulupu Kuini	Kotu	22,630	2,370	10 water cement tanks	Preparation
Leipua 'o e 'Otu Mu'omu'a	Nomuka	22,630	2,370	10 water cement tanks	Preparation
		<b>\$45,260</b>	<b>\$4,740</b>		

**Table 4: : Ha'apai Projects under the HDF and VAI (Government of Australia), 2006/2007**

Project Titles	Project Locations	Approx Grant Total	10% Contribution.	Project Outputs	Status
Komiti Fakakolo	Fotuha'a	133,000	Nil	Construct 29 Composting Toilets	Preparation
Komiti Fakakolo	Matuku	92,000	Nil	Construct 20 Composting Toilets	Preparation
St Josephs Community College	Lifuka	45,000	5000	Purchase Industrial Art Equipments	Preparation
Langa Fonua 'o Toutai	Matuku	16,000	1800	Purchase Outboard Engine	Preparation
Fakalave 'o e Vai Mahanga	Kotu	8,000	900	Purchase Generator, Fridges and Wire	Preparation
Kulupu Koseni	'Uiha	8,600	1000	Grow Pandanus	Preparation
Kulupu Sangato Sosefo	Ha'ato'u	17,000	1900	Grow Yams & Purchase Tools	Preparation
Fe'ofa'aki Development Group	Koulo	8,300	900	Grow Pandanus	Preparation
Kulupu Lotokolo	Felemea	8,200	900	Grow Pandanus	Preparation
Kolofo'ou Development Group	Felemea	8,900	1000	Grow Pandanus	Preparation
Kulupu Houmale'eia	Faleloa	11,000	In-kind	Grow Mulberry	Preparation
Makahokovalu Youth	'Uiha	14,000	1,600	Construct 16 Piggery Fences	Preparation
		<b>\$370,000</b>	<b>\$15,000</b>		
<b>VAI PROJECTS</b>					
FWC Youth	Koulo	7,000	In-kind	Coastal Replanting with fencing	Preparation
Halamangaono Youth Congress	Leimatu'a	6,000	In-kind	Construct 30 Recycling Bins	Preparation
		<b>\$13,000</b>			

## 5.0 Vava'u Region

The European Union (EU) continues to be the core donor for development projects for the Vava'u Region. It is estimated that a total expenditure of approximately \$1.3 million was recorded for 2006/2007 – 2007/2008 and comprised of the following components; Project Management Unit (PMU) ≈ 12 percent , Non State Actors (NSA) ≈ 14 percent , Health ≈ 40 percent , Education ≈ 34 percent . Table 6 lists approved activities that are currently ongoing for 2007/08.

The Government of Japan under the GGP also contributed a total of approximately \$278,000 for upgrading the reticulated water system for Leimatu'a (\$150,000) and Ha'akio (128,000) Villages.

Leimatu'a Village Youth Congress also received approximately \$6,300 from the Government of Australia for the construction of 30 recycling bins for 2007/08.

Table 5: Programmed EU Budget 2006 & 2007 – 2007 & 2008

<b>Project Title Programs</b>	<b>Estimated Total ( \$ )</b>
<b>Education Support and Development</b>	
Repair & Refurbish Vava'u High School	200,000
Assets Management Training& Teachers' Training	50,000
Upgrading primary schools at Ha'akoka, Tu'anuku & 'Utulei	151,714
Architectural Services	50,000
<b>Total Education Budget</b>	<b>451,714</b>
<b>Health and Support Development Component</b>	
Laboratory relocation	57,800
Diabetic Clinic and Optic Section Relocation	22,750
Dental and Public Health Sections Alteration	38,550
Steriliser Store Extension	20,000
X-rays walls upgrading and new X-ray machine and incinerator	112,500
New Laundry Building with equipment	50,000
Assets Management, Plan and Training and Landscaping the Hospital	20,000
Structural Repair and Upgrading of Falevai Rural Clinics	80,000
2 Disposal Rooms – Slice Rooms	20,000
Architectural Services	100,000
<b>Total Health Budget</b>	<b>521,600</b>
<b>Non-State Actors Development Component</b>	
Tailulu Science Laboratory Equipment	18,956
Friendly Islands Teachers Association	7,900
Chanel College	18,300
Tonga Pre-school Association	2,500
Tonga National Council of Churches	17,420
Tonga Red Cross (Vava'u office)	19,206
Vava'u Family Health Association	26,100
Tonga Nurses Association	13,400
Vava'u Youth Congress	22,000
Mizpah College - Upgrading of the Ground Floor of the Staff Office for Computer Lab	19,074
CSFT Administration Cost (10%)	18,311
<b>Total NSA Budget</b>	<b>183,207</b>
<b>EDF Management Unit</b>	<b>162,064</b>
<b>Total Budget</b>	<b>1,318,585</b>

