

# The Tongan economy 2007

Siosuia T.T. Utoikamanu

Tonga's domestic economy is expected to return to positive growth in 2007/08 following a softening of economic activities in 2006/07 that was due largely to two major events: the wage settlement of 2005 and the civil disorder in Nuku'alofa on 16 November 2006. The Government has successfully steered the economy through each crisis.

In order to maintain macroeconomic stability and business confidence, the following are being implemented—completion of the revenue reform program, concessionary finance for reconstruction of Nuku'alofa, pro-poor policies, and further public sector reforms. The most immediate priority is to restore social stability through law and order and political reform. Then the government can address its next highest priority, which is to make sure the needs of the productive sectors are treated equally with the needs of the social sectors. Investment in infrastructure is also urgently required.

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The Tongan economy has demonstrated its ability to withstand severe shocks. After bouncing back from earlier fiscal crises, oil shocks, cyclones, etc, the Tongan economy recently had to recover from two domestic shocks. First, the fiscal shock of the 2006 public sector '60:70:80' pay settlement was offset by substantial public sector redundancies; and second, the government's recovery and reconstruction initiatives have helped to offset some of the damage caused by the 2006 civil disorder.

Once again, the economy's foundations of macroeconomic stability and local and international confidence are being restored, but the far bigger challenge is ahead of us: to unite in building a more dynamic

domestic economy led by an internationally competitive private sector offering growing employment and incomes.

## Production and employment

Over 2001/02 to 2005/06, real GDP for Tonga has trended at around 3 per cent growth per annum, apart from lower growth in 2003/04 and a reduction in 2004/05 (Table 1). However those two years brought the average annual growth in real GDP down to only a little over 1 per cent per annum for the 5-year period.

When the aggregate is analysed into the seven main sectors, the picture is one

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of considerable volatility in the annual growth achieved by each sector. Partly this reflects the relatively small size of the productive sectors. For example, it appears likely that it is the closure of the national airline Royal Tongan Airlines which shows up as a substantial contributor to the fall in 2004/05 real GDP.

However, the pattern over these five years is typical of Tonga's economic fortunes

over a much longer period of time: no single sector consistently provides strong growth, with all sectors showing fluctuating rates of growth; the primary sectors of agriculture, forestry and fisheries make up around 25–30 per cent of total GDP; and domestic manufacturing and construction make a small contribution. The combination of these factors adds up to a low average annual growth rate in real GDP.

Table 1 Tonga real sector developments, 2001/02–2005/06

	2001/02	2002/03	2003/04	2004/05 <sup>e</sup>	2005/06 <sup>e</sup>
Nominal GDP					
In pa'anga million	310.8	349.4	371.9	425.5	473.0
In US\$ million	142.6	159.4	186.9	221.4	229.3
GDP per capita (US\$)	1,433	1,594	1,862	2,197	2,266
Population	99,558	99,958	100,360	100,764	101,169
		Percentage change of GDP			
GDP (2000/01 prices)	3.2	3.4	1.1	-0.3	2.9
of which:					
Agriculture, forestry, and fisheries	3.6	3.8	-1.2	-0.3	-1.5
Manufacturing	6.0	4.1	-4.2	-7.7	-3.4
Construction	5.0	1.3	-2.9	0.4	-1.1
Commerce, restaurants, and hotels	6.5	4.5	7.9	-0.8	-6.2
Transportation and communications	-6.3	9.1	-5.2	-12.2	-2.0
Finance and real estate	4.0	1.7	4.6	2.6	0.3
Government services	2.0	0.6	4.7	1.1	34.4
		Percentage of total GDP			
GDP (by sector; current prices)					
of which:					
Agriculture, forestry, and fisheries	23.5	24.2	23.1	25.5	25.6
Manufacturing	3.9	4.0	4.4	5.1	3.5
Construction	7.8	7.1	6.6	9.9	8.4
Commerce, restaurants, and hotels	12.8	13.1	14.8	16.5	14.3
Transportation and communications	6.4	6.4	5.6	8.5	8.3
Finance and real estate	9.2	9.4	10.2	11.7	11.9
Government services	10.9	9.7	9.6	13.6	18.0
		Consumer prices (period average)			
Consumer prices (period average)					
All items	10.0	10.7	11.8	10.0	7.3
Imported component	12.4	13.2	15.4	8.8	5.3
Domestic component	7.3	7.9	5.4	12.6	11.3

Source: National Reserve Bank of Tonga; Statistics Department, Government of Tonga; International Monetary Fund staff estimates.

