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March 29, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Tonga - Staff Report for the 1991 Interim
Article IV Consultation

Attached for consideration by the Executive Directors is the 1991 staff report for the interim Article IV consultation with Tonga. A tentative date for the possible discussion of the staff report has been set for Wednesday, April 24, 1991.

Unless an Executive Director requests by the close of business on Friday, April 12, 1991 that the report be taken up for discussion in a meeting of the Executive Board, or the Managing Director places the report on the agenda by that date, the report will not be discussed by the Board and the 1991 interim Article IV consultation with Tonga will be completed by way of the adoption on a lapse of time basis of the following proposed decision:

The Fund notes the staff report for the 1991 interim Article IV consultation with Tonga (SM/91/66) and declares the consultation completed.

The decision, if adopted, will be effective as of the close of business on Friday, April 12, 1991, and it will be so recorded in the minutes of the next meeting thereafter. The next Article IV consultation with Tonga would then be completed no later than April 13, 1992.

Mr. Itam (ext. 7306) is available to answer questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

TONGA

Staff Report for the 1991 Interim Article IV Consultation

Prepared by the Staff Representatives for the
1991 Interim Article IV Consultation

Approved by Kunio Saito and Michael Edo

March 28, 1991

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I. Introduction

The 1991 interim Article IV consultation discussions with Tonga were held in Nuku'alofa during January 28-February 8, 1991. The mission 1/ met with the Minister of Finance, the Governor of the National Reserve Bank of Tonga, and other senior officials. Tonga has been placed on the bicyclic consultation procedure by the Executive Board; the last Article IV consultation was completed on February 28, 1990 (EBM/90/28). 2/

Tonga avails itself of the transitional arrangements under the provisions of Article XIV, although no restrictions on payments and transfers for current international transactions are maintained.

The Kingdom of Tonga, which consists of several groups of islands in the South Pacific Ocean, has limited natural resources and an underdeveloped infrastructure. With a per capita income of about US\$910, Tonga ranks among the poorest of the Pacific island economies. 3/ Agriculture is the mainstay of the economy, although a significant portion of GDP is generated in the services sector, particularly by the Government and tourism. Remittances from abroad average about 12 percent of GDP and are used mainly to finance consumption. Like other South Pacific island nations, Tonga faces several impediments to its economic development stemming from its relative isolation, susceptibility to adverse weather, and a narrow domestic market. Partly as a result of these constraints, growth has been slow, providing limited employment opportunities and encouraging emigration.

II. Recent Developments

In recent years, economic performance in Tonga has been modest. Real GDP growth averaged about 2 percent per annum during 1985/86-1988/89 4/ and inflation--averaging some 13 percent annually--fluctuated in response to changes in domestic supply conditions and the cost of imports (Chart 1). 5/ During this period, budget deficits (before foreign grants) were contained mainly through restraint on both current and development expenditures, with the latter closely linked with external grants and loans.

1/ The staff representatives were Messrs. Itam, Kibria, and Ohsawa and Ms. Knauseder as assistant (all ASD).

2/ Tonga's relations with the Fund and the World Bank Group are summarized in Annexes I and II, respectively.

3/ See Annex III. For more details on Tonga's regional setting and background, see Tonga--Recent Economic Developments (SM/90/29; 1/31/90); and Christopher Browne, Economic Development in Seven Pacific Island Countries (1989; International Monetary Fund).

4/ The fiscal year runs from July 1 to June 30.

5/ Most imports originate in New Zealand. Import prices have shown considerable variability in large part with variations in the exchange rate between the Tongan pa'anga (T\$) and the New Zealand dollar.

As a result, the Government was able to avoid domestic bank borrowing and, in fact, built up significant deposits with the commercial bank. Public enterprises' financial performance was broadly satisfactory, with revenue covering costs and only limited budgetary subsidies to meet current operational expenses, although they depended to a large extent on budgetary provisions for their investments. Liquidity expanded at an average annual rate of about 13 percent, reflecting mainly a rapid growth in domestic credit to the private sector for housing and consumption. The balance of payments--characterized by relatively small exports, large imports, and significant inflows of remittances and foreign assistance--recorded a cumulative surplus of about US\$7 million during the period, permitting gross international reserves to remain at the equivalent of 5-6 months of imports. Tonga's competitiveness, as measured by the real effective exchange rate, fluctuated sharply, although it remained broadly unchanged over the period as a whole; the pa'anga remained pegged at par to the Australian dollar (Appendix Table 2). ^{1/}

Economic developments deteriorated somewhat in 1989/90. Real GDP growth slowed to an estimated 2 1/2 percent, as new activities in the agricultural sector--mainly squash cultivation--failed to fully offset the decline in value added by the coconut and banana subsectors and the manufacturing and construction sectors. Inflation, although remaining moderate at an average of about 5 1/2 percent for the year, reverted to a strong upward trend--with the end-period annual rate at about 9 percent--because of lax financial policies and tightened domestic supply conditions for traditional nontraded goods.

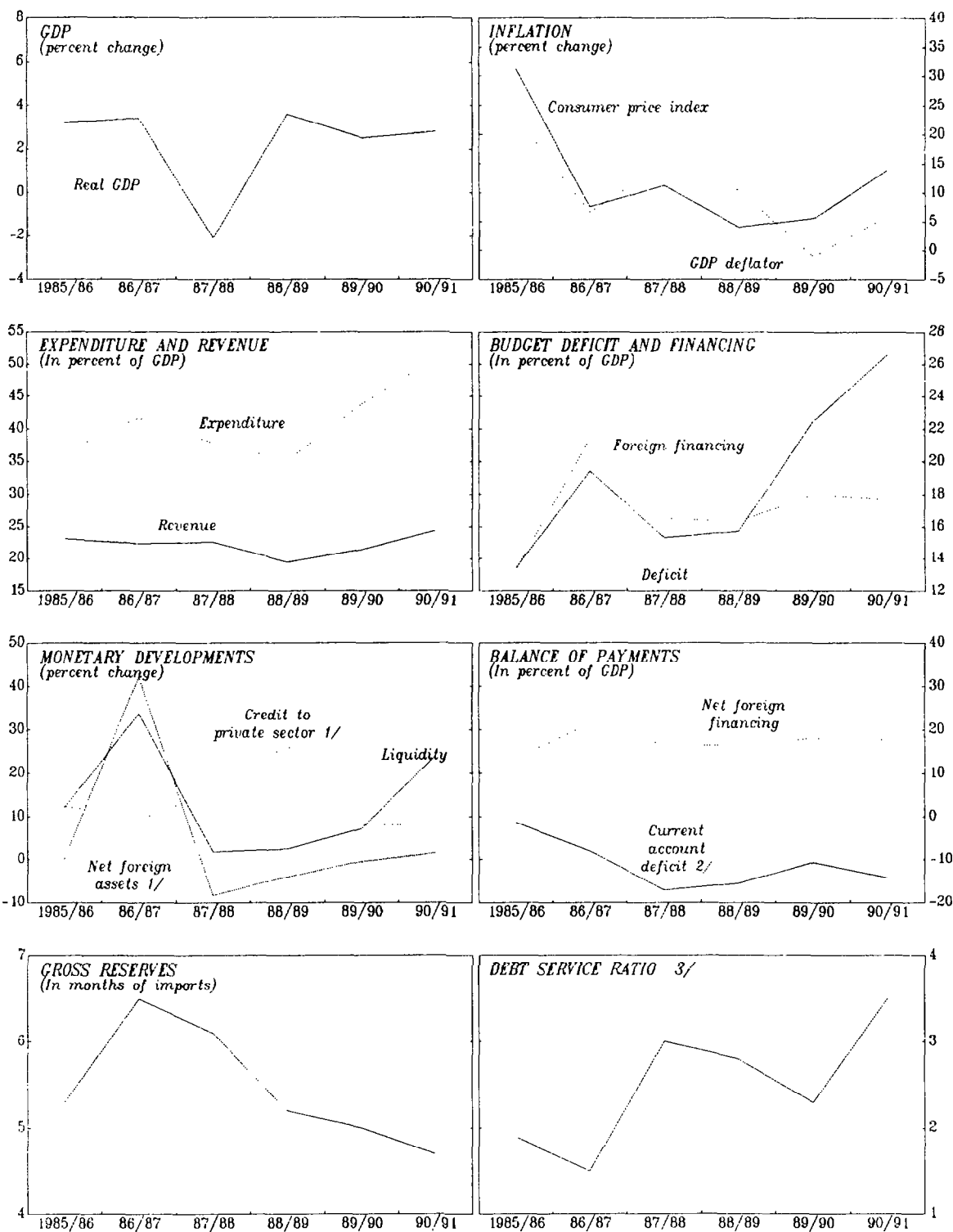
The fiscal performance in 1989/90 was much more expansionary than had been envisaged when the budget was formulated, with the overall budget deficit rising from 16 percent to 22 1/2 percent of GDP (Appendix Table 3). Revenue performance fell significantly short of the target mainly because of slower growth in imports, which limited the increase in receipts from import duties and related port and services taxes, and the withdrawal of some revenue measures that had been included in the budget. The impact of this shortfall was compounded by a large overshooting in expenditure of about

