

Slovenia

Country report

This report captures the main messages of a review of the state of play in Slovenia with regards to closing the finance gap and support compliance with the EU Directives on Drinking Water, Urban Wastewater Treatment and Floods, and to a lesser extent the Water Framework Directive. It reflects OECD analyses, and official and expert opinions expressed at a national workshop held in Ljubljana, 27 September 2019.

The workshop focused on financing compliance towards the EU UWWTD. It was co-convened by the Slovenian Ministry of Environment and Spatial Planning, the OECD and the European Commission (DG Environment). It gathered approximately 25 delegates from national, regional and local authorities and financing institutions.

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Financing compliance with the EU water *acquis*

Focus on wastewater collection and treatment

Recommendations

Slovenia is a water-rich country, endowed with many rivers and abundant aquifers. At the same time, rough topography and dispersed rural settlements have had a large impact on the development of urban infrastructure and of water supply and treatment services. Slovenia has had strong performance on drinking water provision, but significant investment needs remain for sewerage infrastructure.

Slovenia's waste water collection and treatment coverage remains average among European countries. Compliance with the requirements of the Urban Wastewater Treatment Directive remains a point of concern, with levels of secondary and more stringent treatment below required levels. To date, the country has relied extensively on EU funds to finance investment. Considering requests from Slovenia and reasonable assumptions about future trends in Cohesion policy, such funding is expected to cover only a small portion of future investment needs. In addition, existing networks need maintenance to maximise efficiencies. In this context, Slovenia must complete necessary projects to ensure full compliance with the Urban Wastewater Treatment Directive as soon as possible.

Complying with the EU water *acquis* – including UWWTD - delivers multiple benefits for society, the economy and the environment. While some measures can be costly, this report considers options to comply in cost-effective ways, taking account of distinctive capacities and challenges in Slovenia. This report identifies a number of recommendations to assist Slovenia with closing the finance gap and managing the transition towards sustainable water management. Key recommendations include:

- Take advantage of the process of revising the delineation of agglomerations to enhance efficiency of provision for sanitation services. This process could consider delineating service areas to cross-subsidise rural smaller and poorer communities with peri-urban communities. Slovenia could learn from countries who have recently undergone similar processes, such as Ireland or Romania. The delineation revision also creates an opportunity to review tariff policy and tariff-setting processes. The role of a regulator could be considered, for example following the model in Hungary or Lithuania, to take some political pressure off municipalities. Finally, better co-operation among municipal water utilities should be promoted to achieve economies of scale.

- Earmark revenues from water tariffs to fund renewal of water supply and sanitation infrastructure. A solution at national level might be beneficial, to ensure that revenues cover long-term O&M costs. Currently over 90% of the funds from tariffs are managed at municipality level in Slovenia, and there is a risk that they cover short-term needs in other sectors.
- Consider options to crowd in new sources of finance. Discussions at the workshop suggested that domestic financial institutions – such as SID - are willing and able to co-finance water-related investments. Existing small grants can be used strategically, for example, by spreading across multiple projects to improve their bankability. Care should be taken not to spend grants on self-sustainable projects and leave non-sustainable projects subserviced. In addition, projects should be sequenced in such a way to ensure maximum benefit for the investments realised.

In these domains, Slovenia could take advantage of opportunities for technical assistance and peer learning to overcome specific bottlenecks and consider practical ways forward.

1. Background

Slovenia is considered a rural country, with only 50% of the population living in urban areas (Fribourg-Blanc et al., 2017^[1]). Slovenia's land area is about 58.3% covered by forests (Slovenia Forest Service, 2017), with agriculture (25.3%) the next largest land-use type. Less than 5% of total land area is dedicated to residential and service uses, but this category is growing. As much as 9% of land is classified as unused or abandoned (EEA, 2017). Also, nearly 40% of the territory of Slovenia is Natura 2000 sites. This raises investment needs to ensure that the quality of the environment and ecosystems is not affected by polluted water.

Slovenia is water-rich (around 8000 m³/cap/yr, above Netherlands or Portugal), with high average annual precipitations (1500 mm), abundant flow of water from upstream countries and a low rate of abstraction (3%) of its total available resources (OECD, 2012^[2]). Slovenia is endowed with many rivers, abundant aquifers, and is largely able to draw water from natural springs. Groundwater provides as much as 97% of potable public water (World Bank, 2015^[3]). Further, it has a relatively high and stable level of rainfall. Nonetheless, long-term trends suggest the quantity of water available for public use is falling and the spatial distribution of rainfall is changing (WWF, 2018). This will likely lead to a lower ability to store water, as well as increase the risk of both flooding and drought.