## Analysis of performance by sector

### Agriculture

General indicators show that the performance of the agricultural sector has been below expectations since 2003/04.

This performance mainly reflects the low returns from squash exports. Volatile Japanese market prices at times were so low that exporting was not viable, and volumes fell as well. The recent development of a new Korean market for baby squash may partially offset the decline in the Japanese market.

There are other agricultural products that are likely to contribute positively to the sector like Tahitian vanilla, root crops and taro leaves. However, in the short-term the lower than expected performance of the squash industry is likely to outweigh any of the positive contributions from other agricultural export produce.

Partial estimates indicate that vanilla exports are likely to increase in 2006/07, despite the falling prices in the last two years. Returns for vanilla exports from Tonga have been affected by fierce competition in this industry, with prices falling as countries like Indonesia and Vanuatu entered the world market.

Provisional data also suggest that root crop exports improved in 2006/07. The high risks and lower price in the squash industry has caused many farmers to return to growing and exporting more traditional root crops such as yams and taro as well as cassava. These crops have lower returns compared to what squash has achieved in its good years, but less risk year-by-year. The main target markets for these root crops are Tongan communities in New Zealand, Australia and the United States.

### Fishing

Preliminary data indicates a similar situation to agriculture, in that activity in the fishing industry is also expected to stay below

expectations. The projected decline in yield from the industry is attributed to various reasons such as the depletion of fish stock (a general trend in the Pacific region according to various studies), harsh weather conditions, lack of new technology, lack of cargo space in airlines to export fish to markets and lack of accessibility to credit. Provisional indicators for 2006/07 showed fluctuating monthly volumes of marine exports. Although export revenues may be stabilising, they are at much lower levels than hoped for.

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

### Manufacturing

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

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

In addition to the regulatory reform, the ratification of Tonga's membership in various free trade agreements will

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provide some market access for Tonga's manufacturers. Other Regional Trade Agreements like PICTA and EPA will provide market access in Europe, other ACP members and neighbouring countries.

### **Construction**

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

The performance of the industry in 2006/07 is explained by the completion of several major donor-funded projects such as the Waka cyclone rehabilitation project and phase 1 of the health sector support project. In addition, maintaining appropriate credit growth after the large redundancy payouts also constrained the industry. It is expected, however, that with the Reserve Bank's policy of lifting credit ceilings, housing loans should increase. It is also expected that the reconstruction of Nuku'alofa will have major impacts over the next few years.

Other positive influences over 2007/08 and beyond include known projects in tourism development, renovation work by a major church, and phase two of the Vaiola Hospital development.

### **Commerce, restaurants and hotels**

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

The projected weakening of the tourism industry, combined with the estimated fall in consumer spending (after the one-off spending of redundancy pay in 2006), will significantly affect the performance of this sector for 2007/08. However, this may change as a result of higher passenger capacity and forecast increased activity in the transport and communication industry.

### **Transport and communications**

Provisional estimates suggest that the sector is experiencing high levels of activity. Air Pacific has extended its flights to Tonga by two flights per week while Air New Zealand now brings in bigger aircraft with higher capacity. These will contribute positively to other sectors of the economy particularly tourism, where the government has increased its overseas marketing efforts.

Sea transport capacity is also being increased through the replacement of the government-owned domestic ferry 'MV Olovaha' which will result in improved services through more frequent and greater freight capacity for the outer islands.

