Economic survey

The Tongan economy: recent performance and future challenges

Te'o I.J. Fairbairn

Along with many other Pacific island countries, the Kingdom of Tonga faces many problems of development, including those associated with a narrow resource base, geographic isolation and fragmentation, and vulnerability to external shocks. Yet, by comparison with many of its developing island neighbours, Tonga has achieved considerable success in fulfilling some of its development objectives and aspirations. Over the past decade, Tonga has achieved a measure of economic growth sufficient to permit a modest rise in the level of real GDP per capita, currently estimated at around US$1,700, and one of the highest in the South Pacific.

But severe problems continue in the ability of the government to achieve fiscal responsibility—high debt levels, deterioration in the balance of payments and reserves and unemployment continue to be a problem. Tonga has to pursue public sector reform as a start to establishing a competitive environment in which better growth performance can be achieved.

Te'o I.J. Fairbairn is an economic and financial consultant specialising in the development problems of small island countries.

Tonga's development prospects critically depend on its capacity and willingness to put in place economic policies that are forward looking and flexible (given the imperatives of the global economy) and to overcome the familiar development constraints with which it has to contend. A key requirement is to pursue strategies directed at harnessing the development potential inherent in agriculture, fisheries and tourism in particular—key areas of comparative advantage. Another vital challenge relates to the need to maintain the momentum in tackling public sector reforms to ensure, among other things, efficient resource use. Equally important are continued efforts to revitalise the private sector as the principal source of economic growth, and to pursue prudent financial and macroeconomic policies as a basis for achieving an enabling and internationally competitive environment.[1]

Economic growth

Over the past decade (up to 1995/96), Tonga recorded only modest and uneven economic growth. Real GDP growth averaged around 1.1 per cent per annum which, set against an actual population growth of around 0.5 per cent per annum,

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resulted in an annual increase in GDP per capita of approximately 0.6 per cent. This performance, while superior to a number of other Pacific island countries, is nonetheless well below Tonga's medium-term growth potential which the World Bank considered in the early 1990s to be just over 3 per cent per annum (World Bank 1993:36).

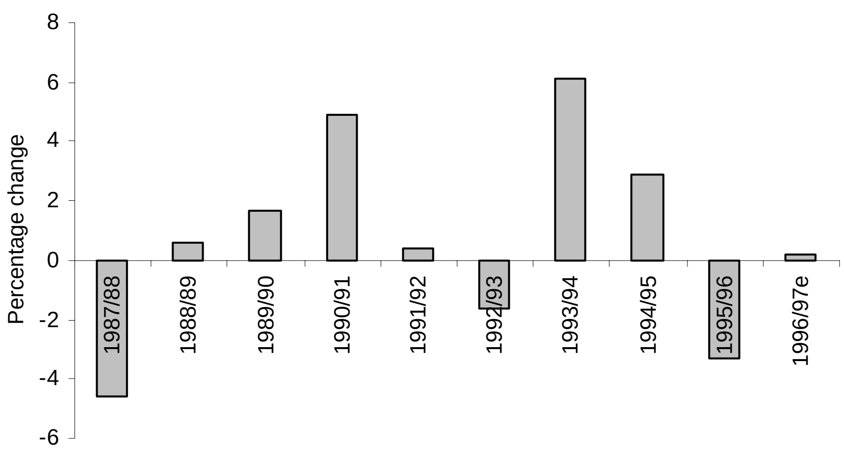
Following a decline in 1992/93, real GDP grew fairly strongly over the 1993/94–1994/95 period before declining again in 1995/96 (Figure 1). Economic growth in 1993/94 was underpinned by the rapid expansion in squash production and, to a lesser extent, fish, as well as a rise in the level of construction, commerce and restaurant activity. The decline in 1995/96 was due to lower levels of activity in agriculture (notably squash) along with construction, manufacturing and tourism. For 1996/97, a significant recovery in GDP is unlikely to have occurred given that the recorded level of activity in agriculture and tourism was rather static (National Reserve Bank of Tonga 1997:S32 and S35).

The recent record of economic growth was largely driven by agricultural products, led in particular by squash (Table A1). Squash emerged as a major export in 1989/90 after Tonga secured a quota to supply the Japanese market during the few months of the year when supply from other regular sources dried up. Other sub-sectors that experienced some expansion were commerce, hotels and restaurants; transport and communications; and government services. In contrast, among the major sub-sectors, manufacturing and construction remained relatively static. As a result of agriculture's fairly strong performance, its relative importance increased from around 31 to 33 per cent of GDP between 1985/86 and 1994/95—a positive feature as it denotes a degree of success in developing major areas of comparative advantage.

Employment

Data on employment are fragmentary, but estimates for 1993/94 indicate that there

Figure 1 **Tonga: growth of real GDP, 1987/88–96/97** (percentage change over previous year)



[e] Estimate
Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin* June, Nuku'alofa:S45

were around 30,000 persons employed as salary and wage earners, own-account workers and employers (Tonga 1994:9). An additional total of around 6,000 persons were engaged in unpaid family work, giving overall employment of 36,000, equal to approximately 36 per cent of the total population. Unemployment was estimated at close to 2,000 persons. Formal sector employment was estimated at 24,000 of which the government sector, including army personnel and state-owned enterprise workers, accounted for around 10,000 persons. On the basis of these estimates, therefore, informal sector activity employs around 12,000 persons—or one-third of total employment at the time.

