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# A Novel HydroEconomic - Econometric Approach for Integrated Transboundary Water Management Under Uncertainty

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## Abstract

The optimal management of scarce transboundary water resources among competitive users is expected to be challenged by the effects of climate change on water availability. The multiple economic and social implications, including conflicts between neighbouring countries, as well as competitive sectors within each country are difficult to estimate and predict, to inform policy-making. In this paper, this problem is approached as a stochastic multistage dynamic game: we develop and apply a novel framework for assessing and evaluating different international strategies regarding transboundary water resources use, under conditions of hydrological uncertainty. The Omo-Turkana transboundary basin in Africa is used as a case study application, since it increasingly faces the above challenges, including the international tension between Kenya and Ethiopia and each individual country's multi-sectoral competition for water use. The mathematical framework combines a hydro-economic model (water balance, water costs and benefits), and an econometric model (production functions and water demand curves) which are tested under cooperative and non-cooperative conditions (Stackelberg “*leader–follower*” game). The results show the cross-country and cross-sectoral water use—economic trade-offs, the future water availability for every game case, the sector-specific production function estimations (including residential, agriculture, energy, mining, tourism sectors), with nonparametric treatment, allowing for technical inefficiency in production and autocorrelated Total Factor Productivity, providing thus a more realistic simulation. Cooperation between the two countries is the most beneficial case for future water availability and economic growth. The study presents a replicable, sophisticated modelling framework, for holistic transboundary water management.

**Keywords** Cooperation games · Demand curve · Endogenous adaptation · Production functions technical inefficiency · Stochasticity · Transboundary water management

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## 1 Introduction

Transboundary river basins should be treated as single units, and be modelled accordingly to maintain the physical integrity of the hydro-economic system and consider overall optimum solutions. Water Resources Management and Economics have gone beyond the traditional approach of monitoring and measuring the spatiotemporal allocation of resources, costs, and benefits, and seek the optimal way to control and manage systems in a way that maximizes the users' welfare under environmental constraints (Gupta et al. 2016). The problem of covering competitive and increasing needs with limited (and often deteriorating) resources becomes more complicated when considering the broad impacts of transboundary water decisions on the context of multiple competitive economic sectors. Additionally, in the coming years, it is expected that the impacts of the changing climate will stress water balances by reduced water availability and increased demand, sharpening thus the competition among different water uses and deteriorating the ecological status of water bodies (Alamanos et al. 2018; Pastor et al. 2022). The negative impacts of scarcer water resources on the economic, production, energy sectors, social stability, and environmental sustainability (Khan et al. 2022a, b; Tang et al. 2022) are calling for multidisciplinary solutions. Subsequently, integrated and detailed modelling is increasingly used in the decision-making process, to provide science-supported policies, especially in cases where holistic approaches and cooperative management can be hardly found (Uitto and Duda, 2003).

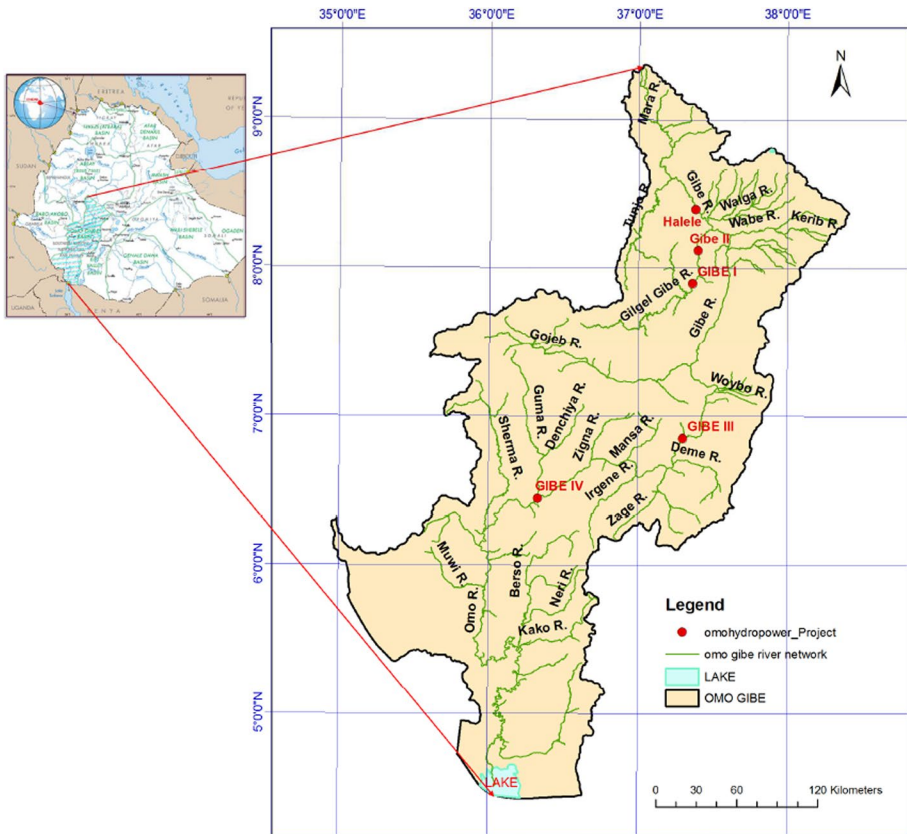
Game theory has been used to describe the actions of the countries-players (Frisvold and Caswell 2000; Dinar and Hogarth 2015). Kucukmehmetoglu (2012) analysed the problem of scarce water resources allocation combining game theory and Pareto frontier, using also linear programming to maximize net economic benefits. Zeng et al. (2019) proposed a hybrid game theory and mathematical programming model for solving transboundary water conflicts, by the optimal water allocation, considering water quality and quantity and the associated benefits and costs. Menga (2016) highlights the interplay between domestic and foreign policy for transboundary waters through the example of the two-level game theory of Putnam (1988). Hu et al. (2017) used the case of hydropower and water supplies within the water-energy nexus using stochastic competitive and cooperative (Nash–Cournot model) analysis. However, there are fewer contributions assessing cross-country together with cross-sectoral water and economic parameters. The aforementioned papers suggest that future studies need to also include uncertainty in hydrological processes. Indeed, the consideration of uncertainty for long-term planning is increasingly used in recent applications (Wine 2019; Kryston et al. 2022), combined with game theory (Bhaduri et al. 2011). Some examples follow: Degefu et al. (2017) analysed the uncertain characteristics of water flow in transboundary waters through a stochastic game. A similar analysis was performed by Janjua and Hassan (2020), who introduced the 'weighted bankruptcy' approach which favors agents with 'high agricultural productivity'. Jiang et al. (2019) used a stochastic differential game to analyze transboundary pollution control options, comparing the non-cooperative and Stackelberg cooperative game pollution results. However, these applications refer to allocation (resource or pollution) and include only economic extensions, as add-ons to the main model, while they focus on the one or two main sectors (water users). In order to better combine hydrological and economic parameters, and increase the number of different sectors considered, integrated hydro-economic models have been highlighted as promising tools for science-supported policies (Booker et al. 2012; Alamanos 2021; Wang et al. 2020). However, the use of hydro-economic models in uncertain transboundary