### **Employment and living standards**

The Government of Tonga does not yet have employment figures from the Census data for 2006 which is still being processed. It is likely that the situation has not improved significantly since the Labour Force Survey of 2003 indicated

- a national unemployment rate of 5.2 per cent
- the rate of female unemployment was 7.4 per cent
- the long term unemployment rate was 3.8 per cent—equivalent to 73.8 per cent of the total number of unemployed people
- the youth (age 15–24) unemployment rate was 11.9 per cent—15.1 per cent for female youth and 9.9 per cent for male youth.
- unemployed young people accounted for 43 per cent of total unemployment
- most unemployed young people (88 per cent) had never held a job
- most unemployed people were low-skilled, especially those long-term unemployed.

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- Tonga's labour force participation rate (64 per cent) matched Australia's (also 64 per cent) but was above average for Pacific island nations.
- The Tongan average level of educational attainment was also much closer to New Zealand or Australia, and significantly better than the Pacific average.

Since then, the commercial damage caused by the 16 November 2006 civil unrest had indirect flow-on effects on employment by reducing economic activity primarily in the Commerce, Hotels and Restaurants industry. This was due to businesses that ceased trading and also to reduced employment and incomes caused by tourist cancellations. These indirect effects also reduced economic activity in other industries, such as Transport and Communications, Financial and Real Estate Services and Manufacturing.

According to surveys by the Ministry of Labour, Commerce and Industries, 153 businesses were directly affected and a further 107 businesses were indirectly affected by the civil unrest. The affected businesses estimated that 678 jobs were affected, although this figure has been revised down reflecting the resilience of the private sector and willingness on the part of employers and employees to be flexible over hours of work and pay levels.

However, the labour force structure does not change rapidly. The situation outlined as at 2003 had been developing over a long period during which Tonga enjoyed some of the highest levels of tertiary qualifications in the world, developed or undeveloped, but the problem of unemployment of poorly-qualified youth has grown at an accelerating rate in recent years.

The labour force analysis must be viewed in the context of the overall demographics of natural growth in population and the impact of migration. Over the five-year period 2001/02 to 2005/06, when real GDP for Tonga averaged only a disappointing 1 per

cent per annum, the population estimates show an even lower annual increase of roughly half that amount, that is, around 0.5 per cent per annum. As a result, real GDP per head increased over that period, but the increase in real living standards over this period was even greater because of remittances.

These figures show that the high outwards migration of relatively skilled Tongan workers has had two positive impacts on living standards in the Kingdom. First, it turns the slow growth from traditional industries into a more acceptable increase in domestic production per head. But the much more important impact has been that it continues to build the expatriate workforce of overseas Tongans whose remittances contribute so much to the Tongan economy—as shown in the next section. In other words, the arithmetic of 'income per head' measurement means that Tonga's 'export' of skilled workers raises domestic living standards in two ways, because it helps both parts of income per head calculations

- reduces the remaining domestic population (the 'per head' part)
- boosts income through remittances.

However, Tonga's future domestic growth in employment and incomes will depend on the development of relatively labour-intensive industries like tourism, which is one of the few obvious sectors that could make a significant contribution to employment. This is of great importance in Tonga where about half of the population is under the age of 20 and where there are growing numbers of youth unemployed with limited employment opportunities.

### **Trends in the real sector**

Historically, Tonga's domestic economy has not achieved sustained high growth in production as measured by real GDP

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Table 2 Tonga: balance of payments (million pa'anga unless otherwise indicated)