Employment creation remains one of the most daunting aspects of Tonga's development and highlights the importance of accelerating economic growth. Past experience shows that the formal sector has a limited capacity to provide jobs for Tonga's steadily growing population. Of the country's 2,000 or so annual school leavers, only around 500 find employment in the formal sector. Such a low absorption rate means a continuing heavy dependence on unpaid family work and other forms of informal activity to absorb labour. It also means continuing pressure for young Tongans to migrate in search of work (as many as 50,000 Tongans are thought to be residing overseas, mainly in New Zealand, Australia and the United States).

Savings and investment

In common with many other Pacific island countries, Tonga remains heavily dependent on external savings, especially in the form of private remittances and official development assistance. Such transfers totalled (net) around T$55 million in 1993/94, equal to 27 per cent of GDP (Fairbairn and Kioa 1996: Tables A3 and A11).[2] These flows have allowed Tonga to sustain large trade account deficits and to consume above GDP (Asian Development Bank 1996:35). High levels of consumption relative to GDP have resulted in significant negative domestic savings, estimated by the Asian Development Bank at 18 per cent of GDP for 1993–94 (the latest recorded figure) (Asian Development Bank 1996:36).

Investment figures for recent years are not available but the gross investment rate averaged 25 per cent of GDP between 1985/86 and 1991/92—a rate that is comparable with that achieved by 'middle-income' countries (World Bank 1995:120). Lack of data precludes a detailed analysis of the composition of investment spending.

On the available evidence, it is apparent that Tonga faces a substantial savings–investment gap, possibly as high as 40 per cent of GDP. This resource gap has persisted given the inflow of substantial external transfers. This situation raises important policy issues that need to be confronted such as whether Tonga wishes to continue the heavy reliance on external aid in particular, and the desirability of taking stronger measures to promote more domestic savings (reduced consumption) as a basis for narrowing the resource gap.

The macroeconomic setting

The attainment of financial and macroeconomic stability—at least up to the last few years—has been elusive. Government's difficulty in achieving balanced fiscal outcomes up to 1992/93 has been a major factor making for significant instability—a situation that, at the time, contributed to high inflation, increased official debt levels and deterioration in the balance of payments. From 1991/92, a further source of instability was the rapid expansion in the level of liquidity in the economy, attributable largely to the entry of two new commercial banks and associated intermediation, and expansion in the lending activities of the Tonga Development Bank. Such credit expansion boosted imports and further weakened the balance of payments and Tonga's international reserve situation. With the aim of restoring more balanced outcomes, the government has renewed its commitment to a balanced recurrent budget strategy and, more recently, tightened monetary policy while recognising the importance of maintaining satisfactory levels of international reserves.

Fiscal policy

The 1997/98 Budget projects a balanced recurrent budget with both revenue and expenditure estimated at T$63.0 million (Figure 2 and Table A2). This fiscal stance is consistent with government's commitment to achieving fiscal consolidation and prudence. Budgeted expenditure compares with a corresponding figure of T$60.6 million for the previous budget (1996/97), and represents an increase of around 4 per cent. Recurrent revenues projected for 1997/98 compare with T$61.7 million for the previous year, an increase of 2 per cent. The latter increase is projected to be financed by improved revenue collection and rises in certain government fees, including school fees (National Reserve Bank of Tonga 1997:8).

Development expenditure is projected at T$77.1 million for 1997/98 (compared with T$95.5 million in the previous year), at least two-thirds of which is expected to be funded from official development assistance sources (and the rest from local funds and external loan disbursement). Of the projected T$77.1 million, a total of T$23.7 million is classified as 'onshore' expenditure in the sense that the funds actually pass through the government's own accounts. Such expenditure is expected to be carried out, in contrast to 'offshore' expenditure where actual expenditure normally falls well below projected figures due to funding shortfalls.

Figure 2 **Tonga government revenue and expenditure as a percentage of GDP, 1986/87–96/97[B]**

[B] Budgeted
Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin*, June, Nuku'alofa:S25

Official budget data reveal that Tonga has recorded a succession of recurrent budget surpluses since 1992/93 (Figure 2). This contrasts with the immediately preceding period (back to the mid-1980s) when recurrent deficits were a regular feature of Tonga's overall fiscal situation. The result was a heavy reliance on loan finance, both domestic and external (but largely in the form of concessionary loans from multilateral financial organisations) to fund these deficits and rising debt levels. Underlying these deficits was pressure on expenditure arising from the effects of fairly regular increases in public service wage and salary payments. Such costs currently account for around 53 per cent of total recurrent expenditure (National Reserve Bank of Tonga 1997:7).

The maintenance of fiscal discipline, as manifested in recent budgets, will help build confidence in Tonga's ability to maintain financial and macroeconomic stability conducive to an economic environment favourable to investment. Key requirements include restraining public service wage and salary adjustments and enhancing the quality of government expenditure (via the implementation of program-oriented budgeting and adequate maintenance of government assets). Major reform measures currently being pursued will contribute in an important way toward strengthening Tonga's overall fiscal position. Particularly important are measures to revamp the taxation system, improve tax administration, and to introduce a new superannuation scheme (providing for employee's contribution).

