

# The situation of the Water Supply and Sanitation (WSS) sector in Albania

## TARIFF SETTING PRINCIPLES IN EUROPE AND ALBANIA

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The WSS sector in Albania has been financially unsustainable. The survival of the WSS sector has been dependent on central government subsidies to cover Operational and Maintenance (O&M) costs. The sector is fragmented into 58 utilities, where only 12 out of the 58 managed to cover O&M costs.

A permanent issue of the sector remained the non-payment of electricity bills to OSHEE (public energy company), which led to the accumulation of considerable debt toward this institution.

The sector is currently undergoing a reform, aggregating the previous 58 utilities into 15 regional companies, in which the state is the main shareholder. Applying the economy of scale is expected to improve the financial sustainability of the sector and the quality of services to consumers.

It is important to emphasise that many units or previous utilities have been operating with low tariffs that couldn't cover the direct O&M costs. It has been difficult to claim the implementation of the Cost Recovery principle by all 58 utilities operating in the sector. In this situation, it is expected that regional utilities will soon apply to ERRU (Regulator) for higher tariffs to increase financial sustainability.

### **Cost Recovery Principle from Tariffs in Albania**

In the application of the principles of Cost Recovery in the WSS sector in Albania, the following questions can be raised:

- In implementing the reform in the sector, is it feasible to fulfil the principle of Cost Recovery for all regional utilities?
- How and when is this principle expected to be fully implemented in the entire sector?

ERRU, as the only legal authority for tariff approval for water and wastewater services, has anticipated this process by improving and adapting the methodology of the tariff approval to be flexible during the transitional period of the sector reform. On the other hand, the tariff methodology had to respond to the requirements in implementing the Cost Recovery principle applicable to the EU, which our country intends to join.

The new methodology foresees the use of the “Cost Plus” method for utilities that intend to cover up to 100% of the O&M costs with the new tariffs. It is not yet mandatory for the utilities to submit a 5 Years Business Plan. Additionally, the tariffs approved by ERRU will be valid for a maximum of 3 years.

The new methodology also contains the “Price Cap” method for the utilities intending to cover Total Costs. The tariff application will be based on a 5-Year Business Plan.

The basic criteria of the methodology are:

- Coverage of justified O&M Costs (OPEX), or Total Costs (OPEX + CAPEX + RAB x WACC)
- Performance estimation of the utility through KPIs.
- Affordability of the water bill.
- Environmental protection for the preservation of water resources.

In addition, ERRU takes into consideration during the analysis and approval of the new tariffs the criteria that “*the tariff increase should not be drastic*”, because this practice brings in a negative financial impact for the utility due to a reduction of the customer’s willingness to pay the new water bill.

Referring to the above-mentioned criteria, ERRU does not directly impose the utilities to apply for tariffs intending to cover all costs concerning the principle of Cost Recovery. The proposal for new tariffs remains an exclusive right of utilities prepared by the management staff and approved by the relevant Supervisory Board of the utility.

However, ERRU plays an active role in encouraging utilities to propose tariffs oriented towards a full Cost Recovery. It plays this role by including as a criterion in the tariff approval methodology the assessment of KPIs performance objectives by a bonus or a penalty in case of weak performance. The tariffs approved by ERRU have a limited time validity from 3 to 5 years. Beyond this time, utilities must apply for new tariffs to ERRU.

ERRU strongly supports the implementation of the principle of Cost Recovery. However, the main role stands on the central government side. With the new reform, the central government, as the main shareholder of the regional utilities, decides the level of service charges the utility intends to propose for ERRU approval. This depends on what

strategy the central government chooses to follow during a transition period of the sector reform about the financial operation of the sector.

Taking into consideration the elements of the Total Costs, the **strategy has to respond to the following questions:**

- **To which rate the O&M costs will be covered through the tariffs during the transition period, and to which by subsidies?**
- **What part of the capital costs during the transition period will be covered by donors' transfer and the general taxes (government grants)?**

The DCM no 302, dated 11.5.2022, is the primary legal act for implementing the reform to aggregate the sector. It intends that the maximum time the regional utilities have to be self-financed will be a maximum of 10 years. The current commitment of the stakeholders in implementing the reform shows an optimistic expectation that the coverage of all the WSS services costs of the sector by tariffs will be reached even before this deadline.

Many of the regional utilities are expected to apply to ERRU for tariffs covering up to 100% of the Total Costs, so with the tariffs, utilities can also self-finance the capital costs.

The application has to be based on a 5-Year Business Plan with the relevant action plans, including the necessary investments for the improvement of KPIs, such as grants from the central government (General Taxes), soft loans from donors (Transfers), as well as, the investments that will be covered by tariffs (Tariffs), i.e., following the 3T national strategy of financing the sector.

The whole process should also be accompanied by a subsidy policy from the central government, converging in the end toward zero subsidies to the regional utilities. In the meantime, the social groups with economic help should be considered, especially in the remote areas where they represent a high rate.

## **Conclusion**

In summary, the EU's Water Framework Directive sets forth key principles like Cost Recovery and Polluter Pays to ensure both financial viability and responsible resource management. Albania, aiming to join the EU, faces the challenge of aligning its financially unstable Water Supply and Sanitation (WSS) sector with these norms. Current reforms include consolidating 58 utilities into 15 larger, more sustainable entities and revising tariffs to align with Cost Recovery principles. The Electricity and Water Regulatory Authority (ERRU) is central to this transition, offering flexible tariff-setting methodologies while emphasizing performance metrics.

The role of the central government is pivotal, as it must balance financial sustainability, environmental protection, and social equity during this transitional period. With the established reforms and stakeholder commitment, there is optimism that Albania can

fully implement EU water management principles in a timeframe shorter than the legal ten-year window.

This transition is not merely a formality for EU accession but a necessity for a sustainable and equitable water resource management future for Albania.