



Government of Tonga

**BUDGET STATEMENT
FOR THE YEAR 2002/2003**

HON. S.T.T 'UTOIKAMANU
MINISTER OF FINANCE

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



Budget Statement for Year Ending 30th June 2003

The Budget Statement

Figure 5. Annual air visitor arrivals

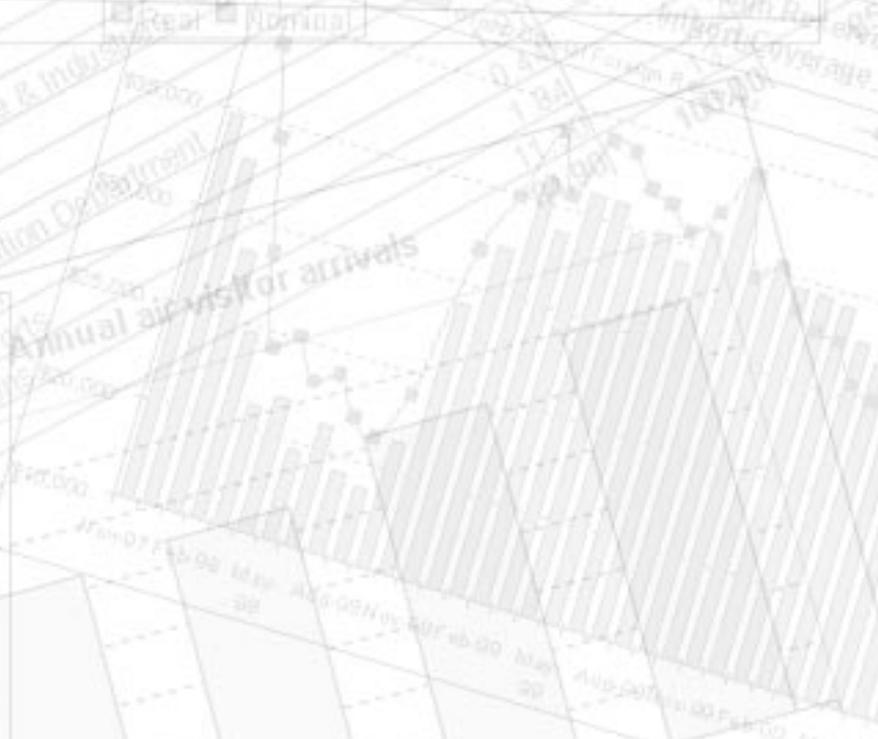


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1. Introduction

The Budget for 2002/03 shall build on the new direction of the Government's policies of preparing the foundation for building and maintaining a fair and sustainable social and economic order.

2. Economic Reform and Social Development

As I had outlined in the budget statement last year, social progress is being undermined by various developments in recent years. Foremost amongst these is the increasing pressure of youth unemployment. Each year about 2,000 young men and women leave school to look for work. Some are able to join their relations overseas but the window of opportunity offered through migration in previous years may be closing as some host countries review their policies on immigration. Others have to compete for a limited number of jobs available in the domestic economy. Unfortunately, only about 500 can find employment on the formal sector. This means that the level of unemployment amongst young school leavers is unacceptably high. This has certain implications. First, the high level of unemployment is associated with other adverse social developments such as the rise in the level of petty, and unfortunately increasingly, serious offences. Second, there are associated developments through the increase of alcohol and substance abuse as well as the incidence of teenage pregnancies. Thirdly the limited resources of the government mean that it is constrained in terms of responding effectively to the adverse social developments. This is exacerbated by the immense pressure on government services brought about by internal migration.

3. The Reform Agenda

The reform agenda is the Government's response to these adverse social development. The twin objectives of the Government's economic and public sector reform programme is (1) to improve the efficiency of the government and so improve service delivery to the public and (2) to create an environment more conducive to economic development which will create employment opportunities over the next 10 years so that school leavers have a reasonable chance of obtaining jobs.

The improved efficiency of Government is to be achieved by stricter fiscal discipline largely achieved through the budgetary resource allocation process and by Civil Service reform, which creates a performance oriented system for recruitment, deployment and remuneration for officials at all levels, as well as for the Government's decisions regarding the allocation of scarce resources to its competing priorities.

The creation of an environment more conducive to economic development is to be achieved by a variety of measures. These include regulatory reform, tax reform aimed at base broadening and rate lowering, and re-examination of the role of the State in activities better left to the private sector.

The Government shall undertake the role of facilitator for the private sector to grow and to serve as the engine of growth. This shall take the following approach:

- The Government shall re-assess its core functions and divest itself of its non-core functions;
- The Government shall review its internal cost structure with a view to putting in place a more cost effective civil service;
- The Government shall put into place new performance indicators and targets to measure success as a means to improve service delivery to the public.
- It follows from the above that the Government should be able to lower the current costs of service delivery and thus be in a position to lower the need to maintain taxes at their present levels.
- The Government shall undertake a major reform of the way that it collects taxes in order to improve compliance and, more importantly, to assist the private sector to enable it to grow.

The Government shall undertake a series of policy initiatives to lower the cost of doing business. This shall encourage businesses to expand and so create more employment opportunities in the process.

4. Fiscal Objectives

The Government's short term and long-term fiscal policy objectives remain broadly unchanged. However, recent performances have been below expectations. While the Government intends to maintain a balanced operating budget over the medium term, urgent action had to be undertaken in 2001/02 and 2002/03 to re-establish the infrastructure destroyed and damaged by Cyclone Waka. Accordingly the Government shall target a gradual return to a more sustainable fiscal position over the next two years.

5. Budget Strategy

The Budget strategy for 2002/03 is to start the process of reducing the wage and salaries share of government cash spending net of debt service from the 57%, which was the case in 2001/02. The government recognises that this is going to be a very difficult process since it involves rightsizing government in an economy where government employment plays a major social as well as an economic role. There is little evidence of over-staffed bureaucracies in the major areas of government employment such as education and health. However, the Government clearly recognises that employment of personnel without being able to provide the resources needed to make staff effective is not in the long run interests of the public.

At the same time the Government recognizes that the ability of the private sector to generate both jobs for the growing labor force and increased foreign exchange earnings to offset potential declines in aid and remittances is a key issue. Export growth in particular requires high priority, and calls for concerted efforts in agricultural diversification, fisheries, tourism development and encouragement of other manufactured exports.

These are areas where the private sector can play a major role, contributing to output, employment and exports. However, this requires a fundamental shift in the role of the public sector and a review of its expenditure priorities, with a major emphasis on creating a favorable environment for the private sector. To support this, the Government proposes to increase the allocation of resources to these sectors.

6. Public Sector Reform

The Government considers public sector reform as a pre-condition for sustainable economic development. The government has been working in this area for some time. In late 2000 and early 2001 the Cabinet committees met to receive reports and recommend to Government next steps for civil service reform.

The emphasis is on improved service delivery to both the public and the private sector. One element on which all are agreed is the need to establish the institutional framework for a performance oriented civil service. Having agreed to civil service reform and taken note of the findings of the Cabinet Committees on such reform, the government has approved the building of a performance oriented civil service by having the Prime Minister's Office establish a Secretariat to monitor, manage, and coordinate civil service reform.

The essence of the reform initiative which the government is considering involves devolution of selected fiscal and personnel management responsibilities to line agencies. As matters stand all significant functions relating to the management of the Civil Service are highly centralized. Development of a more decentralised approach is seen as involving a number of steps. These are being considered for implementation and include the creation of a Public Service Commission.

As I have stated earlier, the ultimate objective is to improve the quality of Government services and to create an enabling environment in which the private sector can expand and so create new employment opportunities.

In this regard two areas that warrant early attention are the right sizing of the public sector and the privatizing of public enterprises. For 2002/03, the Government has approved the abolition of 158 posts and has decided not to fill a further 425 vacant positions while the process of reform is implemented. These savings have been allocated to the other essential commitments identified for 2002/03.

The Government is continuing its plans to privatize public enterprises and/or commercialize the provision of public service in order to enable the Government to concentrate better on priority areas where it has comparative advantage. The Government has approved the sale of its majority shares in Sea Star Fishing Company Limited to a private sector company. The Government has also approved the corporatisation of the Post Office. Work is also proceeding on the corporatisation of other trading entities including the Talamahu Market and the Government Machinery Pool. The Government is also seeking interested investors in Royal Tongan Airlines. These represent the initial efforts of the Government at corporatisation and privatization.

The Government is also considering plans to encourage various groups in civil society who are engaged in the provision of services. In particular the Government shall be allocating additional resources to help these groups carry out and further develop their activities, since it would be more cost effective for the Government to provide additional support to these organizations rather than duplicate their efforts.

7. Sectoral Priorities

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

In line with the Government's plans to support the private sector, allocations to ministries that directly support private sector growth, i.e. agriculture and forestry, fisheries, labour, commerce and industry, are also increased. The increased allocations will provide essential support services.

8. Public Sector Financial Management

One fundamental reform initiative that the Government has endorsed is the drafting of a new Public Finance Management Act designed to strengthen the ability of the Minister of Finance to maintain the integrity of the fiscal framework. This is to be introduced into the Legislative Assembly during the 2002 session. The Government is committed to improving public sector financial management as part of its commitment to reform efforts.

9. The Budget System

As part of the reform process, the Government shall address some of the challenges in the budgeting process such as strategic prioritization and technical efficiency. The present budget format is being reviewed with a view to producing documents which are more reader-friendly. The Government is also considering introducing a medium term expenditure framework which should greatly assist readers in assessing the direction of the budget policy measures.

10. The Private Sector

The Government proposes to improve the environment for doing business. A Government committee is presently reviewing changes to administrative measures which will support and encourage private sector businesses to expand and so create new employment opportunities for school leavers.

11. Tax Reform

The Ministry of Finance is committed to introduce and progressively implement tax reform recognising that the present tax structure is overly dependent on import levies. The Government has been working on such proposals for some time with the help of consultants. These proposals for tax reform are due to be released for public discussion and it is expected that a full timetable for the implementation of tax reform will be worked out by the end of the second quarter of 2002.

The Ministry of Finance shall be proposing that the Government considers introducing two sets of legislation to the present session of the Legislative Assembly. One of the proposed legislation shall deal with a comprehensive reform of the present tax system.

A number of important characteristics of the proposals for the new tax system are envisaged: (i) a minimum number of broad based taxes; (ii) fairness and equity across all; (iii) sectors of the taxpayer base; (iv) transparency, clarity and simplicity of law; (v) simple and cost effective administration (both taxpayer and revenue administration); and (vii) a system suitable to the development of Tonga.

One of the proposed new legislation shall focus on improving revenue administration. The current revenue administration is operating below desirable standards. With limited computerization, an inadequate level of staff experience and training and a lack of a comprehensive and appropriate set of legislative provisions to enforce compliance, the administration is not in a position to effectively administer either the current legislation or the proposed system of taxes. Currently there is about \$10 million in outstanding taxes and it is suggested that there is a great deal more to be found through an effective audit program. This system should be put in place well in advance of the proposed new tax system to allow for the development of the administration prior to the major challenges created by a new tax system.

12. Improving the Investment Climate

The Government will continue to monitor with the view to improving the quality of services, in particular the costs and reliability of utility services of electricity and telecommunications. The Government will also continue to review the procedures for obtaining investment approvals. Improving the investment climate will send a clear message to both local and foreign investors of the Government's commitment to harness the energies of the private sector in achieving sustainable growth.

13. Economic Growth

The year 2001/02 will always be remembered for the September 11 Terrorist attacks on the US. This tragedy came at a time where economic activity in the global economy was rather sluggish and fears arose that any economic recovery would be stalled. However, the International Monetary Fund has reported that the impact was only short term and that global economic recovery is underway. Economic growth in the US and Australia have

picked up in 2002 recording 2.3 percent and 3.9 percent respectively. This has positive implications for Tonga in terms of the annual remittances of \$80 - 90 million that Tonga receive and the impact on the current account balance.

Official statistics of gross domestic product have revised growth rate for 2000/01 down to 0.5 percent. Then Ministry of Finance staff predicted a modest improvement in 2001/02 by 1.6 percent. Our balance of payments continues to be under pressure, with the gross official foreign reserves being currently at just above 2 months of import cover. This is below the Reserve Bank's reserves target of at least 3 months of import cover. The rate of inflation stood at 10.6 percent per annum, higher than the Ministry of Finance had initially projected. This means that the consequential purchasing power of our incomes is being gradually depleted.

14. Economic Outlook

The economic outlook for Tonga in 2002/03 is mixed and to a large extent depends heavily on stability in and impacts from the external market. The global economy is predicted to stabilize in 2002/03 as major advanced economies recover from the economic downturn in 2001/02. This will play a significant role in Tonga's performance in medium term.

GDP growth is expected to record a modest growth in the order of 2.5 percent in 2002/03. The government stricter fiscal discipline proposed for 2002/03 should improve its financial position and moreover, ameliorate some of the pressures on inflation. The current high rate of inflation is expected to stabilize around the 10 percent mark, though it is too early in the economic cycle to forecast any significant reduction in the current high rate. The external position is expected to be stronger than previous years reflecting the disbursement of concessional external loans and the anticipated growth in remittances as global economy strengthens following the recent downturn. Gross official foreign reserves are also projected to improve modestly. Monetary policy will be maintained at tight levels to assist conserving the level of foreign reserve at more acceptable levels.

15. Exchange Rate and Monetary Policies

The recent decline in the value of the pa'anga against the value of the US dollar has affected our economic performance. The cost of paying for imports has increased and has contributed to the higher rate of inflation. It has also increased the cost of doing business. On the other hand, the lower exchange rate favours those sectors that rely on the exports of goods and services, which receive higher income. The Government and the Reserve Bank will continue to monitor the impact of the exchange rate on the economy with a view to ensure that a competitive exchange rate is maintained to support our export sectors, while at the same time minimising the impact of imported inflation.