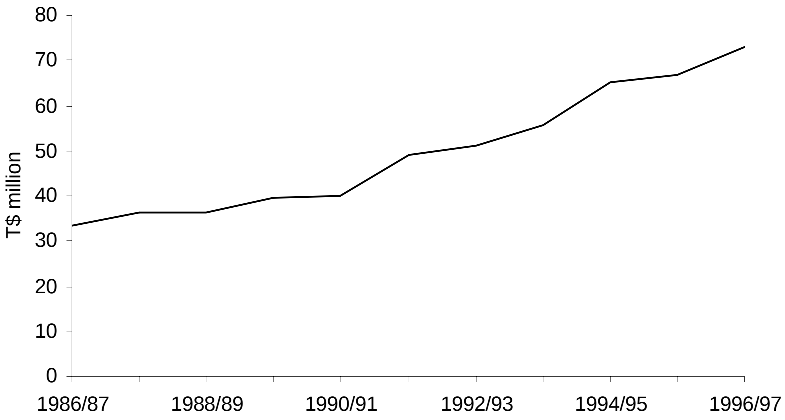
Monetary policy

The money supply (broad money or M2) expanded fairly rapidly from the early 1990s—from T$40.0 million in 1990/91 to T$73.0 million in 1996/97 or by 82 per cent over the six-year period (Figure 3). M2 grew by 22 per cent in 1991/92, largely reflecting substantial public sector borrowing from the banking system, and by 17 per cent in 1994/97, fuelled by a significant expansion in the level of domestic credit, mainly to the private sector. The latter expansion was associated with the entry of two new commercial banks and enhancement of financial intermediation, the build-up of government deposits in the banking system, high expectations over squash revenues, and expanded lending by the Tonga Development Bank. Strong monetary growth had the effect of fuelling the demand for imports, exerted pressure on domestic prices, and, ultimately, caused a significant decline in foreign reserve balances.

The rapid expansion in the money supply forced the Reserve Bank to tighten liquidity through the exercise of both moral suasion and more direct forms of control. In 1996 the Reserve Bank increased the required reserve ratio to 10 per cent, while interest rates on Reserve Bank notes (3 month) were raised from 2.8 per cent per annum to 5.23 per cent (Asian Development Bank 1996:48). Furthermore, government deposits totalling around T$10 million, were shifted from the commercial banks to the Reserve Bank, thereby dampening liquidity and strengthening the financial position of the Reserve Bank. These changes will go some way to helping the Reserve Bank influence the level of domestic liquidity and conduct overall monetary policy.

Interest rates were deregulated in 1991 and have since declined somewhat, reflecting international trends and the effects of reduced inflation. The average lending rates charged by the commercial banks fell from 10.9 to 9 per cent per annum between 1991/92 and 1996/97, although lending rates for home loans and to non-monetary financial institutions

Figure 3 **Tonga money supply (M2), 1986/87–96/97** (T$ million)



Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin*, June, Nuku'alofa:51

have increased (National Reserve Bank of Tonga 1997:S3 and S4). Interest rates have also declined; for example, those for 12 month time deposits fell from 7.5 to 6 per cent over the same period.

Domestic prices

Inflation was recorded at a low 1.8 per cent in 1996/97 and has been fairly subdued since 1992/93 (Figure 4). Price increases in the imported component of the consumer

Figure 4 **Tonga: inflation, 1989/90–96/97** (CPI, per cent)

Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin*, June, Nuku'alofa:S23

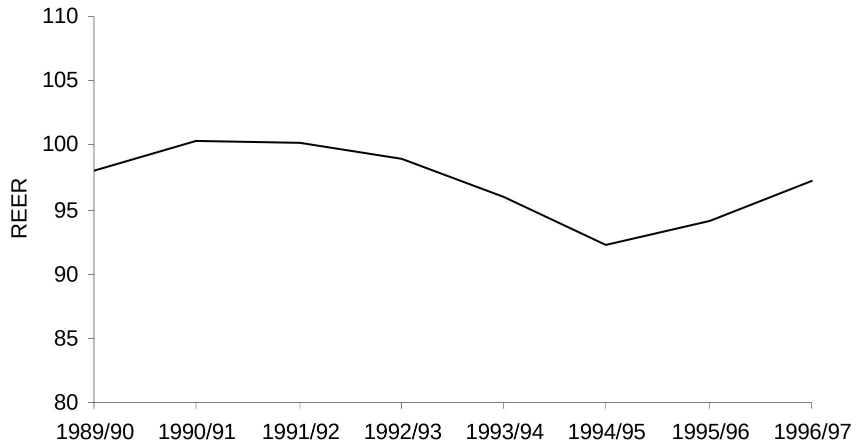
price index (CPI) have been negligible while those for 'local component' have been moderately low. This outcome can be ascribed to several factors, notably low rates of inflation experienced by Tonga's main trading partners, fiscal consolidation (dampening aggregate demand) and relatively benign conditions for agricultural food production. This pattern contrasts with the high inflation recorded during the late 1980s and up to 1991/92, which peaked at 13.3 per cent in 1990/91. (National Reserve Bank of Tonga data on 'underlying inflation', which leaves out certain price-volatile items of the CPI, show the same overall pattern, though less extreme.) Domestic influences including the inflationary effects of persistent fiscal deficits, and the introduction of new government revenue measures, appear to have been dominant factors contributing to this high inflation.

Wage rates have risen strongly over the past decade. Wage and salary increases for the public sector were made in 1989/90, 1991, 1992 and 1996—increases that would have prompted similar adjustments in private sector wage rates. Present government policy is to restrain public sector wage and salary adjustments which, if successfully carried out, will help make for a degree of stability in labour costs.

Since February 1991, the pa'anga has been pegged to a basket of currencies (Australian, New Zealand and US dollars) important to Tonga's trade and financial transactions (it had previously been linked at par with the Australian dollar). This has, among other things, provided an anchor for the domestic price level (Asian Development Bank 1996:23). Over the last few years, the nominal exchange rate has depreciated significantly against the Japanese yen (not part of the basket) and the NZ dollar, but displayed little variation against the Australian and US dollars (Table A3).