	2001/02	2002/03	2003/04 <sup>P</sup>	2004/05 <sup>P</sup>	2005/06 <sup>P</sup>
Balance of trade	-94.9	-110.9	-121.6	-144.9	-169.1
Exports, f.o.b.	38.8	40.1	41.7	40.5	23.4
Of which: Squash exports	7.1	12.9	5.1	10.1	8.3
Imports, f.o.b.	-133.7	-151.0	-163.3	-185.4	-192.5
Services (net)	-4.1	-43.1	-32.3	-53.7	-40.9
Receipts	36.2	48.2	56.6	54.6	74.7
Of which: Tourism receipts	12.4	25.7	30.4	24.4	27.1
Payments	-40.3	-91.3	-88.8	-108.3	-115.6
Income (net)	-1.2	5.9	6.1	0.3	11.5
Receipts	5.0	15.0	13.7	12.8	16.3
Payments	-6.2	-9.1	-7.6	-12.5	-4.8
Current transfers (net)	116.0	121.5	136.4	150.9	164.4
Official transfers (net)	0.8	3.7	11.9	19.4	13.5
Private transfers (net)	115.2	117.8	124.4	131.4	150.9
Official transfer receipts	1.6	5.4	12.6	20.3	13.6
Official transfer payments	-0.8	-1.7	-0.7	-0.9	-0.1
Private transfer receipts	142.1	144.1	147.4	153.9	179.8
Private transfer payments	-26.9	-26.3	-22.9	-22.4	-28.9
Current account balance	15.8	-26.5	-11.3	-47.4	-34.1
(Per cent of GDP)	5.1	-7.6	-3.1	-11.1	-7.2
Capital account balance	25.9	25.5	22.3	23.3	23.1
Official capital (net)	21.4	19.5	21.4	23.3	21.4
Official loans, net			-	-	-
Disbursements			-	-	-
Amortisation			-	-	-
Official capital inflows	27.0	19.5	21.4	23.5	22.2
Official capital outflows	-5.6	0.0	0.0	-0.1	-0.8
Private capital (net)	4.5	6.0	0.9	-0.1	1.7
Private capital inflows	14.0	9.2	2.2	0.7	2.6
Private capital outflows	-9.5	-3.2	-1.3	-0.8	-0.9
Financial account	-13.3	2.6	2.3	23.7	14.4
Other credits	4.8	13.3	70.9	39.7	37.5
Official reserve	-13.8	2.6	-52.8	7.6	-1.1
Debits	4.3	13.3	15.8	23.6	22.0
Basic balance	28.4	1.6	13.3	-0.4	3.3
Errors and omissions	-14.6	-4.3	39.5	-7.2	-2.3
Overall balance	13.8	-2.7	52.8	-7.6	1.1
Memorandum items					
Service, income, and transfers (net)	110.7	84.3	110.3	97.5	148.4
Receipts	183.3	207.3	217.7	221.3	284.4
Payments	-73.4	-126.7	-119.3	-143.2	-149.4
Gross official foreign reserves	39.6	36.9	89.7	82.1	83.2
Months of import cover	2.5	2.4	5.4	4.4	4.3

<sup>P</sup> Provisional

Source: Statistics Department, Government of Tonga, Nuku'alofa.

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growth. However, Tonga has enjoyed increasing real domestic living standards largely due to a combination of

- high levels of formal qualifications within a system of universal education;
- high migration of skilled workers to higher-income countries, and
- high remittances from those skilled workers back to Tonga.

Tourism is one of the only sectors that offers a realistic prospect of sustainable growth in incomes and employment, especially for younger people.

### Prices, money and finance

Analysis of the real economy identifies a number of factors that bring a degree of built-in stability to the Tongan economy. The external sectors' performance is summed up in the balance of payments, which clearly shows Tonga's trade imbalance and the importance of private transfers in funding

this appetite for imports (Table 2). Then the rest of the financial sector data set the scene for considering the contribution that monetary and fiscal policies must make to overall macroeconomic stability.