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

16. Budget Estimates

In economic terms, revenues and grants in 2002/03 will amount to \$103.8 million, with expenditure and net lending totalling some \$112.5 million. This will result in a headline deficit of about \$8.7 million compared with the 2001/02 budget time estimate of a headline deficit of \$7.5 million. Reflecting the Government's commitment to facilitate the growth of the private sector and to avoid crowding out the domestic financial market, this shortfall in revenues will be financed solely by concessional external borrowings and the use of cash balances – the only domestic borrowings planned by the Government for 2002/03 will be to finance the rollover of its maturing bonds.

However, the headline deficit tells only part of the story about the sustainability of fiscal policy. Within the 2002/03 budget estimates is the provision for the expenditure of the proceeds of a \$10.8 million loan from the World Bank to finance the reestablishment of infrastructure in Vava'u and the Niuaus. Deducting this abnormal expenditure from the headline balance results in an underlying surplus for 2002/03 of \$2.1 million. This underlying surplus is the first one for many years and reflects the Government's commitment to the maintenance of a sound fiscal policy.

17. Conclusion

The budget continues to build on the directions for economic reform taken by the Government this year. The Government recognises that economic change is necessary and beneficial to the people of Tonga. This change is needed not because of the failure of the past but precisely in order to preserve what we value the most in Tongan society. We value economic opportunity for our people. We value relatively equitable distribution of benefits within society. We value these things most of all because they underpin what we see as the essential fairness of Tongan society. We recognise that stagnation of our economy and our institutions are beginning to undermine these benefits and it is time to change while we still control the process rather than waiting for change to be forced upon us by circumstances beyond our control.

We must not lose sight of these objectives of reform. These common goals can only be achieved through our patience and collective hard work. The Government is grateful to the people of Tonga for their trust and continued patience and to its overseas development partners for their continued assistance.

S.T.T 'Utoikamanu
Minister of Finance.
30th May 2002

Budget Statement for Year Ending 30th June 2003

Supplement 1: *Review of the Tongan*

Economy & Outlook 2002/03

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1.0 Introduction

This Supplement is set out to address two main issues. Firstly, it provides an overview of the country's economic performance for the 2001/02 financial year. Secondly, it contains a discussion of the macroeconomic framework within which the government approved fiscal policies for 2002/03 as a basis for sustainable economic growth and improve the well being of Tongans as outlined in the Strategic Development Plan Seven.

The first half of 2001/02 the world economy experienced a weaker economic position than the previous period. The setback in the world economy performances has trickled through to the regional and domestic economies. The major factors that weakened the global economy were the slow down of the US economy, the foot and mouth disease outbreak that started in the UK and the September 11th terrorist attack.

The 2002/03 Budget will continue to re-enforce the underpinning principles of program budgeting. That is, encouraging program manager to manage efficiently and operate a programme that is more transparent and affordable by the government. Furthermore the budget also highlights the commencement of the Economic and Public sector Reform Program (EPSRP) which is expected to provide a more efficient government performances and improve macroeconomic environment suitable for development of private sector activities.

The layout consists of Section 2 that presents the performance of the global economy. Section 3 brings to light the latest developments in the domestic economy. Section 4 presents factors behind the increasing inflation rate. Section 5 reviews developments in the monetary policy, and the outlook for interest rates is in Section 6. External sector performances are outlined in section 7. Section 8 discusses the trends in Exchange Rate and finally the economic outlook for 2002/03 and in the medium term is addressed section 9.

2.0 Global Economy

The IMF World Economic Outlook for April 2002 reported that the global economic slowdown is now turning around faster than most analysts expected. The September 11th terrorist attack has had only a short run impact on activities in contrast with the fears that there would be no economic recovery in the first half of 2002. However, major economic indicators now show that economic recovery is underway. The primary levels of consumer and business confidence have been restored, and the industrial production and information technology sector is balancing out. This positive sign can be seen in the United States economy and to a certain extent European economies and some Asians countries. With confidence stabilizing, uncertainties easing and emerging market financing conditions improving more quickly than was previously anticipated, the major potential risk is that any increase in conflict in the Middle East may impose high oil prices that will put pressure on the global recovery.

The projected growth in global output to the end of 2002 is now expected to reach an estimated 2.8 percent compared with 2.5 percent recorded in 2001. The growth in the US and its economic allies has been revised significantly upward as the pace of recovery has exceeded expectations. Economists have asserted that the improvement in the global output, was substantially accredited to the openness of the economies and the policy stimulus that each of the country's adopted to address the downturn.

World inflationary pressures have continued to ease, reflecting weaker global activity. In some advanced countries, inflation is projected to fall to 1.3 percent in 2002.

The major advanced economies economic growth is projected to reach 2.5 percent at the end of 2002. This is an increase of 0.5 percent from the level recorded a year ago. Among the advanced countries, the improvement is expected to be strongest in the United States. Such a powerful surge by the US domestic economy was driven by the completion of the investment cycle, which was fueled by a pickup in final domestic demand and was accentuated by the fall in oil prices. However, fears have provoked such a positive sign for global growth, as there might be a downward adjustment in assets prices.

Japan on the other hand, is currently undergoing its worst ever recession. This became a concern for the world economy because the weak economic activities makes it difficult to neutralize the adverse effects by any policy actions. The financial position of the banking system is increasingly tense as loan-loss announcements have increased undermining consumer and businesses confidence. Moreover, concerns over debt sustainability make the Government of Japan bond market vulnerable to sharp swing in investor sentiment and a peak in yields. As Japan is a significant trading partner, particularly for Tonga's agriculture sector, the current weakness in the Japan economy is of concern.

Table 1.: Advanced Economies: Real GDP, Consumer Prices and Unemployment

	Real GDP				Consumer Prices				Unemployment			
	2000	2001	2002	2003	2000	2001	2002	2003	2000	2001	2002	2003
USA	4.1	1.2	2.3	3.4	3.4	2.8	1.4	2.4	4.0	4.8	5.5	5.3
Japan	2.2	-0.4	-1	0.8	-0.8	-0.7	-1.1	-0.5	4.7	5.0	5.8	5.7
Australia	3.2	2.4	3.9	4.0	4.5	4.4	2.3	2.3	6.3	6.7	6.7	6.5
New Zealand	3.9	2.4	2.6	3.0	2.7	2.7	1.8	1.5	6	5.3	5.5	5.6
European Union	3.4	1.7	1.5	2.9	2.3	2.6	2.0	1.8	8.8	8.3	8.5	8.2

2.1 Regional Economy

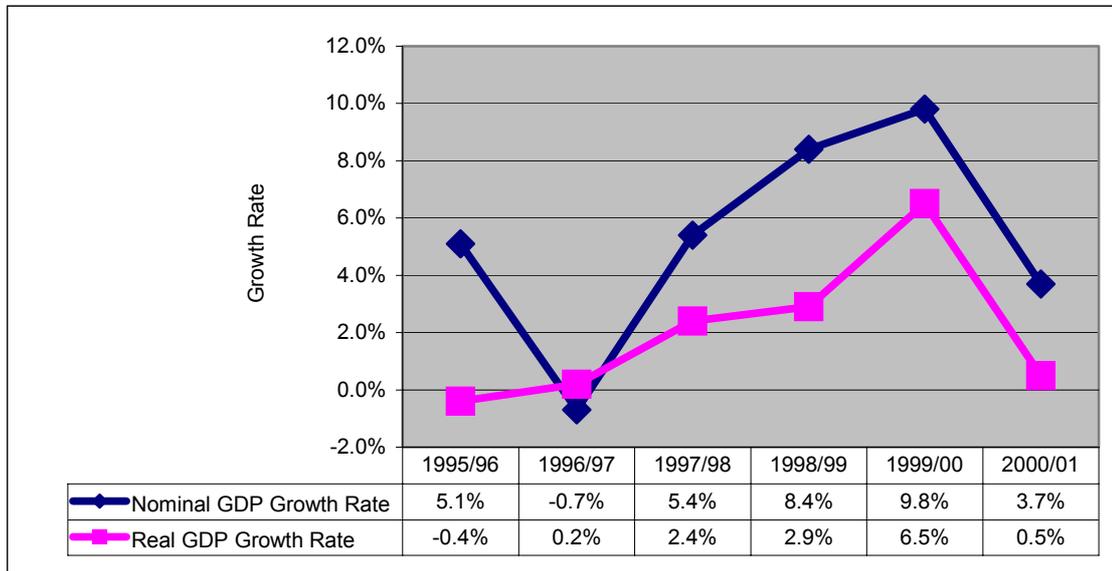
Most economies in the region have experienced a sharp reduction in growth since 2000. However most are now showing signs of a turnaround. The way forward is largely driven by the external environment including the global electronics cycle, a sector that contributed significantly to rapid recoveries following the financial crises of 1997/98. The IMF project the economic growth for Australia and New Zealand to reach 3.9 and 2.6 percents, showing an increase of 1.5 and 0.2 percent respectively from what was recorded in the preceding year. Our neighboring economies, Fiji and Samoa has shown growth rates of 5.0 and 4.8 percent respectively for 2001/02, while inflation for the same period stabilized at less than 3.0 percent.

3.0 Domestic Economy

Official estimates of the performance of the Tongan economy indicated that real gross domestic product slowed down to 0.5 percent in 2000/01. This was a large contraction from the 3.0 percent originally estimated and the high growth rate of 6.5 percent in 1999/00. This has resulted in average growth rates for the period 1997/98 to 2000/01 of 3.1 percent down from 4.4 percent estimated in the last Budget Statement. The contraction of the economy was due to a real decline in the level of activity in the agriculture sector, mostly in

exporting of squash. Other sectors of the economy recorded modest growth with government administration contributing the most, resulting from the 20 percent pay rise for civil servants. The GDP growth pattern for the last six years is depicted in Figure 1.

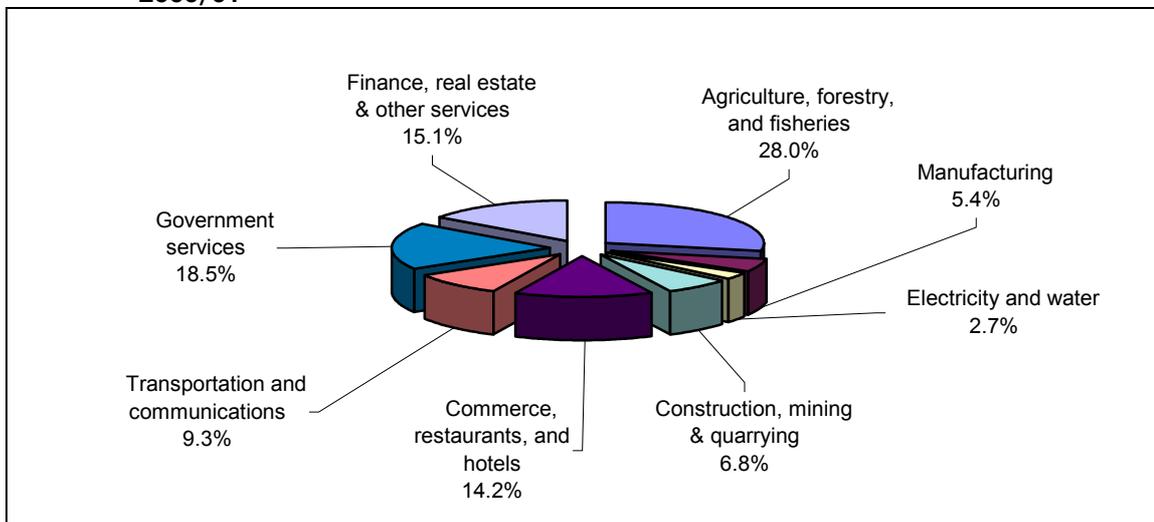
Figure 1 Nominal and Real GDP Growth Rate at Market Prices for the year 1995/96 to 2000/01



Coming off this low, economic growth as projected by Ministry of Finance staff is expected to strengthen to about 1.6 percent for 2001/02. A significant share of this growth is expected to come from the secondary sector construction in particular, related to the rehabilitation and reconstruction in Vava'u and the Niuaus. The tertiary sectors were hampered in 2001/02 by the slow down of the US economy, the tragic September 11 Terrorist Attack, followed by the Afghanistan War. The primary sector is expected to recover based on a more favourable weather conditions contributing to an improved squash season though TC Waka will be a partially offsetting factor in 2001/02.

3.1 Real Sector Developments

Figure 2 Sectoral Contribution to Real Gross Domestic Product at factor cost for the year 2000/01

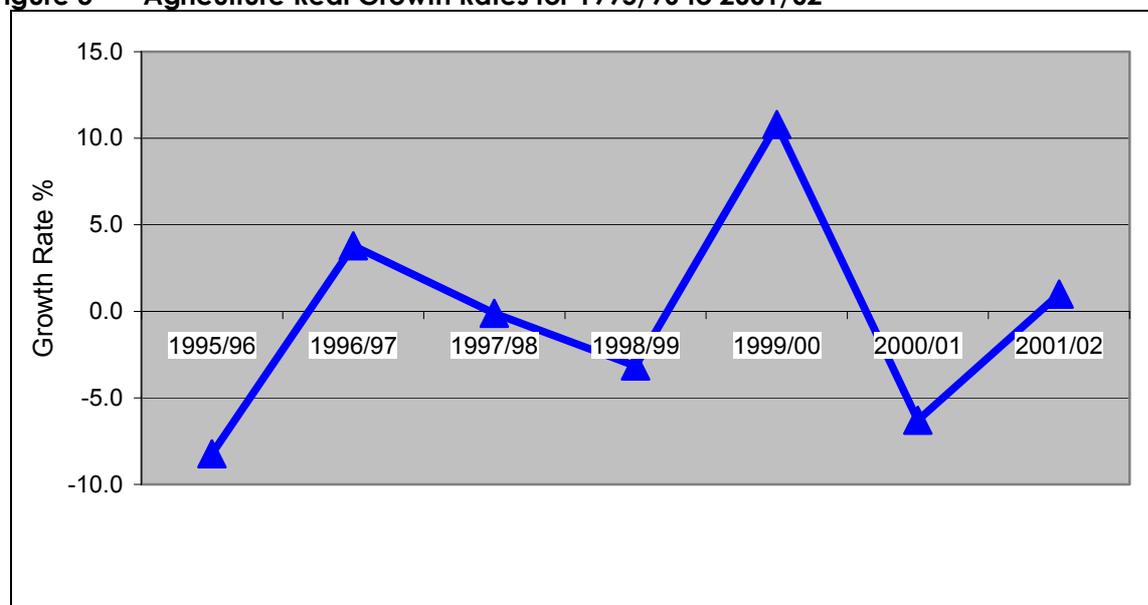


The Tongan economy has gone through some structural changes starting in the late eighties through the nineties and continuing into the new millennium. This is demonstrated by the changes in sectoral contribution to GDP. For 2000/01, about 57 percent of total output is contributed by the services sector whereas the primary sector, which dominated during the eighties and early nineties, now contributes less than 30 percent of the total GDP. The sectoral contribution to GDP for fiscal year 2000/01 is depicted in the preceding pie chart, Figure 2.

