

# **Tonga Ministry of Finance**

Status Report: Regulatory  
reform for private sector  
development and job creation

June 28 2006



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## Foreword

This report covers the activities of and outcomes achieved by a World Bank Group team which provided technical assistance to the Government of Tonga, in relation to regulatory reform for private sector development, during the period 1<sup>st</sup> March 2005 to 7<sup>th</sup> June 2006.

The team comprised staff and consultants from the World Bank and FIAS Offices in Sydney and Washington.

# 1 Origin of the Project

## Background

### Tonga's Economic Performance

The World Bank classifies Tonga as a lower middle income country. The country's economic growth over the past few years has been weak. For the private sector and potential investors the perceived weaknesses in governance standards has been amongst the causes of the low rates of growth. Poor economic performance has worsened the problem of inadequate employment opportunities, especially for young school leavers, and added to the hardship reportedly experienced by 20% of households. This has prompted the Government to give more attention to private sector development and projects to equip unemployed youth with work skills, as well as to implement projects to diversify agricultural output.

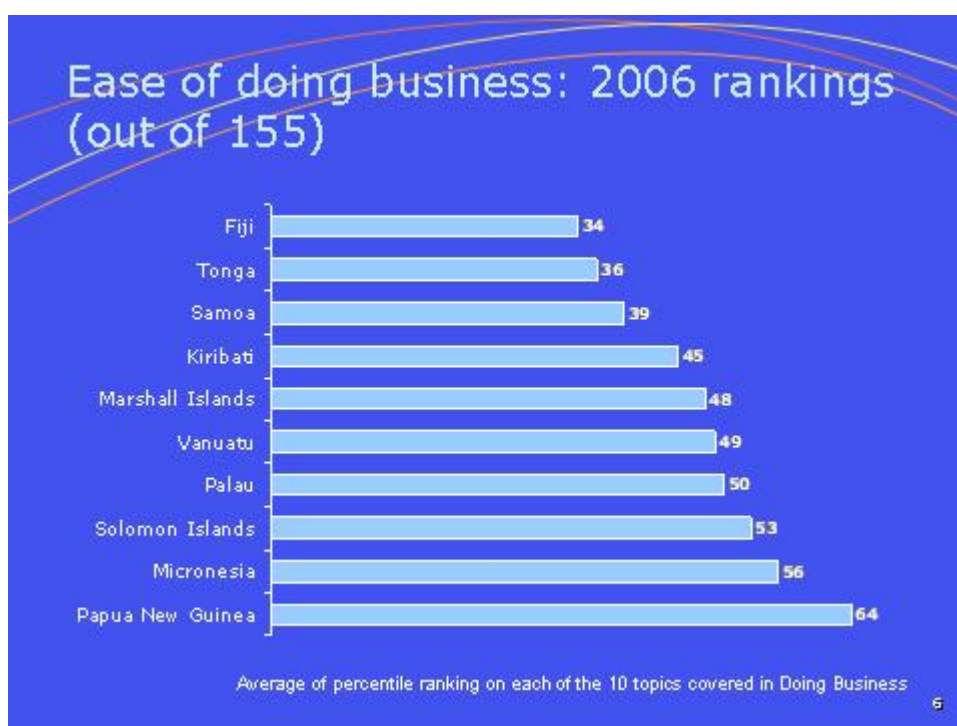
Selected economic indicators	2000	2001	2002	2003	2004 (e)
GDP at current prices (T mn.)	251.4	266.6	296.5	334.6	n/a
GDP at current prices (US\$ mn.)	159.3	141.6	139.5	162.7	n/a
Population ('000)	100.3	100.7	101.0	101.4	n/a
Real GDP growth (average %)	5.2	0.8	1.6	1.9	2.3
GNI per capita (US\$)	1,650	1,520	1,400	1,490	n/a
Consumer price inflation (% change p.a.)	5.9	8.3	10.3	11.6	11.0
Current-account balance (US\$ mn.)	-22	-26	20	-27	n/a
Exchange rate (average Tala:US\$)	1.76	2.12	2.20	2.14	1.98
FDI inflow (US\$ mn)	5	1	2	3	n/a
FDI inflow (as % of total Pacific)	3.9	0.9	2.2	1.9	n/a