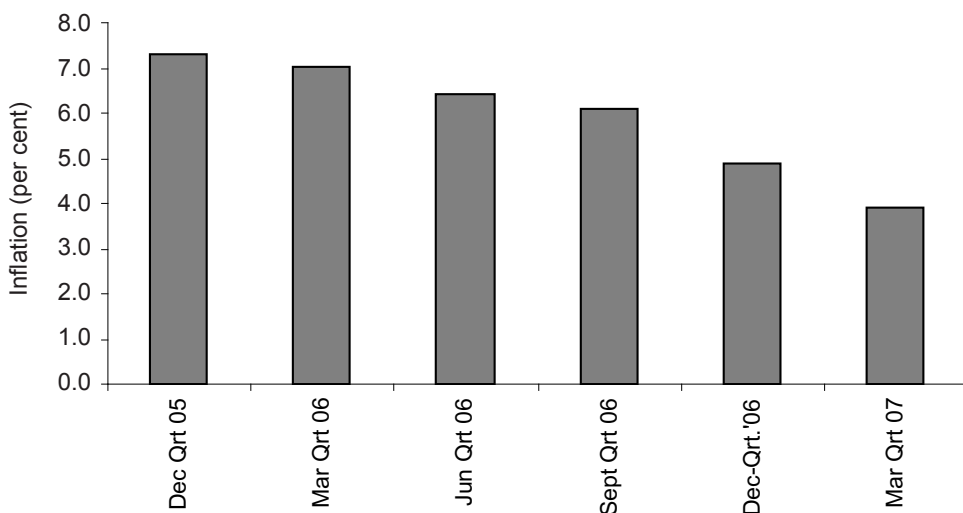
## Balance of payments

### Exports

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

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

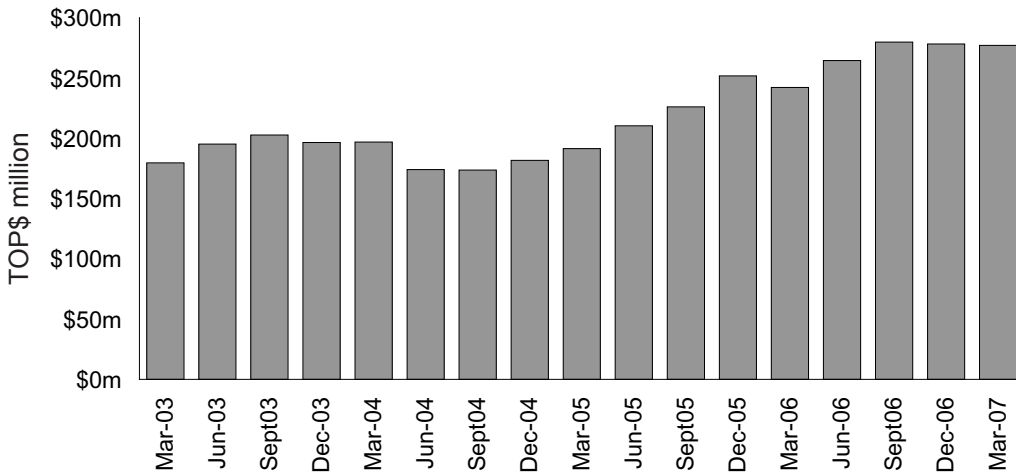
Figure 1 **Tonga: quarterly inflation rate, 2005Q4–2007Q1** (per cent, end period)



Source: National Reserve Bank of Tonga, Nuku'alofa.

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Figure 2 Tonga: domestic credit level, 2003–2007 (TOP\$ million)



Source: National Reserve Bank of Tonga, Nuku'alofa.

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

### Imports

During 2005/06, the value of imports (OET based) rose by TOP\$32.2 million to TOP\$236.3 million, underpinned by firm growth in remittances and growth in business and household credit. During the first eight months of 2006/07, import payments were TOP\$138.8 million, compared with TOP\$158.2 million in the same period last year. The decline in import payments partly reflected the imposition of credit ceilings on bank lending to the private sector.

New Zealand continued to be Tonga's largest supplier of imports (35.0 per cent), followed by Fiji (27.0 per cent), and other countries (14.6 per cent).

### Remittances

Although provisional data for 2006/07 suggests that remittances may have declined, it appears more plausible that this reflects a data problem because one of the key sources of remittance information, the ANZ bank, was affected by the civil disorder of 16 November 2006. Other remittance agencies reported that the underlying trend for remittances remained stable.

The continuing migration of Tongans overseas will contribute to future remittances. The NZ Recognised Seasonal Employment work-scheme is about to start with employment opportunities for Pacific islanders growing at 5 per cent each year. This new scheme is also expected to contribute to longer-term growth in remittances.