Water regulation is set by central government agencies. The Ministry of Environment and Spatial Planning is responsible for water policy, regulatory monitoring, and financing of water investments. The Slovenian Environment Agency is charged with allocating water abstraction rights via permits, monitoring water quality and quantity, and collecting water use/pollution levies. Furthermore, the Slovenian Water Agency and the Slovenian Environment Agency are in charge of allocating water abstraction rights via permits, monitoring water quality and quantity, and collecting water use fees. Environmental tax for wastewater is collected for municipalities by the Financial Administration of the Republic of Slovenia.

2. Water Supply and Sanitation. State of play

Groundwater is the main source of drinking water in Slovenia. About 90% of Slovenia's population is connected to public drinking water supplies and the quality of water delivered is generally of a good standard, typically showing very high compliance with the parameters of the Drinking Water Directive (European Commission, 2019^[4]). However, some regions (e.g. the northeast) show below average rates of connection (OECD, 2012^[3]).

In the past, water losses were a significant issue due to aging systems and lack of maintenance in the mains and distribution network. One-fourth of the Slovenian water network was installed before 1920, and much of the material used for pipe construction is liable to cracking and leakage (World Bank, 2015^[3]). From 2000 to 2010, the rehabilitation of water supply systems was boosted by EU grants and funding specifically dedicated to water infrastructure improvement (World Bank, 2015^[3]). In 2018, 28% of water supplied were lost ((GOV.SI, 2018^[5]), which is higher than the EU average (23%).

Compared to other European countries, the proportion of inhabitants in agglomerations <2,000 p.e. connected to the wastewater drainage system is low (Slovenian Environment Agency, 2018^[6]). However, for agglomerations > 2,000 p.e. the collection of wastewater is steadily increasing due to contribution from EU grants. For 2016, it was estimated by the European Commission that only 4% of the wastewater was still not collected (draft findings of 10th report). In the early 2000s, only 23% of the population was connected to wastewater treatment plants (of which nearly 50% provided only primary treatment). Around 50% of the population used cesspools. The situation improved in 2006, when the construction of large wastewater treatment plants was completed for the main cities increasing the connection rate to 52%. By constructing large capacity water treatment plants in Ljubljana and Maribor, Slovenia met (with some delay) the 2005 target of the UWWTD to connect large agglomerations to wastewater treatment (OECD, 2012^[2]).

For 2016, it was estimated by the European Commission that 7% of the waste water still did not meet requirements for secondary treatment and 43% of the wastewater still did not meet requirements for more stringent treatment (draft findings of 10th report). Major financing challenges remain in agglomerations of all sizes. Several agglomerations must be brought to compliance, which requires sound planning and further investment. However, the distance to target for collection and secondary treatment is low, showing that, although many agglomerations are in non-compliance, lower effort towards reaching compliance is necessary.

Despite heavily investing in constructing basic infrastructure for collecting and treating urban wastewater, including projects co-financed by EU funds, Slovenia did not achieve compliance with the UWWTD for larger agglomerations by the December 2015 deadline.

3. Past financing strategies and future options

Investment in water in the past has been funded mostly by EU funding, with taxes representing a small proportion of total sector financing. Sources of public funding include:

- The wastewater tax, introduced in 1996, which is levied on industrial and communal wastewater per unit of pollution.
- A Water Fund, managed by the Ministry of Environment, which receives its funds from water resources rights. This fund can be used to finance investments in water infrastructure; construction of public and local infrastructure to meet water infrastructure requirements; and for intermunicipal and regional projects for the purpose of constructing facilities for the pumping, filtering, and capturing of water for construction of movable water distribution systems for drinking water supply (World Bank, 2015^[3]).
- Revenues from tariffs which are mostly managed at municipality level and are not earmarked for water expenditures, therefore spent for projects, which are priority for the municipality but unlikely to enhance water services and compliance with the UWWTD.

Compared to other European countries, Slovenia allocates a highest share of GDP to water supply and sanitation expenditures; and per capita expenditure are comparatively high. The fact that such efforts do not translate into rapid progress towards compliance with the UWWTD suggests that expenditures programmes could be improved so as to effectively enhance water treatment services and compliance with the UWWTD.