Sources: Asian Development Bank: *Key indicators of Developing Asian and Pacific Countries: Tonga, 2004*  
EIU, *Country Report: Tonga*, December 2004  
UNCTAD, *World Investment Report 2004*, Country Fact Sheet: Tonga  
World Bank, *World Development Indicators* database, August 2004

### Scope of the Project

Against this economic background, FIAS and the World Bank completed two mission visits to Nuku "Alofa (10-15 September and 15-19 November 2004) to assess the Tongan Government's and the private sector's interest in and commitment to a FIAS/World Bank joint advisory project, focused on regulatory and institutional reform for private sector development.

At all the meetings, the *Doing Business* results were the starting point for discussions. The *Doing Business* findings suggest that Tonga is not the most difficult location to do business in the Pacific (see slide below); neither is it the easiest, performing below OECD averages. Nevertheless, there was a concern, in the Tongan Government and, more especially, the private sector, that over-complex administrative processes were impeding new investment and job creation in the private sector. FIAS's previous administrative barriers work with the Ministry of Labour, Commerce and Industries (MLCI) confirmed this. The Asian Development Bank (ADB) had also reinforced this and called for the Government to take urgent action to remove delays in the issuing of visa and work permits for foreign investors, for example.



The discussions suggested there was a need to improve the regulatory processes that govern businesses and to include more consultation with the private sector. Subsequent to the second mission visit, the Minister of Finance sent a letter of request for assistance regarding the proposed project.

In summary, the Minister of Finance requested the following Scope and Outputs for the project:

### ***Scope of Work***

- To support the creation and first year of operations of a public/private Task Force and Working Group, whose job will be to identify and remove regulatory and administrative obstacles to business. The Task Force and Working Group to be led by and report to the Ministry of Finance (MoF).

- Initial scope of work to be determined by a review of the World Bank's *Doing Business* findings, FIAS's Administrative Barrier's assessment, a private sector benchmarking survey and any other diagnostic work available to Government or the private sector.
- Project to be jointly supported by the World Bank and FIAS, who would provide a part time internationally recruited implementation specialist supported by regular visits by Bank and FIAS staff.
- Government would provide a full time project manager.

### ***Outputs/Deliverables***

- Creation and functioning of joint public/private sector Task Force and Working Group.
- Completion, early in the first year, of benchmarking survey of the private sector to determine the main issues to be addressed by the project.
- Identification of key reform actions required.
- Preparation of workplan to implement actions.
- Removal of obstacles and easing of regulatory and administrative constraints in key areas of concern to the private sector.
- Organisation of private sector workshops and other dissemination events.
- Monthly and quarterly reports on activities and outcomes. Year-end reports on achievements, lessons of experience and implications for subsequent years' programs.

### **Project Commencement**

The project commenced on 21 March 2005 with the recruitment of a FIAS/World Bank consultant with expertise in regulatory reform, based in the Ministry of Finance (MoF). On 29 March 2005 a joint World Bank and FIAS team arrived to present and discuss the *Doing Business* findings to Cabinet, senior government officials and the private sector, and to launch the technical assistance to be provided to the MoF.

During the consultant's first mission to Tonga, between 21 March and 30 April 2005, the consultant began work on the project as envisaged.

## **Project Redirection**

On 22 July, 2005 Tongan civil servants went on strike for seven weeks.

In September 2005, there was a meeting in Washington DC between the Minister MoF and the World Bank and FIAS, covering the serious impacts of civil service strike. The Minister MoF requested short term emergency advisory assistance. The Sydney based World Bank Country Director agreed to make the resident consultant available for advisory assistance under the remit of this project. The consultant's activities on his second mission to Tonga between 27 October to 8 December 2005 shifted focus to advising the Minister of Finance on private sector issues associated with the settlement of the public sector employees strike. He also, where possible, continued consultations with the public and private sector in developing the Task Force/Working Groups concept.