^{1/} The assessment of economic developments is hampered by a lack of comprehensive data in most areas, particularly national accounts--for which there are no official estimates for recent years. The lack of credible current data makes analysis of output and expenditure trends tenuous. Also, there are no official import and export unit value indices. The estimates used in this report are based on World Economic Outlook (WEO) aggregations of partner countries' trade data and, as such, are unavoidably subject to a large margin of error. Tonga recently received technical assistance from the Asian Development Bank (AsDB) for improving both the currentness and quality of national accounts and related data. The methodology established and preliminary estimates compiled at that time are being reviewed for eventual adoption by the authorities. (See Annex IV for more details on the status of statistics.)

CHART 1

TONGA

SELECTED ECONOMIC INDICATORS, 1985/86-1990/91



Sources: Appendix Table 1; data provided by the Tongan authorities; and staff estimates and projections.

1/ Contribution to liquidity growth.

2/ Excluding foreign grants.

3/ In percent of exports of goods and services and private transfers.

9 percent of the budgeted amount. This overshooting occurred primarily because the 25 percent wage increase granted was not staggered into the next 2-3 years as had been envisaged in the budget. ^{1/} Also, the current expenditure restraining measures--including a freeze on hiring, cutbacks in departmental allocations, and reductions in benefits for civil servants--that were introduced in midyear, when a likely shortfall in revenue became apparent, were not adhered to; and development expenditure, particularly on locally funded projects, was much higher than budgeted. Since foreign assistance was also lower than expected, there was significant domestic borrowing equivalent to $4\frac{1}{2}$ percent of GDP--mainly from the National Reserve Bank of Tonga (the central bank)--to finance the budget deficit, compared with the net reduction in domestic debt of about 3 percent of GDP that was planned.

The large amount of government bank borrowing accounted for the bulk of the increase in domestic credit and the growth in liquidity in 1989/90. Domestic credit increased by about $36\frac{1}{2}$ percent, with the net deposits of the Government with the banking system declining by 45 percent (Appendix Table 4). Credit to the private sector, which had increased rapidly in the earlier years, slowed considerably in reflection of the slowdown in economic activity; attempts by the Bank of Tonga to improve the quality of its portfolio after excessively rapid expansion of credit in the previous years; and the effects of the ceiling on lending rates, which constrained lending for some higher-risk but more productive ventures. ^{2/} Nevertheless, the rate of liquidity expansion at over 7 percent was significantly faster than that of nominal GDP.

Despite a significant deterioration in the external terms of trade, the balance of payments position improved somewhat in 1989/90. The external current account deficit (before grants) declined to about 11 percent of GDP, reflecting a slight reduction in the trade deficit and strong increases in receipts from services and remittances (Appendix Table 5). Exports of coconut and related products virtually ceased because of low world market prices relative to production costs, and Tonga lost the important banana export market in New Zealand with the termination in early 1990 of the preferential treatment they had hitherto received. However, the niche market for squash exports to Japan expanded sufficiently for total export receipts to decline only marginally. At the same time, with the slowdown in economic activities--particularly in the construction sector--import payments declined by about 2 percent (about 6 percent in real terms). These developments combined with a sharp rise in the sale of passports to non-nationals and a substantial increase in remittances from Tongans in Australia and the United States to reduce the external current account deficit. The deficit was more than offset by the inflows of grants and

^{1/} The wage increase granted to government employees was followed by similar increases in the public enterprise and private sectors.

^{2/} The ceiling on lending rates was raised to $13\frac{1}{2}$ percent in October 1989 after being maintained at 10 percent since August 1981.

official capital (net of transfers of the proceeds from passport sales to the Tonga Trust Fund abroad) ^{1/} and a marginal overall balance of payments surplus of about US\$1 million was recorded. Gross official reserves rose to about US\$28 million, equivalent to five months of imports.

III. Policy Discussions

At the conclusion of the last Article IV consultation in February 1990, Executive Directors broadly supported Tonga's objectives of containing domestic inflation, maintaining international reserves at a comfortable level, and gradually accelerating the rate of real GDP growth. In that context, Directors were concerned about the rapid expansion in domestic credit and encouraged the authorities to keep fiscal policy on a cautious course. However, financial policies remained somewhat expansionary, resulting in some of the economic deterioration noted earlier.

The staff's short-term projections indicate that real GDP growth will improve slightly to about 3 percent in 1990/91, mainly because of increased agricultural output and a modest pickup in manufacturing and tourism. Domestic inflation is projected to rise sharply partly because of the surge in oil prices but mainly because of the expansionary budgetary stance, especially the large wage increase granted in the latter part of the previous year. The overall budget deficit is projected to widen further, with net domestic borrowing--mainly from the banking system--increasing. Despite a strong pickup in exports, the external current account deficit is projected to widen to about 14 percent of GDP because of increases in consumer goods imports and a sharp decline in the sale of passports to nonnationals. However, with some increase in foreign assistance, the overall balance of payments position is projected to remain in slight surplus, although international reserves coverage of imports will decline to less than five months.

At the outset of the discussions, the authorities expressed serious concern about the rise in domestic inflation and the pressures on the balance of payments that may emerge from budgetary developments. It was recognized that the immediate task is to adopt appropriate domestic financial policies in order to stabilize the short-run situation while creating a strong basis for medium-term efforts to accelerate economic growth. The policy discussions, therefore, focused on the appropriate mix of measures necessary to achieve this short-term goal.

^{1/} Selected fees and charges, mainly fees for Tongan passports sold to nonnationals, are earmarked for savings in the Tonga Trust Fund from which drawings can be made to meet certain government expenses.

1. Public sector policies

a. Fiscal policy

In principle, fiscal policy in Tonga has sought to generate adequate current surpluses in order to provide the required local counterpart funds for foreign-assisted projects and to avoid domestic borrowing. The strategy employed to realize these objectives has been to contain recurrent expenditure while limiting development spending to resources made available through foreign assistance and transfers from the recurrent budget. This strategy was more or less abandoned in 1989/90 when recurrent expenditure was allowed to increase sharply and locally funded projects exceeded the budgetary provisions.

In designing the 1990/91 budget, the authorities' aim was to limit the overall budget deficit, with no recourse to net domestic bank borrowing, in order to contain inflation and avoid balance of payments pressures. Accordingly, the budget envisaged holding the overall deficit at about 22 percent of GDP, which was expected to be financed largely by foreign grants and concessional loans and by drawings on the Tonga Trust Fund held abroad. To achieve these targets, new revenue measures were introduced with an estimated net yield in 1990/91 of about T\$4 million, 2 percent of GDP. These measures were broadly in line with the recommendations of a recent Fund technical assistance mission and included, principally, higher import duties on selected commodities and a shift in the general sales tax from the retail to the wholesale level (Appendix Table 6). In addition, measures were taken to contain total expenditure by curtailing increases in nonsalary recurrent outlays and by focusing the development budget on the rehabilitation of infrastructure.

