A production function approach to value the service for water quality

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Workshop on economic valuation of forest ecosystem services

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Motivations

- **The importance of forest lands in providing ES**
  - **The role of the forest in the supply of a number of goods and services** is recognized by numerous policymakers around the world since a long time (French Forest Orientation Law, 2001)
  - This law reinforces **the role of forest policies** (with other policies in rural development), **to reduce the greenhouse effect, to preserve biological diversity, to protect soils**…
  - **Water protection/purification** is one of the most important **ecological service provided by (forest) ecosystems** to humanity

Motivations

- **<u>Protection</u>: effects of land uses on water quality**
  - **Under forest cover, nitrate levels are low**

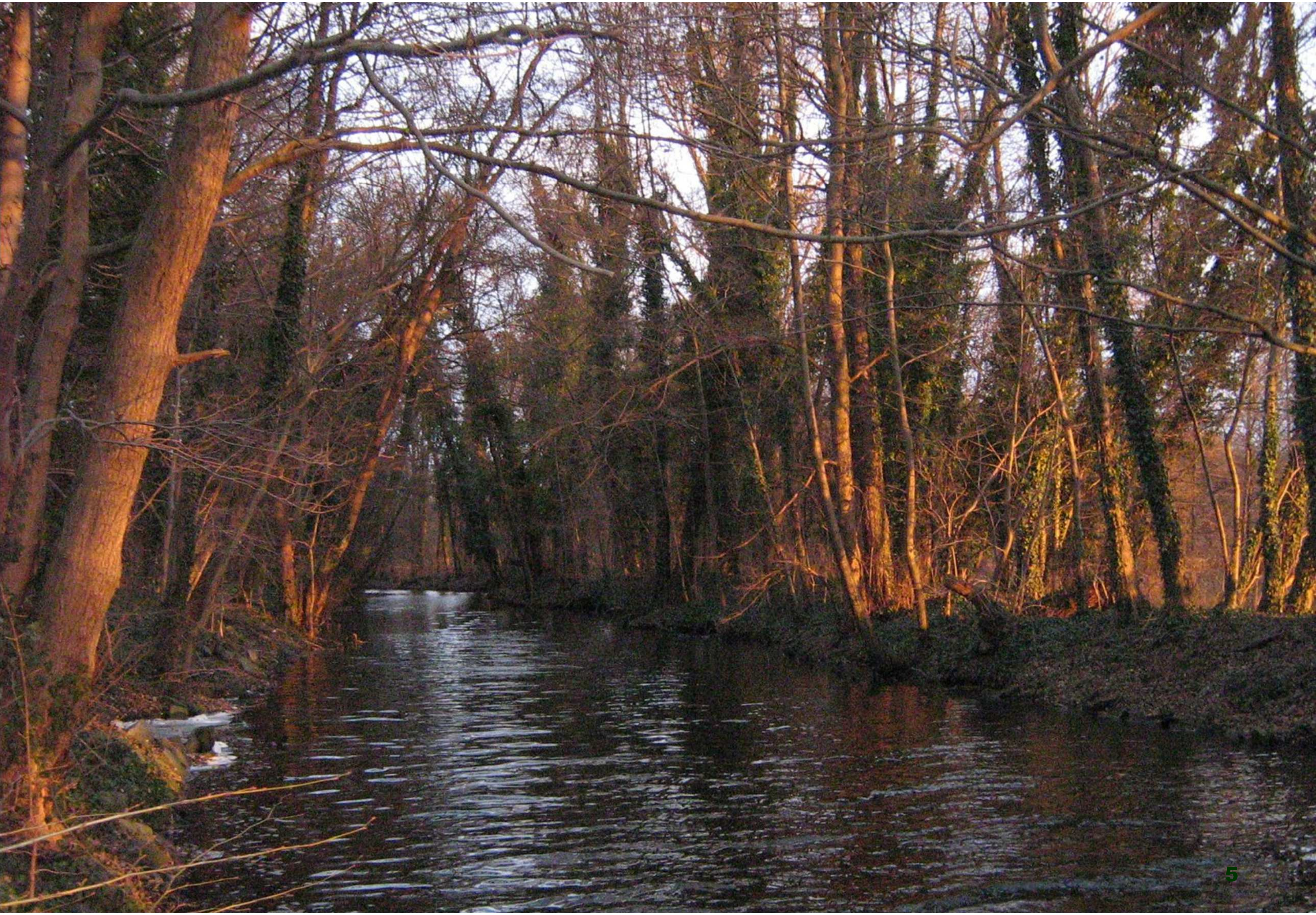
Land cover	$[NO_3^-]$ in water in the soils at a depth of 1,10m in mg/l
Forests	2
Cut fields	19
Pastures	31
Temporary grassland	28
Winter wheat	46
Rape seed (*colza*)	62
Spring cereals	120
Maize as fodder crop (*maïs fourrage*)	126