The project returned to its original focus during the consultant's third and final mission to Tonga between 28 January to 6 June 2006.

## **2 Activities and outputs under the project**

The activities under the project can be divided into six categories:

- Consultation with the public and private sector and development of the Task Force/Working Groups model
- Response to the civil service strike
- Survey of Business Climate
- Establishment of the Public Private Task Force and its activities
- Recommendations for reform actions and the associated Working Groups' activities
- Workshops and public information programs.

### **Consultation with the public and private sector and development of the Task Force/Working Groups model**

During the consultant's first mission to Tonga, between 21 March and 30 April 2005, discussions were held with representatives of the public and the private sector to determine the best model for establishing the proposed Task Force and Working Groups. It became apparent that one of the main factors holding back the implementation of reform in Tonga was the significant communications gap and lack of trust that existed between the two sectors. It was agreed that the way forward was to establish a Task Force and a series of Working Groups 50/50 public/private participation that would focus on particular aspects of regulatory reform for private sector development.

### **Response to the civil service strike**

The consultant returned to Tonga between 27 October to 8 December 2005. The project's main focus during this period was advising the Minister of Finance on private sector issues associated with the settlement of the public sector employees strike. Two short reports were produced on the impact of the settlement and on the private sector's ability to participate in any program of alternative service delivery.

In summary, in the first paper it was suggested that there would be both negative and positive impacts on the private sector and that these could have different effects on particular sectors. Suggestions to ameliorate the negative impacts included speeding up the regulatory reform work as well as extending and expanding the ADB-funded Business Development Facilitation Unit. This Unit was intended to increase the capacity of Tongan businesses to take up opportunities offered to the private sector as a consequence of the down-sizing of the public sector and the outsourcing of services. The second paper suggested a multi-donor approach with the GoT taking a leading role.

The Minister of Labour, Commerce and Industry requested advice on downsizing and private sector outsourcing of two departments in his ministry, the Small Industries Centre, and the Cooperatives and Credit Unions Department. In summary, the operations of both units were evaluated and suggestions were presented to the Minister on how considerable reductions could be made in staffing levels by outsourcing, and by implementing improved management practices such as consolidation of activities and introducing commercial practices into service delivery.

As at June 2006 this process was ongoing with decisions yet to be made on the exact numbers of staff who will be offered redundancy. Any restructuring will follow this decision.

## **Survey of Business Climate**

With the MoF receiving conflicting information on the effect the strike action and the subsequent wage settlement was having on the private sector, it was agreed that it would be suitable to undertake a survey of the business climate in Tonga. This was jointly conducted by the MoF, the MLCI, and the Tonga Chamber of Commerce and Industry in March 2006. Thirty-seven businesses in Tongatapu, Vava'u and Ha'apai ranging in size from one employee to 135 employees, (collectively employing 699 people), were surveyed. The results showed that whilst some businesses had been adversely affected, others had benefited, although all businesses did report significant increases in costs. Employment numbers had increased over the previous 12 months but were expected to stay the same over the next year.

## **Establishment of the Public Private Task Force and its activities**

Cabinet Decision No. 35 of 25<sup>th</sup> January 2006 approved the establishment of a Task Force, and associated working groups, for the Implementation of Regulatory Reform for private sector development and job creation.