management problems (e.g. Jeuland 2010) has been very limited (Tayia 2019), mainly because of their complexity and data requirements (Alamanos et al. 2020).

This study attempts to build on all these gaps of the literature mentioned, by proposing an integrated approach that considers hydrological and economic aspects (based on a hydro-economic model), where the economic aspects are emphasized through econometric modelling, in the context of game theory investigation of transboundary water management strategies, under conditions of hydrological uncertainty. The integrated character of the proposed approach is an added value, which is highly desirable for cross-sectoral transboundary resources management (Bernauer and Böhmelt 2020). We demonstrate how the potential of hydro-economic modelling to simulate in an integrated and expandable way multistage stochastic and dynamic processes under uncertainty can fit into the concept of a transboundary water management-game. The proposed framework combines *hydrological* (precipitation, runoff, outflows from the upstream country, and water stock, stochastically) and *economic components* (social benefits, marginal and total costs), considering the *five sectors-drivers* of water demand and economy (mining, energy, tourism, residential, and agriculture), as well as their water demand curves through production functions and productivity. This study provides also specific modelling advances, as the estimation of the latter relations has been one of the most challenging econometric processes: Biases, inconsistencies, and correlation among the regressors (explanatory variables, e.g. capital or labor, with the error term) often cause endogeneity problems. Traditional approaches (Olley and Pakes 1996; Levinsohn and Petrin 2003) lack of instruments to control for the endogenous inputs and suffer from collinearity problems (Akerberg et al. 2015; Gandhi et al. 2017). Endogeneity problems are still a challenge for stochastic frontier models in efficiency analysis, too (Shee and Stefanou 2014). It usually biases the commonly used tools (e.g. DEA), and Monte Carlo techniques are recently suggested to control the effects of endogeneity in efficiency analysis and estimates (von Cramon-Taubadel and Saldias 2014; Santín and Sicilia 2017). We present a new estimation method of sector-level productivity as an extension of the model proposed by Gandhi et al. (2017), to tackle the existing limitations, introducing technical inefficiency in production, and allowing for autocorrelation of Total Factor Productivity (TFP).

The whole framework is tested under a non-cooperative and a cooperative (Stackelberg leader–follower) game, considering the agreements (e.g. food or energy trade-offs) between the upstream and downstream countries, providing thus a direct link to Water-Food-Energy (WEF) nexus. The transboundary Omo-Turkana River Basin in Africa is used as an example to showcase the framework, while highlighting the significance and impacts of proper management of scarce resources to the economic and WEF issues of the area under baseline and future scenarios. The specific case study results demonstrate the benefits of the cooperation between the two countries towards maximizing the efficiency of all economy sectors, and prolonging the water resources availability, under varying hydrological conditions.

With respect to the novelties of the study, its integrated character and the coupled modelling approach (to our knowledge, no study has combined all the above components in a single framework), are significant. Also, there are specific modelling advances such as: the proposed way for the stochastic description of the hydrological components; the connection of the follower's reaction to the leader's strategy, together with the (quantitatively tractable) optimization of their objective functions over all possible strategies of the stochastic game; the realistic production functions estimations, controlling-allowing for endogeneity, technical inefficiency and autocorrelated TFP. Finally, this study significantly contributes to the transboundary water management in the African context, where there are limited



**Fig. 1** The study area, with the constructed works in Kenya (Gebresenbet 2015)

applications (Basheer et al. 2019; Hughes 2019; Mumbi et al. 2021). To our knowledge, this is also the first study of its kind for the Omo-Turkana basin, with the exception of Giuliani et al. (2022), which was more focused on the hydrology of the area though.

## 2 Study Area

The Omo-Turkana (Omo River and Lake Turkana) basin in Eastern Africa is an area of 130,860 km<sup>2</sup> across Ethiopia and Kenya, and small encroachments into Uganda and South Sudan (95% of the basin is in Ethiopian and Kenya) (Fig. 1). The water-land uses of the broader area are agriculture (main use, including livestock), energy production, mining, residential, and touristic. Lake Turkana receives its inflows from Omo River, which defines its levels and water quality. Turkana concentrates over 70% of Kenya's population, relying on food aid, flood retreat farming along Omo River, cattle-grazing, and fishing (Kaijage and Nyagah 2010; Reta 2016; Oakland Institute 2014; Anaya 2010). A five-plant hydroelectric dam cascade is being constructed in Ethiopia (three of them- GIBE I, GIBE II, GIBE III, are already operating in Omo River) to fulfill energy demand and electricity export ambitions (Regi 2011; Ficquet 2015).