- Source : Benoit et al. 1997

  - **Similar results observed for various pollutants** (e.g., pesticides)

Motivations

- **Purification: forest lands have a major positive impact on water quality**
  - **Some wooded formations clearly have a purification role** such as riparian, alluvial forests: the root system has a filtering role and trap nutritive elements (nitrogen, potassium, phosphorus) and some toxic elements
  - **Cultivated lands liberate five times more sediments** into the water course than wooden lands: the forest contributes to protecting land, favoring infiltration, and reducing rapid flow at the surface
  - **Forests generally limit sediment flow and thus turbidity**



Motivations

- **Influence of <u>forest management</u> on water quality**
  - **Land management in forests is less intensive** than for agriculture and interventions are less frequent
  - **Very limited use of chemicals is made in forest areas**: agro-pharmaceutical products and fertilizers are rarely used
  - **Disturbances in the forest cover**, especially clear cutting, can lead to increase nitrate concentrations in drained water

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Hypothesis

- **Land uses have an impact on water quality and on costs of drinking water production**
  - **Forest land use is associated with the protection of water resources** from contamination and the **reduced cost of drinking water supply** (Abildtrup and Strange 2000, Willis 2002, Ernst 2004, Freeman et al. 2008)
  - Raw water from catchment areas (for drinking water purpose) with **a large portion of forests around** **is of higher quality than that of agricultural, urban or industrial landscapes**
  - **So this reduces the need for treatment of drinking water** and, as a result, the associated **costs and prices of drinking water supply**

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Literature

- **Many scientific (mainly hydrological) works** on the relationship between forest (and other land uses) and water quality
- A **short literature in economics**
  - Impacts of alternative land uses on watershed health (Hascic and Wu, 2006; Langpap et al., 2008).
  - Still very few on ***the value of forests in supplying drinking water*** (Núñez et al. 2006, Biao et al. 2010, Elias et al. 2013)
- Vincent et al. (2015) claimed the first econometric analysis on the effect of forests on water treatment costs
  - BUT…

Literature

- **A new approach** developed by a LEF team from 2009
  - Objective: **estimate the economic value of the (positive or negative) externalities** provided by land uses (especially, forest areas) on quality of raw water used for drinking water supply
  - Hypothesis: If land use affects raw water, then we can **identify this impact in the process of drinking water supply**: Raw water is transformed into drinking water with costs
  - Method: **estimate a (complete) cost model for drinking water supply** by taking the impact of land uses on raw water into account