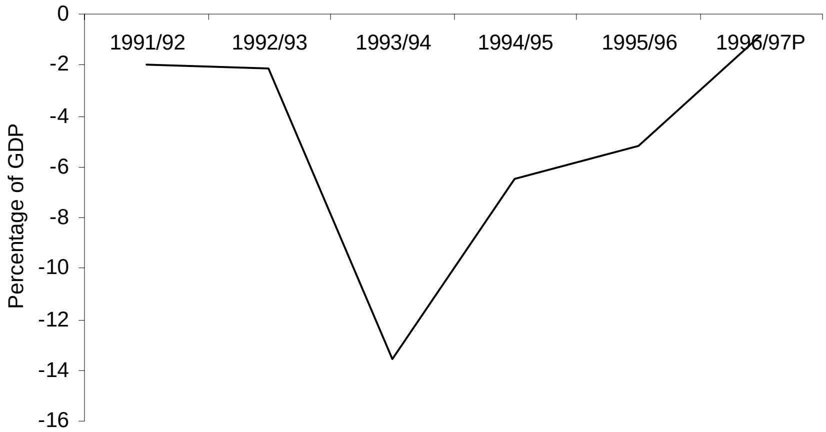
Published estimates of the real effective exchange rate (REER) (the trade weighted exchange rate adjusted for differences in

Figure 5 **National Reserve Bank of Tonga real effective exchange rate index, 1989/90–96/97** (1991=100)



Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S44.

Figure 6 **Tonga: current account balance as a percentage of GDP, 1991/92–96/97**



Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S31.

inflation with regard to Tonga's major trading partners) show that REER declined between 1989/90 and 1995/96, implying an improvement in the level of international competitiveness (Figure 5). The rise in 1996/97 of around 3 per cent reflects, among other things, an appreciation of the pa'anga against the Australian dollar.

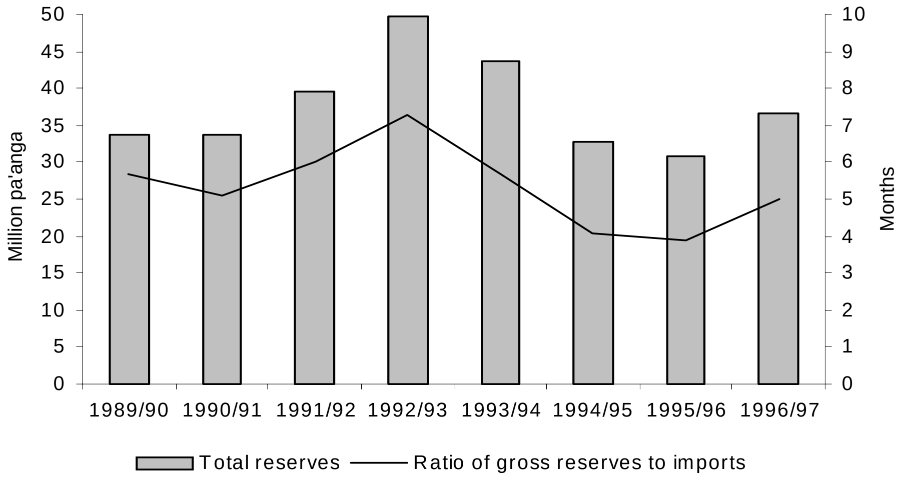
Balance of payments

Export earnings totalled T$16 million in 1996/97 as against imports of T$73 million, resulting in a trade deficit of T$57 million (Table A4). Trade deficits of this order have been a regular feature of Tonga's external accounts over many years. Exports have performed relatively well over the recent period with earnings rising by around 50 per cent since the late 1980s, driven by squash and, to a lesser extent, vanilla and fish (Table A5). Imports have risen more slowly and have in fact fallen from a peak of T$95.2 million in 1994/95 (National Reserve Bank of Tonga 1997:S36), largely reflecting the effects of tighter fiscal and credit policies implemented by the government.

Balance of payments estimates compiled by the Reserve Bank indicate that substantial (net) receipts from transfers combined with smaller contributions from services (positive since 1995/96) and investment receipts have not been sufficient to erase the trade deficit. This has resulted in regular current account deficits (Figure 6). These deficits have been fairly large since 1993/94 although provisional estimates for 1996/97 indicate a sharp decline, largely due to a significant fall in imports. Recorded capital account balances have been positive but small relative to the current account deficits. Therefore, the overall balances recorded on the external account have been consistently negative and have resulted in the erosion of foreign reserves (Figure 7).

Foreign reserves fell from a high of T$49.0 million in 1992/93 to T$28.0 million in the third quarter of 1995, reflecting the adverse balance of payments

Figure 7 **Tonga gross international reserves, 1989/90–96/97**



Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin*, June, Nuku'alofa:S30

situation. The level of foreign reserves recovered somewhat to around T$36.0 million in mid-1997—equal to nearly five months of import coverage.

The government's external debt amounted to T$73.8 million in 1996/97, equal to 83 per cent of total official debt (and around 35 per cent of GDP). The external debt is not considered a major burden as the bulk consists of concessionary loans with international financial agencies. The debt-service ratio (as a percentage of current receipts) is estimated at a low 3–4 per cent.