The case is controversial as there are studies highlighting the engineering achievement of the dams' construction, or criticising it from the ecological point of view (Ambelu et al. 2013). Hydrological studies argue that the impact on the water level of Lake Turkana is negligible (Yesuf, 2012), or dependent on the rainfall and the lake's initial level (Velpuri and Senay 2012), while there are reported phenomena of extreme hunger in the Omo Valley, attributing it to the GIBE III reservoir which holds back the Omo River's annual floods, preventing retreat agriculture for local pastoralists, (Avery 2013) and around Lake Turkana where people (and ethnic groups) are already fighting over dwindling resources (Avery 2013; Carr 2012, 2017). In any case, there are transboundary tensions and territorial conflicts/border disputes around the Lake Turkana border, in contrast with the Ethiopian agricultural and rural-factories development (Kamski 2016; Sugar Corporation 2019). Kenya sees the dam construction as growing poverty because of increased water scarcity; Ethiopia is concerned by land erosion, water access increased poverty, change in livelihood, while points out the positive impact of regulating floods to provide a more constant water availability throughout the downstream (DAFNE 2019). The broader area was in the spotlight last year because of the food crisis caused from a historic locust swarm invasion.<sup>1</sup>

The dams' construction allows Ethiopia to export electricity to Kenya, Sudan, and Djibouti. This agreement exists only in a form of Memorandum of Understanding (MoU), that only Kenya's Electricity Company has signed in 2006 (Eastern Electricity Highway Project—construction of a 1000 km power line from Ethiopia to Kenya), while other trade-offs refer to food production (irrigation and fishing) and tourism (DAFNE 2019). In particular, the downstream country offers a discounted price for food exports to the upstream country, in exchange for greater transboundary water flow (and hydropower) that results in a higher water reserve accumulation and sequentially in a higher production of food (Fig. 2). The environmental and social impact assessment report was approved in 2012, although it has been criticised as it was conducted after any objection could be made (Abbink 2012). Following a World Bank loan of US\$684 million (World Bank 2012), construction began in June 2016.<sup>2</sup> While the 2016 agreement is not yet publicly available, it is reported that the agreement will allow Ethiopia to supply Kenya with 400 megawatts of hydropower at less than 1 US cent/kwh.<sup>3</sup> However, the hydropower source (or sources) that will supply this transmission line is not officially stated, although the World Bank modified an official project report specifying that power would be sourced “from Ethiopia's GIBE hydropower scheme”, changing the reference to the dam in its next report instead to “Ethiopia's power grid” (AthiWater 2018).

### 3 Conceptual Framework: Hydro-Economic Model

The situation described is a typical example of transboundary water management problem, where the links to the WEF nexus are expressed as agreements and social welfare for both the Upstream ( $h=U$ ) and Downstream ( $h=D$ ) countries. Hydrological, economic, WEF,

<sup>1</sup> Locust swarm: UN warns of food crisis in Ethiopia, Kenya, Uganda, Tanzania and Somalia. (2020, February 14). Retrieved November 22, 2021, from <https://www.bbc.com/news/world-africa-51501832>.

<sup>2</sup> Kenya-Ethiopia Electricity Highway. (2020, November 18). Retrieved November 22, 2020, from <https://www.power-technology.com/projects/kenya-ethiopia-electricity-highway/>.

<sup>3</sup> Ethiopia, Kenya to enhance cooperation on energy sector. (n.d.). Retrieved November 22, 2020, from [http://www.china.org.cn/world/Off\\_the\\_Wire/2016-06/24/content\\_38742095.htm](http://www.china.org.cn/world/Off_the_Wire/2016-06/24/content_38742095.htm).

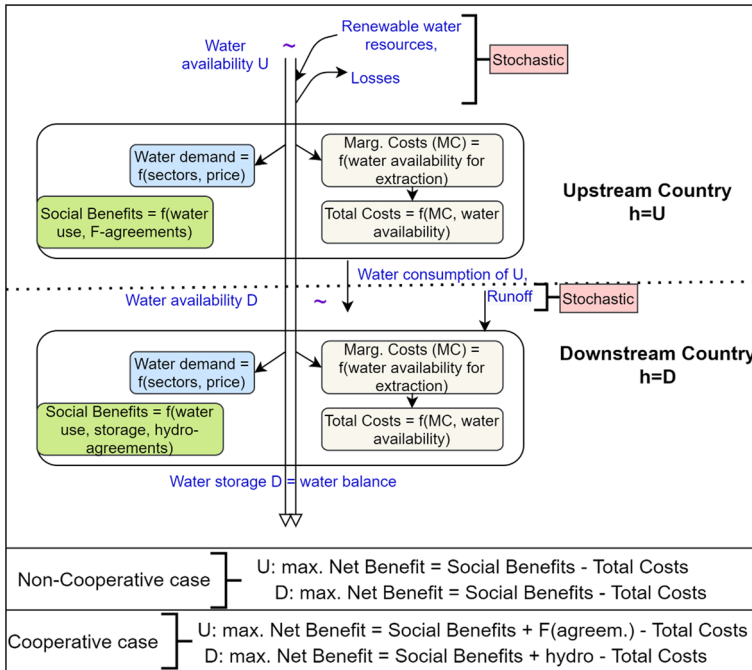


Fig. 2 Conceptual flowchart with the factors considered and their brief description

uncertainty factors and leader–follower games can describe the general form of the problem (Fig. 2).

The proposed framework enables the quantitative estimation of the influence of stochastic water resources on transboundary water allocation over multiple (all the five) sectors of the economy, following a multistage dynamic cooperative game (Stackelberg “leader–follower”) framework.