3.2 Agriculture

The level of production in the agriculture sector is estimated to register negative growth of 6.3 percent in 2000/01, in contrast to the high growth rate recorded in 1999/00. The basis for the downward revision was attributed to a much lower squash production than originally projected. In addition, the locally marketed agricultural products declined compared to its level in 1999/00. The performance of agriculture sector over the last seven years is illustrated in Figure 3.

Figure 3 Agriculture Real Growth Rates for 1995/96 to 2001/02



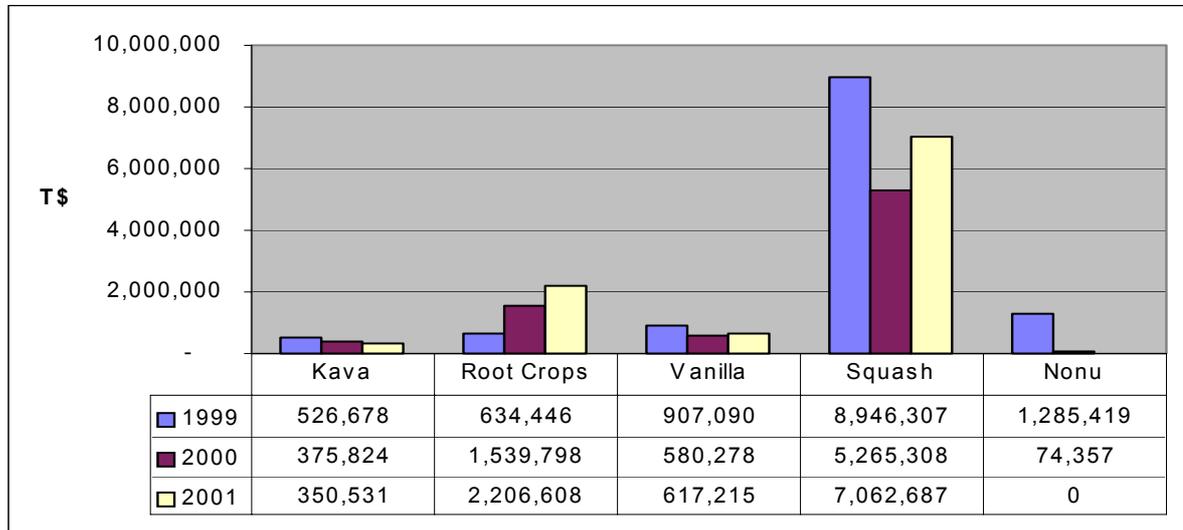
Notwithstanding the impact of TC Waka, agriculture production in 2001/02 has become more stable. Indicators show an improvement both in the agriculture exporting sector and domestic marketed products. Following TC Waka, the government has redirected some of its resources to the rehabilitation process fast tracking the recovery process of the sector to restore food security in the Vava'u group.

The locally marketed agricultural products are predominated by root crops (notably yam, taro, cassava and kumala), a variety of vegetables and fruits, and marine resources (string fish, tuna, octopus, cockles and lobsters). Despite mixed weather conditions, locally production has been favourable as evidenced by abundant products sold in the Talamahu Market and the establishment of mini-market outlet in rural village. The price levels of most root crops also show minor fluctuations over the last three years.

On the export front, the 2001 squash season has shown an improvement from the volume recorded in the previous year. Actual data on squash export revealed 13,390.5mt of squash was exported in 2001, a vast improvement from the 12,535mt exported in 2000. In

addition, the price per kg was around \$1.07 on average, the best price the squash industry has ever experienced. Figure 4 shows graphical representation of major agricultural export commodities.

Figure 4 Principal Exports of Agricultural Products



Vanilla exports showed continued downward trend in the second half of the 1990s, as international prices constantly declined from more than \$80 per kg in 1992 to just above \$25 per kg in 2000. Last financial year signified the commencement of the rehabilitation of the vanilla industry, triggered by a strong rebound in international prices. The current price now stands at around \$150 per kg (ADB, August 2001). At the same time, the industry diversified its production to Tahitian vanilla, which is used in the production of fragrances. The effect of TC Waka has severely repressed the vanilla industry in Vava'u. However, the Ministry of Agriculture is actively seeking ways to rehabilitate the industry.

Root crops have continued to make a good contribution to total exports. The government continues to explore opportunities to export root crops, fruits and vegetables to our neighboring countries such as Samoa and Fiji in addition to New Zealand, including assessing the role it might play in addressing quarantine issues, and clearing barriers to market access.

Kava production is forecast to decline due to the damages done by the cyclone in Vava'u, where most commercial kava plantation is concentrated. MAF's research division is currently breeding kava seedlings in an attempt to rehabilitate the industry. There is still substantial demand for Nonu though the local supply has declined rapidly resulting in the closedown of two manufacturing businesses which process the raw products before being exported. In addition, Ministry of Agriculture continues with existing projects, such as papaya¹, and rehabilitation of green coconut. Coffee² has been taken over by private sector.

¹ The establishment of the HFTA Treatment plant at the Fua'amotu airport was developed to enable the exporting of papaya, eggplant, breadfruit, local mango and tomatoes.

² The coffee project was initially nurtured by MAF before being taken up by a private sector company. Currently this business is doing very well however the scale of production is still comparatively small and expected to diversify in 1-2 years time.

3.3 Fisheries

The fishing industry has continued to expand, as indicated by investment activities in the industry and increased in fish exports. Official data on fisheries exports are based on information supplied by Customs, using a local price of \$3.50 per kg. It is considered that this approach results in an understatement of the real value of fisheries exports. In order to qualify for the concession, licensed tuna and snapper fishers are required to submit copies of their sales dockets to the Ministry, consequently net export quantities and values of these data have become available (Table 2 below). The discrepancy has been reconciled with data from NRBT, fishing representatives and fuel concession scheme.

Tuna exports account for more than half of total fish exported, with other main exports comprising snapper, grouper and seaweed (limu). Table 2 depicted exports statistics on Tuna and Snapper from Fuel Concession Committee. The data shows that the value of fish exports increased dramatically in 2000/2001, mainly due to exports of tuna. By the end of the year, the value of tuna exports had exceeded \$13.3 million, with a mean value of \$10.70 per kg. The total value of tuna, including both domestic and export sales, was \$14.3 million from a catch of 1,610 tonnes. The lower catch in the third quarter of the year reflects the seasonality of the tuna fishery.

Table 2.: Fisheries Statistics Based on the Fuel Concession Scheme, 2000/2001

	Qtr Sep 00	Qtr Dec 00	Qtr Mar 01	Qtr Jun 01	Qtr Sep 01	Qtr Dec 01
Tuna						
Local fish (kg)	156,861	210,679	113,046	34,711	101,395	156,089
Local fish (\$)	405,474	547,512	317,676	100,649	245,625	421,625
Export fish (kg)	197,455	412,318	260,527	224,627	420,246	335,931
Export fish (\$)	1,699,037	3,355,077	1,712,140	4,950,939	3,016,314	3,583,213
Snapper						
Local fish (kg)	42,753	23,137	21,337	19,412	30,341	44,364
Local fish (\$)	155,614	70,980	76,553	69,066	106,355	133,014
Export fish (kg)	26,951	35,934	30,390	30,593	44,717	31,441
Export fish (\$)	331,793	362,234	322,737	410,325	629,400	451,917
Total Tuna + Snapper						
Local fish (kg)	199,613	233,816	134,383	54,123	131,736	200,453
Local fish (\$)	561,088	618,493	394,230	169,715	352,190	554,639
Export fish (kg)	224,406	448,252	290,917	255,220	464,963	367,372
Export fish (\$)	2,030,830	3,717,311	2,034,876	5,352,263	3,645,714	4,035,130
Total catch (kg)	424,019	682,068	425,299	309,343	596,699	567,825
Total value (\$)	2,591,918	4,335,803	2,429,106	5,521,978	3,997,904	4,589,769
Number of vessels	20	18	12	23	26	29

Source: Ministry of Fisheries.

Fishing industry is marked vulnerable to the weather conditions, and its performance has been constrained by the availability of domestic capital for investment and the high transportation cost, especially airfreight for fresh fish exports. These issues have been factored into the fisheries project, which is assisted by the AusAID. The emphasis of the

project will be on institutional strengthening linked to stakeholder input, assistance to small-scale fishers, development of the commercial tuna longline fishery and community inshore resource management.

3.4 Manufacturing

The manufacturing industry is relatively small in Tonga, contributing less than 5 percent to GDP and was estimated to record a modest growth rate of 2 percent for 2000/01. Most of the growth has been driven from manufacturing of food and construction materials for domestic consumption.

For 2001/02, the performance of the industry has been rather slow hence 4.0 percent growth originally projected by the IMF for 2001/02 is further revised down. However it is expected that the harvesting of kava (matured and immature) due to the damage by TC Waka as well as the increased in construction activities at Vava'u will prop up manufacturing sector in the short-term.

The main obstacles perceived to the manufacturing industry growth include high costs for input goods and services such as electricity, water costs, telecommunications, labour, and transportation. These constraints have further exacerbated by the depreciation of pa'anga. Moreover, the small size of the domestic market makes it difficult for import substitution enterprises to realize economies of scale needed to compete against foreign producers, while consumer preferences in most times tend to favor imported commodities over the locally produced ones.

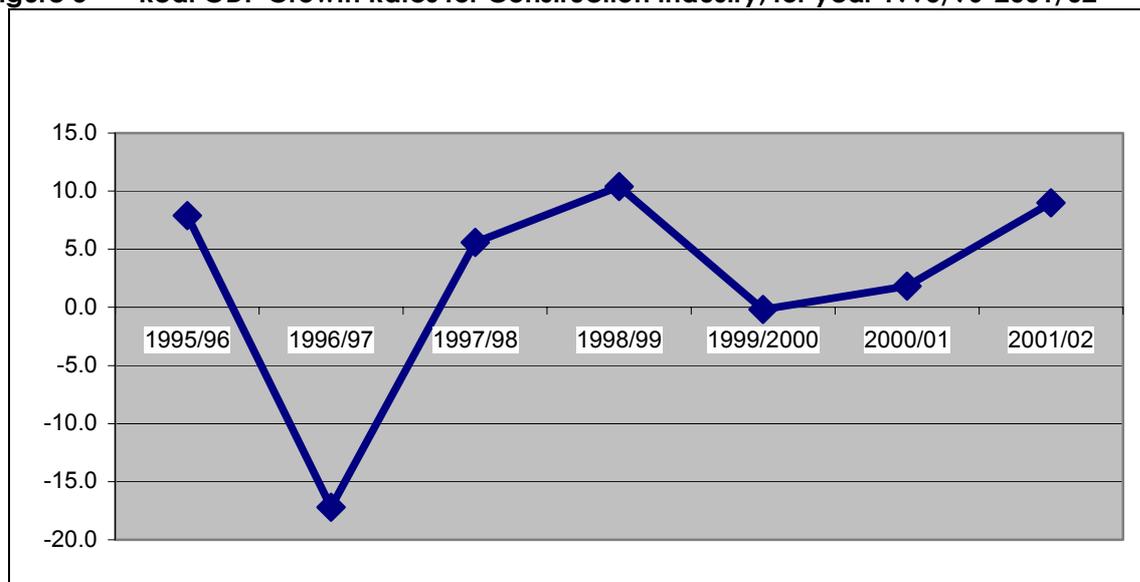
In recognition of the difficulties faced by the manufacturing sector, the government has implemented a range of tax exemptions and subsidy schemes to boost this sector and help the generation of sustainable employment for Tongans. Government will also promote private sector development through EPSRP. The program will assist through the provision of efficient government services, minimal administrative barriers, increased specific technical training and availability of funds for private sector investment.

3.5 Construction and Mining & Quarrying

The construction sector is expected to recover in 2000/01 posting a 1.8 percent growth, a significant turnaround from the negative 0.2 percent growth recorded in 1999/00. The performance of the industry has been influenced heavily by some large external financed projects. The slow growth in the industry over the last two years is largely attributed to the completion of some major projects in 2000/01 such as the Tonga Water Project, Outer Island Agricultural Development Project, major new shopping complex, as well as slowdown of the global economy that affected remittance flows. This contraction has also resulted in a slowing of sales and the laying off of workers by some wholesaler and construction companies.

The current slow recovery in the sector is expected to strengthen in 2001/02 due to the commencement of reconstruction work in Vava'u and the Niuas following TC Waka. In response to the estimated damage to infrastructure, amounting to more than \$70 million (Office of the Chief of Staff, Waka Recovery Programme, January 2002), the government had approved a Cyclone Emergency Recovery and Management Project (CERMP) with the World Bank to build housing in the Vava'u and Niua group. In addition, assistance is also being provided by our other development partners.

Figure 5 Real GDP Growth Rates for Construction Industry, for year 1995/96-2001/02



Funds from the Japanese Grassroots projects have been approved for \$0.9 million and they are to be utilized to upgrade water supply for rural area, classrooms and toilets for some of the primary schools. Other approved projects include the Ha'ano jetty and electrification project for the Ha'apai group, Ha'apai High School (which was completed in the first half of 2001/02), renovation of the International Dateline hotel and proposal for construction of new Tonga High School (most likely to start in 2002/03). In addition, as evidenced by growth in bank lending for residential housing, the small scale construction of residential and business purposes were reported to be stronger compared to the level last year. Hence, the sector is projected to register strong growth in 2001/02.

Mining & Quarrying sector is expected to record a 9.0 percent growth after taking into account its close tie to the performance of the construction sector.