The recent tightening of fiscal and credit policy will continue to dampen import demand and this should help ease the pressure on Tonga's external financial position. Over the longer term, to strengthen the balance of payments, major efforts are required to encourage greater export orientation and reduce the over-dependence on a single crop (squash) and on the Japanese market. Greater emphasis should also be given to further strengthening tourism as a source of foreign exchange and encouraging more foreign investment.

Sectoral development

Agriculture remains the leading sector, contributing close to 30 per cent of GDP, 70 per cent of export earnings and 60–70 per cent of employment (broadly defined). Agricultural production rose strongly from the late 1980s, peaking during the 1991/92–1993/94 period, led by squash production which took over from coconuts as the principal commercial crop. The subsequent decline has been quite marked with agricultural export values falling from a total of T$16 million in 1991/92 to T$9 million in 1996/97 with the volume of agricultural products marketed in Tonga falling by at least 13 per cent over the same period (Table A5). This weakening in the performance of agriculture can be attributed to a number of factors including bad weather (a prolonged drought in 1995) and low prices, particularly for vanilla.

A key element in Tonga's present agricultural strategy is to further diversify the agricultural base especially through the development of other high value horticultural crops with promising export prospects. This would allow Tonga to reduce the dependence on squash which is vulnerable to the vagaries of weather (plus pests and plant diseases) and dependence on a single seasonal market. Other major strategies relate to measures to raise productivity through improved advisory and technical services for farmers.

Commercial fishing for export grew satisfactorily from the late 1980s and prospects for further significant expansion are present. Fish exports—mainly high-grade tuna and snapper for the US, Fiji and American Samoa markets—peaked in 1994/95 with a total of T$4.4 million, largely boosted by the effects of more active involvement by private fishing companies following the removal of a government monopoly (Sea Star) in deep sea fishing. Export earnings have subsequently weakened, totalling T$2.1 million in 1996/97, due mainly to the decline in the production of bêche-de-mer and lower average prices.

Tonga's potential for expanded deep sea fishing is considerable but much needs to be done to develop a capacity to realise this potential. Fishing for bottom fish (snapper) on near-shore reef slopes and seamount zones has limited scope as these waters have been subjected to intensive exploitation in the past. To gain maximum benefit from its fisheries resources, Tonga needs to develop a coherent policy that addresses such basic issues as the role foreign fishing companies are to play in this area, required infrastructure, and safeguarding the sustainability of this vital resource.

Government has done much to foster industrial development, especially for export, yet manufacturing activity remains modest and has declined in the recent period. From the mid-1980s up to the early 1990s, manufacturing contributed around 5 per cent of GDP and employed an estimated 1,300 persons, but more recently the corresponding figures have fallen to 4 per cent and 1,000 persons. Exports have declined from around T$3–4 million to only T$1.3 million in 1996/97. Such a trend reflects the decline in the processing and export of coconut products, the closure of several export-oriented industrial enterprises, notably knitwear, and the progressive erosion of trade preferences under SPARTECA. Paucity of industrial skills and the disincentive stemming from high tariff levels on many imported materials and components have also been contributory factors.

Meaningful industrial development for small island countries like Tonga has become more difficult with the advent of a more open and competitive global economy, although, for Tonga, prospects for agriprocessing are not unpromising. Nonetheless, government's current reform agenda contains many measures that are capable of improving the local environment for industrial development in selected, predominantly export-oriented, areas. These measures include tax reforms, entrepreneurial training, strengthening investment appraisal procedures and efforts to improve basic infrastructure (including the possibility of establishing an Export Processing Zone).

Tourism recorded significant growth over the past decade with receipts rising from T$10 million to T$15 million (Table 1). This was underpinned by the growth in the number of air arrivals (from around 20,000 in the early 1990s to 27,000 in 1995/96), in contrast to cruise ship visitors which have declined markedly over the

Table 1 **Tonga: tourist arrivals and receipts, 1987/88–96/97**

	Air arrivals (No.)	Cruise ship arrivals (No.)	Tourist receipts (T$ '000)
1987/88	18,096	13,490	12,147
1988/89	20,011	5,612	9,231
1989/90	21,338	4,025	8,764
1990/91	21,266	2,602	9,637
1991/92	22,053	4,524	10,066
1992/93	24,450	3,590	12,477
1993/94	26,673	10,029	12,500
1994/95	29,001	2,113	12,563
1995/96	27,754	4,522	15,640[p]
1996/97	22,733	1,865	15,529[p]

Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S35

past decade. Much of this growth can be attributed to significant improvements in air transport, both international and domestic, following a rationalisation of the national airline (Royal Air Tonga). So far as can be ascertained, the tourist industry's contribution to GDP is around 2–3 per cent, allowing for imports and associated leakages. An estimated 1,400 persons are directly or indirectly employed in this sub-sector.

A continuing effort is needed to further strengthen Tonga's tourism industry as a potential leading sector. Particular attention needs to be given to improving the standard of accommodation and related infrastructure facilities, and to developing mutually beneficial promotional arrange-ments with neighbouring countries, including Australia and New Zealand. Appropriate measures should also be considered for attracting foreign investment which could play a vital part in the establishment of high quality hotel/resort projects.

Public sector reform

Among the range of development issues presently confronting Tonga, perhaps the most immediately challenging is the need for reform in selected areas of the public sector. There is a recognition by government of this need as a means of promoting more efficient resource use, creating a more enabling economic environment and, generally, enhancing the capacity of the public sector to respond more effectively to the challenge of modern times. The need is to transform a public sector-dominated economy into a more dynamic market-based economy and to enhance Tonga's capacity to achieve faster growth (World Bank 1995:121). Such reforms are also vital for reducing fiscal pressures and for stimulating private sector development through the creation of a less regulated and growth-oriented policy and institutional framework.