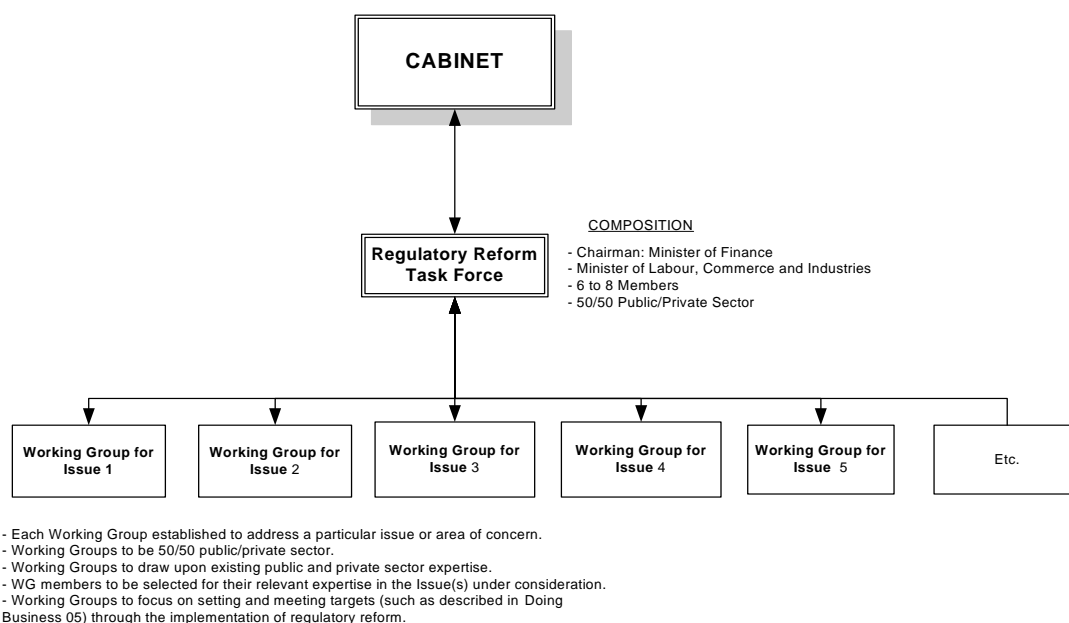
## **Role and Function of the Task Force**

The intention was for the Task Force to be a decision-making body, with the detailed investigation and evaluation work being undertaken by designated Working Groups. Being established by Cabinet, the Task Force has the appropriate authority to carry out its tasks. Given this, its main functions are:

- Provide strong leadership in driving the regulatory reform process.
- Provide a high level forum for the discussion of regulatory reform as it affects private sector development and job creation.
- Report to Cabinet on the progress being made on regulatory reform and make recommendations on changes to Legislation and Regulations as may be required.
- Set priorities and measurable targets for the implementation of regulatory reform in those areas of public sector policy that have a direct effect on private sector development and job creation so that the progress of implementation of those reforms can be monitored.
- Establish Working Groups that will investigate alternatives for the acceleration of the regulatory reform process and make recommendations to the Task Force.
- Assess the recommendations made by the Working Groups and, where those recommendations are agreed, ensure that they are implemented within the agreed timeframe, initiating corrective actions as may be needed.

It was recommended that the Task Force and Working Groups be organised in the following manner:

**Table 1: Organisation for implementation of regulatory reform**



### ORGANISATION FOR IMPLEMENTATION OF REGULATORY REFORM

#### Composition of the Task Force

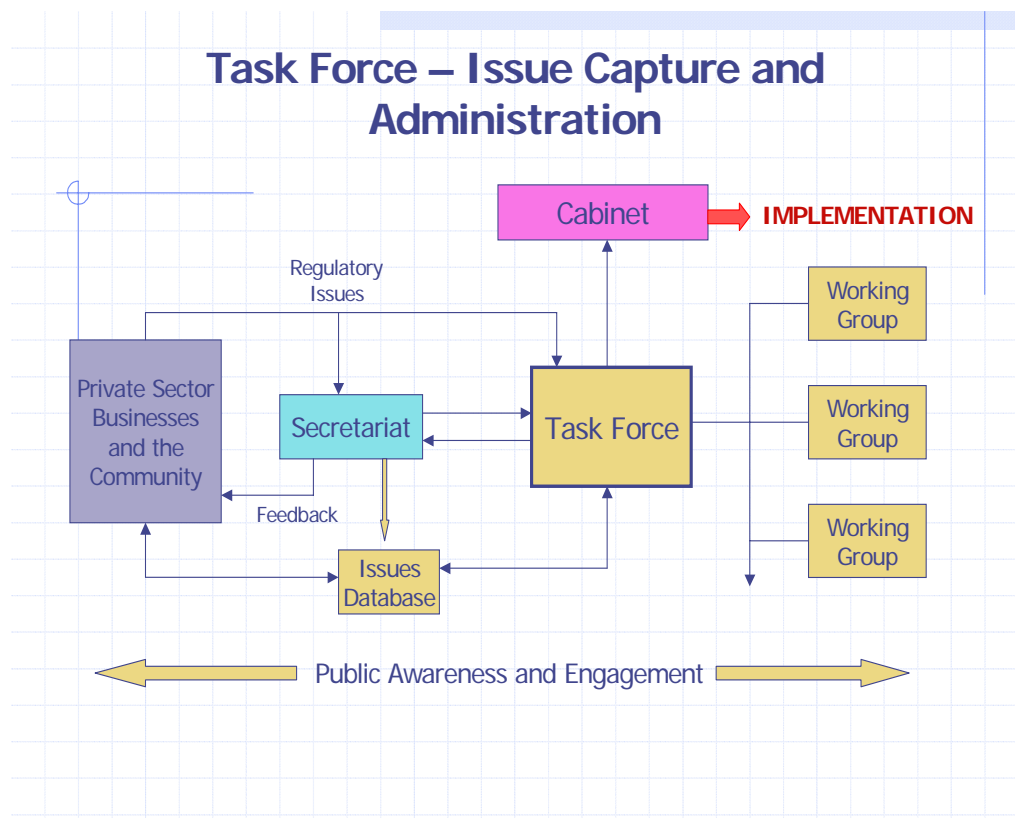
The Task Force is chaired by the Minister of Finance and is made up of 8 representatives from the private and public sectors: the Minister of Labour, Commerce and Industries, Hon. Tuita Minister of Agriculture, Fisheries and Food<sup>1</sup>, ‘Alisi Taumoepeau, Solicitor General, ‘Afu’alo Matoto, General Manager, Tonga Development Bank, Mishka Tu’ifua, General Manager Westpac- BOT, Tapu Panuve, President of the Tonga Chamber of Commerce and Industry, Timote Katoanga, Deputy General Manager TCC.

#### Secretariat

Secretarial services are being provided by the MoF with support from World Bank / FIAS consultant. Other donor agencies including AusAID, NZAID and ADB have indicated their support for regulatory reform and could provide assistance for any activities identified by the Task Force and the Working Groups.

<sup>1</sup> In May 2006 the Prime Minister announced a Ministerial reshuffle. This saw the Hon. Tuita take over the Lands Ministry and ‘Alisi Taumoepeau promoted to Justice Minister. In addition he selected Paul Karalus, Chairman of Working Group on licenses, permits and inspections, to be Transport Minister.

**Table 2: Task Force issue capture and administration**



**Task Force activities**

The Task Force has held four meetings to date. Significant developments resulting from these meetings include:

- Agreement that the Task Force’s activities be expanded so that the whole community could be engaged in the regulatory reform programme. The Task Force was of the opinion that more attention needed to be given to the smaller local businesses, particularly those in the other islands, and this would best be achieved if there was significant public participation in the regulatory reform processes. Concurrent with this, the Minister of Finance reported that the National Committee for Political Reform (NCPR) had reported that in their consultations with the Tongan community many of the issues that were brought to their attention were actually regulatory in nature and not political. It was therefore timely that the Task Force should expand its activities at this time to demonstrate to the general public that government was responding to their concerns. As a direct consequence of this, the Secretariat made three presentations at public forums.