Deconstructing the flowchart, the proposed approach is based on the following pillars:

### 3.1 Water Resources

Hydrological cycle’s components such as water availability, losses, and runoff, that are necessary for integrated modelling often face many data limitations and their accurate simulation is accompanied with many uncertainties. Hydrological modelling itself is not always enough for their complete and integrated simulation (Van Emmerik et al. 2014). Thus, in this framework these components are expressed stochastically, by geometric Brownian motion functions, which have been proved to simulate flows better than other deterministic models (Lefebvre 2002), and its proportional changes describe the most natural continuous random movements. Given the different hydrological-social-future regional climate conditions that may affect the flows in the upstream and downstream countries, we provide the option (and develop the framework accordingly) to use Brownian motions with different characteristics in terms of variance between the upstream and the downstream country. Additionally, this allows to determine how the water abstraction of the riparian countries will change in the long run, considering the greater variability of water availability caused

by climate change or other uncertainties. Another benefit of this approach is the ability to model the water allocation between the upstream and the downstream country, with and without any cooperation in water sharing, taking into account how uncertainty in water supply affects the water abstraction rates of the countries, and explore the underlying conditions that may influence allocation decisions. The upstream country has the upper riparian right to unilaterally divert water while the freshwater availability of the downstream one partially depends on the water usage in the upstream country.

Following Bhaduri et al. (2011), we consider at first a complete filtered probability space  $(\Omega, J, J_t, P)$  for the stochastic water flow. Then the annual renewable water resource (mainly precipitation) due to the river basin,  $W_t$ , evolves through time according to the Geometric Brownian motion:

$$dW_t = \sigma^W W_t dz_t^W, \quad t \geq 0 \tag{1}$$

where  $\sigma^W$  is the volatility of water flow in the upstream country,  $z_t^W$  is a standard Wiener process—standard Brownian Motion, (see also next paragraph).

In Fig. 2, the term losses refer to the natural outflows and evaporation/ evapotransiration (ET), here denoted by  $O_t$  which can be formulated by another Geometric Brownian motion:

$$dO_t = \sigma^O O_t dz_t^O, \quad t \geq 0 \tag{2}$$

where  $\sigma^O$  is the volatility of the losses and  $z_t^O$  a standard Wiener process.

The water availability in D depends on the total water consumption in U and runoff (to the Lake), denoted by R, which is expressed by a third Geometric Brownian motion as:

$$dR_t = \sigma^R R_t dz_t^R, \quad t \geq 0 \tag{3}$$

where  $\sigma^R$  is the runoff volatility and  $z_t^R$  the standard Wiener process ( $z_t^W, z_t^O, z_t^R$  are independent Wiener processes).

### 3.2 Water Demand

As mentioned above, the framework provides the option to use all the involved sectors-water consumers  $i$  (here  $i=5$ ), and their water use in a way that highlights the scarce character of the input resource, unlike with previous studies (as in Eq. 4, for the upstream country  $h=U$ ):

$$dW_{jt}^U = \left[ W_t - \sum_{i=j}^5 w_{it}^U \right] dt, \quad T_{j-1}^U \leq t < T_j^U, \quad j = 1, 2, \dots, 5 \tag{4}$$

where  $W_t^h$  is the total freshwater utilization (see Eq. 1) by country U,  $w_{it}^U$  is the water utilization per sector  $i$  in U, for a specific time:  $T_i^h$  is the end of use (*exit*) time<sup>4</sup> of the  $i$ -th sector of U ( $T_0=0$  and  $T_5=\infty$ ). So, Eq. (4) expresses the water stock (available resources) change in the upstream country,  $W_{jt}^U$ , for the  $j$ -th *exit* stage.

The stock of water (water storage  $D$ =water balance, as in Fig. 2) in country D (i.e. in the lake), where agricultural products and fisheries are produced, is denoted by  $S$  and is actually based on the general water balance equation:  $\Delta S = Available - Use + Runoff - Losses$ . Thus, Eq. (5) is a function of the stochastic water resources and the control (water use)

<sup>4</sup> When an economic sector exits the market as its water demand reaches zero.



variables =  $w_t^h(w_1^h, w_2^h, \dots, w_5^h)$  per country  $h=U, D$ . For the  $(j,k)$ -th exit stage of U and D, respectively, it follows the dynamics:

$$dS_{jkt} = \left\{ W_t - \sum_{i=j}^5 w_{it}^U - \sum_{l=k}^5 w_{lt}^D + R_t - O_t \right\} dt, \quad T_{j-1}^U \leq t < T_j^U \tag{5}$$

with  $T_{k-1}^D \leq t < T_k^D, j, k = 1, 2, \dots, 5$  and  $S(0) = S_0$  (initial condition).

So, the inverse demand function takes into account the water utilization  $w_i^h$  of the  $j$ -th exit stage, and the price of water  $p_{jt}^h$  which is the same for the different sectors  $i$ :

$$p_{jt}^h = \frac{a_i^h}{b_i^h} - \frac{1}{b_i^h} \cdot w_{it}^h, \quad T_{j-1}^h \leq t < T_j^h, \quad i = j, \dots, 5, j = 1, 2, \dots, 5 \tag{6}$$

where  $a_i^h \in \mathbb{R}, b_i^h > 0$  are constant sector-specific parameters that define their water demand.

The sector-specific inverse demand curves are ordered so that  $a_1^h/b_1^h < a_2^h/b_2^h < \dots < a_5^h/b_5^h$ , which implies that water demand for each of the five sectors reaches zero sequentially over time as the price of water increases over time, leading to the endogenously defined exit times  $T_j^h$ , giving thus piecewise linear demand functions.

### 3.3 Costs

Water abstraction from rivers may be taken directly from the flowing waters in the channel (surface water abstraction) or can be achieved through inter-basin flow transfer schemes. Thus, we may assume that the marginal extraction cost (MC) for the  $j$ -th exit stage of the upstream country is a decreasing function of the available water  $W_j^U$  of the form:

$$MC^U(W_j^U) = k_2^U - k_1^U W_j^U, \quad j = 1, 2, \dots, 5 \tag{7}$$

where  $k_1^U, k_2^U > 0$  given constants which define the cost magnitudes.