3.6 Electricity and Water

The projected growth for the utilities industry for 2000/01 declined to negative 1.8 percent following the high growth of 22.7 percent posted in 1999/00 due to a large one-off increase in capacity for the millennium celebration. The decline in the production of electricity to more normal levels does not warrant major concern.

There has been a gradual increase in the number of active power consumers as a consequence of the number of new buildings under construction. This growth has been supplemented by the completion of the water project for the Nuku'alofa area. Stronger nominal growth is expected in 2001/02 reflecting higher prices and higher consumption of both power and water. Higher fuel costs have pushed the price of electricity to 0.375 cents per kilowatt and the price of water has risen from 1.12 cents to 1.51 cents per thousand liters.

3.7 Tertiary Sectors

The tertiary sector expanded by 3.9 percent in 2000/01, but the performance of the sub-sectors displayed considerable volatility. The commerce, hotels, & restaurants sub-sector contracted to 0.5 percent growth in 2000/01 after significant abnormal expansion in 1999/00 due to millennium celebrations and a higher than normal number of conferences. The

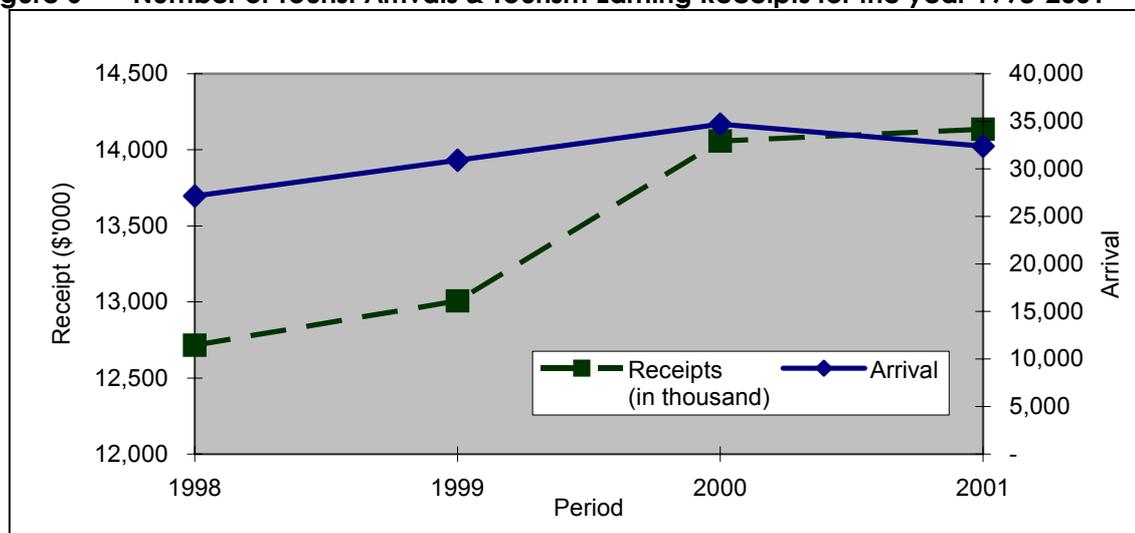
government administration and community services sub-sector increased by 10 percent as a result of the 20 percent pay rise for civil servants. Most other services sub-sectors recorded modest growth.

3.8 Tourism

Tourism is still considered by the government as one of the three most promising industries in terms of the potential for sustainable growth in employment opportunities. Although the performance of tourism is not separated from Commerce in the GDP compilation, its performance is reviewed based on partial indicators such as tourist arrival, tourist receipts as recorded by the banking system as well as development in the industry. Indicators show that growth was rather moderate in 2000/01 after the strong surge in previous year (refer to Figure 5). Air visitor arrivals for the last six months of 2000 exceeded the corresponding period of 1999, despite the absence of millenium events, and reports on accommodation occupancy rates have been positive.

For 2001/02, the performance of the sector is estimated to be somewhat more subdued reflecting the massive setback experienced by global tourism industry following the September 11 Terrorist attacks. The traditional market for tourist is the United States and the reduction by 40 percent in air access to and from the US has adversely impacted the industry significantly. In addition, the havoc caused by TC Waka has posted major setback to the Vava'u tourism industry. The Tonga Visitor Bureau estimates air visitors to decline by 4 percent.

Figure 6 Number of Tourist Arrivals & Tourism Earning Receipts for the year 1998-2001



In recognition of the positive impact a strong tourism industry can have on the sustainable growth in employment opportunities for all Tongans, the government together with its donor partners continues its effort to develop this industry to realize its full potential. AusAID has agreed to extend its tourism development project to include a second phase. This project will focus more on developing tourism business such as Tonga National Centre, handicrafts and cultural development in the Ha'apai groups. The government is also developing 'nature tourism' in 'Eua and Vava'u with assistance from NZODA. This project looks into enhancing natural environment particularly scenic attractions in 'Eua. Furthermore, the government has tightened the law on minimum standard to raise the quality of hotel and tourist facilities in Tongatapu. This initiative is expected to extend to

the outer islands. The Beautification committee continues its awareness campaign to reduce littering in Nuku'alofa region. The upgrading of the Janful International Dateline Hotel to a three star level hotel provides a promising prospect for attracting up market visitors who demand high class facilities and tend to spend more on each visit to Tonga as well as the industry as a whole.

3.9 Wholesale, Retail and Distribution

Activity in the retail and wholesale sector contracted to 0.5 percent growth in 2000/01 compared to an increase of 17.9 percent in the previous year. A survey conducted by Ministry of Finance suggest that performance of this sector has deteriorated further into 2001/02 despite establishment of the new supermarket and increase in the value of imports. This softness is attributed to the increasing price level of imported goods stemming from the impact of weaker pa'anga. For the month of April 2002 inflation stood at 10.6 percent.

The common indicator used to determine performance level of this sector is international trade, particularly growth of imports. Over the years, despite escalating price levels, imports have continued to increase especially food commodities, tobacco and motor vehicles. The strength and behaviour of consumer expenditure in Tonga seems to be linked closely to the continued growth of private household remittances. The government is currently seeking ways to encourage the transfer of remittance inflows into productive investment rather than merely consumption.

After the high growth registered in 1999/00, the commerce, restaurants and hotels industry is expected to deteriorate in 2001/02 reflecting the slowdown in both tourism and retail industries.

3.10 Transportation & Communication

The entrance of Shoreline into telecommunication as a second operator and the introduction of mobile phones continues the expansion of this sub-sector. However, the smallness in size of domestic market limits any significant growth to the sector as a whole. The financial difficulty faced by the national airline is expected to undermine the potential for growth in this sector, as will the decline of air passenger volumes following the terrorist attacks on the US.

On the other hand, shipping on the other hand improves rapidly. The purchasing of Fuakavenga II and new barge for the outer islands has made a positive contribution to growth in this sector. Overall growth in the sector for 2001/02 is expected to improve from 1.1 percent recorded in 2000/01.

3.11 Finance and Business Services

With the banking sector recording strong profits, insurance and business services benefiting from general economic growth, this sector contributed high GDP growth during 1999/2000. In 2000/2001 and 2001/02, some growth is expected but as with other services at a much more subdued rate than previously.

3.12 Government Services

By convention, the value added to the economy by this industry is equal to the compensation of its employees. In 2000/01, the 20 percent COLA led to a 10 percent growth rate for this sector. The increase also resulted in some fiscal difficulties for the

government. The situation forced the government to apply expenditure constraints in an attempt to contain the size of the fiscal deficit. The size of the deficit has contributed to an expansion in the balance of payment current account deficit, which in turn put pressures on level of foreign reserves and were a primary factor in inflation increasing to an unsustainable level. The strategy and policy implemented by the government in 2002/03 will be discussed in detail in the next supplement.

4.0 Domestic Price Developments

Annual inflation rate has grown steadily over recent years recording 1.9 percent in 1997/98, 3.9 percent in 1998/99 and 4.9 percent in 1999/00. The latest statistics available (April 2002) show inflation has reached 10.6 percent, which is 0.1 percent below the highest annual rate over the past 10 years. Other contributors to the increase in inflation are as follows:

- The recent increase in shipping freight costs by 10%.
- The significant weakening in pa'anga against US dollar magnifying the freight margins and import prices.
- The common practice of overseas product suppliers imposing a general price increase two to three times a year. (Since the beginning of 2001, there was a price rise in January, another revision in July and then again was in September of that year.

One of the notable features of the CPI is the 12.2% increase in the prices of imported goods. A major contributor to the jump in inflation rate has been the increase in the prices of meat, which carries a weight of 18% of the consumer price index basket. Based on a dialogue with local traders, the factors that have contributed to the recent increase in meat prices have been:

- The outbreak of Foot & Mouth Diseases, which prohibited the international trade of UK meat, adding to the demand for NZ meat around the world. In addition, New Zealand weather conditions have not been favorable recently and the limited supply of meat domestically in NZ has placed pressure on prices.
- China and Russia have recently opened their markets for NZ meat and this has affected the available supply and price to the South Pacific.
- Due to the nature of the commodity, local distributors can only stock a limited volume of meat to guard against cyclical impacts on supply and prices.

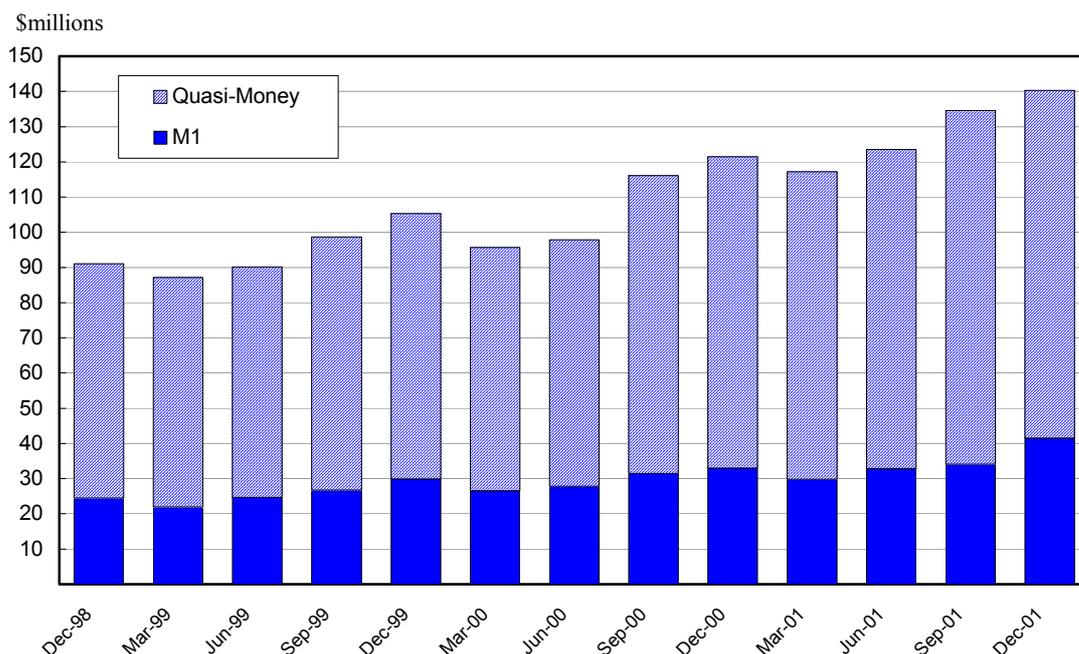
The most probable outlook for remaining 2001/02 is that inflation should not rise at a faster rate than in the past year and should ease a little from its present level. However, it is likely to remain high relative to historic levels. With a small economy Tonga's inflation rate remains vulnerable to shocks, such as the recent fuel price increases or adverse climatic condition affecting supplies of agricultural produce. Within these constraints, government policy aims to stabilise inflation at a low level.

5.0 Monetary Policy & Development

5.1 Money Supply

During 2000/01, the broad money supply M2 reached \$123.0 million compared to \$97.2 million in 1999/2000. This represented a growth rate of 26.5 percent, an increase from the 8.4 percent growth rate recorded for the previous year

Figure 7 Money Supply (M2): Components



The strong growth in money supply during the year was reflected by an increase in both quasi-money and M1, by \$20.6 million and \$5.2 million, respectively. The two components of M1, currency in circulation and demand deposits, both increased by \$2.4 million and \$2.8 million, respectively. The growth in quasi-money was a result of an increase in foreign currency deposits of \$12.3 million, savings deposits by \$6.6 million and term deposits by \$1.7 million.

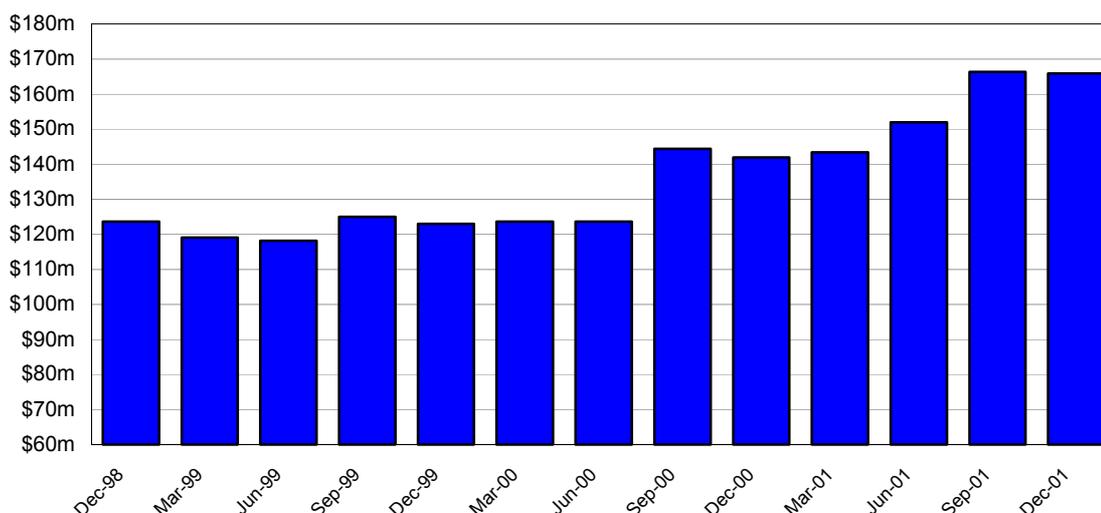
During the first half of 2001/02, broad money increased by almost 14 percent, to \$139.7 million in December 2001, largely reflecting the growth in demand, time and savings deposits.