Source: VSSSP, PE3

## 6.0 Tongatapu Region

Communities on Tongatapu have benefited from various projects funded by the Governments of Australia, New Zealand and Japan.

### 6.1 Government of New Zealand:- Community Development Fund (CDF) Assistance

The Government of New Zealand has assisted with rural community projects in the agriculture and water and sanitation sectors, youth and gender, and is expected to contribute approximately \$141,119 for projects under the CDF assistance in Tongatapu for 2007/08. Table 7 details projects to be funded this year under the Government of New Zealand's CDF assistance.

**Table 6: : Projects Funded under CDF assistance- 2007/2008**

Region	Applicant	Project	Location	Amount Requested \$	Status
Tongatapu	ComCare/COT Women in Development	Purchase of Processed Pandanus	Patangata/Popua	15,000	Preparation
Tongatapu	Komiti Hala Fatumu	Agricultural Road construction	Fatumu	19,872	Preparation
Tongatapu	Langafonua 'a Fafine Tonga	Launching & Awareness Campaign on <i>National Papers of Women and NGO in Development</i>	Nuku'alofa	7,952	Preparation
Tongatapu	Langafonua 'a Fafine Toloa	Purchase of Sewing Machines	Toloa	12,636.	Preparation
Tongatapu	Kalapu 'Initia	Yam Plantation & Hoes/spades	Utulau	19,113	Preparation
Tongatapu	Teketua 'oe Vai ko Latai Women Development Group	Pandanus & Mulberry	Fua'amotu	16,346	Preparation
Tongatapu	Nualei Old and Young Growers Dev	Agricultural Road construction	Nualei	20,000	Preparation
Tongatapu	Nukunuku Water Committee	Water Tanks	Nukunuku	10,200	Preparation
Tongatapu	Komiti Fakakolo 'o Talasiu	Road construction	Talasiu	20,000	Preparation
			TOTAL	<b>141,119</b>	

### 6.2 Government of Australia's TCDS/ACAS and VAI program

Table 8 lists the activities that are still ongoing in 2006/2007 which were approved under the ACAS scheme for Tongatapu and funded under TCDS for 2005/2006. Table 9 shows the lists of activities that have been recently approved for 2006/2007. The GOA contributed a total of \$1,334,080 for ongoing development projects in Tongatapu in 06/07.

The TCDS activities from 2005/2006FY & 2006/2007 activities are currently ongoing and will be carried through into 2007/2008.