The staff endorsed the strategy for reducing the overall budget deficit, particularly the avoidance of net domestic bank borrowing, in order to limit the disequilibria in the economy. However, the staff pointed out that projections indicate that the budget deficit is likely to be some 5 percent of GDP larger than budgeted, with shortfalls in revenue collections as well as higher-than-budgeted expenditures. Therefore, additional measures--involving significant cuts in expenditure as the main component--would be required if the 1990/91 budgetary targets are not to be severely compromised. Such measures should concentrate on streamlining recurrent expenditure; prioritizing development projects to accord greater importance to those that are quick-yielding and could enhance the productive capacity of the economy; improving revenue administration; and rationalizing the tariff structure in order to increase the buoyancy of the existing tax system.

However, the staff stressed that, in implementing the above additional measures, care should be exercised to address two major concerns. First, adequate budgetary provision should be made for operations and maintenance in order to preserve the utility of the existing stock of infrastructure. Second, sufficient local counterpart funds should be generated in order for

Tonga to fully avail itself of offered foreign assistance. While these concerns may suggest larger expenditures and greater revenue efforts, the staff noted that total expenditure and revenue, equivalent to about 44 percent and 22 percent of GDP, respectively, may already be high compared with other South Pacific island countries in similar stages of development. Therefore, emphasis must be placed on improving the efficiency of expenditures and strengthening revenue administration rather than on raising the levels of expenditure and increasing the tax burden.

The authorities agreed with the staff that the 1990/91 budget deficit is likely to exceed the target by a considerable margin, which would entail another year of substantial government borrowing from the domestic banking system. They explained that the Government eschews domestic financing of the budget deficit and that the exceptional developments regarding wages and pressures to undertake locally funded projects had contributed to the worsening of the budgetary situation in recent years. For 1990/91, the Government is continuing to closely monitor developments and is aiming at limiting its bank borrowings to the T\$5 million--2 1/2 percent of GDP--that has already been undertaken.

While broadly agreeing with the staff's recommendations for reducing the budget deficit, the authorities indicated that expenditure may remain relatively large for some time. They explained that the general policy is to reduce the size of the Government. However, development expenditure may have to increase somewhat over the medium term, given the overall size of the economy and the relatively large projects that are involved if the infrastructure is to be strengthened. Nevertheless, steps are being taken to gradually shift commercially viable activities to the private sector, leaving the Government to concentrate on providing the necessary economic and social infrastructure for accelerated growth.

b. Public enterprises

Although public enterprises in general run small operating surpluses, they rely almost exclusively on the Government for financing their investments. ^{1/} Some of these investments are undertaken at the behest of the Government in connection with the development plans while others represent commercial decisions by the enterprises. The staff suggested that efforts should concentrate on streamlining less essential current outlays by these enterprises and establishing flexible pricing policies in order to internally generate resources for investments associated with commercial decisions. Over the long run, consideration should be given to the privatization of activities that could profitably be carried out in the private sector.

^{1/} The most important loss-making enterprises are the Tonga Commodities Board and the Friendly Islands Airways Limited (the national airline).

The authorities indicated that efforts to strengthen the operations of the public enterprises have intensified in recent years and are being expanded. These efforts include a restructuring of the Tonga Commodities Board that may involve the privatization of all its operations except those related to the agricultural sector. In addition, the operations of the national airline are being reviewed to identify and implement measures that would make it profitable. In this connection, the Government recently injected T\$2 million in equity in an attempt to lessen the airline's debt burden. The authorities explained that the Government will continue to undertake increased equity participation in selected public enterprises with the intention of privatizing them once they become financially sound. In this respect, a list of public enterprises suitable for privatization is under preparation. In particular, the Government has decided to sell the International Dateline Hotel and a fishing company that is being formed from the present fisheries department in the Ministry of Agriculture, Forests and Fisheries. Additionally, the prospects for the sale of the agricultural machinery pool, government sawmill, government printer, and the post office are being explored.

2. Monetary policy

Monetary policy, which had been largely accommodative of credit demand in the private sector, was modified in the recent period to take account of the significant deterioration in the loan portfolio of the commercial bank. Following two years of rapid growth in private sector credit, which had been undertaken in an attempt to offset the expected loss of earnings with the transfer of official reserves to the newly established central bank, 1/ the Bank of Tonga had to write off a major bad debt. Consequently, it has had to restrain credit expansion to the private sector during 1990/91. However, the large resort by the Government to bank financing of the budget deficit has maintained the demand pressure, which is translating into higher consumer imports and rapid inflation. The staff recommended that too much burden should not be placed on monetary policy in reducing the imbalances, lest the modest economic growth that is in prospect be stifled. Instead, sufficient room should be made for an expansion of credit to productive activities in the private sector through a tighter fiscal stance.

Following the raising of the ceiling on lending interest rates in October 1989--with associated upward adjustments in deposit rates--there was a significant improvement in real interest rates that arrested the declining trend in domestic financial savings that had persisted during the previous two years. However, the interest rate structure remains uncompetitive

1/ The Central Bank--the National Reserve Bank of Tonga--was established in July 1989. Prior to this date, the functions of the monetary authority were carried out jointly by the Treasury--a department of the Ministry of Finance; the Board of Currency Commissioners and the Board of Coinage Commissioners; and the commercial bank as the Government banker.

relative to alternative markets (e.g., Australia) and has deteriorated significantly in recent months with the surge in domestic inflation. The staff pointed out that the ceiling on lending rates, and by extension on deposit rates, constituted a major distortion in the savings-investment process and encourages consumption at the expense of savings. Interest rates that are more reflective of market conditions could have beneficial effects by stimulating private savings and promoting efficiency in investment. The staff, therefore, recommended the removal of the ceiling on the lending rates of banks.

While agreeing that, in principle, there could be beneficial effects from interest rate liberalization, the authorities expressed concern that in the situation of Tonga--with only one commercial bank--removal of the ceiling on lending rates may lead to inefficiency and unnecessarily high interest rates. At the same time, the authorities indicated their awareness of the general supervisory role of the central bank and the various indirect instruments--particularly rediscount facilities--that could be used to affect the interest rate structure. In any event, the authorities stressed that a decision on the removal of the ceiling would be political and that present circumstances were not entirely opportune.

On the financial system, the staff observed that the Tongan economy has developed sufficiently to warrant the establishment of a comprehensive regulatory framework. Such a framework would furnish the necessary guidelines for agencies that provide, or are contemplating the provision of, financial services--including commercial banking, insurance, public offering of securities, and portfolio investment management. Also, this framework would be essential for eliciting competition in the banking sector, developing financial markets, and enhancing the supervision of financial services and companies. Therefore, the staff recommended the passage of the draft bill on financial institutions, which would provide an appropriate legal structure.