5.2 Domestic Credit

During the year ended June 2001, the domestic credit extended by the banking system rose by \$28.3 million to \$152.0 million. This represented an annual growth of 22.9 percent compared with the 4.7 percent increase in 1999/2000. The higher level of domestic credit was a result of increased private, government and non-financial public enterprise credit. Private sector credit increased by \$20.9 million to \$141.9 million (including a one-off loan for a telecommunication project) while net credit to the Government rose by \$4.4 million to \$3.7 million. At the same time, credit to the non-financial public enterprises rose by \$3.0 million to \$6.4 million.

During the first half of 2001/02, domestic credit increased sharply by \$13.9 million to \$165.9 million at the end of December 2001, a 9.1 percent increase from end of June 2001. Almost 50 percent of this credit expansion was due to movements in Governments' financial position with the banking system. Credit to the private sector rose by 4.5 percent.

Figure 8 Domestic Credit Level



5.3 Bank Lending

During 2000/01, loans and advances from the commercial banks to the private sector increased by \$21.4 million to \$107.8 million. Loans to industry, housing and agricultural sectors increased by \$16.1 million, \$5.2 million and \$1.9 million to \$53.2 million, \$33.6 million and \$6.7 million, respectively.

During the first half of 2001/02, loans and advances to the private sector increased further by \$4.9 million to \$112.7 million in December 2001. This increase, reflected increases in lending to the industrial sector (\$2.5 million) and housing sector (\$2.4 million).

5.4 Deposits with the Banking System

During 2000/2001, total deposits with the banking system showed a substantial increase of \$18.1 million to a level of \$121.5 million. The rise was a result of higher private sector deposits, which more than offset a decline in government and 'others' deposits. Private sector deposits increased by \$26.8 million to a level of \$109.3 million. This increase was largely due to higher foreign currency account deposits (telecommunication projects) which grew by \$12.3 million, saving deposits rose by \$6.5 million, time deposits increased by \$4.5 million and demand deposits by \$3.3 million. However, government deposits declined by \$3.5 million to a level of \$6.8 million and 'others' deposits fell by \$5.2 million to a level of \$5.5 million.

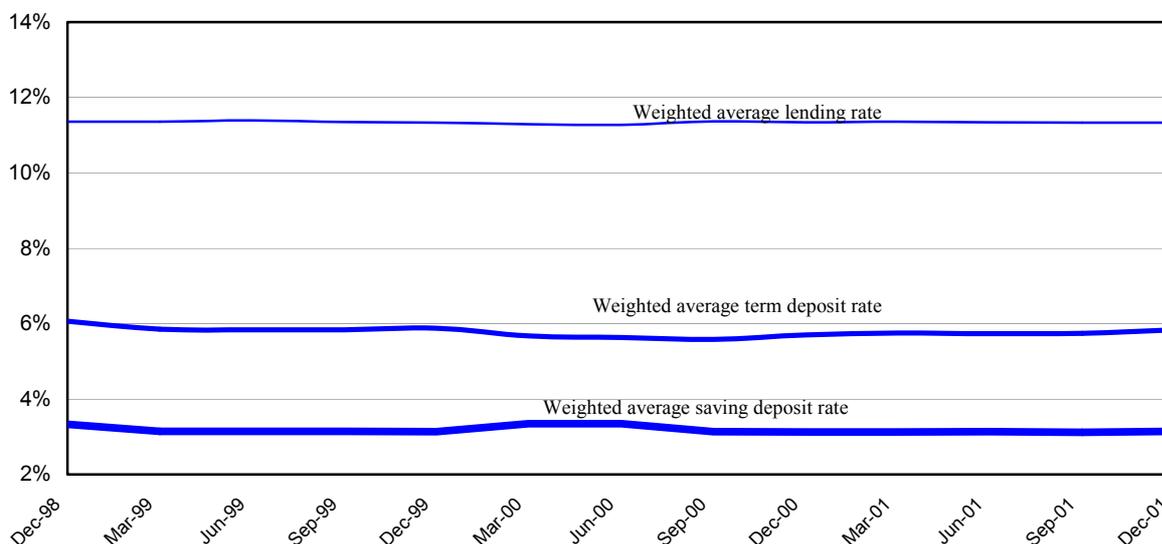
During the first half of 2001/02, total deposit with the banking system showed a further increase of \$14.0 million to \$135.5 million. This growth reflected increase in private sector deposits by \$12.4 million. This increase mainly reflected receipts from squash exports. On the other hand government deposits declined further by \$1.8 million.

6.0 Interest Rates

Interest rates in Tonga are freely determined by the market. Deposit rates in recent years have followed a slow downward trend. This is indicated by the weighted average of deposit rates published by the commercial banks, which declined from 5.24 percent in June 1998, to 4.86 percent in June 1999, 4.81 percent in June 2000, 4.70 percent in June 2001 and 4.63

percent in December 2001. Lending interest rates in Tonga remained stable, with the Reserve Bank's lending indicator rate remaining between 11.29 and 11.44 percent throughout the same period.

Figure 9 Commercial Banks Interest Rates



7.0 External Sector Development

7.1 Exports

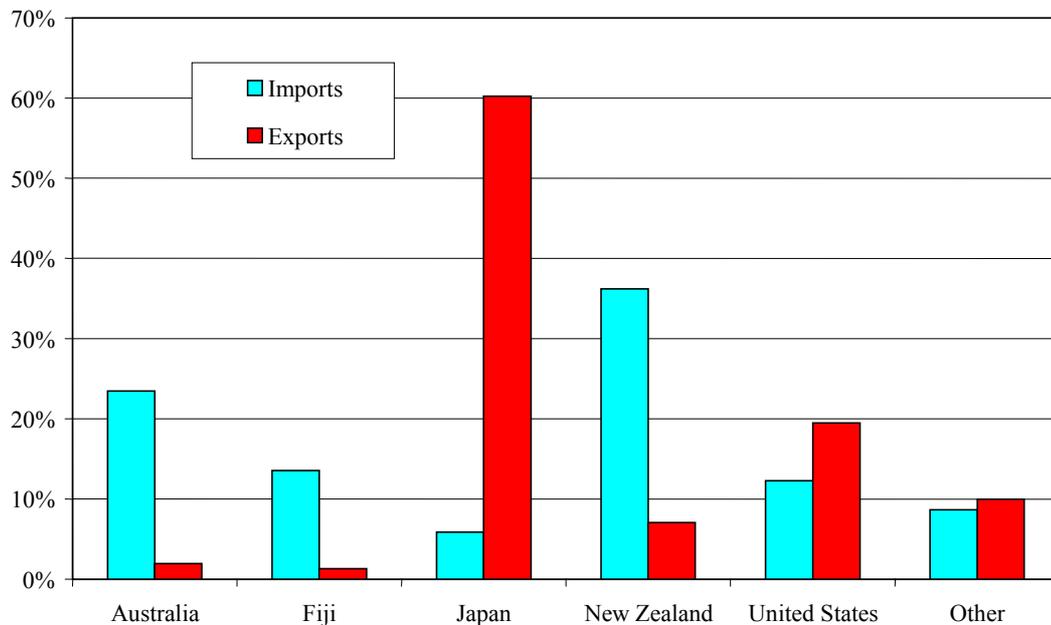
According to estimates based on the overseas exchange transactions data (OET), on a cash basis, collected by the NRBT and the commercial banks, **total export** receipts during 2000/01 at \$23.3 million, were 30 percent higher than in the previous year. This reflected increasing volumes in exports of fish, and receipts for squash, root crops and kava. During the first half of 2001/02 exports earnings reached of \$25.5 million. This increase largely reflected higher squash earnings. Squash remains the leading export commodity closely followed by fish and other marine products which have been picking up strongly in recent years. Other primary sector exports include root crops, kava and vanilla. Exports of manufactured goods remain relatively low. Japan is the largest market for Tonga's exports, absorbing about half of the total, mainly squash and fish, followed by the United States (including Hawaii) and New Zealand. The government is seeking to further diversify exports into areas such as deep-sea fishing (particularly tuna), pearl farming, and agricultural products such as coffee, nonu leaves, kava and Tahitian vanilla.

7.2 Imports

In 2000/01, merchandise imports (OET based) rose by 17 percent, mainly due to increases in imports of consumer items such as food, passenger vehicles, construction materials and manufactured goods, and by an increased fuel bill (reflecting both increased prices and consumption), plus imports of capital items such as telecommunication equipment. The value of fuel imports increased sharply, due to a combination of world fuel price increases and higher domestic fuel consumption in line with the increase in imports of motor vehicles. During the first half of 2001/02 import payments were \$70.0 million, an increase of \$6.1

million. This increase largely reflected imports of consumer goods, motor vehicles, construction materials, fuel and capital equipment. New Zealand is Tonga's largest supplier (36 percent), followed by Australia (23 percent), Fiji (13.6 percent) and the United States (12.3 percent).

Figure 10 Direction of Trade for 1999/2000



7.3 Balance of Payments

Substantial trade deficits and negative balances on the services account have characterized Tonga's current account balance. The current account deficits have averaged 5-10 percent of GDP, and in recent years have led to significant foreign reserve losses, as net capital inflows have not been large enough to cover those deficits.

Table 3. Balance of Payments for 1999/2000 to 2001/02(OET Basis)

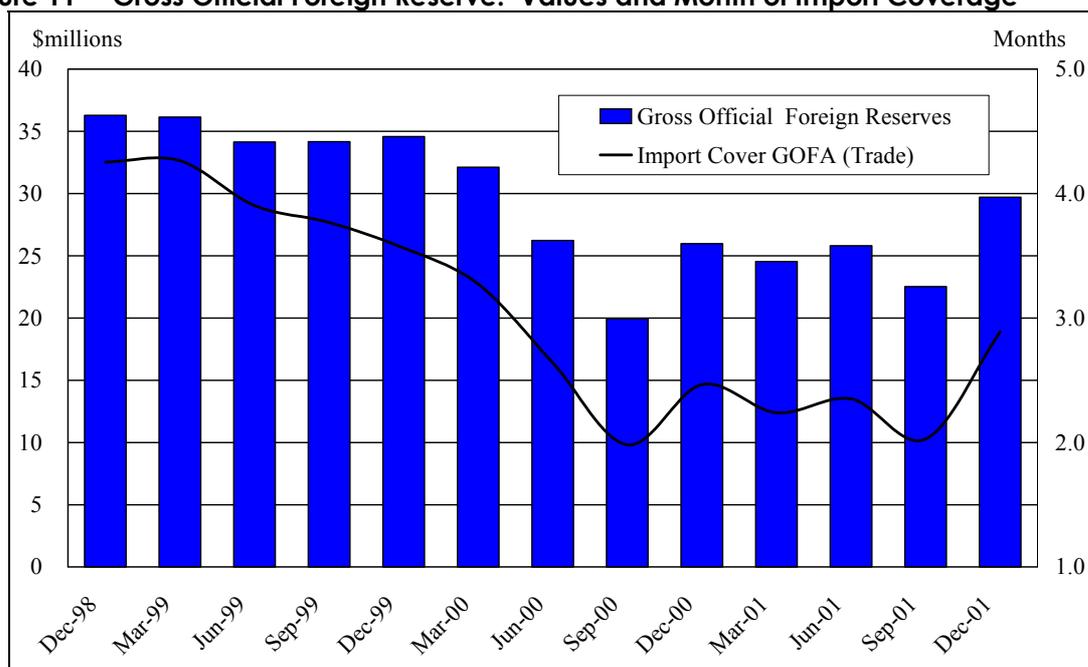
	1999/00	2000/01	2001/02 first six months
Balance of Trade	-84.7	-96.7	-44.5
Services Balance	3.2	-17.2	-1.7
Investment Income Balance	0.8	-2.2	-2.0
Transfers Balance	66.3	89.9	60.3
Current Account Balance	-16	-26.2	12.1
Capital and Financial Balance	4.2	8.7	0.0
Other Items Net	3.9	19.5	-8.2
Overall balance	-7.9	-0.4	3.9

The overall balance of payments improved from an overall deficit of \$7.9 million in 1999/00 (OET basis) to an overall deficit of \$0.4 million in 2000/01, even though the current account deficit was larger than in the previous year (\$26.2 million compared with \$16.0 million), as it may have been largely financed from unrecorded inflows.

During the first half of 2001/02, the balance of payments recorded a surplus of \$3.9 million as net transfers from abroad and made it possible to record a current account surplus.

Gross official foreign reserves declined from \$26.2 million at the end of June 2000, to \$25.8 million at the end of June 2001; over the following six months, however, reserves increased by \$3.9 million, to \$29.7 million at the end of December 2001, equivalent to 2.9 months of import covers. This improvement was due to seasonal inflow of proceeds from squash exports.

Figure 11 Gross Official Foreign Reserve: Values and Month of Import Coverage



8.0 Exchange Rates

During the year ended in June 2001, the pa'anga weakened against all the currencies of Tonga's major trading partners. The pa'anga depreciated by 21.5 percent against the US dollar, by 9.4 percent against New Zealand dollar, by 8.6 percent against the Japanese Yen, by 6.6 percent against the Australian dollar, and by 10.6 percent against the Fiji dollar.

Between the end of June 2001 and the end of December 2001, the pa'anga depreciated against the New Zealand, Australian, United States and Fijian dollars by 4.7 percent, 3.4 percent, 2.3 percent and 4.6 percent, respectively. However, the pa'anga appreciated by 2.5 percent against the Japanese yen. In the year ended December 2001, the pa'anga depreciated by 10.2 percent against the United States dollar, by 5.1 percent against the New Zealand dollar, by 2.9 percent against the Australian dollar, and by 5.0 percent against the Fijian dollar but strengthened by 1.1 percent against the Japanese yen.