There presently appear to be many weaknesses in the structure and functioning of Tonga's public sector that call for major reform in the interest of sound economic and financial management.

These include an extensive involvement in many commercial activities that are best suited to private sector operation, and cumbersome governmental structures that make for excessive compartmentalisation, fragmentation and a degree of duplication in the delivery of services. Financial management and control systems have been less than adequate, undermining efforts to achieving more balanced fiscal outcomes and efficient use of government financial resources. Development planning is poorly integrated with budgetary mechanisms, while the performance of the many state-owned enterprises (14 in all) has been far from adequate and poorly monitored. Other major concerns relate to the stifling effect of an excessively regulated business sector and a tax system that is considered to be too narrowly based, distorted, inequitable and deficient in what it provides by way of financial inducement for private sector investment.

Recent government action to promote the reform process has been conspicuous in many areas of the public sector. Thus a Cabinet Sub-Committee on Civil Service Rationalisation has been established to coordinate and oversee the rationalisation effort and, specifically, to help define the role of government and the scope for enhancing the efficiency and effectiveness of government operations. Under New Zealand funding, the Prime Minister's Office has been involved in promoting 'rationalisation' through the implementation of strategic management projects designed to define specific plans and objectives of individual ministries and departments.

Other recent initiatives include the adoption and progressive implementation of performance budgeting so as to achieve a greater focus on actual outcomes and results rather than on inputs. Traditional forms of comprehensive medium-term development planning have been abandoned in favour of strategic planning with a focus on the formulation and implementation of strategic policies capable of more effectively achieving the country's development goals. Efforts are also underway to overhaul the taxation system to establish a stronger revenue base and eliminate existing distortions including those that tend to discourage or deter private investment.

Some areas of public sector reform are by no means straightforward and call for particular attention if they are to be successfully carried out. This applies particularly to efforts to implement performance budgeting, to improve tax administration and to undertake departmental restructuring. In some of these cases, the shortage of experienced and trained staff appears to be a major hurdle. Another difficult area relates to state-owned enterprises and the need for detailed review so as to improve overall performance, introduce more effective monitoring of their activities and possible restructuring, and identify those enterprises that ought to be transferred to the private sector.

Private sector development

Tonga's private sector has been characterised as narrow and undeveloped. It is dominated by agriculture (and fisheries) and service industries such as trade, restaurants and hotels. The private sector accounts for around 60 per cent of formal sector employment—a modest proportion and one reflecting the relatively large and extensive role of government in the economy. If allowance is made for the group of unpaid family workers and several other forms of non-formal activity, the importance of the overall private sector is greatly enhanced—possibly close to 70 per cent of total employment (both formal and non-formal).

Since the late 1970s, government has done much to stimulate private sector investment. Among earlier measures introduced were those aimed at simplifying business licensing procedures, reducing income tax rates, and providing more attractive investment incentives. A key institutional initiative was the establishment of the Tonga Development Bank (in 1977) to provide development finance for the private sector as was the establishment of the Small Industry Centre (in 1980) to foster industrial development via the provision of fully serviced factory space at nominal rentals. More recently, government has intensified efforts to strengthen business and entrepreneurial training and advisory services, and to streamline the application process for investment proposals. Current attempts to overhaul the taxation system include efforts to remove the current bias in customs duty against production, provide a more effective investment incentive system and, in general, to install a more 'business friendly' taxation regime.

Strengthening Tonga's private sector calls for continued efforts to improve basic infrastructure, carry out much-needed tax and tariff reforms and upgrade business training and related support services. Further efforts are needed to simplify application and processing procedures for foreign investment, to persevere with public service reforms, and to create greater opportunities for private sector expansion through various forms of privatisation including sub-contracting and outright sale of government-owned assets and operations. The importance of maintaining a congenial macroeconomic environment is also vital from the viewpoint of efficiency and encouraging private sector investment. Here key requirements include the need to restrain public service wage and salary increases, unsustainable fiscal deficits, and excessive credit creation.

Other development imperatives

Tonga's ability to attain higher and sustainable rates of economic growth calls for the strengthening of major complementary areas of development. Among these are human resource development, the role of women in Tonga's social and economic life, and the state of the natural environment and resource base. These areas of development are fundamental in the sense that they play an integral role in determining not only the pace of economic growth over the longer term but also the quality and soundness of the overall development process.

Tonga has a well-developed education system characterised by free and compulsory primary schooling (up to age 14), and subsidised secondary schools. The post-secondary sector is well provided for with close to 20 institutions in operation, including a number of private agricultural colleges, the Community Training Development Centre and the University of the South Pacific Extension Centre. Adult literacy is almost complete and a scholarship scheme is in place for overseas study.

Nonetheless, there are areas of weaknesss that need to be remedied if the quality and effectiveness of education and training systems are to be further improved. In this, several practical issues are important, for example, the need to address Tonga's skills shortage, the issue of replenishing skills lost through emigration, and the problem of having to cope with the educational needs of a steadily expanding population. Among specific problem areas that particularly need attention are inadequate facilities in non-government secondary schools (which dominate this sector), the presence of a large number of unqualified and inexperienced teachers among non-government schools, and the substantial drop-out rate among 18–19 year olds at post-primary school level.

Another key problem is the need to improve vocational training institutions to make them more responsive to the labour needs of the country.