As water becomes increasingly scarce in the economy, the government will exploit water through appropriating and purchasing a greater share of aggregate economic output, in terms of dams, pumping stations, supply infrastructure, etc. (Barbier 2004). Given the high cost of building infrastructure and expanding supplies, this will lead to a higher marginal cost of water. Then the Total Cost (TC) function of water withdrawing  $w_i^U$  from the river per sector  $i=j, \dots, 5$ , for the  $j$ -th exit stage of the upstream country is given by an increasing function of the water extraction variable:

$$TC^U(W_j^U, w_i^U) = (k_2^U - k_1^U W_j^U)w_i^U, \quad i = j, \dots, 5, j = 1, 2, \dots, 5 \tag{8}$$

On the other hand, D country extracts water from its available stock, thus for the  $(j,k)$ -th exit stage the MC of the downstream country is a decreasing function of the available water stock  $S_{jk}$  (Eq. 9). Similarly, the TC function of water withdrawing  $w_l^D$  from the water stock per sector  $l=k, \dots, 5$  for the  $(j,k)$ -th exit stage is given by Eq. (10).

$$MC^D(S_{jk}) = k_2^D - k_1^D S_{jk}, \quad j, k = 1, 2, \dots, 5 \tag{9}$$

$$TC^D(S_{jk}, w_l^D) = (k_2^D - k_1^D S_{jk})w_l^D, \quad l = k, \dots, 5, k = 1, 2, \dots, 5 \tag{10}$$

where  $k_1^D, k_2^D > 0$  given constants.

### 3.4 Social Benefits

The last component of Figure’s 2 flowchart refers to the *Benefits*. Since consumers are deriving benefits from water, the inverse demand curve (Eq. 6) is the marginal social benefit curve. Hence, consider further the benefit of water consumption  $w_i^h$  per sector i of country h, namely social benefit (SB), as:

$$SB_i^h(w_i^h) = \int_0^{w_i^h} \left( \frac{a_i^h}{b_i^h} - \frac{1}{b_i^h} \cdot w_i^h \right) dw_i^h = \frac{a_i^h}{b_i^h} w_i^h - \frac{1}{2b_i^h} \cdot (w_i^h)^2 \tag{11}$$

It is obvious that the benefit function is strictly concave for all possible values of  $w_i^h$ .

As mentioned, D country’s benefits occurring from storing water, while U country receives an additional benefit in the cooperation case, from their agreement, as the net consumer surplus or economic benefit from food (agricultural product and fisheries) production. This can be described by a linear function of water stock  $S_{jk}$  per (j,k)-th exit stage:

$$F(S_{jk}) = \eta_1 S_{jk} + \eta_2, j, k = 1, 2, \dots, 5, \eta_1 > 0, \eta_2 \in R \text{ (constants)} \tag{12}$$

This relation’s form describes these benefits, and allow us to use the coefficient  $\eta_1$  to represent the intensity of the contribution that the water storage of the lake has to the corresponding food benefits enjoyed by the upstream country.

### 3.5 Game

Figure 2 also shows the two game-cases we define, using an inter-sectoral Stackelberg leader (U)-follower (D) game. Bhaduri et al. (2011) used a stochastic differential Stackelberg game to produce qualitative results on the optimal transboundary water allocation between an upstream and a downstream area. The leader (U) applies its strategy first, a priori knowing that the follower (D) observes its actions and posteriori moves accordingly. In contrast to Bhaduri et al. (2011), who had to restrict the U’s strategy space to quadratic functions of the state variable in order to obtain a sub-optimal qualitative solution of the problem, we maximize the leader’s objective function, using the D’s reaction strategy, over all possible strategies to provide an optimal solution of our stochastic game problem that is also quantitatively tractable. Assuming that both countries use Markovian perfect strategies, since all model coefficients are deterministic functions of time, a subgame perfect equilibrium and an equilibrium set of decisions dependent on previous actions are defined. These strategies are decision rules that dictate the optimal action, conditional on the current values of the state variables (e.g. water resources of U, water stock of D), that summarize the latest available information of the dynamic system. The following sections analyse the two cases of the game.

## 4 Non-Cooperative Case

In the case of a non-cooperative framework, where there is no agreement between the two countries regarding either water or food sharing, the benefit maximization and the impact on water balance is presented for each country (hydro-economic model).

### 4.1 Upstream

The upstream country chooses the economically potential rate of water utilization that maximizes its own net benefit (NB) per  $j$ -th exit stage:

$$NB_j^U = \sum_{i=j}^5 SB_i^U(w_i^U) - \sum_{i=j}^5 TC^U(W_j^U, w_i^U), \quad j = 1, 2, \dots, 5 \tag{13}$$

Thus, U country’s maximization problem is based on its net social benefit ( $J_j^U$ ) of the  $j$ -th exit stage ( $j = 1, 2, \dots, 5$ ), and is formulated as follows:

$$\begin{aligned} J^U &= \max_{w^U} \sum_{j=1}^5 J_j^U = \max_{w^U} \sum_{j=1}^5 E \left\{ \int_{T_{j-1}^U}^{T_j^U} e^{-rt} NB_j^U dt \right\} \\ &= \max_{w^U} \sum_{j=1}^5 E \left\{ \int_{T_{j-1}^U}^{T_j^U} e^{-rt} \sum_{i=j}^5 [SB_i^U(w_{it}^U) - TC^U(W_{jt}^U, w_{it}^U)] dt \right\} \\ &= \max_{w^U} \sum_{j=1}^5 E \left\{ \int_{T_{j-1}^U}^{T_j^U} e^{-rt} \sum_{i=j}^5 \left[ \frac{a_i^U}{b_i^U} w_{it}^U - \frac{1}{2b_i^U} \cdot (w_{it}^U)^2 + c_i^U - (k_2^U - k_1^U W_{jt}^U) w_{it}^U \right] dt \right\} \end{aligned} \tag{14}$$

Which subjects to the renewable water (precipitation) in U (Eq. 1), and the water stock change in U (Eq. 4). An explicit solution of this stochastic control problem via a decoupling method for forward–backward stochastic differential equations (FBSDEs) is analytically derived in Appendix A.