3. External policies

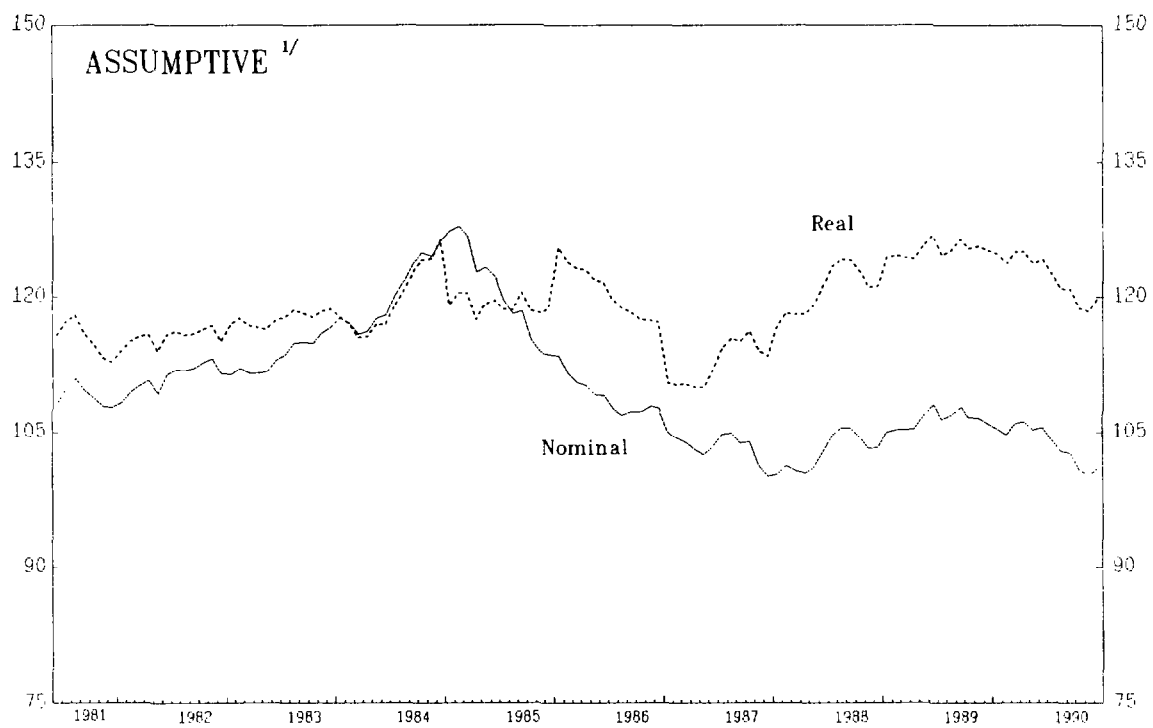
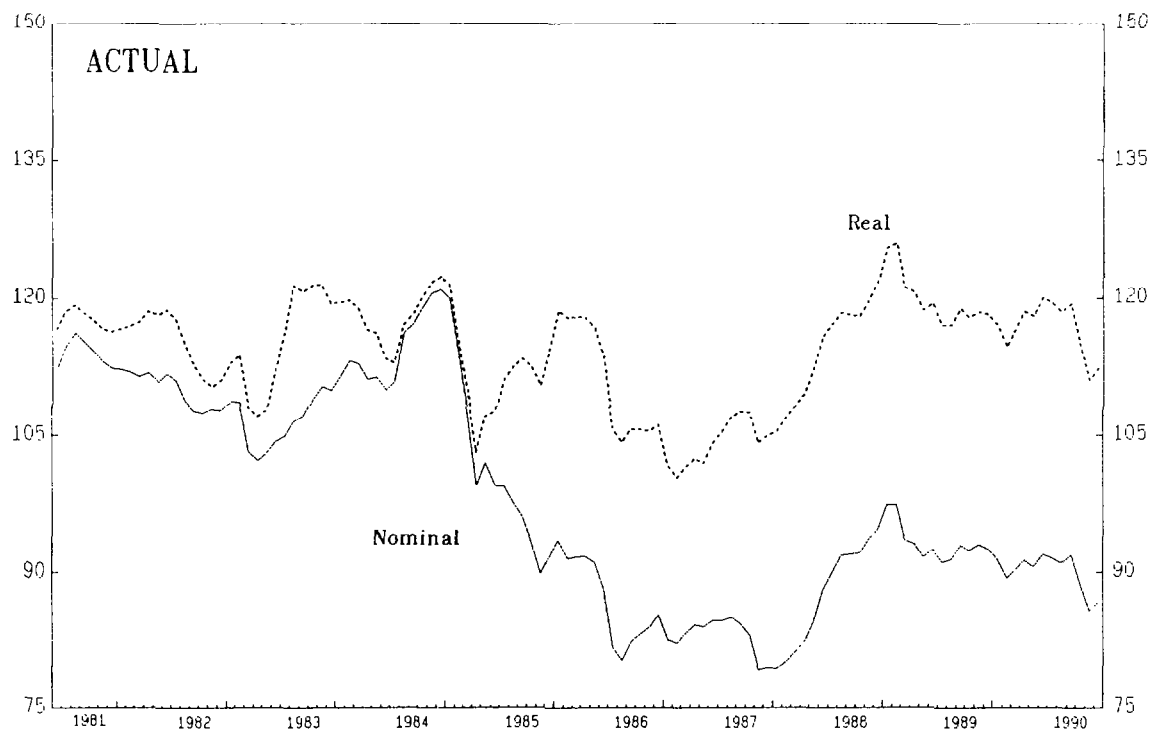
Effective February 11, 1991, the Tongan authorities changed the exchange arrangement. The link at par between the pa'anga and the Australian dollar, which had existed since November 1976, was terminated. The pa'anga is now pegged to a weighted basket of the currencies of Tonga's most important partners in trade and payments transactions, with the U.S. dollar as the intervention currency.

The authorities noted that although the real effective exchange rate had remained broadly unchanged over the last decade, it fluctuated sharply during the period (Chart 2). Although this was partly due to fluctuations in inflation generated by domestic factors, a significant part was due to movements in the nominal effective rate stemming from the exchange arrangement. The authorities added that the volatility of the pa'anga vis-a-vis major trading partner countries had increased uncertainty and complicated economic decisionmaking. They also pointed out that the new exchange

CHART 2

TONGA

EFFECTIVE EXCHANGE RATES, 1981-90



Sources: IMF, Information Notice System; and staff estimates.

1/ Assuming that the new exchange arrangements for the pa'anga that was introduced in February 1991 was effective from January 1990.

arrangement would enable the use of the exchange rate as a policy instrument, although the immediate intention is to adjust the nominal effective exchange rate--through changes vis-a-vis the intervention currency--only to smooth out short-term fluctuations.

The staff concurred with the authorities' view that a shift in the exchange arrangement to a basket peg would better reflect Tonga's trading pattern and developments in competitor countries. Simulations of the new exchange arrangement indicate that, indeed, the basket peg would have reduced the variability over time of both the nominal and real effective exchange rates for the pa'anga. Regarding the possibility of using the exchange rate as an instrument, the staff noted that, in the case of Tonga, the role of exchange rate in the promotion of exports and import substitution is limited because of the economic structure. Instead, emphasis should be placed on removing structural impediments to production, maintaining a stable financial environment, and observing wage restraint in order to achieve improvements in competitiveness.

Tonga maintains an exchange system free of restrictions on payments and transfers for current international transactions. ^{1/} The Government's policy is to maintain a restriction-free exchange and trade system. The staff, therefore, recommended that the authorities consider an early acceptance of the obligations of Article VIII, Sections 2, 3, and 4. The staff pointed out that Tonga has nothing to gain by maintaining its present Article XIV membership status, since the introduction of any new exchange restrictions would necessarily require Fund approval--just as it would be if Tonga accepted the obligations of Article VIII. In response, the authorities informed the staff that consideration was being given to moving to Article VIII status, and a decision will be communicated to the Fund in due course.

The Government has pursued a cautious external debt policy that has succeeded in limiting its debt service obligations. Most of Tonga's external debt is on highly concessional terms and external debt service relative to external current receipts has remained low, increasing only modestly from about 1 1/2 percent in 1986/87 to about 2 1/2 percent in 1989/90. The debt service ratio is expected to rise to about 3 1/2 percent in 1990/91 and to decline to about 3 percent over the medium term (Appendix Table 7). The authorities are confident that Tonga will be able to meet its future obligations to multilateral institutions and other donors in a timely manner and will continue to pursue prudent policies as regards new external

^{1/} A complete description of Tonga's exchange and trade system as of end-1989 may be found in IMF, Annual Report on Exchange Arrangements and Exchange Restrictions, 1990. There were no changes in the policies/regulations in the exchange and trade system during 1990. Tonga has not imposed any exchange measures vis-a-vis Iraq and Kuwait following UN Resolution No. 661.

borrowings. In particular, the Government intends to avoid external borrowing on commercial terms.