Literature

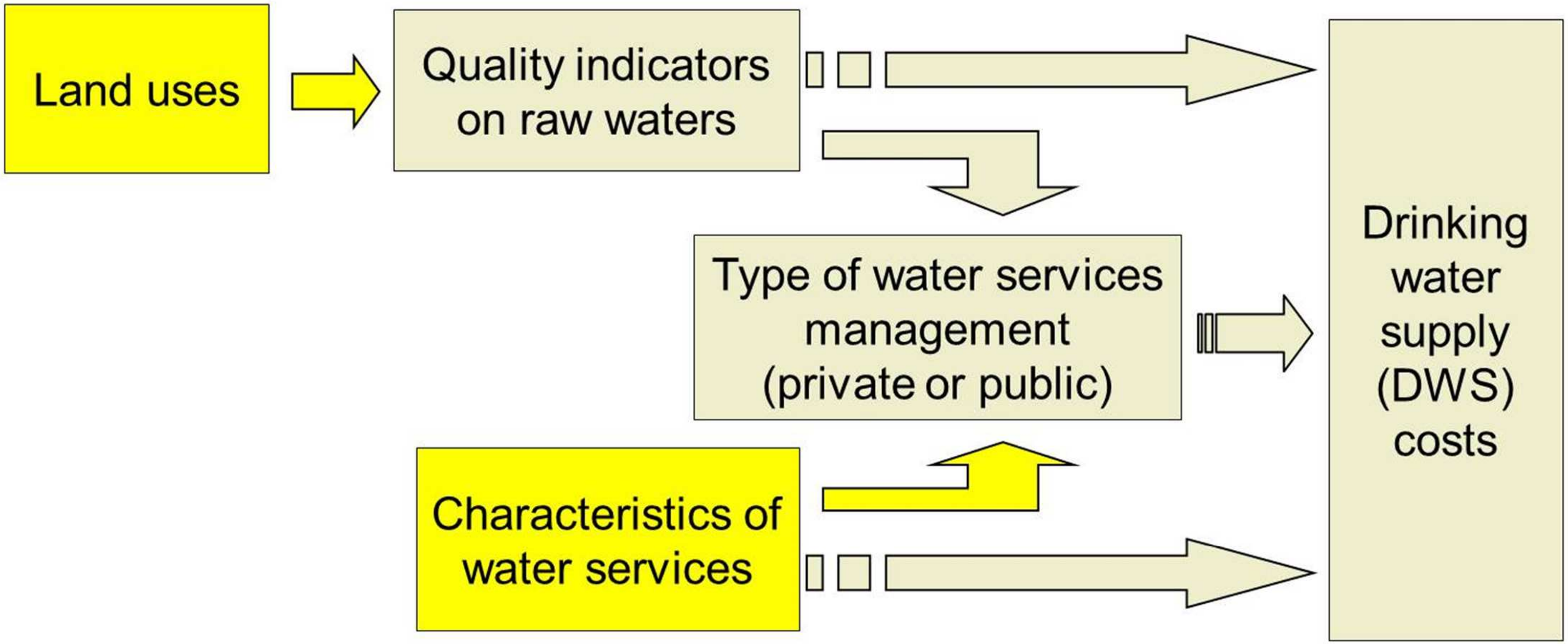
- **A new approach from LEF**
  - Fiquepron J., Garcia S., Stenger A. (2013). Land use impact on water quality: Valuing forest services in terms of the water supply sector. ***Journal of Environmental Management***, 126, 113-121
  - Abildtrup, J., Garcia S., Stenger A. (2013). The effect of forest land use on the cost of drinking water supply: A spatial econometric analysis. ***Ecological Economics***, 92, 126-136
  - Abildtrup J., Garcia S., Kéré E. (2015). Land use and drinking water supply: A sample selection model with spatial dependence. ***Journal of Regional and Urban Economics-Revue d'Économie Régionale et Urbaine***, 1/2015 (mai), 321-342
  - Abildtrup J., Garcia S., Le Gallo J., Ndiaye Y. (Ongoing work).

Drinking water supply (DWS)

- **DWS covers all operations from resource extraction to customer tap**. Several functions with specific costs:
  - Production and treatment: resource extraction (groundwater or surface water) and purification (disinfection, filtering, softening)
  - Transfer and stocking in water tanks and towers and
  - Pressurization of water (gravity or pump-operated system)
  - Distribution to users by distribution mains and service lines
- **Trade-off between treatment costs and distribution costs**, according to water availability and quality
- The sole **analysis of treatment costs could be fake**