### Foreign reserves

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



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2006, the total level of gross official foreign reserves was TOP\$83.2 million, equivalent to 4.3 months of imports. This compared with TOP\$82.1 million at the end of June 2005, equivalent to 4.4 months of imports. At the end of March 2007, gross official foreign reserves amounted to TOP\$90.4 million, equivalent to 4.7 months of imports. This was above the level of external reserves of TOP\$77.4 million, equivalent to 3.9 months of imports a year earlier.

### Prices

The annual inflation rate has been falling since December 2005 and dropped to 3.9 per cent at the end of March 2007 (Figure 1). This decrease in the rate of inflation has largely been due to falling domestic prices. In the year to March 2007, the domestic rate of inflation was close to the rate of inflation for imported goods, whereas previously domestic inflation had been higher than imported inflation.

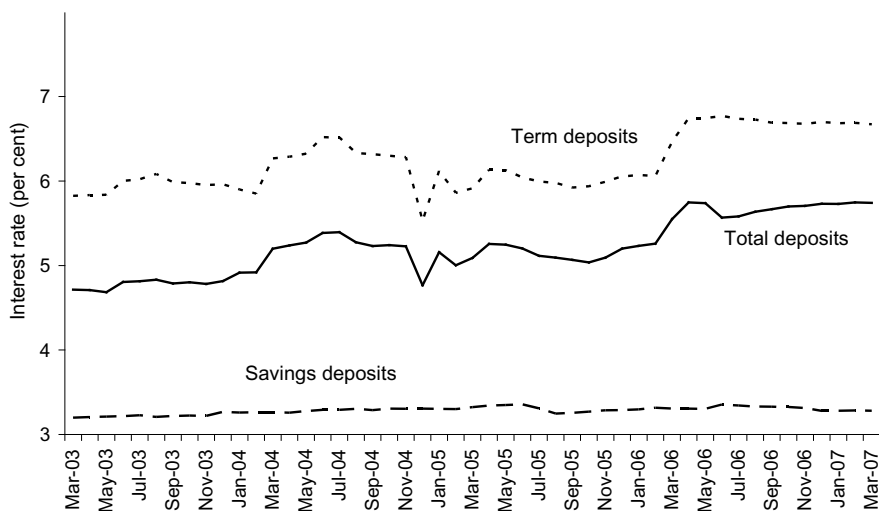
Monetary policy plus reduced reliance on taxes on imports have both helped in restraining domestic inflation. This contributed to higher real living standards.

### Domestic credit

Over the year-ended June 2006, net domestic credit (net of government deposits) extended by the banking system increased by TOP\$54.2 million to TOP\$264.5 million (Figure 2). This represented an increase of 25.8 per cent compared with a 20.9 per cent increase in 2004/05. The rise in the level of net domestic credit was largely due to an increase in private sector credit.

Total credit extended to the private sector increased by 22.6 per cent to TOP\$278 million, reflecting an increase in lending to the household and business sectors. At the end of June 2006, the government was a net lender to the banking system, with a net balance of TOP\$18.9 million compared to a net lending position of TOP\$25.2 million in June 2005.

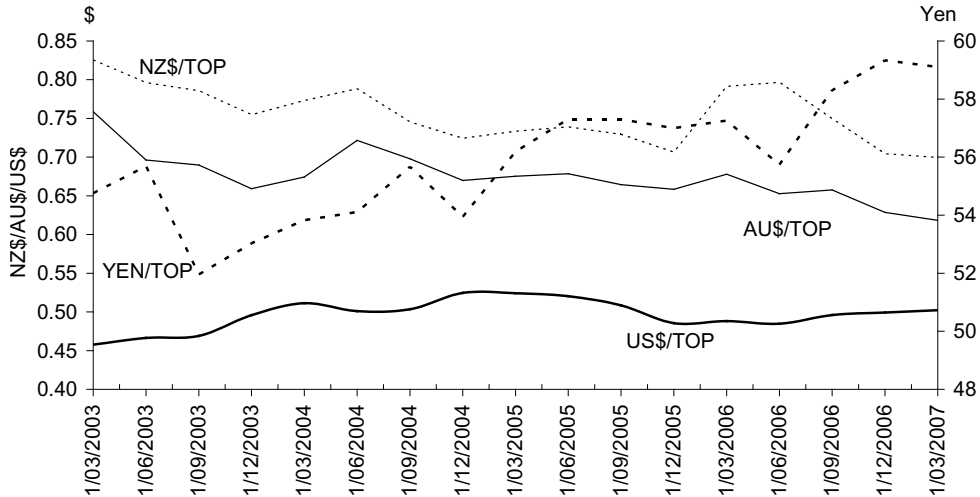
Figure 3 Tonga: weighted deposit interest rates, 2003–2007 (per cent)