4. Medium-term prospects

The continuation of current policies implies a significant deterioration in the economic situation over the medium term (1991/92-1995/96) (Appendix Tables 7 and 8). The staff's projections--baseline scenario--show that growth will slow to about 2 percent per annum, as the development of new niches of activities is unlikely to be sufficient to maintain even the present modest momentum. Inflation will remain high, despite a projected deceleration in partner countries' prices because of expansionary financial policies. Both recurrent and development expenditure will rise substantially unless policies are adjusted, and the fiscal deficit will remain large, with associated large recourse to domestic bank financing. On the external side, the current account deficit is projected to remain high at about 13 percent of GDP on an annual average basis, despite sharp increases in exports of squash and watermelon, mainly because of rising import demand and stagnant services receipts. Even though foreign assistance will rise steadily during this period, a cumulative overall balance of payments deficit of US\$15 million will be recorded. Consequently, the international reserves position will worsen, and its coverage of imports will decline to less than two months by end-1995/96.

The staff expressed concern about the sustainability of the economic situation over the medium term and stressed that adjustment efforts must concentrate on reducing the budget deficit, limiting private sector credit expansion to productive activities, and encouraging domestic savings. The staff observed that medium-term projections--based on a policy (alternative) scenario that incorporates the staff recommended macroeconomic measures and structural adjustments to ease supply constraints--show that the economic prospects could be more favorable. In such a scenario, real GDP growth would be higher; inflation lower, approaching that in partner countries; and the external current account deficit smaller, with modest overall balance of payments surpluses that would permit sufficient increases in international reserves to maintain import coverage at about five months. The authorities, being in general agreement with the medium-term projections, shared the concern of the staff. They indicated that policy adjustments along the lines recommended by the staff will be considered, particularly in connection with the preparation of the Sixth Development Plan (1990/91-1994/95).

IV. Staff Appraisal

The economic performance of Tonga deteriorated somewhat in 1989/90. Real GDP growth is estimated at about 2 1/2 percent, and inflation--though moderate on a yearly average basis--took a strong upward trend. The budget deficit (before grants)--contained for many years through expenditure restraint--widened substantially primarily because of increases in wages of about 25 percent and a sharp expansion in development expenditure. To

finance the budget deficit, net domestic borrowing--mainly from the banking system--rose to the equivalent of 4 1/2 percent of GDP. This government borrowing accounted for the bulk of the large increase in domestic credit and contributed most of the growth in domestic liquidity. Nevertheless, the external position improved considerably, with the current account deficit (before grants) declining to about 11 percent of GDP, because of large receipts from services--particularly the sale of passports to nonnationals--and a sharp rise in remittances. Overall, the balance of payments recorded a surplus of about US\$1 million and gross international reserves remained at about the equivalent of five months of imports.

Preliminary data point to a continuation of these trends in 1990/91. Real GDP growth is projected at about 3 percent, while inflation is expected to rise sharply partly owing to the surge in oil prices but mostly because of the expansionary budgetary stance. The overall budget deficit is projected to widen further, with net domestic borrowing rising to about 9 percent of GDP. Despite a strong pickup in exports, the external current account deficit is projected to widen to about 14 percent of GDP because of strong consumer goods imports and a decline in the sale of passports to nonnationals. However, with some increase in foreign assistance, the overall balance of payments position is expected to be in slight surplus.

The staff shares the authorities' concerns about the upward trend of domestic inflation and potential pressures on the balance of payments. These concerns have emerged as direct results of strong demand pressures fueled by expansionary fiscal and monetary policies. In particular, increases in government sector wages have been excessive and have elicited wage adjustments in the public enterprise and private sectors that diverged substantially from improvements in productivity; domestic financing of the budget deficit has been large; and, until recently, bank credit to the private sector--mainly for consumption--has been growing too rapidly. The continuation of these policies is likely to cause unsustainable overall balance of payments deficits over the medium term. The immediate task for the authorities is to adopt an appropriate mix of domestic financial policies in order to stabilize the short-run situation while creating a strong basis for medium-term efforts to accelerate economic growth. The staff believes that reduction of the budget deficit--and the associated domestic borrowing--through expenditure cuts must be the centerpiece of the policy mix. Such policy measures should comprise the containment of recurrent expenditure, including wage restraint; limiting the increase in development expenditure through enhanced prioritization of projects to concentrate on those that are quick-yielding and could expand the productive capacity of the economy; strengthening of revenue administration; removal of the ceiling on lending interest rates; and a further tightening of credit, while ensuring adequate credit for productive private sector activities.

The staff supports the recent change in the exchange arrangement for the pa'anga and agrees with the authorities that the new arrangement will better reflect Tonga's trading pattern and developments in competitor countries.

The staff welcomes the maintenance by Tonga of an exchange system that is free of restrictions on payments and transfers for current international transactions. The staff notes that the authorities are considering accepting the obligations of Article VIII, Sections 2, 3, and 4, and recommends the transition from Article XIV to Article VIII status at the earliest opportunity.

Article IV consultations with Tonga are held under the bicyclic procedure. Accordingly, the next Article IV consultation with Tonga will be completed within 12 months of the completion of the 1991 interim Article IV consultation.

Table 1. Tonga: Selected Economic and Financial Indicators, 1986/87-1990/91

	1986/87	1987/88	1988/89	1989/90 Est.	1990/91 Proj.
(Percentage change)					
Output and prices					
Nominal GDP (T\$ mn.)	132.0	148.5	170.0	172.3	188.2
Real GDP	3.4	-2.1	3.6	2.5	2.8
Consumer prices (end-period)	7.0	7.7	3.7	8.9	16.1 ^{1/}
(Period average)	7.5	11.3	4.0	5.6	14.0
Money and credit (end-period)					
Domestic credit	1.7	61.5	19.0	36.4	36.7
Private sector	17.2	34.1	42.5	9.2	9.2
Total liquidity (M2) (end-period)	33.7	1.7	2.5	7.2	24.0
Average stock of liquidity	14.4	15.4	2.2	4.8	15.9
One-year bank deposit rate (in percent)	5.75	5.75	5.75	7.25	7.25
Maximum bank lending rate (in percent) ^{2/}	10.0	10.0	10.0	13.5	13.5
Exchange rate ^{3/}					
Nominal effective exchange rate	-10.50	-0.53	13.14	-1.90	-6.7 ^{4/}
Real effective exchange rate	-9.49	4.12	30.32	-2.21	-7.7 ^{4/}
Terms of trade ^{5/}	-9.2	14.3	2.0	-17.9	-17.4
(In percent of GDP)					
National savings	29.0	16.9	28.1	39.7	35.8
Investment	20.1	23.5	29.0	29.7	30.0
Central government budget					
Revenue ^{6/}	22.3	22.5	19.4	21.3	24.3
Current expenditure	22.5	20.9	18.6	22.3	26.4
Development expenditure and net lending	19.2	16.9	16.4	21.5	24.4
Overall balance					
(Before grants)	-19.4	-15.3	-15.7	-22.5	-26.6
(After grants)	-3.3	0.1	-1.5	-5.4	-10.4
External financing (including grants)	21.4	16.5	16.3	18.0	17.7
Domestic financing ^{7/}	-1.9	-1.3	-0.6	4.5	8.9
Banking system	-1.3	0.5	-3.2	3.1	4.4
(In millions of U.S. dollars)					
Balance of payments					
Exports, f.o.b.	7.4	6.4	9.9	9.3	13.6
Imports, c.i.f.	-49.7	-50.9	-62.9	-61.7	-70.6
Current account balance (before grants)	-7.5	-18.7	-21.7	-14.2	-22.2
In percent of GDP	-8.0	-17.2	-15.6	-10.7	-14.3
Current account balance (after grants)	6.5	-2.0	-2.0	8.5	2.8
In percent of GDP	6.9	-1.8	-1.4	6.4	1.8
Overall balance	9.3	0.4	-2.5	0.9	0.5
Gross official reserves (end-period)	27.2	27.9	25.4	27.8	28.3
In months of imports	6.5	6.1	5.2	5.0	4.7
Debt service (in percent of current receipts)	1.5	3.0	2.8	2.3	3.5
T\$ per US\$ (period average)	1.51	1.37	1.23	1.30	1.22
T\$ per US\$ (end-period)	1.39	1.26	1.32	1.27	1.22

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

^{1/} December 1990.

^{2/} Average lending rates were about 9.1 percent during 1985/86 - 1989/90.

^{3/} Minus sign indicates depreciation of the pa'anga; period average data.