A Production approach…

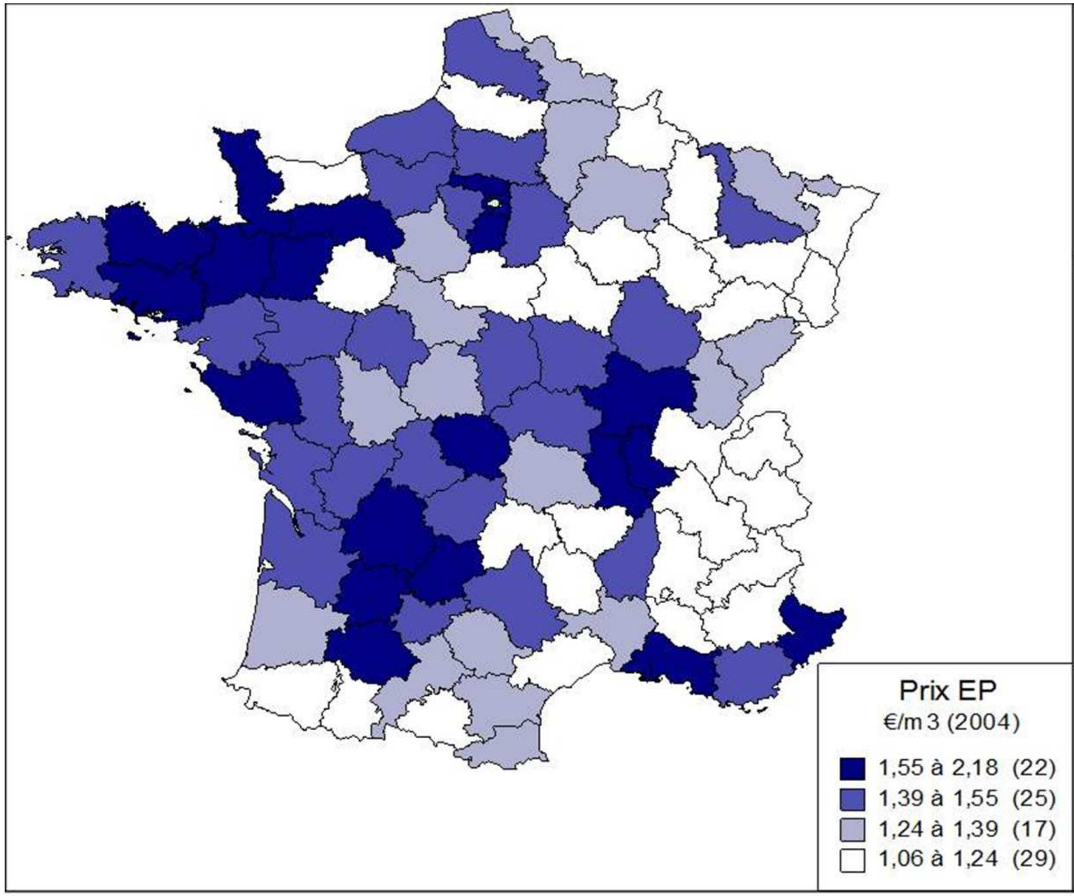
- **A bioeconomic model**



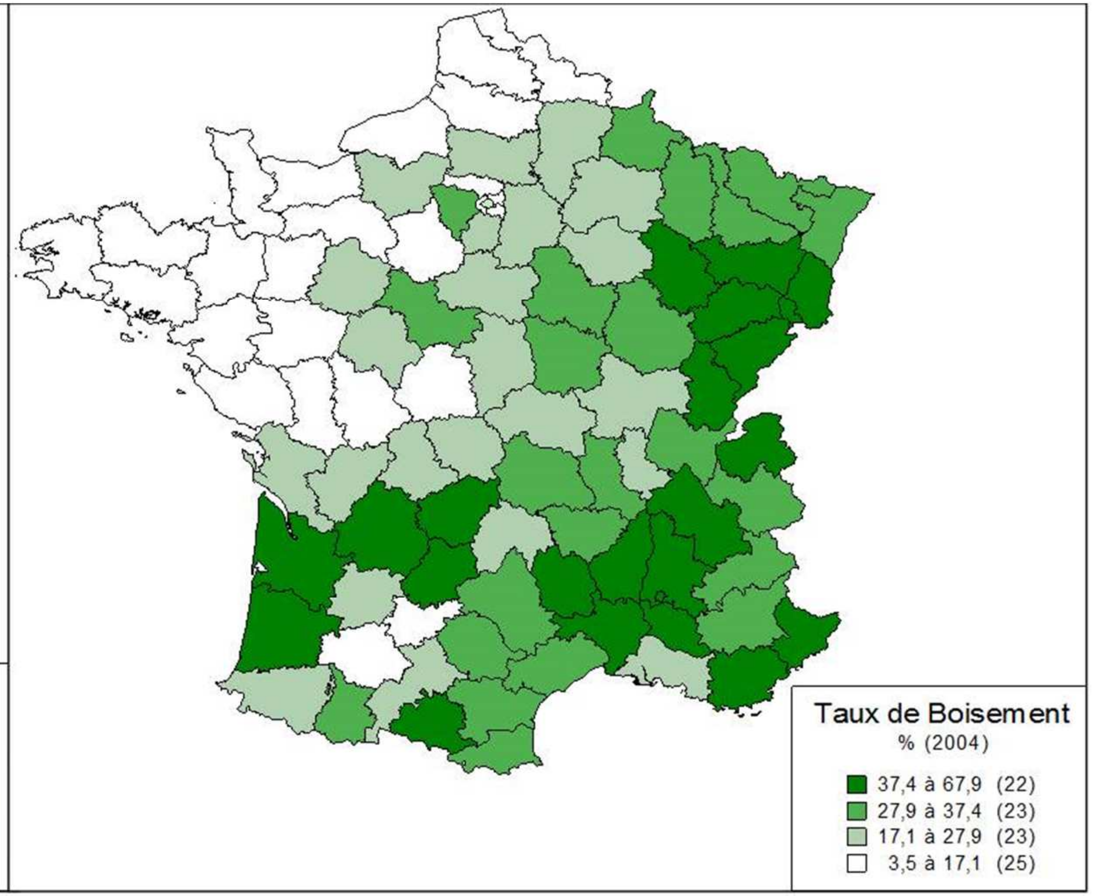
…Combined with a preference approach

- We estimate **welfare changes for the water drinkers**
  - We measure the impact of land use changes on water price
  - And determine the value of one ha of afforested land from the water invoice

Appli 1: Fiquepron et al. (2013)



Water price (2004; €/m³; IFEN SCEES)



% of land area covered by forest (2004; SCEES)

Simple correlation or causality?