Tonga has achieved considerable success with health care. Key indicators such as access to safe water, access to health care facilities and population per physician are all highly favourable compared with many other Pacific island countries. In particular, access to health care is generally good, with one referral hospital in Nuku'alofa, three district hospitals and a large number of health centres and clinics spread out throughout the country providing primary, maternal and child health and family planning services, and a network of village health workers. Health services are provided to the public either free or at nominal charges.

Despite the achievements to date, there are areas of the health sector that could be improved in the interest of raising overall standards. Among the problem areas that need to be addressed is the continual loss of skilled personnel to rim countries, the need for a greater effort in promoting public health education, the need for more maintenance work and for new equipment, and possibilities for improving the financial situation of the health system (which is subject to national budgetary constraints). Possible corrective measures are to provide adequate incentives for skilled medical personnel to remain in Tonga, to encourage private medical practices and to devise new ways for strengthening the financial situation of the health sector. Recent measures have been taken to alleviate financial pressures by raising user charges in a number of health areas, including higher charges for hospital beds.

Providing greater opportunities for women to participate in the development process and to overcome social and institutional disadvantages are viewed as essential elements in government's efforts to achieve overall meaningful and sustainable development. Women's needs are being provided for in various ways, principally through the coordinating work of a Women's Affairs Unit, recently established within the Prime Minister's Office, the establishment of a number of specific small-scale credit schemes for development projects, and encouragement of and assistance to an extensive network of women's non-government organisations.

To date, Tonga has not had to face an environmental catastrophe or even a serious threat, but the danger is there. Signs of environmental deterioration are already clear in a number of key environmental and resource areas—environmental damage caused by sand mining on beaches for construction purposes, serious pollution of ground water in certain areas of Nuku'alofa, an apparent over-use of agro-chemicals in efforts to improve agricultural output, the destruction of sensitive mangrove and marsh areas, and heavy exploitation of reef and lagoon fisheries.

The protection and enhancement of Tonga's natural environment and resource base calls for continuing action on a wide front. While a National Environmental Management Plan and an Environment Planning Unit have been established there is still a need to clarify policies in this area and to provide adequate resources for carrying out essential environmental and resource conservation work. (A recent AusAID-sponsored study of land use and pollution around the main lagoon zones in Nuku'alofa should help policy formation in some of these areas.) Other major requirements include measures to raise public awareness of environmental issues and their importance for future economic sustainability, improve water disposal systems, and protect Tonga's water resources. With increasing pressure on water supply, there is a need to improve the management of this resource, including the possibility of more realistic user charges.

Conclusion

Although the recent record of economic development in Tonga contains many positive features, there are also many difficult problems that remain to be addressed if Tonga is to attain accelerated and sustainable growth with stability. Economic growth over the past decade has been modest at best, although, due to low (actual) population increase, this growth has been sufficient to allow some increase in real GDP per capita. Clearly, the need to raise the pace of economic growth (and employment generation) must remain a major, if not the paramount, development objective. Other closely related areas of concern are the need to reverse the recent decline in export earnings, further diversify exports, and to strengthen the domestic savings base.

The need to persevere with public sector reform is a matter of priority. The public sector is sizeable, and any progress achieved in implementing government's declared reform program is likely to bring about considerable benefits in terms of enhanced efficiency in the use of public sector resources, private sector development, and generally in setting the stage for a more competitive and facilitative economic environment. Efforts to formulate appropriate growth-oriented strategies at the sector level are important, particularly in harnessing the development potential of agriculture, fisheries and tourism. Equally important for accelerating growth are measures designed to strengthen private sector development and to foster the contribution of the business community to the overall growth process. The creation of a more congenial environment for foreign investment in particular merits further attention. In striving to maintain financial and macroeconomic stability—a vital prerequisite for sound economic growth—the importance of an ongoing commitment by the government to the principle of fiscal prudence and a capacity to control effectively the level of liquidity in the economy goes without saying.

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Notes

1 This paper draws heavily on an unpublished report on the Tongan economy prepared by the author for AusAID in 1996 with Dr Sione N. Kioa.

2 Throughout this paper values are expressed in terms of the Tongan pa'anga. As at June 1997, the pa'anga was equal to A$1.06 and US$0.80. See Table A3 for exchange rate data.

Appendix

Table A1 **Tonga: GDP at constant prices, 1989/90–94/95** (T$'000 in 1984/85 prices)[a]

Sub-sector	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95[P]
Agriculture, forestry & fishing	25,205	27,083	29,710	30,502	32,655	34,412
Mining and quarrying	319	244	247	257	289	238
Manufacturing	4,154	3,905	3,863	4,085	4,097	3,913
Electricity and water	1,147	1,202	1,223	1,247	1,296	1,378
Construction	5,143	4,327	4,375	4,681	5,275	5,170
Commerce, hotels and restaurants	9,776	11,015	11,141	11,671	12,498	12,292
Transport and communication	6,373	5,886	6,004	6,123	6,411	6,550
Finance and business services	6,727	5,460	4,957	5,566	5,828	5,954
Community and personal services						
Government	12,210	14,413	14,267	14,236	14,768	14,768
Private	3,933	4,012	4,092	4,173	1,256	4,341
Ownership of dwellings	3,108	3,123	3,138	3,156	3,178	3,174
Imputed bank charges	4,779	3,960	3,067	3,456	3,652	3,731
GDP at factor cost	73,316	77,310	79,990	82,209	86,899	88,479
Indirect tax	13,949	15,553	13,107	14,368	14,221	14,833
GDP	87,265	92,863	93,097	96,577	101,120	103,312

Sources: Based on National Reserve Bank of Tonga figures published in Asian Development Bank, 1996. *Tonga: economic performance and selected development issues*, Office of Pacific Operations, Port Vila:156, Table 2.2); National Reserve Bank of Tonga has since published revised data on GDP as reflected in GDP growth figures in Figure 1.