9.0 Economic Outlook for 2002/03

The outlook for the Tongan economy in 2002/03 is mixed and to a large extent depends heavily on stability in and impacts from the external market. The International Monetary Fund has predicted a more stabilised global economy through 2002-03 as major advanced

economies recover from the economic downturn in 2001/02. This will play a significant role in Tonga's performance in medium term.

It is projected that real GDP growth in the order of 2.5 percent reflecting further improvement from 1.6 percent forecast for 2001/02. A stimulus to growth is expected from continued increase in production of fish for exports and a modest expansion in agricultural production. Commerce, restaurants, and hotels activities are expected to pick up as tourism sector shows additional strength.

The government tight fiscal policy proposed for 2002/03 should ameliorate some of the pressures on inflation. Nevertheless, the current high rate of inflation remains a genuine concern. The external position is expected to be stronger than previous years reflecting the disbursement of concessional external loans and the anticipated growth in remittances as global economy strengthen following the recent downturn. The pressure on foreign reserves is expected to reduce in the medium term. Nevertheless, monetary policy will be maintained at tight levels to conserve the level of foreign reserve at more acceptable levels.

Budget Statement for Year Ending 30th June 2003

Supplement 2: *Government Revenue and Expenditure*

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



Figure 3. Construction Annual Growth Rates during the period 1996/97-1999/2000



Figure 12. Exchange rates, 1999/2001



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1.0 Introduction

Supplement Two of the Budget Statement focuses on two issues. First, the Supplement analyses the economic impact of the interaction of the budget on the rest of the economy. Second the Supplement summarizes the budget allocations proposed by the government to each line ministry to meet its various responsibilities, as well as the estimated collection of receipts by each line ministry. In general terms, in addition to the government's principle functions, this year's budget continues the government's focus on improving efficiency in government services, diversifying and enhancing the services to the outer islands, and supporting productive sectors of the economy to stimulate sustainable economic growth. With assistance from the ADB, the government has embarked upon an ambitious Economic and Public Sector Reform Program. Following the considerable damage in Vava'u and the Niuaus as a result of Tropical Cyclone Waka, the government has completed negotiations with the World Bank for the provision of financing to rebuild urgently needed infrastructure. The budget includes provision for the expenditure of more than \$10 million on that important task.

For many years, the government's budget has been significantly constrained by the level of revenues it can collect in that year. The level of economic activity in both the domestic and global economies have been the primary influence on actual revenue collections achieved. The only significant revenue measure proposed for fiscal year 2002/03 is the replacement of trade tax concessions to public enterprises and sections of the private sector with the payment of an explicit subsidy equivalent to the former tax concessions to those industries. Replacing tax concessions, the extent of which are generally unreported, with explicit subsidies increases fiscal transparency and ensure the extent of those benefits are subject to annual scrutiny. The other increases in estimated revenue collections is dependent upon economic developments in Tonga and overseas, as well as efforts by the Revenue Services to improve compliance. As part of the Economic and Public Sector Reform Program, the Government is committed to a tax reform program aimed at broadening the tax base and at the same time assisting the enhancement of private sector development, as well as further institutional strengthening for Revenue Services to improve their capacity to ensure greater tax compliance.

On the expenditure side of the budget, the government's tight fiscal policies have been designed to ensure borrowings are applied to high yielding capital development projects, rather than recurrent expenditure.

2.0 Overall Balance

In addition to disclosing the program estimates in the Appropriation Bill classified on an accounting basis, the Government has decided to also disclose the budget estimates classified on a Government Finance Statistics (GFS) basis. Presenting estimates on a GFS basis facilitates the analysis of government operations and of its impact on the economy as a whole and on particular segments of the economy. As the GFS system of classifying government transactions is used in most other countries, presenting the budget estimates in that form allows for ready international comparison.

The budget estimates in Table 1 following show that on a GFS basis, the estimated underlying budget balance for 2002/03 will be a surplus of \$2.1 million, compared with a revised estimated deficit of \$1.5 million in fiscal year 2001/02.

Table 1: Overall Budget Balance (\$)

	Budget Estimate 2001/02	Revised Estimate 2001/02	Budget Estimate 2002/03
Revenues and Grants	99,304,513	89,944,234	103,807,175
Expenditure and Net Lending	106,838,563	91,493,360	112,544,850
Headline Balance	-7,534,050	-1,549,126	-8,737,675
<i>Less abnormal items</i>	-	-	10,800,000
Underlying Balance	-7,534,050	-1,549,126	2,062,325

The GFS definition of overall (or headline) balance of government provides a widely used reference point for fiscal policy analysis. It aims to identify those transactions of government that result in net borrowing from other economic sectors (and are “deficit or surplus creating” or “above the line”), and provides a focus for analysis of the size of the deficit/surplus and its components, as well as the sources of deficit financing (or “below-the-line” transactions). The overall balance provides an indication of the impact of fiscal policy on aggregate demand, while components of deficit financing can indicate more specific consequences of fiscal policy (e.g., the impact of borrowing from the central bank on money supply and inflation and the impact of domestic borrowing on interest rates, investment, and growth).

However, the headline GFS balance measure has acknowledged shortcomings in some circumstances, though these can be largely overcome by providing supplementary information on alternative balance measures to meet particular policy needs. For example, there are circumstances where it is appropriate to exclude certain items from the overall balance where these items are large and possibly highly variable, and thus make the overall balance a misleading indicator of the macroeconomic impact of fiscal policy and fiscal trends and sustainability. This is the case in Tonga where the financing associated with the need to rebuild urgently needed infrastructure in Vava’u and the Niuas following Tropical Cyclone Waka has resulted in a ‘one-off’ increase in expenditure in 2002/03 of more than 9%. In these circumstances, it is considered that the measurement of the underlying balance is a more appropriate measure of the sustainability of the Government’s fiscal policy stance.

In setting its fiscal policy framework, the government intends to:

- (a) maintain a balanced operating budget or an operating budget deficit of less than 1 percent of GDP;
- (b) ensure the budget outcome as a whole is returned to balance and maintained in balance over the medium term;
- (c) minimize the government’s call on domestic markets to eliminate the crowding out of the private sector;
- (d) maintain the public debt at sustainable levels where the associated debt servicing costs do not act as constraint to the government’s capacity to target expenditure at high priority areas; and
- (e) apply the proceeds of overseas borrowings to high yielding capital development projects, rather than recurrent expenditure

3.0 Revenue and Grants

Total revenue and grants estimated to be collected by government for the 2002/03 budget amounts to \$103.8 million, which is about \$13.9 million, or 15.4 percent higher than the revised Estimated Outturn for 2001/02. About one third of this increase is a result of the

government's decision to replace tax exemptions to assist public enterprises and certain sections of the private sector with the payment to them of explicit subsidies. The balance of the increase is related to growth in the economy and improved tax compliance, partly as a result of the Government's ongoing institutional strengthening program in the Revenue Service. Table 2 following outlines the breakdown of revenue collection into its component economic categories.

Table 2: Estimated Revenues and Grants (\$)

	Actual Outturn 2000/01	Original Estimate 2001/02	Revised Estimate 2001/02	Budget Estimate 2002/03
Taxes on income profits	10,000,000	11,000,000	11,000,000	12,000,000
Taxes on property	81,380	24,800	47,300	81,000
Domestic taxes on goods and services	8,288,149	10,063,139	8,894,939	9,716,400
Sales tax	6,224,491	6,500,000	6,500,000	6,700,000
Other taxes	2,063,658	3,563,139	2,394,939	3,016,400
Taxes on international trade and transactions	35,822,024	37,266,000	46,142,000	50,356,137
Customs duties	18,142,357	18,700,000	23,000,000	24,502,367
Other import charges	17,679,667	18,566,000	23,142,000	25,853,770
Other taxes	394,731	500,000	450,000	450,000
Tax revenue	54,586,284	58,853,939	66,534,239	72,603,537
Entrepreneurial and property income	6,696,907	6,878,856	4,112,020	6,661,966
Administrative fees and charges	10,766,516	19,753,837	14,404,778	16,083,816
Fines and forfeits	242,057	190,100	227,100	165,100
Other nontax revenue	3,809,565	753,503	568,004	435,501
Nontax revenue	21,515,045	27,576,297	19,311,902	23,346,383
Current revenue	76,101,329	86,430,236	85,846,141	95,949,920
Capital revenue	4,778	398,109	18,004	407,002
Total revenue	76,106,107	86,828,345	85,864,145	96,356,922
Grants from abroad	2,374,677	12,476,166	4,080,089	7,450,251
Grants from other levels of national government	0	2	0	2
Grants (in cash)	2,374,677	12,476,168	4,080,089	7,450,253
Total revenue and grants	78,480,784	99,304,513	89,944,234	103,807,175

3.1 Current Revenues

Current revenue accounts for almost 99.6 percent of the total revenues available to the Government. The main bulk of current revenue is in the form of taxation i.e. 75.7 percent of the total revenue estimates, where 52.5 percent is collected through custom duties and the port and services tax, 10.1 percent is domestic taxes on goods & services and income taxes amounts to 12.5 percent. The remaining 24.3 percent of current revenue is from non-tax revenue. Most of the non-tax revenue comprises of administrative fees & charges (16.8 percent) and entrepreneurial & property income (6.9 percent).

Compared to the revised estimated revenue for 2001/02, and after taking account of the increase in gross revenues associated with the replacement of certain tax concessions with direct subsidy payments, tax revenue collections have only increased modestly, reflecting the Government's desire not to impose too heavy a burden on the private sector. The amount of nontax revenue estimated to be collected in 2002/03 has also increased modestly by the amount of \$4.0 million compared to the revised estimates for 2001/02.

3.2 Grants

Moneys estimated to be available to the government from grants, particularly those from our overseas donor partners, are expected to increase by 82.6 percent to \$7.5 million compared to the revised estimates for 2001/02. The strong growth in funding from grants reflects the willingness of the Government to bring all its influence to bear to bring about sustainable growth for Tonga, as well as the strength our relationship with our development partners.

In addition to direct cash grants to the budget from Tonga's development partners, the government has successfully negotiated significant loans on concessional terms to finance much needed rebuilding of infrastructure on Vava'u and the Niuaus following Tropical Cyclone Waka as well as our Economic and Public Sector Reform Program. In GFS terms, the proceeds of these loans are classified as financing transactions and are discussed in Section 5.0. In addition, it is estimated that Tonga's overseas development partners will deliver a further \$6.3 million of aid in-kind to the domestic economy

4.0 Expenditure and Net Lending

At the aggregate level, expenditure and net lending in 2002/03 is estimated to total some \$112.5 million. Table 3 following outlines the breakdown of expenditure and net lending into their component economic categories.

Table 3: Estimated Expenditure and Net Lending (\$)

	Actual Outturn 2000/01	Original Estimate 2001/02	Revised Estimate 2001/02	Budget Estimate 2002/03
Wages and salaries	39,918,602	47,233,734	44,749,566	50,645,676
Employer contributions	2,036,612	1,918,000	1,640,000	1,500,001
Other purchases of goods and services	21,022,459	29,992,355	25,441,306	32,831,576
Interest payments	1,654,753	2,230,467	4,755,249	2,849,309
Additional expenditures	0	1,600,000	1,600,000	1,600,000
Subsidies to non-financial public enterprises	59,960	1	4,223,211	3,064,455
Subsidies to financial institutions	77,138	1,200,002	200,002	1,000,003
Subsidies to other enterprises	0	0	0	2,206,683
Transfers to non-profit institutions	2,437,145	1,361,787	693,389	1,615,220
Transfers to households	2,745,537	3,119,428	2,941,937	3,161,540
Transfers abroad	802,964	511,501	412,159	1,459,000
Subsidies and other current transfers	6,122,744	6,192,719	8,470,698	12,506,901
Current expenditure	70,755,170	89,167,275	86,656,819	101,933,463
Acquisition of fixed capital assets	2,193,802	7,310,632	2,299,255	9,660,075
Purchases of land and intangible assets	113,738	143,756	122,257	707,653
Capital transfers	641,240	3,697,272	793,077	880,516
Capital expenditure	2,948,780	11,151,660	3,214,589	11,248,244
Total expenditure	73,703,950	100,318,935	89,871,408	113,181,707
Net Lending to non-financial public enterprises (net)	6,892,045	7,860,243	3,462,566	707,758
Net Lending to financial institutions (net)	-1,471,097	-1,340,616	-1,840,615	-1,344,616
Domestic lending minus repayments	5,420,948	6,519,627	1,621,951	-636,858
Abroad lending minus repayments	0	1	1	1
Lending minus repayments	5,420,948	6,519,628	1,621,952	-636,857
Total expenditure and lending minus repayments	79,124,898	106,838,563	91,493,360	112,544,850

When compared to the initial budget estimate for 2001/02, the estimate of expenditure and net lending for 2002/03 represents an increase of \$5.7 million, or 5.3 percent. Compared to

the revised estimates for 2001/02, the estimate of expenditure and net lending for 2002/03 represents an increase of \$21.1 million or 23.0 percent.

4.1 Current Expenditure

Table 4 following shows the budget estimates of current expenditure and their composition for the financial years 2001/02 and 2002/2003.

Table 4: Distribution of Estimated Current Expenditure (\$)

	Original Estimate 2001/02		Budget Estimate 2002/03	
Wages and salaries	47,233,734	53.0%	50,645,676	49.7%
Employer contributions	1,918,000	2.2%	1,500,001	1.5%
Other purchases of goods and services	29,992,355	33.6%	32,831,576	32.2%
Interest payments	2,230,467	2.5%	2,849,309	2.8%
Additional expenditures	1,600,000	1.8%	1,600,000	1.6%
Subsidies to non-financial public enterprises	1	..	3,064,455	3.0%
Subsidies to financial institutions	1,200,002	1.3%	1,000,003	1.0%
Subsidies to other enterprises	-	-	2,206,683	2.2%
Transfers to non-profit institutions	1,361,787	1.5%	1,615,220	1.6%
Transfers to households	3,119,428	3.5%	3,161,540	3.1%
Transfers abroad	511,501	0.6%	1,459,000	1.4%
Subsidies and other current transfers	6,192,719	6.9%	12,506,901	12.3%
Total current expenditure	89,167,275	100.0%	101,933,463	100.0%

The reduction in the percentage of current expenditure in 2002/03 estimated to be consumed by wages and salaries and the purchase of goods and services is a reflection of the Government's continued determination to increase efficiency within the public sector to ensure high quality services are delivered to Tongans at a realistic cost. The increase of more than \$6 million in estimated expenditure on subsidies and other current transfers in 2002/03 reflects the government's decision to replace some existing tax concessions available to public enterprises and certain sections of the private sector with an explicit subsidy of the equivalent value.