Appli 1: The econometric model

- **System of simultaneous equations**
  - **Quality equations**

X Characteristics of WSS
L Land uses

PESTI $= \gamma_0 + \gamma_x$ **X** $+ \gamma_z$ **L** $+ \varepsilon_{PESTI}$

NO3 $= \delta_0 + \delta_x$ **X** $+ \delta_z$ **L** $+ \varepsilon_{NO3}$

  - **Price equation**

PRICE $= \alpha_0 + \alpha_x$ **X** $+ \alpha_2$ **PESTI** $+ \alpha_3$ **NO3** $+ \alpha_4$ **PRIVAT** $+ \varepsilon_P$

  - **Management equation (PRIVAT = % of private delegation)**

PRIVAT $= \beta_0 + \beta_x$ **X** $+ \beta_1$ **PESTI** $+ \beta_2$ **NO3** $+ \varepsilon_D$

Appli 1: Empirical strategy

- **Econometric analysis**
  - A national study, at the French administrative department level

  Sample : 93 administrative departments (without Paris et Corse)

  - The econometric estimation method

  Estimation of the system of simultaneous equations by GMM

Appli 1: Results

- **Estimation results**

Variable to be explained	Explanatory Variable	Impact
Pesticides (PESTI)	% Forest land use	- - -
	% permanent grassland	- - -
	% cereal, oilseeds, protein crops	+ + +
	% vine, arboriculture, market gardening	+ + +
	% underground resources	- - -
Nitrates (NO3)	% Forest land use	- - -
	% permanent grassland	- - -
	% cereal, oilseeds, protein crops	+ + +
	% vine, arboriculture, market gardening	- - -
	% mountain area	- - -
	Number of pigs per ha	+ + +
	% underground resources	+ + +

Appli 1: Results

- **Estimation results**

Variable to be explained	Explanatory Variable	Impact
Management type (PRIVATE)	Delivered drinking water volume	+ + +
	Population density	+ +
	Water recharge	- - -
	Maximal Population	+ + +
	PESTI	+ +
Drinking water price (PRICE)	Length of water network	+ + +
	% groundwater	- - -
	PRIVATE	+ + +
	NO3	+ +

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Appli 1: Results

- **Simulation of land use changes**

Scenario : substitution forests → mains crops

Change of land uses	**Variation / total surface**	**Surface**
% forests	+ 5pts (from 28% to 33%)	+ 2675901 ha
% crops	- 5pts (from 32,5% to 27,5%)	- 2675901 ha