- Following on from this expansion of the Task Force’s activities, the Secretariat prepared a Communications Strategy. This was formally approved by the Task Force and application for funding to implement this strategy was made to the Aid Management Unit of MoF. This has been approved by Cabinet.
- The Task Force approved the formation of four Working Groups, namely: Starting a Business; Licenses, Permits and Inspections; Immigration; and the Fishing Industry. The Task Force has endorsed Terms of Reference and selected members for each Working Group.
- The Task Force is investigating certain regulatory issues where it is not appropriate at this stage to initiate a Working Group, but have been raised as being regulatory issues of immediate concern to the private sector. These include compilation of all legislation into electronic format, online registration of companies, some consumption tax issues, and some land issues. The Task Force has asked the Secretariat to progress these issues with the intention of having some ‘quick wins’ to further establish the credibility of the Task Force.

## **Recommendations for reform actions and the associated Working Groups’ activities**

It was recommended that the primary role of the Working Groups should be to make specific and detailed recommendations to the Task Force on how to make improvements in the regulatory environment in Tonga as it affects private sector development and job creation. At its initial meeting the Task Force considered a list of possible areas of focus as summarized in the table below.

<b>ISSUE / AREA OF REFORM</b>	<b>RATIONALE</b>
<b>1. Starting a Business:</b>	Benchmarked in Doing Business 2005 at 39 days and 14% of GNI per capita
1.1 Company Registration	(a) This is the major time and cost component of starting a business. (b) Anecdotal evidence suggests that the actual time can vary from 2 days to 2 months or more depending on the applicant's local knowledge and contacts. This suggests that if this knowledge could be made available to all applicants the time required could be reduced substantially.
1.2 Other procedures?	Needs to be investigated to see if any other procedures, e.g. starting a bank account, are causing delays.
<b>2. Business Licenses and Inspections:</b>	This is not currently benchmarked (to be included next year) but is closely related to Starting a Business. Has been identified by the private sector as important. Because of work already done, implementation could possibly be fast tracked by a Working Group.
2.1 Business License	(a) Business Licenses Act was assented in Dec 2002 but drafting of Regulations not completed. (b) Has been assessed by the MLCI/FIAS Admin Barriers Projects and recommendations made.
2.2 Development License	(a) IDI Act (b) Has been assessed by the MLCI/FIAS Admin Barriers Projects and recommendations made.
2.3 Foreign Investment	(a) Foreign Investment Act was assented in April 2003; Regulations have been drafted and passed to Crown Law for review.
<b>3. Employment:</b>	Whilst perhaps not as important to locally owned businesses as to foreign investors, it is perceived to be a significant obstacle to attracting new businesses.
3.1 Rigidity of Employment	(a) Benchmarked in DB '05 as 7 on a 0-100 scale. (b) New Employment Bill currently at Crown Law.
3.2 Work Permits and Visas	(a) This is seen as a major issue by the private sector. (b) Has been assessed by the MLCI/FIAS Admin Barriers Projects and recommendations made.

<b>4. Contract Enforcement:</b>	Benchmarked in DB '05 as 305 days and 47% of debt. Not certain as to how much of an issue this is in Tonga. Needs further investigation.
<b>5. Credit Markets:</b>	Benchmarked in DB '05 as 0.
4.1 Establishment of a Pacific Region credit information agency	(a) This has been suggested in other PI countries. Fiji is a possible model. Tonga could possibly lead a regional initiative.
<b>6. Property:</b>	This is reported to be a major issue with no obvious short-term solutions. Presumably work has already been done on studying the problems, so an assessment needs to be done as to whether a WG could assist in implementation of regulatory reform.
6.1 Land	(a) The availability of suitable land for long-term leasing appears to be restricting PSD. (b) Security of tenure of lease agreements appears to be an issue. (c) Uncertainty of the 5 yearly rent review may also be a problem.
<b>7. Bankruptcy:</b>	Benchmarked in DB '05 as 37. Relevance in Tonga is not certain at this stage.