^{4/} July-November 1990.

^{5/} Based on WEO trading partner country data.

^{6/} Excluding sales of Tonga Protective Citizen passports to nonnationals and telecommunication rights.

^{7/} Including use of Tonga Trust Fund balances.

Table 2. Tonga: Effective and Selected Exchange Rates, 1985/86-1990/91

(1980 = 100; and in unit of foreign currency per pa'anga) 1/

	<u>Effective Exchange Rates</u>		Australian dollar	New Zealand dollar	U.S. dollar	Japanese yen	SDR
	Real	Nominal					
1985/86	113.6	88.2	1.00	0.80	1.48	0.009	0.58
1986/87	104.0	84.6	1.00	0.82	1.39	0.009	0.56
1987/88	115.8	88.1	1.00	0.84	1.26	0.010	0.61
1988/89	119.4	92.5	1.00	0.76	1.32	0.009	0.61
1989/90							
September	118.9	93.0	1.00	0.76	1.29	0.009	0.60
December	118.1	92.6	1.00	0.75	1.26	0.009	0.60
March	116.5	90.3	1.00	0.77	1.32	0.008	0.58
June	120.0	91.0	1.00	0.75	1.27	0.008	0.59
1990/91							
September	119.3	91.9	1.00	0.74	1.21	0.009	0.59
December	110.7	85.8	1.00	0.76	1.30	0.010	0.54
Memorandum items:							
Trade share <u>2/</u>							
Exports							
1985/86	...	...	30	54	8	--	...
1989/90	...	...	22	35	13	17	...
Imports							
1985/86	...	...	25	39	6	9	...
1989/90	...	...	23	30	12	7	...

Sources: IMF, Information Notice System Index; data provided by the Tongan authorities; and staff estimates.

1/ Midpoint rates at end of period.

2/ As percent of total.

Table 3. Tonga: Summary of Central Government Operations, 1986/87-1990/91 ^{1/}

	1986/87	1987/88	1988/89	1989/90		1990/91	
				Budget	Est.	Budget	Proj.
	(In millions of pa'anga)						
Revenue	29.5	33.4	32.9	40.5	36.7	47.2	45.7
Tax	21.1	24.3	24.9	29.7	27.4	35.0	33.9
Nontax 2/	8.4	9.1	8.0	10.8	9.3	12.2	11.8
Expenditure and net lending	55.2	56.1	59.6	69.1	75.4	88.3	95.7
Current expenditure	29.7	31.0	31.7	37.4	38.4	45.3	49.7
Development expenditure and net lending	25.5	25.1	27.9	31.7	37.0	43.0	46.0
Overall balance	-25.7	-22.7	-26.7	-28.6	-38.7	-41.1	-50.0
Foreign financing (net)	28.2	24.6	27.8	33.4	31.0	38.1	33.2
Grants	21.1	22.9	24.2	31.0	29.4	35.0	30.4
Loans (net)	7.0	1.7	3.6	2.4	1.6	3.1	2.8
Domestic financing (net)	-2.5	-1.9	-1.1	-4.8	7.7	3.0	16.8
Bank	(-1.7)	(0.7)	(-5.4)	(1.5)	(5.3)	(--)	(8.2)
Other 3/	(-0.8)	(-2.6)	(4.3)	(-6.3)	(2.4)	(3.0)	(8.6)
	(Percentage change)						
Revenue	9.3	13.2	-1.5	23.1	11.6	28.6	24.5
Tax	14.1	15.2	2.5	19.3	10.0	27.7	23.7
Nontax 2/	-1.1	8.3	-12.1	35.0	16.3	31.2	26.9
Expenditure and net lending	26.4	1.8	6.2	15.9	26.5	17.1	26.9
Current expenditure	16.0	4.4	2.3	18.0	21.1	18.0	29.4
Development expenditure and net lending	41.1	-1.2	11.2	13.6	32.6	16.2	24.3
	(In percent of GDP)						
Revenue	22.3	22.5	19.4	23.5	21.3	25.1	24.3
Tax	16.0	16.4	14.6	17.2	15.9	18.6	18.0
Nontax 2/	6.4	6.1	4.7	6.3	5.4	6.5	6.3
Expenditure and net lending	41.7	37.8	35.1	40.1	43.8	46.9	50.9
Current expenditure	22.5	20.9	18.6	21.7	22.3	24.1	26.4
Development expenditure and net lending	19.2	16.9	16.4	18.4	21.5	22.8	24.4
Overall balance	-19.4	-15.3	-15.7	-16.6	-22.5	-21.8	-26.6
Financing							
External grants	16.1	15.4	14.2	18.0	17.1	18.6	16.2
Foreign loans (net)	5.3	1.1	2.1	1.4	0.9	1.6	1.5
Domestic	-1.9	-1.3	-0.6	-2.8	4.5	1.6	8.9
Memorandum items:							
Current balance (T\$ mn.)	-0.2	2.4	1.2	3.1	-1.7	-0.1	-4.0
In percent of GDP	-0.2	1.6	0.7	1.8	-1.0	-0.1	-2.1

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

^{1/} Components may not add to totals because of rounding.

^{2/} Excluding revenue earmarked for the Tonga Trust Fund.

^{3/} Includes changes in the balance of the Tonga Trust Fund.

Table 4. Tonga: Monetary Survey, 1986/87-1990/91 1/ 2/

	1986/87	1987/88	1988/89	1989/90 Est.	1990/91 Proj.
<u>(In millions of pa'anga; end of period)</u>					
Net foreign assets	37.8	34.8	33.3	33.1	33.7
Assets	38.7	35.4	33.8	33.7	34.3
Liabilities	0.9	0.6	0.5	0.6	0.6
Net domestic assets	-1.7	1.9	4.3	7.2	16.3
Domestic credit	11.7	18.9	22.5	30.7	42.0
Public sector	-5.3	-3.9	-10.0	-4.8	3.2
Net claims on Government 3/	-7.1	-6.4	-11.8	-6.5	1.7
Public enterprises	1.8	2.5	1.8	1.7	1.5
Private sector	17.0	22.8	32.5	35.5	38.8
Other items, net 4/	-13.4	-17.0	-18.2	-23.5	-25.7
Liquidity (M2)	36.1	36.7	37.6	40.3	50.0
Narrow money	14.3	17.0	14.8	16.5	20.5
Time and savings deposits	21.8	19.7	22.8	23.8	29.5
<u>(Annual percentage change)</u>					
Net foreign assets	43.2	-7.9	-4.3	-0.6	1.7
Domestic credit	1.7	61.5	19.0	36.4	36.7
Private sector	17.2	34.1	42.5	9.2	9.2
Liquidity (M2), end of period	33.7	1.7	2.5	7.2	24.0
Liquidity (M2), average stock	14.4	15.4	2.2	4.8	15.9
<u>(Percent contribution to change in liquidity)</u>					
Net foreign assets	42.2	-8.3	-4.1	-0.5	1.4
Domestic credit	0.7	19.9	9.8	21.8	28.0
Net claims on Government	-6.3	1.9	-14.7	14.1	20.3
Public enterprises	-2.2	1.9	-1.9	-0.3	-0.5
Private sector	9.3	16.1	26.4	8.0	8.1
Memorandum item:					
Velocity (GDP/average stock of M2)	3.7	4.1	4.6	4.4	4.2

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

1/ Incorporates the relevant accounts of the Treasury and the Boards of Currency and Coinage Commissioners.

2/ Components may not add to totals because of rounding.

3/ Includes aircraft loan to Government.

4/ Includes bills payable.

