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SM/86/88
Correction 1

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INFORMATION

April 29, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Tonga - Staff Report for the 1986 Article IV Consultation

The following correction has been made in SM/86/88 (4/25/86):

Page 7, 3rd full para., line 2: for "1.5 percent" read "3.7 percent"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

covers development expenditure, including both development projects executed directly by the Government and projects supported and paid directly by foreign aid donors. During the discussions, the authorities indicated that their operational guidelines call for generating a small surplus in the recurrent budget and limiting development expenditure to the resources made available through foreign aid grants and loans, thus avoiding recourse to domestic bank financing and to foreign commercial borrowing.

In the past two fiscal years, current expenditure accounted for over half of total expenditure. About one third of current expenditure was on economic services, and the rest was split equally between public administration and social and community services, mostly education and health. On the revenue side, taxes on international trade accounted for more than half of total revenue in the last two fiscal years. Taxes on income and profit were much less important (about 12 percent on average) and taxes on goods and services accounted for a minimal share of revenue. About 30 percent of revenue originated in the sale of government goods and services and income from investment. Foreign aid, mainly from Australia, New Zealand, and the European Community, was equivalent to about 16 percent of GDP in the last two fiscal years.

The overall fiscal balance (including grants) registered a small surplus, for the second year in a row, in 1983/84 (Table 2 and Chart 3). Revenue and expenditure changed only marginally, although the authorities adopted a number of initiatives in both areas. The Government took measures to reduce the income tax burden and thus increase the incentive to earn income. The personal exemption was doubled and special deductions, including education allowances, were raised. In order to offset the revenue impact of these tax concessions, the Government raised taxes on international trade. Current expenditure associated with the cyclone contracted sharply, but the wage bill--which accounts for more than half of current expenditure--rose substantially. Although the number of posts was frozen, the Government granted the first of a series of salary adjustments designed to stem a drain of qualified personnel and to encourage productivity increases. Development expenditure contracted in 1983/84, reflecting the decline in foreign aid from the high levels attained after the cyclone.

In 1984/85, the overall balance swung to a deficit equivalent to 3.7 percent of GDP. Revenue increased considerably, but grants declined and expenditure picked up. Import duties rose by 34 percent as tariff rates and other import charges were raised and the customs administration was strengthened. On the other hand, income taxes declined because of a 33 percent increase in the personal exemption. Current spending rose by 19 percent, reflecting the second stage of the programmed salary adjustments for government staff, and development expenditure increased

Table 2. Tonga: Summary of Central Government Operations, 1980/81-1985/86 ^{1/}

(In millions of pa'anga)

	1980/81	1981/82	1982/83	1983/84	1984/85 Prel. Actual	1984/85 Budget Est.	1985/86 Budget Est.
Revenue and grants	27.1	31.0	34.7	33.9	36.4	36.7	50.1
Revenue	12.6	15.7	18.3	18.0	22.6	18.9	22.4
Tax revenue	9.1	10.5	12.3	12.6	15.8	13.7	16.3
Nontax revenue	3.5	5.3	6.0	5.4	6.8	5.1	6.1
Grants ^{2/}	14.5	15.3	16.4	15.9	13.7	17.8	27.6
Of which: cash grants	2.5	2.2	2.3	4.2	3.7	5.5	9.7
Expenditure and net lending	28.5	33.1	34.3	33.9	39.8	40.7	54.6
Current expenditure	11.8	16.3	17.0	17.8	21.3	19.1	22.8
Development expenditure ^{3/}	16.7	16.9	17.3	16.1	18.5	21.5	31.6
Overall surplus/deficit (-)	-1.5	-2.2	0.3	0.1	-3.5	-4.0	-4.7
Financing	1.5	2.2	-0.3	-0.1	3.5	4.0	4.7
Domestic financing (net)	-0.9	1.6	-0.8	-0.2	3.4	2.5	3.1
Banking system	-0.8	-0.6	-2.5	-0.8	1.8
Other domestic financing ^{4/}	-0.1	2.2	1.7	0.6	1.6	2.5	3.1
Foreign financing	2.4	0.6	0.5	0.1	0.1	1.5	1.6
Drawings	2.5	0.7	0.8	0.4	0.8	1.9	2.1
Repayments	0.2	0.2	0.2	0.3	0.7	0.4	0.5
(Annual percentage change)							
Revenue and grants	-11.7	14.5	11.9	-2.3	7.3	0.8	36.5
Of which: revenue	18.6	25.1	16.1	-1.4	25.7	-16.7	18.9
Expenditure and net lending	-8.9	16.3	3.6	-1.1	17.3	2.1	34.3
Current expenditure	...	38.3	4.4	5.0	19.2	-10.0	18.9
Development expenditure ^{2/}	...	0.8	2.8	-7.1	15.2	16.0	47.1
(In percent of GDP)							
Revenue and grants	49.8	48.3	47.7	38.5	38.1	38.4	...
Of which: revenue	23.1	24.5	25.1	20.4	23.7	19.7	...
Expenditure and net lending	52.4	51.6	47.2	38.5	41.7	42.5	...
Overall surplus/deficit (-)	-2.7	-3.4	0.3	0.1	-3.7	-4.2	...
Recurrent budget	1.7	-0.8	1.8	0.2	1.5
Development budget	-4.3	-2.6	-1.5	--	-5.2

Sources: Data provided by the Tongan authorities; and staff estimates.

^{1/} The fiscal year runs from July 1 to June 30.

^{2/} Includes the offshore cost of projects supported by foreign aid donors.

^{3/} Includes net lending.

^{4/} Includes balancing items.