NO3	- 1.9 mg/l
PESTI	- 4.1 pts of outflows to treat

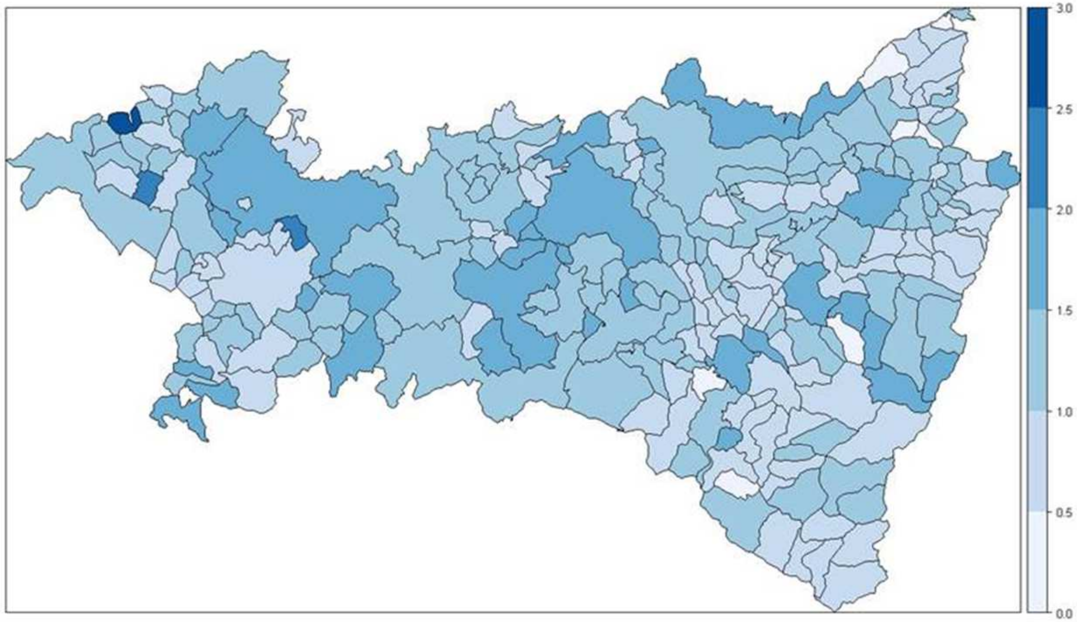
PRICE	- 0.003 €/m3

Savings on water bill for domestic users	12 million € per year
	22 €/ha/year

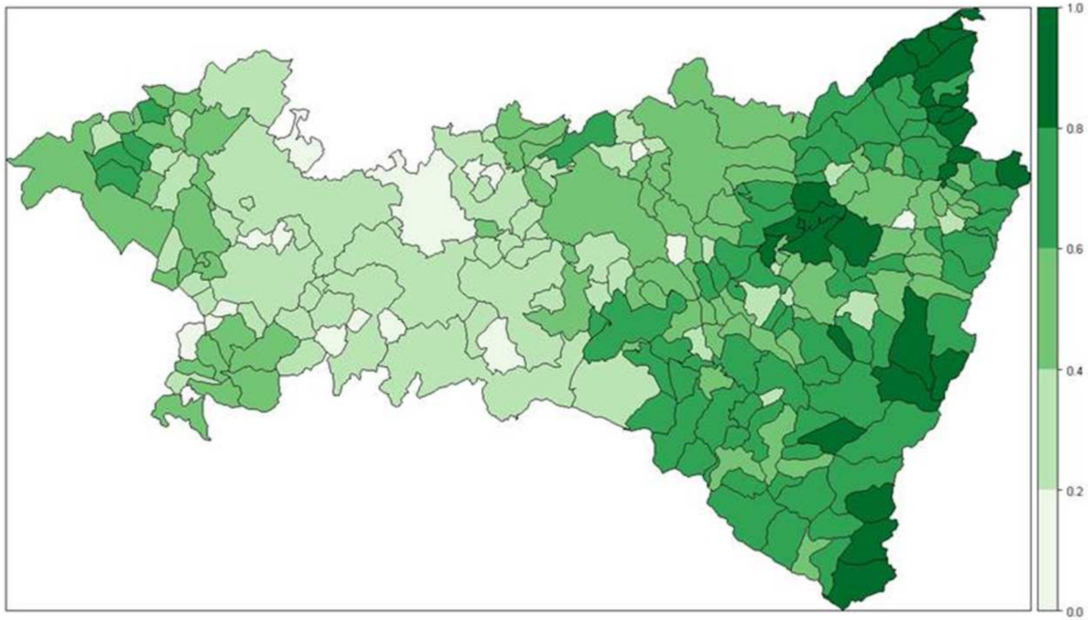
Appli 2: Abildtrup et al. (2013)

A study on the Vosges Department in France ?