The first two issues – starting a business and licenses, permits and inspections – were seen as areas where there was urgent need for reform, and some ‘quick wins’ could be made. The Task Force also asked for a Working Group to be established on the fishing industry as a response to lobbying from the export fishing industry. This was expanded to include all fishing sectors partly to complement the existing AusAID-funded Tonga Fisheries Project and partly in response to comments from fishing industry representatives. A fourth Working Group on immigration was requested by the Task Force at a later meeting in response to urgent calls from the private sector to review the regulatory environment in this area.

The following reform areas are discussed in the sections below:

- Starting a business
- Licenses, permits and inspections
- Immigration
- Fishing
- Land issues
- Customs

## **Starting a Business**

A long list of issues that could be considered was developed, and from this the registration of new businesses was selected as a priority by the Task Force. The intention is to benchmark the Tongan system against the New Zealand system (recognised as amongst the best in the world) and use this to identify specific changes that should be made in Tonga. An immediate problem that has been identified is in the delegation of authority to register companies. The Working Group (WG) is also road mapping the whole process with the aim of identifying blockages and inefficiencies that can be improved on. This will have the added benefit of linking their work with the closely associated work being done by the licenses, permits and inspections WG and the immigration WG.

## **Licenses, permits and inspections**

This working group has met only once. In light of the poor level of participation, the future of this working group will have to be reviewed.

## **Immigration**

This working group has met on a number of occasions and is focussing on some key issues. The Immigration Department has developed draft procedures for issuing each category of visa and these are being evaluated in the WG with the intention of making them available broadly available to the public. The Department has also been reviewing the categories of visas that can be issued. These are being discussed in the WG with the intention of increasing the duration of business visas from 2 years to at least 10 years for foreign investors. Consideration is also being given to the establishment of new categories of visas, e.g. for short term business visitors.

## **Fishing**

This WG has been focussing on implementation issues associated with the consumption tax that was introduced in 2005. This is of particular relevance to the export fishing industry and is deemed to be a priority because of its economic significance. The industry representatives have raised a number of issues with the implementation of Consumption Tax (CT), the most urgent of which concerns the timing of submitting their returns (currently every 15 days). The refunding of input credits is also being delayed by a range of issues such as late or non-filing of returns, errors in returns, and other information delays (two months or more is not uncommon). This is placing severe stress on their cash flow situation. They are requesting via the WG that this be changed. Other issues that are of concern to them include the exemption on CT given to the agriculture industry but not to the fishing industry. The Secretariat is working with the WG to prepare an issues paper for presentation to the TF that will make specific recommendations for changes.

## **Land Issues**

A briefing paper on land issues was accepted by the Task Force and used as the basis for preparing a Cabinet submission, which is awaiting consideration by Cabinet. The Crown Law Department will now be progressing the amendment to the Land Act.

Although it is recognised that the Land Act is in need of review this is going to take several years to achieve. The Task Force was able to identify one issue that is particularly related to private sector development that could be considered separately and was unlikely to be seen as culturally sensitive. This relates to the “tax allotments” that are allocated to Tongan males and can be sub-leased for commercial development. Whereas “urban allotments” could be sub-leased for periods of up to 99 years, tax allotments, which constitute the majority of the available land, particularly for tourist developments, could only be leased for a maximum of 20 years. An amendment to the Act has been proposed and approved by Cabinet that will see tax allotments treated in the same way as urban allotments, thus releasing a significant amount of land for private sector development including tourism.

## **Customs and Trade**

Cabinet has agreed to a proposal from the Minister MLCI to establish a separate Task Force to look at this issue. The Task Force therefore agreed to put this issue on hold.

## **Workshops and public information programs**

The Task Force has emphasised the importance of community consultation and public participation in all its activities. The Communications Strategy was developed in consultation with the Reform Information Office (RIO) of the MoF and is being implemented with their assistance although external donor funding is also being sought. The strategy being followed is to use a range of media tools that are simple and powerful in spreading the message to key stakeholder groups which include the private sector, NGOs, women’s group and the general public. The approach is proactive and involves approaching the community to (a) determine what regulatory issues are of most concern to them, and (b) train them in how to use the participatory processes that have been established by the Task Force. The key message is to inform the public that the Task Force is focussing on the implementation of regulatory reform that will significantly improve the environment in which all businesses operate. Full information about the TF and WG’ has been added to a dedicated section of the MOF’s website [www.tonga-now.to](http://www.tonga-now.to).