Table 5. Tonga: Balance of Payments Summary, 1986/87-1990/91 1/

(In millions of U.S. dollars)

	1986/87	1987/88	1988/89	1989/90 Est.	1990/91 Proj.
Exports (f.o.b.)	7.4	6.4	9.9	9.3	13.6
Imports (c.i.f.)	-49.7	-50.9	-62.9	-61.7	-70.6
Trade balance	-42.3	-44.5	-53.0	-52.4	-57.0
Services (net)	10.6	4.5	6.5	9.1	1.7
Receipts	25.3	24.7	25.7	33.9	29.1
Payments	-14.6	20.2	-19.2	-24.8	-27.4
Private transfers (net)	24.1	21.3	24.7	29.1	33.1
Remittances	23.7	20.8	21.0	28.3	32.1
Other	0.4	0.5	3.8	0.8	1.0
Current account deficit <u>2/</u> (In percent of GDP)	-7.5 -8.0	-18.7 -17.2	-21.7 -15.6	-14.2 -10.7	-22.2 -14.3
Grants and nonmonetary capital (net)	19.3	17.9	20.7	12.0	22.7
Grants	14.0	16.7	19.8	22.6	25.0
Official capital (net)	5.4	1.3	2.9	1.2	2.3
Disbursements	6.0	2.3	4.0	2.2	4.1
Amortization	-0.6	-1.0	-1.1	-0.9	-1.8
Direct investment <u>3/</u>	-0.1	-0.1	-2.0	-11.9	-4.6
Errors and omissions <u>4/</u>	-2.6	1.2	-1.5	3.0	--
Overall balance	9.3	0.4	-2.5	0.9	0.5
Memorandum items:					
Current account <u>5/</u> (In percent of GDP)	6.5 6.9	-2.0 -1.8	-2.0 -1.4	8.5 6.4	2.8 1.8

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

1/ Components may not add to totals because of rounding.

2/ Excluding foreign grants.

3/ Portfolio investment of proceeds from the sale of passports to nonnationals.

4/ Including private capital and valuation adjustment.

5/ Including foreign grants.

Table 6. Tonga: New Revenue Measures in 1990/91

(In millions of pa'anga)

Measures	Estimated Yield
Income tax exemptions (Tax threshold raised from T\$2,000 to T\$2,500; farmers and fishermen exempted from income tax for five years)	-0.6
Shifting the general sales tax from retail to wholesale level	0.8
Higher import duties on alcohol, tobacco, and fuel	3.3
Exemption from excise for Royal Beer Brewery	--
Increase in wharfage charges	0.2
Increase in tax rate for ports and services from 17.5 percent to 20.0 percent	0.6
Total	<u>4.3</u>
(Percent of GDP)	(2.3)

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

Table 7. Tonga: Summary of Medium-Term Scenarios, 1989/90-1995/96 ^{1/}

	1989/90 Est.	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
		Projections					
(Baseline Scenario) 2/							
Real GDP growth	2.5	2.8	2.5	2.0	2.0	2.0	2.0
Inflation (CPI) 3/	5.6	14.0	10.0	10.0	10.0	10.0	10.0
GDP deflator	-1.1	6.0	10.0	11.9	10.0	10.2	12.0
Investment/GDP	26.0	27.0	26.1	25.3	25.4	24.7	22.9
National savings/GDP	15.3	13.4	10.9	11.0	11.1	11.4	11.7
Overall budget deficit/GDP 4/, 5/	-22.5	-26.6	-26.6	-24.2	-22.2	-20.2	-18.2
External current account deficit 4/, 6/							
(In millions of US\$)	14.2	22.2	27.4	29.8	31.8	32.8	34.4
(In percent of GDP)	10.7	14.3	15.2	14.3	13.3	12.3	11.2
Gross foreign assistance							
(In millions of US\$)	24.8	29.1	30.9	33.5	35.2	37.0	38.9
(In percent of GDP)	18.7	18.8	17.2	16.1	15.0	13.9	12.6
Gross international reserves							
(In millions of US\$)	27.8	28.3	25.5	22.6	19.6	16.5	13.2
(In months of imports) 7/	4.7	4.4	3.6	2.9	2.4	1.9	1.5
Debt service ratio 8/	2.3	3.5	2.7	2.7	2.8	3.0	3.1
Debt/GDP	35.1	31.7	28.9	26.9	25.4	23.8	21.7
(Alternative Scenario) 2/							
Real GDP growth	2.5	2.8	3.0	3.0	3.2	3.4	3.5
Inflation (CPI)	5.6	13.0	8.5	6.5	5.0	4.0	3.0
GDP deflator	-1.1	5.6	8.5	8.5	5.2	4.4	5.3
Investment/GDP	26.0	27.0	26.6	27.2	27.5	27.5	27.5
National savings/GDP	15.3	13.4	13.3	14.8	15.8	16.5	17.3
Overall budget deficit/GDP 4/, 5/	-22.5	-24.5	-22.6	-19.8	-17.3	-14.9	-12.7
External current account deficit 4/, 6/							
(In millions of US\$)	14.2	21.1	23.7	25.0	25.9	26.5	27.1
(In percent of GDP)	10.7	13.6	13.3	12.4	11.7	11.0	10.2
Gross foreign assistance							
(In millions of US\$)	24.8	28.0	30.9	33.5	35.2	37.0	38.9
(In percent of GDP)	18.7	18.1	17.3	16.6	15.9	15.4	14.7
Gross international reserves							
(In millions of US\$)	27.8	28.5	29.2	31.0	33.4	36.5	40.6
(In months of imports) 7/	4.7	4.4	4.2	4.2	4.7	4.2	4.4
Debt service ratio 8/	2.3	3.5	2.6	2.7	2.8	2.9	3.1
Debt/GDP	35.1	31.7	29.2	27.7	27.1	26.4	25.2

Sources: Appendix Table 8; data provided by the Tongan authorities; and staff estimates and projections.

^{1/} The medium-term projections are based on WEO assumptions for the external environment. Data are expressed in percent, unless indicated otherwise.

^{2/} Based on current policies.

^{3/} Period average.

^{4/} Excluding foreign grants.

^{5/} Excluding proceeds from the sale of passports to nonnationals.

^{6/} Including proceeds from the sale of passports to nonnationals.

^{7/} In months of imports of goods (c.i.f.) in the succeeding year.

^{8/} Ratio of debt service to exports of goods and services and private transfers.

^{9/} Based on policy adjustments to achieve medium-term objectives in terms of growth, inflation, and international reserves.

Table 8. Tonga: Medium-Term Balance of Payments Projections, 1989/90-1995/96

(In millions of U.S. dollars)

	1989/90 Est.	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
		Projections					
<u>(Baseline Scenario) 1/</u>							
Exports, f.o.b.	9.3	13.6	17.1	22.0	26.3	31.0	36.2
Imports, c.i.f.	-61.7	-70.6	-80.0	-88.2	-96.5	-104.6	-113.5
Trade balance	-52.4	-57.0	-62.9	-66.3	-70.2	-73.6	-77.3
Services (net)	9.1	1.7	0.1	-1.1	-1.0	-1.0	-1.1
Private transfers (net)	29.1	33.1	35.4	37.7	40.0	41.9	44.0
Current account	-14.2	-22.2	-27.4	-29.8	-31.2	-32.8	-34.4
(In percent of GDP)	-10.7	-14.3	-15.2	-14.3	-13.3	-12.3	-11.2
Grants and nonmonetary capital (net) 2/	15.0	22.7	24.6	26.8	28.2	29.7	31.2
Overall balance	0.9	0.5	-2.8	-2.9	-3.0	-3.1	-3.2
Memorandum items:							
Gross reserves	27.8	28.3	25.5	22.6	19.6	16.5	13.2
(In months of imports) 3/	5.0	4.7	3.9	3.2	2.6	2.0	1.5
Export volume (percentage change)	10.4	65.2	12.5	10.0	8.0	6.0	4.0
Import volume (percentage change)	-5.7	7.3	8.0	6.0	5.0	4.5	4.5
Terms of trade (percentage change)	-17.9	-17.4	5.2	11.7	5.5	6.0	9.3
<u>(Alternative Scenario) 4/</u>							
Exports, f.o.b.	9.3	13.6	17.7	23.1	28.1	33.9	40.3
Imports, c.i.f.	-61.7	-69.5	-77.7	-85.1	-93.1	-100.7	-108.7
Trade balance	-52.4	-55.9	-59.9	-62.0	-65.0	-66.8	-68.5
Services (net)	9.1	1.7	0.8	-0.6	-0.5	-0.5	-0.5
Private transfers (net)	29.1	33.1	35.4	37.7	40.0	41.9	44.0
Current account	-14.2	-21.1	-23.7	-25.0	-25.9	-26.5	-27.1
(In percent of GDP)	-10.7	-13.6	-13.3	-12.4	-11.7	-11.0	-10.2
Grants and nonmonetary capital (net) 2/	15.0	21.8	24.6	26.8	28.2	29.7	31.2
Overall balance	0.9	0.7	0.9	1.8	2.3	3.1	4.1
Memorandum items:							
Gross reserves	27.8	28.5	29.2	31.0	33.4	36.5	40.6
(In months of imports) 3/	5.0	4.4	4.6	4.5	4.5	4.5	4.7
Export volume (Percentage change)	10.4	65.2	16.4	12.0	9.6	8.4	6.0
Import volume (Percentage change)	-5.7	7.0	6.0	5.4	5.0	4.3	4.1
Terms of trade (percentage change)	-17.9	-17.4	5.2	11.7	5.5	6.0	9.3

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

1/ Based on current policies.