4.2 Capital Expenditure

The total capital expenditure for the 2002/03 budget is estimated at \$11.3 million, of which about 81 percent is funded from grants and loans from our development partners, and the remaining 19 percent of capital expenditure funded from general government revenues (including revenues of revolving funds and local community contributions).

The most significant component of the Government's capital expenditure program for the 2002/03 fiscal year is the expenditure associated with the restoration of infrastructure in Vava'u and the Niuas following Tropical Cyclone Waka for which the Government has negotiated a loan of \$10.8 million on extremely favorable terms with the world Bank. The Government's determination to ensure this restoration in Vava'u and the Niuas is completed expeditiously is a positive demonstration of its commitment to ensure government services and essential infrastructure are made available to all the people of the Kingdom of Tonga.

5.0 Financing Transactions

Net financing transactions measure the manner in which a headline budget deficit is financed, or a budget surplus is utilized. Table 5 following outlines the financing transactions components of the budget for 2002/03 and the preceding years.

Table 5: Estimated Financing transactions (\$)

	Actual Outturn 2000/01	Original Estimate 2001/02	Revised Estimate 2001/02	Budget Estimate 2002/03
External financing				
Disbursements	2,580	19	129,016	10,805,024
Principal repayments	6,197,115	3,924,706	1,413,135	4,538,316
Subtotal external financing	-6,194,535	-3,924,687	-1,284,119	6,266,708
Domestic bond financing				
Bonds issued	9,476,135	6,250,000	6,250,000	4,000,000
Principal repayments	1,845,160	2,099,000	2,057,212	4,000,000
Subtotal domestic bond financing	7,630,975	4,151,000	4,192,788	-
Tonga Trust Fund	100,000	7,100,002	102,002	10
Net changes in Government cash balances and investment	-892,326	207,735	-1,461,545	2,470,957
Total financing	644,114	7,534,050	1,549,126	8,737,675

In order to avoid crowding out the emerging financial market in Tonga, with the consequential impact upon the private sector's capacity to borrow to finance expansion, the highest priority will be placed in 2002/03 on financing the headline budget deficit from overseas borrowings that can be undertaken at concessional rates therefore reducing the pressure on budget expenditures. On the domestic front, it is estimated that bond issues will be undertaken in 2002/03 only for the purpose of financing the rollover of bonds that are scheduled to mature in 2002/03.

5.1 Public Debt

At the end of 2001/02, provisional data indicates that the total Government public debt outstanding issued by or guaranteed by the Kingdom of Tonga amounted to \$164.1 million, with external debt amounting to \$130.4 million and domestic debt amounting to \$33.7 million. About 20.4 percent or \$33.5 million of Government public debt has been on-lent to government owned enterprises and statutory boards.

Of the \$130.4 million external debt, government debt totaled \$122.7 million and the debt of public corporations guaranteed by the Kingdom of Tonga is \$7.7 million. The total external government debt outstanding is projected to increase to \$129.0 million in 2002/03. Total external disbursements are projected to be \$10.8 million by the end of 2002/03. Principal repayments for 2002/03 are projected to be about \$4.5 million. During the same period, interest payments are estimated at \$1.4 million.

Of the \$33.7 million domestic debt, government debt totaled \$24.7 million and the debt of public corporations guaranteed by the Kingdom of Tonga is \$9.0 million. The total domestic government debt outstanding is expected to be unchanged in 2002/03 with loan raising limited to the amount necessary to finance the rollover of maturing bonds. Interest payments on domestic debt in 2002/03 are estimated at \$1.5 million.

6.0 Alternate Classifications of Financial Transactions

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

However, since the general framework of government accounting practices was formalised, there have been substantial developments both in economic thinking and in the role of Government in the economy. With these developments has come a demand for new uses of statistics on the Government's financial transactions that could not have been envisaged by those who designed that system.

The Government Finance Statistics (GFS) system of classification was 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 a revenue of the government. Furthermore, by bringing together expenditures directed towards like purposes, GFS system of classification also facilitates presentation of information on the total resources devoted by the Government to those purposes and allows international comparisons independently of local administrative structures. It is for these reasons that the primary presentation of budget estimates in the Budget Statements is on a GFS basis.

The following table provides a reconciliation between the cash inflow estimates of the Government of Tonga Fund in 2002/03 and the estimates of revenues classified on a GFS basis.

Table 6: Reconciliation between Cash Inflows to the Government of Tonga Fund and Revenues as per the Budget Statements

Inflows to the Government of Tonga Fund		96,161,708
<i>Plus Inflows to other Funds</i>		
Tonga Trust Fund	10	
Revolving Funds	5,395,073	
Local Community	407,002	
Donor Cash Aid	18,285,275	24,087,360
Total Inflows (as per Program Estimates)		120,249,068
<i>Less Inflows classified as offsets to expenditure</i>		
Repayments of net lending		1,636,859
<i>Less Inflows classified as financing transactions</i>		
External Financing	10,805,024	
Domestic Financing	4,000,010	14,805,034
Total Revenues(as per Budget Statements)		103,807,175

The next table provides a reconciliation between the appropriations of the Government of Tonga Fund in 2002-03 and the estimates of expenditure classified on a GFS basis.

Table 7: Reconciliation between Appropriations the Government of Tonga Fund and Expenditure as per the Budget Statements

Appropriation of the Government of Tonga Fund		98,632,662
<i>Plus Appropriations of other funds</i>		
Tonga Trust Fund	10	
Revolving Funds	5,395,072	
Local Community	407,002	
Donor Cash Aid	18,285,279	24,087,363
Total Appropriations (as per Program Estimates)		122,720,025
<i>Less Inflows classified as offsets to expenditure</i>		
Repayments of net lending		1,636,859
<i>Less Appropriations classified as financing transactions</i>		
External Financing	4,538,316	
Domestic Financing	4,000,000	8,538,316
Total Expenditures (as per Budget Statements)		112,544,850

6.1 Estimates of Cash Flows

The cash flow estimates for 2002/03 across all funding sources, together with estimates of in-kind assistance are set out in the following table.

Table 8: Aggregate resources available to the Government

Funding Source	Inflows	Outflows	Balance
Government of Tonga Fund	96,161,708	98,632,662	2,470,954
Tonga Trust Fund	10	10	-
Revolving Funds	5,395,073	5,395,072	1
Local community	407,002	407,002	-
Donor cash	18,285,275	18,285,279	-4
Budget sector (Cash)	120,249,068	122,720,025	-2,470,957
Donor aid in-kind	6,341,430	6,341,430	-
Total budget sector	126,590,498	129,061,455	-2,470,957

Table 9 following provides a breakdown of moneys from all sources to be collected by the various Ministries and Departments.

Table 9: Moneys to be collected by Ministry

Vote Ministry	Revised Estimate 2001/02	%	Budget Estimate 2002/03	%
1 Palace Office	-	-	1	..
2 Legislative Assembly	-	-	1	..
3 Prime Minister's Office	224,302	0.2	2,133,865	1.8
4 Ministry of Foreign Affairs	1,900,000	1.9	2,000,000	1.7
5 Governor of Ha'apai	8,525	0.0	2	0.0
6 Governor of Vava'u	-	-	1	..
7 Ministry of Lands, Survey & Natural Resources	440,676	0.4	1,480,802	1.2
8 Printing Department	700,000	0.7	750,001	0.6
9 Commissioner of Public Relation	-	-	-	-
10 Justice	509,002	0.5	391,005	0.3
11 Ministry of Police	1,481,234	1.5	1,425,184	1.2
12 Crown Law Department	-	-	-	-
13 Ministry of Defence	95,000	0.1	100,001	0.1
14 Ministry of Finance	66,532,822	67.4	75,319,492	62.6
18 Audit Department	69,000	0.1	32,001	0.0
19 Ministry of Education	1,260,447	1.3	1,139,323	0.9
20 Ministry of Health	691,014	0.7	1,240,024	1.0
21 Civil Pensions, Gratuities & Contribution to NRF	-	-	-	-
22 Prison Department	81,000	0.1	160,000	0.1
23 Ministry of Agriculture & Forestry	4,823,820	4.9	3,838,057	3.2
24 Ministry of Fisheries	810,028	0.8	1,168,530	1.0
25 Central Planning Department	410,642	0.4	1,068,519	0.9
26 Ministry of Labour, Commerce & Industries	1,178,152	1.2	2,060,004	1.7
27 Tonga Visitors Bureau	351,695	0.4	432,950	0.4
28 Ministry of Works	2,148,679	2.2	10,080,774	8.4
29 Environment & Conservation Department	86,348	0.1	156,697	0.1
30 Ministry of Civil Aviation	2,120,907	2.1	3,000,004	2.5
31 Ministry of Marine & Ports	388,000	0.4	340,000	0.3
32 Financial Contributions	2,678,127	2.7	5,760,773	4.8
33 Public debts	9,746,199	9.9	6,171,057	5.1
TOTAL	98,735,619	100.0	120,249,068	100.0

The increase of more than 350% in the moneys to be received by the Ministry of Works is largely associated with receipt of the proceeds of a loan from the World Bank to facilitate the restoration of infrastructure in Vava'u following Cyclone Waka. About a third of the increase in receipts by the Ministry of Finance is associated with the decision to replace certain tax concessions for public authorities and sections of the private sector with direct subsidies of the same amount.

Table 10 following provides a breakdown of moneys appropriated from all sources and for all purposes expected to be available to the various Ministries and Departments.

Table 10: Moneys to be Appropriated by Ministry

Vote Ministry	Revised Estimate 2001/02	%	Budget Estimate 2002/03	%
1 Palace Office	1,711,083	1.8	1,765,767	1.4
2 Legislative Assembly	2,070,469	2.1	2,070,470	1.7
3 Prime Minister's Office	2,805,617	2.9	3,700,647	3.0
4 Ministry of Foreign Affairs	5,116,828	5.3	6,055,595	4.9
5 Governor of Ha'apai	88,868	0.1	96,347	0.1
6 Governor of Vava'u	142,374	0.1	201,953	0.2
7 Ministry of Lands, Survey & Natural Resources	1,301,682	1.3	2,754,819	2.2
8 Printing Department	857,522	0.9	857,123	0.7
9 Commissioner of Public Relation	122,617	0.1	122,617	0.1
10 Justice	1,013,199	1.0	1,407,174	1.1
11 Ministry of Police	3,928,724	4.0	4,283,933	3.5
12 Crown Law Department	345,675	0.4	656,675	0.5
13 Ministry of Defence	4,209,835	4.3	4,314,254	3.5
14 Ministry of Finance	4,777,333	4.9	7,830,566	6.4
18 Audit Department	466,273	0.5	510,824	0.4
19 Ministry of Education	14,430,170	14.8	16,571,021	13.5
20 Ministry of Health	9,926,824	10.2	11,134,842	9.1
21 Civil Pensions, Gratuities & Contribution to NRF	7,592,457	7.8	7,745,000	6.3
22 Prison Department	670,954	0.7	722,532	0.6
23 Ministry of Agriculture & Forestry	5,021,290	5.2	6,468,139	5.3
24 Ministry of Fisheries	1,563,098	1.6	1,855,977	1.5
25 Central Planning Department	1,264,586	1.3	1,584,217	1.3
26 Ministry of Labour, Commerce & Industries	1,535,994	1.6	2,617,909	2.1
27 Tonga Visitors Bureau	1,101,110	1.1	1,263,689	1.0
28 Ministry of Works	4,605,842	4.7	13,716,290	11.2
29 Environment & Conservation Department	422,432	0.4	522,494	0.4
30 Ministry of Civil Aviation	2,346,721	2.4	2,317,954	1.9
31 Ministry of Marine & Ports	606,950	0.6	630,527	0.5
32 Financial Contributions	8,443,373	8.7	7,701,141	6.3
33 Public debts	8,784,174	9.0	11,239,529	9.2
TOTAL	97,274,074	100.0	122,720,025	100.0

As for receipts, the significant increase in expenditure by the Ministry of Works is a reflection of the Government's determination to restore as a matter of priority the infrastructure in Vava'u that was damaged or destroyed by Cyclone Waka.