Source: National Reserve Bank of Tonga, Nuku'alofa.

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Figure 4 Exchange rates, 2003–2007



Source: National Reserve Bank of Tonga, Nuku'alofa.

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

In June 2006 household credit was the largest contributor to private sector credit growth with a year-ended growth of 22.4 per cent. The trend after November with the credit ceiling and after the events of 16 November 2006, showed business credit surpassing household credit with household credit growth falling to 1 per cent in November and declining further

reaching a record low of negative 6.1 per cent year-ended growth in January 2007. It recovered slowly through the months to a growth of negative 1.5 per cent in March 2007, whereas business credit growth rose from 16.5 per cent in November 2006 to 18.6 per cent in March 2007.

In February 2007, the Reserve Bank officially announced the suspension of credit ceilings on individual banks. The suspension of credit ceilings was to allow banks to consider lending for the recovery of those who were affected by the civil disorder in November 2006. In addition, the Reserve Bank reduced the Statutory Required Reserves ratio by 2.5 per cent to 10 per cent effective April 2007. This added TOP\$6.2 million into the banking system.

#### Interest rates

Nominal interest rates on savings deposits published by the banks were unchanged in the 2005/06 financial year (Figure 4).

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However, weighted average deposit rates have followed an upward trend as reflected by the Reserve Bank's deposits indicator rate. This is indicated by an increase in the weighted average interest rate paid on term deposits, from 6.04 per cent at the end of June 2005 to 6.77 per cent at the end of June 2006. Since July 2006, term deposit interest rates have been flat. However, over the same period the weighted average interest rate on both term and savings deposits increased from 5.58 per cent to 5.74 per cent at the end of March 2007, reflecting a move towards more term deposits.

### Exchange rates

In 2005/06, the pa'anga depreciated against the United States dollar by 6.8 per cent, the Australian dollar by 3.8 per cent and the Japanese yen by 2.7 per cent. In contrast, the pa'anga appreciated against the New Zealand dollar by 7.8 per cent (Figure 4). During the first nine months of 2006/07, the pa'anga depreciated against the Australian dollar by 5.3 per cent and against the New Zealand dollar by 12.2 per cent. However, it appreciated against the US dollar by 3.6 per cent and the Japanese yen by 6.0 per cent, reflecting the weakening of the United States dollar. The fall in the Tongan pa'anga against the Australian dollar and the NZ dollar reflects the strengthening of the Australian dollar and the NZ dollar against the US dollar during this period.

### Monetary and fiscal policy

The emphasis on macroeconomic stability has been maintained as the driver for prudent monetary and fiscal policies.

The Government has managed to ensure that there is sufficient credit to enable the private sector to borrow and expand without threat to the economy from the private sector having to compete against government domestic borrowing. Legislative moves are planned to further

strengthen the inflation-fighting capability and focus of the National Reserve Bank of Tonga.

Fiscal controls have protected core services for the public, and a successful program of revenue reforms is now nearing completion. An excessive reliance on taxes on imports is being overcome.

