



**Government of the**

# **Federated States of Micronesia**

## **APPLICATION FORM**

**FOR**

**JAPAN'S NON-PROJECT GRANT AID**

**(NPGA)**

**2008**

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Note:

The submission of this application form is a prerequisite condition for requesting JAPAN'S NON-PROJECT GRANT AID (NPGA).

The receipt of this application form by the Japanese Embassy does not mean in any way a commitment by the Japanese Government to extend NPGA.

I. THE SITUATIONS WHICH NEED TO BE SUPPORTED BY NPGA

1. Has your Government applied for NPGA in 2008?

Yes \_\_\_\_\_

No **X** \_\_\_\_\_

2. Please describe situations which need to be supported by NPGA in line with the Poverty Reduction Strategy Paper(s) and/or National Development Programme.

The current energy crisis that the Federated States of Micronesia now faces is the top national priority and every opportunity to offset the impacts of this mounting problem must be undertaken to address its negative socio-economic impacts. Until such time that the longer-term policy of renewable energy infrastructure and the technologies that will support them are able to be implemented and take hold as practical measures, the strategy for the FSM is to ensure immediate support to the nation's utilities and by extension, its people.

The import of fossil fuel alone accounts for over 30 % of the FSM national budget. More importantly, up to 91% of the Utilities' revenue collections are being used just to pay for fuel and salaries to keep the utilities operational with little or no reserve funds for maintenance and improvements. The utilities can continue to increase their tariffs to recover the increasing cost of fuel, but an increase following the current energy prices would have seriously adverse effects on our people and the nation's economy. As it is, FSM utility and gas prices have increased by over 60% since 2005<sup>1</sup>. Not coincidentally, all of the FSM Utilities have been running operating losses since 2005<sup>2</sup>. The utilities have thus steadily increased their kWh electricity prices to the end users to try and keep pace. This has enabled them to barely maintain operations, while largely ignoring the major, necessary investments required of an efficient and sustainable utility company. This has led to more energy losses on unmaintained distribution systems and increasingly inefficient generators. Combined with the current high fuel prices and the inability to pass on these steep increases to the end users due to increasing poverty and hardship, this has created a pressing immediate cash flow problem. If left unaddressed, this crisis will lead to huge losses, mounting debt, inadequately maintained systems, an increasing inability to purchase fuel and ultimately lead to power failures and blackouts across the nation. This in turn will lead to backward economic and private sector growth and the creation of ever larger pockets of hardship and poverty.

<sup>1</sup>Association of Micronesian Utilities (AMU) – 2008

<sup>2</sup>Association of Micronesian Utilities (AMU) – 2008

Consistent electrical power and economic and social development are closely linked. There is a pressing need to support our utilities so that they can maintain their systems and key functions over the short term and for sustained economic growth for FSM society over the long term. The NPGA programme is an opportunity to address this urgent situation in line with the poverty reduction strategies outlined in the FSM Millennium Development Goals (FSM MDG):

- *To provide employment and income generation;*

and the FSM Strategic Development Goals (FSM SDP) to:

- *Create sustainable financing mechanisms for environmental and sustainable resource initiatives; and*
- *Reduce energy use and convert to renewable energy sources/Minimize emission of greenhouse gasses.*

As such, this is the situation that needs to be supported by NPGA in line with the Poverty Reduction Strategy Paper(s) (FSM MDG) and the National Development Programme (FSM SDP) of the nation.

### 3. Sector Development Programme

Please describe the sector(s) which your Government is strongly extending under your development programmes and for which your government wishes to use the local currency deposited as the counterpart fund.

The key sectors that the Government of FSM is currently placing as high priorities are the Energy and Transport sectors, and for which it will utilize the NPGA funds provided by the Government of Japan.

First, immediate assistance is requested to assist in the establishment of a sustainable financing mechanism in the form of a *Working Capital Revolving Line of Credit* so as to stabilize the operational costs of the utilities and to mitigate the need to pay cash on delivery of fuel. Paying cash on delivery, or up front, for fuel is having a crushing effect on the four FSM utilities of the FSM to operate effectively, particularly in this time of increasing fuel prices and cash shortages.