Budget Statement for Year Ending 30th June 2003

Appendix

Figure 12: Exchange rates, 1999/2001

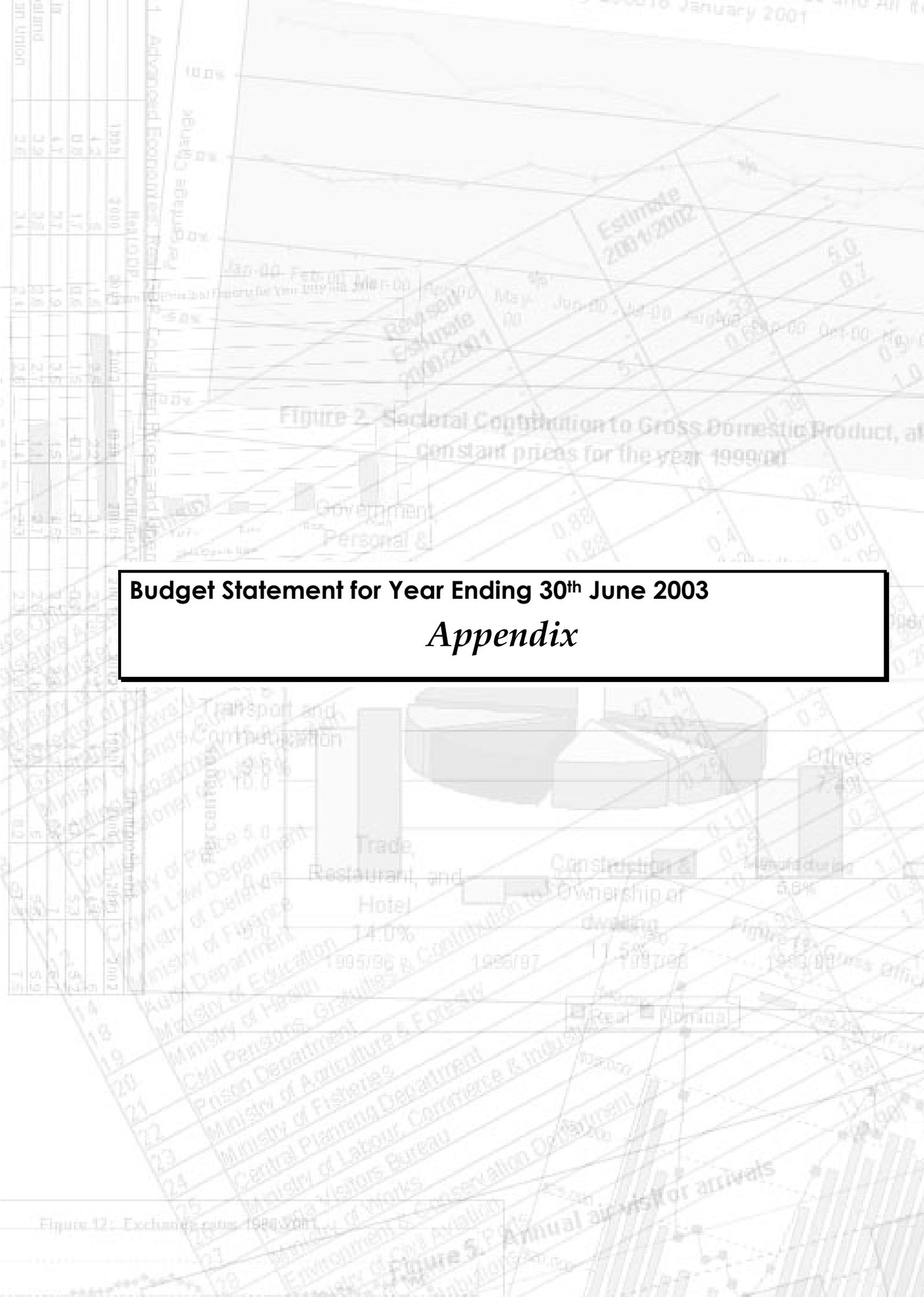


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Table 1. Tonga: Selected Indicators, 1996/97-2000/01¹

	1996/97	1997/98	1998/99	1999/00 Prel.	2000/01 ² Est
Output and prices					
Real GDP	0.2	2.4	2.9	6.5	0.5
Consumer prices (period average)	-8.2	2.9	3.9	4.9	7.3
Central government finance					
Revenue	29.9	28.8	26.1	27.7	28.5
Grants	1.9	1.6	0.5	1.0	0.9
Current expenditure	28.4	29.3	26.7	26.3	26.5
Development expenditure	8.2	4.6	1.3	2.2	1.1
Overall balance	-4.8	-2.5	-0.2	0.8	-0.2
External loans (net)	-0.1	1.5	1.4	-0.5	-2.3
Tonga Trust Fund drawings	0.5	2.2	0.1	0.7	0.0
Domestic financing	0.9	-0.2	-0.3	0.3	2.9
Money and credit (end-period)					
Broad money (M2)	14.1	2.4	15.0	8.3	26.6
Private sector credit ³	11.5	21.1	2.2	7.0	24.7
Balance of payments					
Exports, f.o.b.	13.5	12.3	11.5	19.5	20.7
Imports, f.o.b.	-82.7	-94.0	-86.8	-99.0	-109.9
Services and Income (net)	-5.7	-32.3	-15.3	-15.8	-0.6
Transfers (net)	49.8	87.8	62.8	73.1	76.6
Current account balance	-18.7	-14.1	-17.6	-19.7	-14.5
(In percent of GDP)	-9.0	-6.4	-7.4	-7.8	-5.4
Overall balance	3.0	-11.5	12.8	-7.8	-0.4
Gross international reserves (end-period)					
In millions of pa'anga	32.8	21.3	34.1	26.3	25.9
In months of following year's imports of goods	4.4	2.5	3.9	2.8	2.5
External debt					
External debt/GDP	33.5	41.0	41.5	41.5	44.2
Debt service ratio ⁴	6.6	3.3	8.3	5.2	1.7
Exchange rate (period average)					
T\$ per US\$ (end-period)	1.25	1.50	1.59	1.69	2.15
T\$ per US\$	1.23	1.35	1.58	1.64	1.95

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

¹ Fiscal year begins in July.

² Government finance data are staff estimates.

³ Does not include Tonga Development Bank.

⁴ In percent of exports of goods and services

Table 2. Tonga: Real Sector Developments, 1996/97-2000/01

	1996/97	1997/98	1998/99 Est.	1999/00 Est.	2000/01 Est.
Nominal GDP					
In pa'anga mn.	207.8	218.9	237.3	251.4	266.6
In US\$ mn.	168.7	160.0	147.4	150.6	139.1
GDP per capita (US\$)	1,720	1,626	1,493	1,521	1,400
GDP (1995/96 prices)	0.2	2.4	2.9	6.5	0.5
of which:					
Agriculture, forestry, and fisheries	3.8	-0.1	-3.2	10.6	-6.3
Manufacturing	0.3	11.4	16.4	0.8	2.0
Construction	-17.2	5.6	10.4	-0.2	1.8
Commerce, restaurants, and hotels	-5.5	2.3	-6.0	17.9	0.5
Transportation and communications	1.9	3.0	10.4	4.6	1.1
Finance and real estate	7.1	14.0	7.5	6.2	0.4
Government services	4.9	0.3	8.9	-2.9	10.0
GDP (by sector; current prices)					
of which:					
Agriculture, forestry, and fisheries	24.2	25.7	26.4	23.7	22.6
Manufacturing	3.9	4.0	4.6	4.7	4.6
Construction	5.2	5.3	5.5	5.6	5.8
Commerce, restaurants, and hotels	12.0	11.9	10.8	12.5	11.9
Transportation and communications	7.2	7.0	7.2	7.1	7.2
Finance and real estate	7.5	8.4	8.7	9.0	8.9
Government services	15.2	14.9	15.5	15.1	16.3
Consumer prices (period average)					
All items	-8.2	2.9	3.9	4.9	7.3
Domestic component	-11.5	6.9	6.2	-0.2	7.3
Imported component	-3.7	-0.7	1.9	9.9	7.2

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

Table 3. Tonga: Summary Table of Government Operations, 1996/97-2000/01

Years ending June 30	1996/97	1997/98	1998/9 9	1999/00	2000/01
			Prel.	Prel.	Prel.
(In millions of pa'anga)					
Total revenue and grants	66.1	66.6	63.3	72.1	78.5
Total revenue	62.1	63.0	62.1	69.6	76.1
Current revenue	62.1	63.0	62.1	69.6	76.1
Tax revenue	45.0	43.9	47.1	52.9	54.6
Nontax revenue	17.1	19.1	14.9	16.7	21.5
Capital revenue	0.0	0.0	0.0	0.0	0.0
Grants (in cash)	4.0	3.5	1.3	2.5	2.4
Total expenditure and lending minus repayments	76.2	72.0	63.9	70.2	79.1
Total expenditure	76.2	74.3	66.6	71.9	73.7
Current expenditure	59.1	64.2	63.4	66.2	70.8
Capital expenditure	17.1	10.1	3.2	5.6	2.9
Additional expenditures					0.0
Total lending minus repayments	n.a.	-2.3	-2.7	-1.7	5.4
Overall deficit/surplus	-10.1	-5.4	-0.6	1.9	-0.6
Total financing	10.1	5.4	0.6	-1.9	0.6
External financing	-0.2	3.4	3.4	-1.4	-6.2
Domestic bank financing	1.8	-0.4	-0.6	0.8	7.6
Tonga Trust Fund	1.1	4.7	0.3	1.9	0.1
Discrepancy	7.4	-2.3	-2.5	-3.3	-0.9
(In percent of GDP)					
Total revenue and grants	31.8	30.4	26.7	28.7	29.4
Total revenue	29.9	28.8	26.1	27.7	28.5
Current revenue	29.9	28.8	26.1	27.7	28.5
Tax revenue	21.7	20.0	19.9	21.1	20.5
Nontax revenue	8.2	8.7	6.3	6.6	8.1
Capital revenue	0.0	0.0	0.0	0.0	0.0
Grants	1.9	1.6	0.5	1.0	0.9
Total expenditure and lending minus repayments	36.7	32.9	26.9	27.9	29.7
Total expenditure	36.7	34.0	28.1	28.6	27.6
Current expenditure	28.4	29.3	26.7	26.3	26.5
Capital expenditure	8.2	4.6	1.3	2.2	1.1
Additional expenditures					
Total lending minus repayments	n.a.	-1.1	-1.1	-0.7	2.0
Overall deficit/surplus	-4.8	-2.5	-0.2	0.8	-0.2
Total financing	4.8	2.5	0.2	-0.8	0.2
External financing	-0.1	1.5	1.4	-0.5	-2.3
Domestic bank financing	0.9	-0.2	-0.3	0.3	2.9
Tonga Trust Fund	0.5	2.2	0.1	0.7	0.0
Discrepancy	3.5	-1.0	-1.1	-1.3	-0.3
Memorandum items:					
Current balance excluding grants	1.4	-0.6	-0.6	1.3	2.0
Overall balance excluding grants	-6.8	-4.1	-0.8	-0.2	-1.1
Current expenditure	28.4	29.3	26.7	26.3	26.5
Total revenue	29.9	28.8	26.1	27.7	28.5
Effective import tariff (In percent)	39.2	26.3	33.5	34.3	31.0
GDP	207.8	218.9	237.3	251.4	266.6

Table 4. Tonga: Monetary Survey, 1996/97-2000/01¹

	1996/97	1997/98	1998/99	1999/00	2000/01
Net foreign assets	33.0	16.4	34.4	26.9	32.7
Gross international reserves	37.8	26.0	39.7	32.0	46.5
Foreign liabilities	-4.9	-9.7	-5.3	-5.1	-13.8
Net domestic assets	43.2	61.6	55.3	70.4	90.3
Domestic credit	69.8	84.4	85.0	89.3	119.1
Central government (net)	2.4	2.0	0.7	0.8	4.3
Public enterprises	0.4	0.6	1.5	2.3	5.4
Private sector	65.3	79.1	80.8	86.5	107.9
Other financial institutions	-1.2	-0.2	-4.5	-0.3	1.5
Other items (net)	-23.7	-20.0	-24.1	-18.9	-28.8
Broad money (M2)	76.2	78.0	89.7	97.2	123.0
Narrow money	20.9	21.3	24.7	27.8	33.0
Quasi-money	55.3	56.7	65.0	69.4	90.0
Net foreign assets	10.8	-50.4	110.2	-21.8	21.6
Net credit to central government	266.6	-16.8	-64.6	14.3	437.5
Credit to Private sector	11.5	21.1	2.2	7.0	24.7
Broad money	14.1	2.4	15.0	8.3	26.6
Narrow money	2.4	1.8	16.0	12.7	18.7
Quasi-money	19.3	2.6	14.7	6.7	29.7
Memorandum items:					
Velocity (GDP/average stock of M2)	2.8	2.8	2.7	2.6	2.2
Nominal GDP (pa'anga mn.)	207.8	218.9	237.3	251.4	266.6
Average stock of M2 (pa'anga mn.)	74.0	77.5	87.9	97.9	119.0

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

¹ Monetary Survey excludes Tonga Development Bank.

Table 5. Tonga: Balance of Payments, 1995/96-2000/01

(In millions of pa'anga, unless otherwise indicated)

	1996/97	1997/98	1998/99	1999/00 Prel.	2000/01 Proj.
Balance of Trade	-69.2	-81.7	-75.3	-79.6	-89.2
Exports, f.o.b.	13.5	12.3	11.5	19.5	20.7
Imports, f.o.b.	-82.7	-94.0	-86.8	-99.0	-109.9
Services (net)	-5.7	-32.3	-15.3	-15.8	-0.6
Receipts	50.1	42.9	36.6	30.0	33.0
Payments	-55.8	-75.2	-51.8	-45.8	-33.6
Income (net)	6.4	12.1	10.2	2.5	-1.3
Receipts	11.5	15.9	13.2	9.3	3.1
Payments	-5.1	-3.8	-3.0	-6.7	-4.4
Current Transfers (net)	49.8	87.8	62.8	73.1	76.6
Official transfers (net)	10.8	10.9	11.0	0.9	0.2
Private transfers (net)	39.0	76.9	51.7	72.2	76.4
Private transfer receipts	45.6	65.6	61.8	97.6	91.9
Private transfer payments	-6.6	11.3	-10.1	-25.4	-15.5
Current account balance	-18.7	-14.1	-17.6	-19.7	-14.5
(Percent of GDP)	-9.0	-6.4	-7.4	-7.8	-5.4
Capital account balance	26.3	20.9	44.8	12.4	-1.2
Official capital (net)	23.9	17.4	18.2	8.3	2.1
Official capital inflows	23.9	17.4	18.2	8.4	6.6
Official capital outflows	0.0	0.0	0.0	-0.1	-4.5
Private capital (net)	2.4	3.6	26.7	4.1	-3.3
Private capital inflows	26.1	31.7	18.9	13.1	15.7
Private capital outflows	-23.7	-28.2	7.7	-9.0	-19.0
Errors and omissions	-4.6	-18.3	-14.4	-0.5	15.3
Overall balance	3.0	-11.5	12.8	-7.8	-0.4
Memorandum items:					
Service, income, and transfers (net)	50.5	67.6	57.7	59.9	74.7
Receipts	107.2	124.3	111.6	136.9	128.0
Payments	-67.5	-67.7	-64.9	-77.9	-53.5
Net official foreign reserves 1/	32.6	20.9	33.6	25.7	32.4
Gross official foreign reserves					
In millions of Pa'anga	32.8	21.3	34.1	26.3	25.9
In months of following year's imports of goods	4.4	2.5	3.9	2.8	2.5

Source: Statistics Department & National Reserve Bank of Tonga