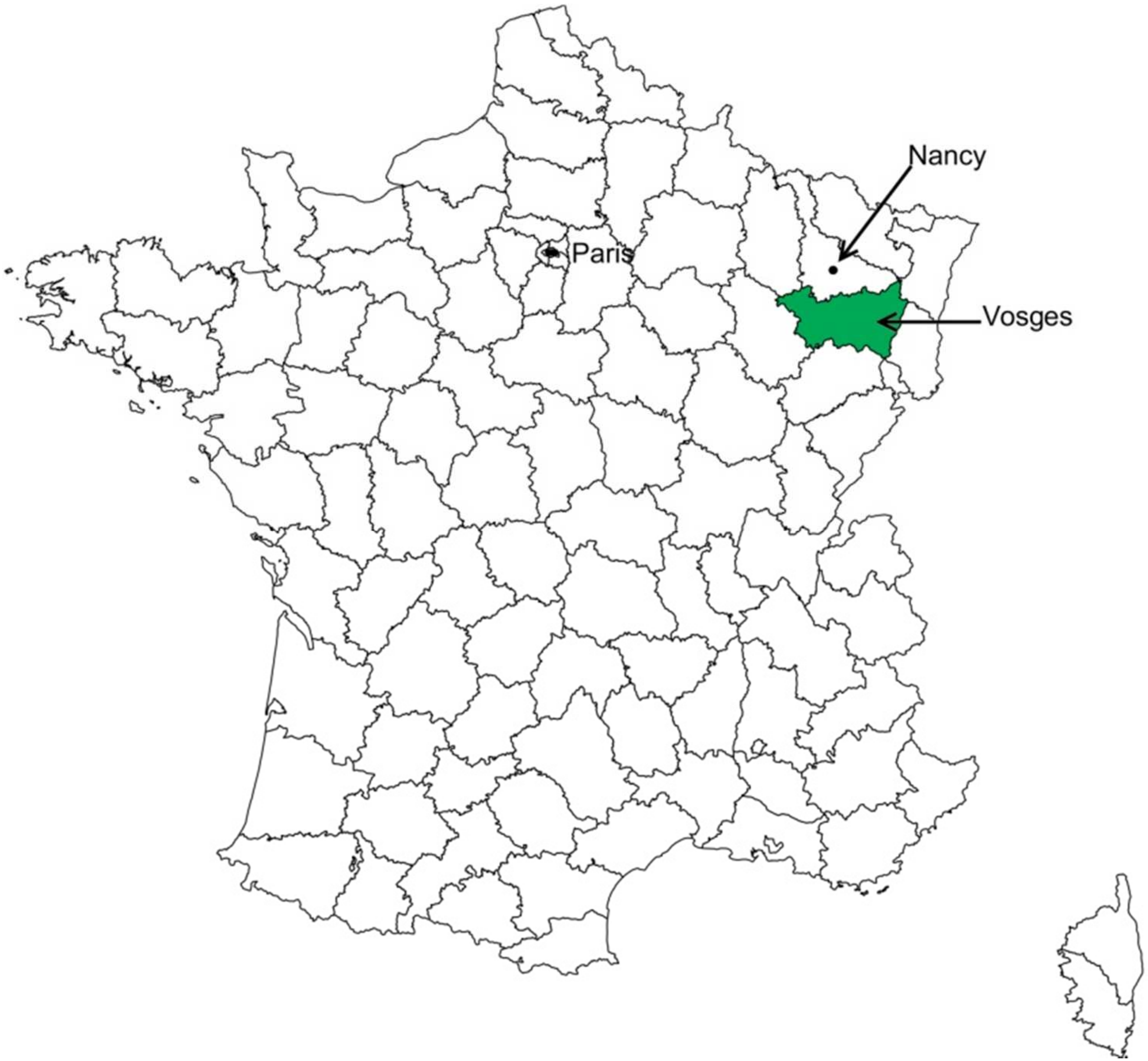
Spatial distribution of water prices



Spatial distribution of forest



The Vosges department in France



Appli 2: Spatial issues

- **(Positive or negative) externalities between Water Supply Services (WSS) arising from characteristics of neighborhood WSS**
  - The costs of water supply may be influenced by **local competition for scarce local water resource**s :

If quantity and quality are low, the WSS can decide to use other water resources further (even in another WSS), consequently increasing scarcity and water supply costs for neighboring WSS

  - **Technical spillovers** may occur as a result of knowledge diffusion or the sharing of inputs (including raw waters):

Existence of scale economies can impact the organization of WSS: grouping of municipalities, extension of delegation

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Appli 2: Spatial issues

- **Spatial heterogeneity/homogeneity** can be explained by the proximity of WSS that exhibit the same conditions of operation due to geographical, topographical factors or even the extraction of water in the same aquifer
- **WSS area and land uses generally do not match**. The impact of land uses on service costs should thus be measured by **<u>taking both land distribution on the WSS and on its neighbors into account</u>**.