4. A case for economic regulation of service provision

Robust economic regulation and supervision of service providers would help address some of the challenges faced in Slovenia. It could:

- Support sound tariff policy and appropriate measures to address affordability issues
- Incentivise operational efficiency of utilities, building on benchmarking
- Allocate revenues from water tariffs to cost-effective expenditure programmes.

4.1. Support sound tariff policy and measures to address affordability issues

The national government has promulgated a compulsory methodology for pricing water, but delegates the actual setting of tariffs to the local government-owned utilities, although municipal councils must approve the annual rate changes (World Bank, 2015^[3]). These comprise of fixed and variable prices, with a uniform rate applied regardless of user type (i.e. households, industrial users, and agricultural producers all face the same rates). Some exceptions may apply for large industrial users when negotiating prices directly.

According to the law, all regions should practice full cost recovery for drinking water supply. However, prior to 2013, the national government had set the level of water tariffs at a low level, thus bearing much of the cost of providing water sanitation services through taxes and transfers. This set a low bar for tariffs, which has persisted. As of 2015, about 55% of total expenditure, representing operation and maintenance costs only, are covered by utility-collected tariffs (World Bank, 2015^[3]).

To manage affordability concerns, individual municipalities can issue subsidies, however there is no common methodology and it is up to municipalities discretion. The lack of standardisation of affordability measures can put additional political pressure on municipalities to keep costs low. Considering introducing a type of economic regulator could ease this burden.

4.2. Incentivise operational efficiency of utilities

The performance of operators is currently benchmarked. However, this information is not made public, and there is little evidence that benchmarking actually serves as an incentive for efficient practices. Good practices from neighbouring countries could inspire more robust use of benchmarking as a driver for efficiency enhancement, thereby minimising future financing needed to renew and upgrade degrading infrastructures.

The process of revising the delineation of agglomerations could consider delineating service areas to cross-subsidize rural smaller and poorer communities with peri-urban communities. Agglomerating service provision at the right scale can generate multiple co-benefits, in terms of economies of scale and access to technical expertise and know-how.

4.3. Allocate revenues from water tariffs to cost-effective expenditure programmes

One potential challenge in Slovenia is that funding raised through water tariffs is not earmarked, as it goes into the general budgets of local governments. This can be problematic, as it can result in funding for water infrastructure maintenance which is often a low visibility item to the general population, being in competition with other more visible needs such as a new school or road maintenance.

Slovenia could divert revenues from water tariffs to renewal of water supply and sanitation infrastructure. A solution might be explored at national level for covering long-term O&M costs to mitigate risk of diversion at municipal level.

In addition, there may be opportunities to enhance the effectiveness of expenditure programmes. Slovenia could consider encouraging smaller, most cost-effective projects in places where large infrastructure does not make economic sense and does not lead to environmental benefits. One option to explore could be systematic grant for home treatment.

4.4. Financing capital investment

As reported by Slovenia under Article 17 of the UWWTD, estimated investment needs to reach full compliance with the Directive are of EUR 503 million (European Commission, draft findings of 10th report). In the 2014-20 programming period, the largest priority of Slovenia's cohesion policy budget for the environment (over EUR 570 million) has been the water sector, flood control included, with approximately EUR 390 million: EUR 161 million has been allocated for urban wastewater treatment, EUR 125 million for drinking water, EUR 90 million is for climate change adaptation focused on flood protection measures and EUR 14 million for other water measures (European Commission, 2019_[4]).

So far, capital investments have been covered mostly by EU funding, with taxes representing a small proportion of total sector financing. Debt finance has not played a significant role in financing wastewater infrastructure in Slovenia to date. While capital and financial markets are currently shallow, practices could be adopted to make better use of grant funding, and encourage staged growth in the market for debt finance for water. These include:

- Insuring that operations that are potentially commercially attractive are not funded through public funds.
- Using rare grants horizontally, in a selective way, to make all projects viable for commercial finance. Avoid spending grants on self-sustainable projects and leaving non-sustainable projects unserved.
- Providing a possibility for municipalities to raise more loans by expanding their borrowing quota.
- Analyse all projects from the point of view of who bears the financial burden, to understand where additional sources could be leveraged.

Another challenge is around capacity of small municipalities (< 2,000 p.e.) to raise funds. Municipalities with small populations by default have less income. This is compounded by the trend of rural flight, as losing population equates to losing money that could be available to invest in water treatment. Low capacity in municipalities could be addressed in part by putting incentives in place for cooperation between municipalities to improve economies of scale. A proper service based on decentralised systems, with thorough performance monitoring and compliance enforcement, can be a viable solution in such a context.

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