### 4.2 Downstream

On the other hand, the water consumption/production of D depends on the inflow from U, and the runoff generated within the country’s share of the water stock in D (Fig. 2). Based on the given water availability, D maximizes its NB per exit stage ( $j, k$ ) as:

$$NB_{jk}^D = \sum_{l=k}^5 SB_l^D(w_{jl}^D) - \sum_{l=k}^5 TC^D(S_{jk}, w_{jl}^D), \quad k = 1, 2, \dots, 5 \tag{15}$$

Thus, putting together Eqs. (11), and (10) in the above relation, the maximization problem of the net social benefit ( $J_j^D$ ) of the  $j$ -th exit stage ( $j = 1, 2, \dots, 5$ ), is:

$$\begin{aligned} J^D &= \max_{w^D} \sum_{k=1}^5 \sum_{j=1}^5 J_{jk}^D = \max_{w^D} \sum_{k=1}^5 \sum_{j=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t < T_j^U\} \cap \{T_{k-1}^D \leq t < T_k^D\}} e^{-rt} NB_{jk}^D dt \right\} \\ &= \max_{w^D} \sum_{k=1}^5 \sum_{j=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t < T_j^U\} \cap \{T_{k-1}^D \leq t < T_k^D\}} e^{-rt} \left[ \sum_{l=k}^5 SB_l^D(w_{jt}^D) - \sum_{l=k}^5 TC^D(S_{jkt}, w_{jt}^D) \right] dt \right\} \\ &= \max_{w^D} \sum_{k=1}^5 \sum_{j=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t < T_j^U\} \cap \{T_{k-1}^D \leq t < T_k^D\}} e^{-rt} \left[ \sum_{l=k}^5 \left( \frac{a_l^D}{b_l^D} w_{jt}^D - \frac{1}{2b_l^D} \cdot (w_{jt}^D)^2 \right) - (k_2^D - k_1^D S_{jkt}) \sum_{l=k}^5 w_{jt}^D \right] dt \right\} \end{aligned} \tag{16}$$

where  $J_{jk}^D$  represents the downstream country’s net social benefit of the (j,k)-th exit stage,  $j, k=1,2,\dots,5$ , and  $w_{jlt}^D=(w_{1lt}^D, w_{2lt}^D, \dots, w_{5lt}^D)$  is the sectorial water extraction vector for D. This relation subjects to the river basin annual renewable water resource Eq. (1), outflow Eq. (2), runoff Eq. (3), the upstream area water resources Eq. (4), and the stock of water (state variable) in the downstream area Eq. (5). The analytical solution of this stochastic optimization problem can be found in Appendix A.

### 5 Cooperative Case

In this case the agreements described earlier apply, so the formed Stackelberg game determines the inter-sector optimal water allocation between U and D countries. First, we find the solution to the follower’s (D) problem of maximizing a payoff function, and then, using D’s reaction strategy, we maximize the U’s objective function.

#### 5.1 Downstream

Receiving now hydropower benefits, denoted by a variable *hydro*, from U at a discount rate and given its announced intersectoral water abstraction policy  $w_{jkt}^U=(w_{1kt}^U, w_{2kt}^U, \dots, w_{5kt}^U)$  per (j,k)-th exit stage, the follower D is faced with an optimal water management problem as in the non-cooperative case, i.e., maximise Eq. (16) augmented by *hydro* subject to the state Eqs. (2)–(6). For every  $j, k=1, 2, \dots, 5$ , the (j,k)-th exit stage Hamiltonian of the system is also given by Eq. (A.14), whose necessary optimality conditions Eqs. (A15) and (A16) result in the optimal water allocation path of Eq. (A17) and in the same FBSDEs system which will constitute a state system for the upstream country, too.

#### 5.2 Upstream

U receives now food benefits from D as in Eq. (12), and its NB function (Fig. 2) is given by:

$$NB_{jk}^U = \sum_{i=j}^5 SB_i^U(w_{it}^U) + F(S_{jk}) - \sum_{i=j}^5 TC^U(W_j^U, w_i^U), j, k = 1, 2, \dots, 5 \quad (17)$$

Therefore, U, anticipating the D’s optimal response as analysed in the previous case, chooses the optimal water abstraction vector process  $w^U = (w_1^U, w_2^U, \dots, w_5^U)$  under cooperation by solving the maximization problem:

$$\begin{aligned} J^U &= \max_{w^U} \sum_{j=1}^5 \sum_{k=1}^5 J_{jk}^U = \max_{w^U} \sum_{j=1}^5 \sum_{k=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t \leq T_j^U\} \cap \{T_{k-1}^D \leq t \leq T_k^D\}} e^{-rt} NB_{jk}^U dt \right\} \\ &= \max_{w^U} \sum_{j=1}^5 \sum_{k=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t \leq T_j^U\} \cap \{T_{k-1}^D \leq t \leq T_k^D\}} e^{-rt} \left[ \sum_{i=j}^5 SB_i^U(w_{ikt}^U) + F_{jk}(S_{jkt}) - \sum_{i=j}^5 TC^U(W_{jt}^U, w_{ikt}^U) \right] dt \right\} \\ &= \max_{w^U} \sum_{j=1}^5 \sum_{k=1}^5 E \left\{ \int_{\{T_{j-1}^U \leq t \leq T_j^U\} \cap \{T_{k-1}^D \leq t \leq T_k^D\}} e^{-rt} \left[ \sum_{i=j}^5 \left( \frac{a_i^U}{b_i^U} w_{it}^U - \frac{1}{2b_i^U} \cdot (w_{it}^U)^2 \right) + \eta_1 S_{jkt} + \eta_2 - (k_2^U - k_1^U W_{jt}^U) \sum_{i=j}^5 w_{it}^U \right] dt \right\} \end{aligned} \quad (18)$$

subject to the state equation subject to the river basin annual renewable water resource Eq. (1), the upstream country water demand Eq. (4), the runoff Eq. (2), the outflow Eq. (3), and the Hamiltonian FBSDEs state system of the downstream country, Eq. (A18). In Appendix B one can find an explicit solution of this stochastic maximization problem.