**Table 7: ACAS Projects funded under TCDS and VAI for 2006/07**

Project Titles	Project Locations	Grant Total	10% Contribution	Project Outputs	Status
Kulupu Lata 'i Petani	Tofoa	26,910	2,990	13 water cement tanks	Preparation
Kulupu Vaitulua #4	Havelu	31,050	3,450	15 water cement tanks	Preparation
Kulupu Kakai Fefine SUTT	Niutoua	70,380	7,820	34 water cement tanks	Implement
Kulupu Tala Faite #4	Talafo'ou	31,050	3,450	15 water cement tanks	Preparation
Kulupu Fietokoni 'oe Afo e 100	Malapo	43,470	4,830	21 water cement tanks	Preparation
Komiti Fakakolo	Ha'akame	62,100	6,900	30 water cement tanks	Implement
Kulupu Toa Ko Ma'afu	Longolongo	31,050	3,450	15 water cement tanks	Preparation
Kulupu Feinga Langahake	Halaleva	6,210	690	3 water cement tanks	Completed
Tekifaiva WDG	Ngele'ia	20,700	2,300	10 water cement tanks	Completed
Halafuoleva Cooperative Society	Veitongo	27,184	3,020.	22 acres of vegetables for boys & micro enterprise for girls	Implement
Feinga Mo'ui Multipurpose Coop Society	'Utulau	15,129	1,680	17 acres of vegetable production	Completed & Ongoing
Punugamalu 'oe Mapu 'a Vaea Credit Union	Houma	20,690	2,300	25 acres of vegetable production	Completed & Ongoing
'ApiFo'ou College	Ma'ufanga	73,745	8,194	Renovation of Industrial Arts Classroom with Equipment	Implement
Prison Fellowship Centre	Hu'atolitoli	57,937	6,437	Construction of Training Centre	Preparation
Gospel Fellowship Centre	Mataika	9,144	In-kind	Purchase of Industrial Sewing Machines & Training	Completed & Ongoing
Tonga Family Health Association	Nuku'alofa	7,335	In-kind	Young Women at Risk Program	Completed
		<b>\$534,084</b>	<b>\$57,511</b>		
<b>VAI PROJECTS</b>					
Kulupu Fakalalaka #8	Sopu	67,473	7,497	Filling of 21 residential blocks	Completed
Taungasisi Women's Group	Nukunuku	61,740	11,420	Filling 118 residential blocks	Completed
		<b>\$129,213</b>	<b>\$18,917</b>		

**Table 8 : Project funded under ACAS and VAI for Tongatapu 06/07**

Project Titles	Project Locations	Grant Total	10% Contri.	Project Outputs	Status
Lolo Paongo Group	Kahoua	8,546	In-kind	Install new tank and repair tank stand	Preparation
Kulupu Lototaha 'o e Hala Fatafehi	Kolofo'ou	53,900	5,990	20 water cement tanks	Preparation
Kihe Lelei Taha Group	Hofoa	78,540	4,760	26 water cement tanks	Preparation
Halakafa WDG	Fua'amotu	68,040	7,560	27 water cement tanks	Preparation
Kulupu Fietokoni	Lavengatonga	50,400	5,600	20 water cement tanks	Preparation
Kulupu Matahiva	Tokomololo	28,000	2,800	11 water cement tanks	Preparation
Tofoa Women In Development	Tofoa	52,920	5,880	21 water cement tanks	Preparation
Kulupu Kapakau Tatangi	Pelehake	66,290	6,160	24 water cement tanks	Preparation
Kulupu Ngaue Lototaha	Houmakelikao	54,670	6,075	21 water cement tanks	Preparation
Kulupu Funga Tufukafa	Holonga	19,534	1,500	Grow Yam & Mulberry	Preparation
Fakamohe Mei 'Ulu Club	Holonga	18,850	1,998	Grow Yam	Preparation
Kulupu Tokamu'a 'o Sangato Sosefo	Lapaha	56,410	8,193	Grow Yam	Preparation
Talafo'ou Youth	Talafo'ou	4,216	In-kind	Grow 4 acres of Peanuts	Preparation
Kalapu Fuiono	Lapaha	24,360	In-kind	Grow Yam	Preparation
Fu'u Fa ko Hala ki Langi Credit Union	Ha'asini	9,315	1,035	Grow 4 acres of Watermelon	Preparation
Kalapu Fevanga 'o 'Ahopanilolo	Ma'ufanga	73,430	10,000	Purchase tractor & equipment	Preparation
Mailo Kava Tonga Club	Houma	45,000	5,000	Construct 17 Pen Community Piggery Building	Preparation
I 'o Lupea Coop. Society	Pelehake	53,736	5,970	Construct 16 Piggery Fences	Preparation
Ngalukilo Women's Group	Matahau	63,000	7,000	Construct 35 Piggery Fences	Preparation
CommCARE Tonga	Patangata	111,965	In-kind	Purchase 4 Fishing Boats, 4 Outboard Engine, Trailer and Safety Equipments	Preparation
Kulupu Hala 'o Maui	Hala'ovave	42,615	4,735	Landfill 16 town allotments	Preparation
Komiti Fakakolo	Pelehake	65,304	7,256	Upgrade Road and Tar-sealed	Preparation