While all four FSM state utilities continue to improve means to receive prompt or advance payment for power supplied to consumers, this is still a work in progress. While income may be variable it is often the case that at the time that replenishment of fuel is required the cash on hand is not sufficient to meet the supply costs, caused not only by 30 or 60-day billing cycles to their own customers, but also the increasing cash crunch on the utilities' bottom line. This cash flow shortage is additionally exacerbated when fuel prices increase significantly between deliveries.

The *Working Capital Revolving Line of Credit* will be established with one of the commercial banks of the nation and remain as a principal balance and continue to accrue interest for the benefit of the utilities and the nation. This will establish a sustainable facility, or financial mechanism, rather than a one-off grant to the utilities. This will also allow the utilities to continue to access this credit facility on an as-need basis to cover situations when the state utilities are short of immediate working cash to meet their entire fuel supply requirements at the time of delivery. Ultimately, this will ensure stability in fuel supply to the utilities against short-term cash flow shortages, and as a result, a stable power supply to society.

Second, the establishment of a *Utility Maintenance Fund* (UMF) is requested to assist the nation's utilities replace inefficient and outdated generators, to help in improving their power distribution and fuel conservation and to jump start the process of expanding the use and utilization of renewable sources of energy, such as hydro, solar, wind and bio-fuel. Most of the FSM utilities are utilizing very inefficient and outdated generators that are showing increasing signs of deterioration and breakdown, and more vital, utilizing much more fuel than what newer, more efficient generators utilize for the same amount of output. Distribution lines and the equipment needed for linemen to repair and upgrade power distribution are also important and urgent needs that a UMF would be able to address in a sustainable manner. The establishment and continuing perpetuation of a UMF then would expand the capacity of the utilities to operate more stably and efficiently in terms of supply-side power distribution, as well as operationally. A mechanism between the FSM government and the utilities will be put in place to ensure maximum benefit and sustainability.

Last is requested support to the vital transport sector, by way of *Scheduled Field Trip Vessels* to the outer islands of the nation, where nearly 25% of the FSM population resides<sup>3</sup>. In this sector critical government field trip services have been and continue to be crippled by the increases in fuel prices. This particular situation has often compromised regular trips to the outer islands by government field trip vessels for medical, health and humanitarian needs, with resultant negative impact upon these vulnerable outer island communities. This situation increases the tendency for outer islanders to abandon their atolls in search of a more stable life in the urban centers leading to overcrowded and sub-standard living conditions. Poverty is thus increased in the outer islands, with fewer producers available there to meet communal needs while poverty also increases in the urban centers as too many people become clustered amidst ever tighter socio-economic conditions.

The NPGA funds would be made available to State Governments to use to guarantee fuel purchases required for government scheduled vessels for medical, health and food needs on the outer-islands as well as potential humanitarian emergencies. The fund may also be used to supplement fuel purchase needs where fuel prices have increased over initial projections.

<sup>3</sup>FSM Census - 2000

Total NPGA Request:

(a) Utility Credit Line	\$ 1,500,000
(b) Utility Maintenance Fund	1,400,000
(c) Scheduled Field Trip Vessels	600,000
Total	\$ 3,500,000

II. UTILISATION OF THE PREVIOUS NPGA

1. Has your Government already received NPGA in past years?

Yes \_\_\_\_\_

No     **X**    

-If yes, please answer the following questions.

2. How NPGA contributed to the economic structural adjustment efforts as well as mitigation of the economic difficulties?

N/A

3. Please describe problems/difficulties that occurred to the implantation of previous NPGA, if any.

N/A

4. Counterpart fund

(1) Status of the counterpart fund of the previous NPGA

N/A

(2) In case there is a shortage of the counterpart fund although the final date as agreed in Exchange of Notes (two or three years from the signing date of the Exchange of Notes) has come, please describe the reason of the shortage and the measures your Government intends to take in order to fulfill its commitment:

N/A