The Task Force is committed to a policy of full transparency in its operations and in line with this has approved the publishing of all minutes of all Task Force and Working Group meetings on the website. Future planned activities include:

- Regular consultation with all sections of the community through open meetings in all parts of the Kingdom;
- Expansion of the website to include an interactive database where progress on regulatory reform issues can be tracked; and
- Exploring new ways to involve the wider community in regulatory reform, such as talk back radio, youth and women's programmes.

## **Other Related Activities**

At the request of the Government, NZAID has recently approved the funding of a legislation compilation project. This project will see all Tongan Acts, Regulations and Amendments compiled into electronic format and the establishment of a searchable database on the internet. Access to this database will be free. There will also be 500 CDs prepared and distributed widely to the private and public sector in Tonga. The electronic compilation of all legislation in Tonga will be a significant step forward in terms of good governance. Implementation of this project is expected to significantly assist regulatory reform for private sector development by focusing attention on the role of law in everyday business activities and making this information freely available to them.

### 3 Future issues facing the PSD regulatory reform process in Tonga

The continued existence of the Task Force is very much dependant on two issues. First, the active support of the key government counterparts including the leadership provided by the Minister of Finance. Second, the continued active involvement of representatives of the private sector on the Task Force and the Working Groups.

The workload of the Secretariat is expected to increase significantly in the near future brought about by:

- Supporting the Task Force with the provision of technical advice and support on a range of investment climate issues;
- Supporting the 4 Working Groups that have already been approved and others as they are established;
- Implementing the communications strategy; and
- Managing the community's participation in the activities of the Task Force.

This will necessitate an increase in human and physical resources. While the World Bank Group long term consultant was able to assist with some of this work, it clearly requires significant and sustained inputs from the MoF itself if full ownership of the process is to be achieved. Some extremely useful work has been provided by the counterpart from the MoF but, in light of the proposed enhanced workload it may be this part time role has to be increased to a full time position. Additional Tongan personnel may also be required on an ad hoc basis depending on how the Working Groups programmes of activities evolve.

The strategy being followed of maximising broad public support for the Task Force both through membership of the Task Force and the Working Groups and by having a high public profile will add to the longer term stability of the Task Force. However, this effort needs to be maintained over time and possibly expanded. Although the private sector, at least in Tongatapu, appears to support this initiative, this will only last if the Task Force both achieves results and is seen to be achieving results. There is also a need to extend this awareness/support into parts of the private sector that have been largely ignored up until now, including rural and remote areas. Although this engagement has commenced, additional resources will be required to fully implement the strategy. However, it would be advisable to ensure that some reforms have been agreed and implemented before embarking on a communications strategy which unrealistically raised expectations in Tonga.

## 4 Next Steps

Following meetings with the Minister of Finance in Sydney with senior representatives from the World Bank Group and subsequent meetings in Tonga in late May 2006, the Government has indicated that it is committed to continuing with regulatory reform of the investment climate. On this basis, the establishment of the Task Force and the four key Working Groups should be viewed as a good foundation upon which further reform efforts could be constructed.

Discussions with the Government and the private sector representatives suggest that there is a case for designing and implementing a follow-on stage of the investment climate reform program which would have a number of components including:

- Extending the provision of the long term World Bank Group resident advisor for a further extended period to assist the Government and its Task Force with implementing the reform program;
- Extending the range of work to include issues such as: i) improving the foreign companies registration process; ii) improving the regulatory environment in the tourism sector; and iii) exploring the possibility of establishing a Public-Private Forum for the discussion of investment climate reform issues.

The Government has written formally to the World Bank Group asking for assistance in these areas and this request will be examined as a matter of priority.