Appli 2: The economic model

- **The costs of supplying drinking water to users** can be described by the cost function:

$$C_i = C(W_i, q_i, X_i, \varepsilon_{ci}; W_{n(j)}, q_{n(j)}, X_{n(j)}, \varepsilon_{cn(j)})$$

  - The service i , the neighboring services ***n(j)***
  - ***W*** : delivered water volume, ***X*** : characteristics of the WSS
  - ***q*** : quality of raw water supposed to depend on land uses **L**:

$$q(L_i, \varepsilon_{qi}; L_{n(j)}, \varepsilon_{qn(j)})$$

- **The pricing model** is:

$$P = AC\left(W_i, L_i, X_i, \varepsilon_i; W_{n(j)}, L_{n(j)}, X_{n(j)}, \varepsilon_{n(j)}\right) + R$$

  - ***AC*** : average cost of drinking water supply
  - ***P*** : water price, ***R*** : private operator rent

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Appli 2: Data

- **Study:** The Vosges (515 communes, which form 283 WSS)
  - **Sample:** 232 WSS, including 21 WSS privately operated (9% of the sample)
- **Variables:**
  - **PRICE**: average drinking water price (composed of a fixed charge and a marginal price) for a consumption of 120 m3, without VAT
  - **MUNICIP**: number of municipalities served by the WSS
  - **USER**: number of users served by the WSS
  - Number of intakes (**INTAKE**) and type: **DRILL** (deep), **WELL** (less), **SOURCE** (surface)
  - **ALT-DIF**: Difference of altitudes between WSS and intake
  - Land uses (in %): **FOREST, AGRI, URBAN, OTHER** (Total = 100%)
  - **DELEG** = 1 if WSS is privately operated

Appli 2: The econometric model

- W : a spatial weights matrix to define the dependence between the individual observations
  - Based on neighbourhood contiguity, distance between centroids
- Several spatial econometric models:

$$P = X\beta + L\gamma + W_1 Z\delta + \varepsilon$$

with:

$$\varepsilon = \lambda W_2 \varepsilon + u$$

- Econometric method (Fingleton and Le Gallo, 2008):
  - 2SLS (multi-step) estimation method

Appli 2: Estimation results (2SLS)

Pricing model with AGRI as reference land use

Variable	Estimate	Estimate (spatial)
(Intercept)	1.8843*	2.8562**
WATER (in log)	-0.5471**	-0.4708**
USER (in log)	0.6091**	0.4441**
DENSITY (in log)	-0.1978***	-0.1118*
DELEG	0.4866***	0.4510***
MUNICIP	0.0220	0.0216*
DELEG x MUNICIP	-0.0241	-0.0268*
INTAKE	0.0070	0.0084
FOREST	-0.9502***	-0.7059***
URBAN	0.0763	-0.0268
OTHER	-0.8201**	-0.6529**
FOREST_lag	--	-0.8405*
URBAN_lag	--	8.1980*
OTHER_lag	--	-1.3144
WATER_lag (in log)	--	0.0489*
λ (spatial error)	--	0.2557**

Note: ***: significant at 1%, **: at 5%, *: at 10%.

Appli 2: Estimation results (2SLS)

Pricing model with “other non-polluting land uses” as reference

Variable	Estimate
(Intercept)	1.7141*
WATER (in log)	-0.3707**
USER (in log)	0.3504**
DENSITY (in log)	-0.1020*
DELEG	0.4307***
MUNICIP	0.0216*
DELEG x MUNICIP	-0.0231
INTAKE	0.0078
FOREST	0.0202
URBAN	0.5567
AGRI	0.6871**
FOREST_lag	-1.1049**
URBAN_lag	9.6119*
AGRI_lag	-1.2841
WATER_lag (in log)	0.0399*
λ (spatial error)	0.2368**

Note: ***: significant at 1%, **: at 5%, *: at 10%.

Appli 2: Estimation results

Average value estimates of forests in supplying water for human consumption (in €)

	No spatial	AGRI as reference	OTHER as reference
Direct impact	-0.0095	-0.0071[a]	0[b]
Indirect impact	--	-0.0084	-0.0110
Total impact	-0.0095	-0.0155	-0.0110
Direct value of 1ha	85.08	63.20	0
Indirect value of 1ha	--	75.25	98.93
Total value of 1ha	85.08	138.46	98.93

Note: Values are computed for an average WSS: average water price = €1.08 per m3, average delivered drinking water volume = 104,676 m3, average WSS area = 2165 ha, average proportion of forest lands.

[a] From estimation results, an increase of one point in the proportion of forest (for an equivalent decrease of the proportion of agricultural lands) would imply a decrease of €0.0071 of the water price per m3.

[b] Non significant value.

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Conclusions

- A valuation method for the water quality service of forests
- A significant impact of forest land use on water costs
- And a value of the ecological service provided by forests significantly different from zero
- A (relative) value of service different according to different land uses
- Importance to deal with the complete costs of DWS
- Importance of taking spatial issues into account:
  - Forest lands and water supply areas do not match together
  - Spatial spillovers from the water market valuation method

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Merci

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