Table A2 **Government revenue and expenditure 1987/88–97/98** (T$ million)

	Recurrent revenue (plus repayment of loans)	Recurrent expenditure	Recurrent budget (surplus/deficit)	Total 'onshore' development expenditure
1987/88	34.4	33.9	0.5	6.4
1988/89	33.7	34.8	-1.1	6.3
1989/90	40.9	44.5	-3.6	11.5
1990/91	47.4	47.4	-	15.1
1991/92	46.2	51.1	-4.8	6.2
1992/93	52.3	49.9	2.4	10.2
1993/94	54.7	50.4	4.4	9.3
1994/95	58.2	55.5	2.7	16.2
1995/96	64.6	62.8	1.9	13.8
1996/97	61.7[B]	60.6	1.1	34.9
1997/98	63.0[B]	63.0	-	23.7

[B] Budgeted figures
Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S27–S28

Table A3 **Selected foreign exchange rates: end of period, 1989/90–96/97** (units per pa'anga)

	A$	NZ$	US$	Japanese yen	Real effective exchange rate (1991=100)
1989/90	1.0000	1.3434	0.7900	120.19	98.0
1990/91	1.0040	1.3346	0.7717	105.89	100.4
1991/92	1.0059	1.3809	0.7520	93.91	100.2
1992/93	1.0735	1.3354	0.7188	76.35	99.0
1993/94	1.0097	1.2387	0.7350	72.44	96.0
1994/95	1.0947	1.1711	0.7831	66.45	92.3
1995/96	1.0280	1.1882	0.8116	88.57	94.1
1996/97	1.0717	1.1753	0.7997	91.56	97.2

Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S42 and S44.

Table A4 **Balance of payments, 1991/92–96/97** (T$ million)

	1991/92	1992/93	1993/94	1994/95	1995/96[p]	1996/97[p]
Merchandise trade						
Exports f.o.b.	25.0	14.8	25.8	21.9	15.9	16.2
Imports	72.6	76.3	95.8	94.7	83.5	73.4
Balance on trade	-47.6	-61.5	-70.0	-72.8	-67.6	-57.2
Services						
Services receipts	23.9	22.9	26.2	31.9	43.4	38.3
Services payments	30.6	26.1	33.9	40.0	33.0	30.2
Balance on services	-6.6	-3.2	-7.7	-8.1	10.3	8.2
Investment income						
Income receipts	4.3	6.3	5.1	3.6	4.8	3.2
Income payments	1.3	3.2	1.9	1.9	3.9	1.4
Balance on income	3.0	3.1	3.2	1.7	0.8	1.8
Transfers						
Private transfer receipts	44.9	57.4	59.7	68.1	56.4	54.4
Official transfer receipts	11.3	15.6	9.4	19.8	1.0	1.6
Private transfer payments	6.6	9.6	18.1	19.8	10.8	9.6
Official transfer payments	2.3	6.1	4.8	2.7	1.1	1.0
Balance on transfers	47.3	57.4	46.3	65.4	45.4	45.4
Current account balance	-3.8	-4.2	-28.3	-13.9	-11.0	-1.8
Direct investment	1.6	-	3.4	1.9	2.3	0.8
Portfolio investment	-	-	..	-	..	0.1
Long-term capital	-0.7	4.2	1.0	-1.2	2.8	0.8
Other short-term	5.1	-	-	4.3	-2.2	-0.1
Capital account balance	6.0	4.2	4.5	5.0	2.8	1.6
Overall balance	2.2	-	-23.8	-8.9	-8.2	-0.3

[p] Provisional

Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin,* June, Nuku'alofa:S31

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Table A5 **Principal exports and re-exports, f.o.b., 1987/88–96/97** (T$ million)

	Total exports and re-exports (f.o.b.)	Fish	Root [a] crops	Squash	Vanilla	Other[b] agricultural product	Manu-[c] factured goods	Other exports and re-exports
1987/88	8.8	1.3	0.6	0.1	1.2	0.9	2.4	2.4
1988/89	11.6	2.1	0.9	..	2.4	0.7	3.1	2.4
1989/90	11.6	1.4	2.0	2.0	0.8	0.3	3.6	1.4
1990/91	14.6	1.2	0.8	4.8	3.3	0.1	3.2	1.1
1991/92	22.5	2.1	0.6	12.4	3.1	0.2	3.0	1.1
1992/93	17.0	2.2	0.8	8.7	2.0	0.3	2.3	0.7
1993/94	23.2	3.6	1.0	13.0	2.3	0.1	2.1	1.1
1994/95	18.5	4.4	0.6	8.9	2.8	0.1	0.8	0.9
1995/96	18.1	4.2	1.0	8.4	2.1	-	1.3	1.1
1996/97	15.1	2.1	1.2	6.5	1.6	0.1	1.3	2.2

[a] comprising kape, cassava, taro, yams and sweet potatoes
[b] includes machinery and transport equipment
[c] fish exports in 1988/89 includes T$1.3 million for fish exported to Puerto Rico for which value was not received in Tonga
Source: National Reserve Bank of Tonga, 1997. *Quarterly Bulletin*, June, Nuku'alofa:S32