TNYC Future Farmers	Tongatapu	22,806	2,534	Farm Business Skills Training	Preparation
CSFT	Tongatapu	8,000	800	NGO Training and Skills Share Project	Preparation
TNYC Young Entrepreneurs	Tongatapu	31,420	In-kind	Small Business Traineeships and Skills Development	Preparation
		<b>\$1,111,267</b>	<b>\$100,846</b>		
<b>VAI PROJECTS:</b>					
Komiti Vai Hihifo	Hihifo District	72,163	In-kind	Upgrade Water Supply System	Preparation
CommCARE Tonga	Patangata	150,650	Nil	35 water poly tanks	Preparation
		<b>\$222,813</b>			

### 6.3 Government of Japan 's Grant Assistance for Grassroots (GGP)

The Japanese Government's GGP scheme contributed a grand total of \$1,286,610 to Tongatapu for 2006/07. Table 9 lists the projects that were approved, and will be ongoing for 2007/08.

**Table 9: Japan's Grant Assistance for Grassroots Projects - 2006/2007 & 2007/2008**

	Project Titles		Location	Approved Allocation from Japan (\$)	Project Outputs		Project Status
1.	Hofoa Supply	Water	Tongatapu	149,866	Upgrade Production	Water	Ongoing
2.	Lakepa Supply	Water	Tongatapu	148,980	Upgrade Production (solar pump)	Water	Completed
3.	Tupou College Water Supply	Water	Tongatapu	118,103	Upgrade Production	Water	Completed
4.	Kolonga Supply	Water	Tongatapu	150,000	Upgrade Production	Water	Ongoing
5.	Tokomololo Supply	Water	Tongatapu	154,986	Upgrade Production	Water	Ongoing
6.	Makaunga Supply	Water	Tongatapu	98,345	Upgrade Production	Water	Ongoing
7.	Nukuleka Supply	Water	Tongatapu	136,346	Upgrade Production	Water	Ongoing
8.	Mu'a Fire Station		Tongatapu	164,992	Construction of 1 Fire Station		Ongoing
9.	Nukunuku Station	Fire	Tongatapu	164,992	Construction of 1 Fire Station		Ongoing
<b>TOTAL ALLOCATION</b>				<b>1, 286,610</b>			

## 6.4 Outcome of Regional and Rural Development Program

The Government of Tonga's regional and rural development program has enhanced development in the region and rural communities. A few of the benefits received by rural and regional communities include:

### ***Better access to water:***

The donor supported RRDP has improved reticulated water supplies enabling these communities' water supply to operate 24 hours, 7 days a week.

Many villages whom have benefited from this program previously experienced problems with their local water supply as the villages' water-generating equipment were outdated and subject to frequent breakdowns.

The RRDP has provided new water pumps, tanks and equipment for the villages which have contributed to improved water generation to households.

### ***Increased access to electricity:***

The donor supported RRDP has also increased access to electricity in rural communities especially in the outer regions.

The most recent beneficiaries of assistance in this sector are households in Niuafu'ou Island who now have access to solar-powered electricity which not only provides better lighting but is cheaper than the alternative source of light, kerosene lamps. This has the effect of reducing households' expenditure on kerosene for lighting.

Children on the Island can now do their homework and studies with better lighting – it is therefore expected that this new development would have a positive impact on Niuafu'ou students' educational performance.

Women who rely on weaving as a major source of income on the island also have better access to lighting and can now produce more outputs for more income.

### ***Better infrastructure:***

Roads and other infrastructures like wharves are being developed making road access and boat access easier for regional communities.

### ***Better resources for public service delivery:***

Government and private schools are either being upgraded or getting new classrooms and better equipment which will enhance the learning environment in rural schools thus improving learning outcomes at these schools.

Regional hospitals and rural clinics are also receiving assistance through upgrades or new constructions of buildings as well as new equipment which will all contribute to better service delivery in these areas.

***Better skills & Income Generating Projects:***

Youth groups and Women's Development Groups are also getting resources for micro-enterprise and income generating activities as well as training programs in these areas. These will improve rural communities' skills and sources of income thus reducing hardship/poverty in these areas.

Young farmers and women are getting funding to start commercial vegetable farming, yam planting, pandanus and mulberry tree planting. If managed properly, these projects have the potential to continue into the future contributing to better income for rural communities.

With the assistance of her development partners, the Government of Tonga has effectively implemented regional and rural development strategies, and will continue to ensuring that basic infrastructure and utilities are maintained