## 6 Econometric Model: Production Functions Through Stochastic Frontier Estimation and Water Demand Curves

The hydro-economic model shows how all parts of the economy—in our case the sectors (agriculture, residential, mining industry, energy production, tourism) are based on water use directly or indirectly, so are the benefits of U and D. Water is an input (as well as labour, capital, natural capital, etc.) for the production process, hence the inverse demand curves we imposed in Sect. 3, as a way to express the input price-quantity relation. The marginal contribution of water in consumption and production of each sector, can be obtained if in Eq. (6), we collapse all variables, except of  $w_i$ , to their means (ceteris paribus). Then we will have a relation of the form  $p_i = \hat{f}_i(w_i)$ , where  $\hat{f}_i$  expresses the maximum Willingness-To-Pay (WTP) by sector  $i$  for each unit of water, in a price  $p_i$ . The integration of this curve will result the SB of each sector.<sup>5</sup>

We propose a stochastic frontier model and a typical quadratic production function, the form of which remains unknown (Brems 1968). Copulas are used to estimate non-parametrically the dependence between the endogenous regressors and the composed error terms directly, and thus the marginal product function of our hydro-economic model without biases. Bayesian analysis is performed using a Sequential Monte Carlo/Particle-Filtering approach for the computations (Tsionas 2017; Tsionas and Mamatzakis 2019; Tsionas and Mallick 2019, see Appendix B).

Consider the following stochastic frontier model for the production function(s):

$$y_{it} = \varphi(x_{it}, z_{it}; \beta) + v_{it} - u_{it}, \quad i = 1, \dots, n, t = 1, \dots, T \quad (19)$$

where  $y_{it}$  is the output of sector  $i$  in time  $t$ ,  $\varphi()$  is an unknown functional form,  $z_{it}$  is a  $p \times 1$  vector of exogenous inputs,  $x_{it}$  is a  $p \times 1$  vector of endogenous inputs,  $\beta$  is a  $d \times 1$  vectors of unknown parameters,  $v_{it}$  is a symmetric random error,  $u_{it}$  is the one-sided random disturbance representing technical inefficiency.<sup>6</sup> We assume that  $z_{it}$  is uncorrelated with  $v_{it}$  and  $u_{it}$  but  $x_{it}$  is allowed to be correlated with  $v_{it}$  and possibly with  $u_{it}$ . This, of course, generates an endogeneity problem. We also assume that  $u_{it}$  and  $v_{it}$  are independent and leave the form of  $u_{it}$  unrestricted. The model can be easily extended to the case of exogenous (environmental) variables are included in the distribution of technical inefficiency (e.g. Battese and Coelli 1995; Caudill et al. 1993). To address the endogeneity problem, we propose a copula function approach to determine the joint distribution of the endogenous regressors and the composed errors that effectively capture the dependency among them.<sup>7</sup>

<sup>5</sup> As analysed in Sect. 3, the inverse demand curve (Eq. 6) is the marginal SB curve.

<sup>6</sup> The production function used to express the “maximum” output that can be obtained from any fixed and specific set of inputs and describes how inputs are transformed into output. As in reality, cases of reducing outputs by inefficient management (getting less output than the maximum), are considered, by the concept of technically inefficiency (Shephard 1970; Saari 2006, 2011), as an one-sided random disturbance.

<sup>7</sup> Independent and Identically Distributed (probability distribution).

We first assume that  $v_{it} \sim ii.i.d.N(0, \sigma_v^2)$  and  $u_{it} \sim ii.i.d.|N(0, \sigma_u^2)|$ . Then the density of  $\varepsilon_{it} = v_{it} - u_{it} = y_{it} - \varphi(x_{it}, z_{it}; \beta)$  is given by:

$$g(\varepsilon_{it}) = \int_0^\infty f_v(\varepsilon_{it} + u_{it})f_u(u_{it})du_{it} = \frac{2}{\sigma} \varphi\left(\frac{\varepsilon_{it}}{\sigma}\right)\Phi\left(-\frac{\lambda\varepsilon_{it}}{\sigma}\right) \tag{20}$$

where  $\sigma^2 = \sigma_v^2 + \sigma_u^2$ ,  $\lambda = \sigma_u/\sigma_v$ ,  $\varphi(\cdot)$  and  $\Phi(\cdot)$  are the Probability Density Function (PDF) and cumulative distribution function of a standard normal random variable, respectively. To avoid the non-negativity restrictions, we make use of the following transformation:  $\bar{\lambda} = \log(\lambda)$  and  $\bar{\sigma}^2 = \log(\sigma^2)$ . Let  $\theta = (\beta', \bar{\lambda}, \bar{\sigma}^2)'$  then the conditional PDF of  $y$  given  $x$  and  $z$  is:

$$f(y_{it}|x_{it}, z_{it}) = \frac{2}{\bar{\sigma}} \varphi\left(\frac{y_{it} - \varphi(x_{it}, z_{it}; \beta)}{\bar{\sigma}}\right)\Phi\left(-\frac{\bar{\lambda}}{\bar{\sigma}_v}(y_{it} - \varphi(x_{it}, z_{it}; \beta))\right) \tag{21}$$

and conditional log-likelihood is then given by:

$$\log L(\theta) = \sum_{i=1}^n \sum_{t=0}^T \log f(y_{it}; \theta | x, z) \tag{22}$$