2/ Including private capital, valuation adjustment, and errors and omissions.

3/ In months of imports (c.i.f.).

4/ Based on policy adjustments.

Tonga - Fund Relations
(As of February 28, 1991)

I. Membership Status

(a) Date of membership: September 13, 1985
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

Quota: SDR 3.25 million
Total Fund holdings of currency: SDR 2.51 million
(77.30 percent of quota)
Fund credit: None
Reserve tranche position: SDR 0.74 million
Lending to the Fund: None
Current operational budget: None

III. Stand-by or extended arrangement
and special facilities

Tonga has not used Fund resources since becoming a member.

IV. SDR Department

Tonga is a participant.
Net cumulative allocation: None
Holdings: SDR 0.19 million
Current designation plan: None

V. Administered accounts

Trust Fund loans: Not applicable
SFF Subsidy Account: Not applicable

VI. Overdue obligations to the Fund None

B. Nonfinancial Relations

VII. Exchange rate arrangement

Effective February 11, 1991, the pa'anga has been pegged to a weighted basket of currencies of Tonga's most important partners in trade and payments transactions, with the U.S. dollar as the intervention currency. Prior to this arrangement, the pa'anga was pegged at par to the Australian dollar during November 1976-February 1991. The central bank (National Reserve Bank of Tonga) quotes daily rates for the pa'anga against other currencies on the basis of their respective values vis-a-vis the U.S. dollar. There are no taxes or subsidies on purchases or sales of foreign exchange.

VIII. Last Article IV consultation

Staff discussions were held during December 1-15, 1989 and the Executive Board discussed the staff report (SM/90/22, 1/25/90) on February 28, 1990 (EBM/90/28).

IX. Consultation cycle

The bicyclic consultation procedure has been adopted.

X. Technical assistance

CBD: An expert was assigned for one year from May 1987 to assist in the establishment and initial operations of the central bank; his term was extended for another year and he has since been appointed Governor of the National Reserve Bank of Tonga. A second CBD expert, formerly a staff member of STA, took up a two-year assignment at end-July 1989 as Research Manager to assist with statistics and research in the central bank. The authorities have requested that both these positions continue to be filled by CBD experts for the period 1991-93.

FAD: An FAD consultant visited Tonga in early 1989 to review the budgetary and accounting systems. Another technical assistance mission visited Tonga in early 1990 to prepare a general survey of the tax system, paying special attention to the need to broaden the tax base and to mobilize revenue.

STA: Assistance was provided during 1986 in the areas of balance of payments and money and banking statistics.

XI. Resident Representative/Advisor

None.

Tonga--Relations with the World Bank Group 1/

Tonga joined the World Bank Group on October 23, 1985. An introductory country economic memorandum, entitled "The Kingdom of Tonga: An Introductory Economic Report" (Report No. 6379 - TON, November 25, 1986), provides the general background for the World Bank's operations in Tonga. An economic report for the South Pacific entitled "Toward Higher Growth in Pacific Island Economies: Lessons from the 1980s" (Report No. 9059-ASI) includes a development survey of Tonga; the report is expected to be issued shortly.

An IDA credit of US\$2 million, cofinanced by the Asian Development Bank (AsDB), was approved on June 2, 1987 for the Tonga Development Bank (TDB). The credit was designed to provide the TDB with long-term resources to meet investment demand--particularly in the agricultural, industry, and tourism--as well as to support institutional development. A second Tonga Development Bank credit of US\$3 million was approved on January 4, 1990 and is also being cofinanced by the AsDB. This credit is to support interest rate reform as well as to provide financing for projects in the agricultural, industrial, and services sectors. A third credit for the TDB is under consideration.

1/ Prepared by the World Bank staff.

Tonga: Social and Demographic Indicators

		Reference Group
		<u>Lower mid-income</u>
<u>Area</u>		
Total land area (sq. kilometers)	750	
Agricultural land (percent of total)	69.3	
<u>Population</u> (1989)		
Total population ('000)	100	
Urban population (percent of total)	20.3	59.2
Growth rate (percent)		
Total	1.0	2.1
Urban	1.8	3.0
Life expectancy at birth (years)	67	65
Density per sq. km. of agricultural land	185	82
Crude birth rate (per thousand)	31	30
Crude death rate (per thousand)	6.6	8.1
Total fertility rate	4.1	3.9
Infant mortality rate (per thousand)	23	53
Child death rate (per thousand)	24	82
<u>Income</u> (1989)		
GNP per capita (current US\$)	910	1,320
<u>Health</u>		
Population per physician ('000)	1.7	1.6
Population per nurse ('000)	0.5	...
Population per hospital bed ('000)	0.3	...
<u>Access to safe water</u> (percent of population)		
Total	99	64
Urban	100	77
Rural	99	47
<u>Labor Force</u>		
Total ('000)	40	...
Agriculture (percent of total)	51	...
Industry (percent of total)	9	...
<u>Education</u>		
Enrollment rates <u>1/</u>		
Primary	...	102
Secondary	...	52
Pupil-teacher ratio		
Primary	22	26
Secondary	18	17
<u>Consumption</u>		
Energy consumption per capita (kg of oil equivalent)	160	886

Sources: World Bank, Social Indicators of Development, 1990; and data provided by the Tongan authorities.

1/ Gross enrollment of all ages at primary and secondary levels (including vocational or teacher training secondary schools) as a percentage of school-age children.

Tonga--Statistical Issues

1. Outstanding statistical issues

a. Real sector

The official national accounts estimates for Tonga are not reliable. An Asian Development Bank technical assistance mission visited Tonga recently with a view to preparing recommendations for improvements in the quality of national accounts data. The mission also prepared revised estimates of GDP. The estimates are still unofficial, pending review by the authorities.

b. Government finance

The 1990 Government Finance Statistical Yearbook (GFSY) contains data for fiscal years 1983/84 through 1987/88. However, new data for 1979/80 through 1990/91 were recently received. The data are currently being processed for inclusion in EIS.

c. Balance of payments

The recommendations of a 1986 STA mission are gradually being implemented. The quality of the data suffers from classification and coverage problems. No data were reported for 1989.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Tonga in the March 1991 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the National Reserve Bank of Tonga, which, during the past year, have been provided on time.

Status of IFS Data

Sector	Series	Latest Data in March 1991 Issue
Real sector	- National Accounts	1985 (partial)
	- Prices: WPI	n.a.
	CPI	Q2 1990
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	Year ended June 30 1988
	- Financing	1988
	- Debt	1987
Monetary Accounts	- Monetary Authorities	October 1990
	- Deposit Money Banks	October 1990
	- Other Banking Institutions	September 1990
Interest Rates	- Discount Rate	n.a.
	- Bank Deposit/Lending Rates	September 1990
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values:	
	Exports	June 1990
	Imports	June 1990
	Volumes:	
	Coconut oil	June 1990
	Unit Value: Coconut oil	December 1989
	- Balance of Payments	December 1988
	- International Reserves	January 1991
	- Exchange Rates	January 1991