In 2003/04 taxes on international trade provided 53 per cent of Government revenue leaving only 47 per cent to be raised from domestic sources. It is estimated in the year ended 30 June 2007, at least 63 per cent of Government revenues will be from domestic taxes on incomes, general goods and services (consumption tax), and excise goods (alcohol and tobacco). By the time that the third and final stage of this process is completed by new legislation for customs and excise, and income tax, it is expected that domestic taxes will account for almost 90 per cent of Government revenues, with only around 10 per cent being raised from border taxes.

This modernising of the tax system prepares the way for Tongan-based businesses to compete on an equal footing with foreign-based businesses without the artificial disincentives and commercial distortions arising from over-reliance on trade taxes. These microeconomic impacts are being supplemented by reducing regulatory costs and barriers to the private sector.

### Improving the regulatory environment: the IRR Project

As mentioned above in discussion of prospects for investment in manufacturing production, the Government has created a Task Force for Implementation of Regulatory Reform (IRR) for private sector development. This was approved by Cabinet on 25 January 2006 with four working groups, namely: Starting a Business; Licenses, Permits and Inspections; Immigration; and Fishing Industry. The World Bank is the financier for the project and a Consultant has been

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assigned by the World Bank to assist Tonga on this work.

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

- addressing specific regulatory reform issues, finding appropriate solutions, implementing them and then monitoring the results
- ensuring that there is a high degree of community consultation and public participation in the regulatory reform process.
- improving the efficiency and effectiveness of the Task Force, the Working Groups and the Secretariat
- embedding processes so that the project, as much as possible, becomes sustainable.

Since its inception, the project's main achievement has been engagement of both the private and the public sectors in working to resolve regulatory reform issues.

## Summary

Tonga's domestic economy is expected to return to positive growth in 2007/08 following a softening of economic activities in 2006/07 that was due largely to two major events: the wage settlement of 2005 and the civil disorder in Nuku'alofa on 16 November 2006.

The wage settlement of 2005 led to the large civil servant wage increases and consequential reductions in public employment and government purchases of goods and services. These contributed to the softening of economic activity in 2006/07. The civil disorder led to the destruction of shops, offices, plant and equipment, and stocks of goods for sale. Tourists' expenditure in Tonga fell, with tourists cancelling their travel or travelling elsewhere.

The Government has successfully steered the economy through each crisis.

The wage settlement was honoured in full while maintaining macroeconomic stability through a responsible monetary and fiscal policy. Following the civil unrest of 16 November 2006, the Government has facilitated reconstruction and recovery efforts and ensured and supported the restoration of business confidence. As a result, the economy is forecast to strengthen in 2007/08 but without excessive price increases as the recent falls in inflation to about 4 per cent are consolidated and maintained.

The following policies are being implemented to maintain macroeconomic stability and business confidence in the economy

- completion of the revenue reform program
- arranging concessionary finance for reconstruction of Nuku'alofa
- pro-poor policies
- further public sector reforms.

Those recovery policies are generally within the scope of government to achieve, but the government has recognised that Tonga's future and greater challenge is to move beyond recovery to sustainable private sector-led growth. That is something that no previous government has achieved, and it will require a lot more than just action by the government alone.

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But we do have experience of successful teamwork. This survey of the economy shows that macroeconomic stability has been achieved through a combination of

- in-built stability from continuing remittances plus responsible fiscal and monetary policies that have adapted to changing economic conditions
- the resilience of the domestic businesses sector which has been courageous and committed to recovering from the damage to the central business district
- strong friends in the international community
- effective teamwork in bringing everything together.

New and unifying priorities have been agreed by Cabinet. The most immediate priority is to restore social stability through law and order and political reform. Then the government can address its next highest priority, which is to make sure the needs of the productive sectors are treated equally with the needs of the social sectors. Investment in infrastructure is also urgently required.

The process of achieving reconciliation and a new consensus on political reform has started. Alongside that process, the government is taking a leadership and promotional role in bringing together the people of Tonga, overseas Tongans, development partners, public servants and others to sit down with the private sector and agree on a shared program of action for private sector-led growth.

The Tongan economy has resisted external and internal shocks. Will it now respond to internal and external support designed to boost the long-term rate of economic growth?