From the estimated production function for each of the two countries (considering regional differences in productivity) we can easily obtain their corresponding marginal product function, which is connected with the water use ( $w_i^h$ ) input variable via Eq. (23) (see first paragraph of this section). Consequently, the derived demand curve for water of the producer is represented at Eq. (24):

$$\text{Marginal product} = \alpha + \beta \cdot w_i^h \tag{23}$$

$$w_i^h = a + b \cdot \text{price} \tag{24}$$

where  $\alpha, \beta$  are water demand parameters (coefficients) of each sector and  $b$  water demand price elasticity, estimated as:

$$\text{price elasticity} = \frac{d(w_i^h)}{d(\text{price})} \cdot \frac{\text{price}}{w_i^h} \tag{25}$$

As mentioned, copulas will determine the joint distribution of the endogenous regressors and the composed errors that capture their dependencies (Nelsen 2006). In Appendix B we scrutinise this concept, taking the function  $\varphi()$  as given, and we elaborate on the dynamic latent productivity.

Overall, the proposed methodological framework allows to assess multiple economic and social parameters, for all different economic sectors, with their dependance on variable water resources. The knowledge of the trade-offs among these factors is crucial for identifying the best management strategies. The societal implications are expected to be significant, as conflicts between neighbouring countries can be avoided by following more reasonable practices. Moreover, the ability of the adaptation of the best practices according to the strategy followed by the neighbouring country is expected to be particularly useful for the economic stability, for any region, but especially for the study area: The Omo-Turkana river basin is historically facing transboundary management problems and cross-sectoral conflicts, and is to our opinion an overlooked case in terms of scientific-supported

policy-making. In the near future such problems are expected to get worse due to more challenging climatic conditions that affect the hydrologic variability (Sidibe et al. 2020). Thus, it would be highly valuable to consider tools able to estimate and predict with detail hydrologic, economic, and policy parameters, under such uncertain conditions.

## 7 Results and Discussion

### 7.1 Production Functions and Water Demand Functions

In this section we present a simple nonparametric estimation of the production function per sector in Ethiopia and Kenya. Human input (labour, machinery), land, and ecosystem-based inputs need to be accounted in production function estimations, which lead to the integrated hydro-economic modelling (the existence of natural capital<sup>8</sup> is necessary to characterise water resources in each country). For each sector involved data on Natural Capital were collected using Environmental Indices (EI) as approximations of both quality and quantity, indicatively shown in Table 1, in detail described in Appendix D. The Eora global supply chain database consists of a Multi-Region Input–Output table (MRIO) model that provides time series of high-resolution Input–Output (IO) tables with matching environmental and social satellite accounts for 190 countries (35 types of EI air pollution, energy use, greenhouse gas emissions, water use, land occupation, N and P emissions, etc.). 16 IO tables, each for the period 2000–2017 for Ethiopia and Kenya were used.

The results of the nonparametric estimation are presented below (Table 2), following the Copula function approach and production frontier analysis, described in the previous section. From the estimated production functions we can easily obtain their corresponding marginal product function, which is connected with the water use input variable, according to Eq. (23) (see also Fig. 5). The estimated  $\alpha$ ,  $\beta$  parameters have the expected signs, which define the form of the demand curves.

Regarding the price elasticity, which is also presented in Table 2, based on Eqs. (24)–(25), as expected, all sectors are exceptionally inelastic to a price change for water use (price cannot affect water use). Agriculture seems to be perfectly inelastic to any price change, which means that in both countries the demand will remain stable for any price change. This implies an extremely strong relationship between the input ( $w_i$ ) and the corresponding crop output, since the producer lacks alternatives, actually depends on the scarce water resources, which is highly valued. These well-known findings that are confirmed by our results, strengthen the validity of the proposed framework.

The respective demand curves (Eq. (24)), provide an ordering of these sectors via their demand function intercepts (Fig. 3). Sequential “exits from the market” are defined by the relative importance of sector-specific demand parameter ratio  $a$ , with  $a = \alpha/\beta$ . As  $w_i$  reaches zero sequentially, its price increases revealing producers’ preferences for water use. At these prices, in Ethiopia, Tourism sector should exit the market first followed by Residential and Energy sectors, while in Kenya, Mining would exit the market first trailed by the Tourism sector. Moreover, mining producers in Kenya value higher the water than in Ethiopia, and that happens because Kenya relies strongly on groundwater for mining

<sup>8</sup> Natural Capital is linked with its Ecosystem Services (ES), e.g. provisioning services (water, food), regulating services (flood prevention, erosion control), supporting-habitat services (biodiversity), cultural-recreational services (tourism). Based on these categories we selected the factors per sector.

**Table 1** Factors (data) used per sector

| Sector                   | Factors (with the necessary input information)                                                                                                                                                                                                                         |
|--------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Agriculture              | Land use (agricultural area, arable land, permanent crops, total area equipped for irrigation), forest<br>Soil erosion/degradation<br>Agricultural production, fishery production, aquaculture production<br>Use of pesticides /fertilizers<br>Raw materials (biomass) |
| Energy                   | Energy for renewable resources<br>Dam capacity                                                                                                                                                                                                                         |
| Mining                   | Raw materials (construction material, and total fossil fuel)                                                                                                                                                                                                           |
| Tourism                  | International tourism,<br>Expenditures<br>Number of arrivals<br>Terrestrial Conservation Areas                                                                                                                                                                         |
| Residential Water Supply | Access to clean water                                                                                                                                                                                                                                                  |

Note: All EIs were converted to same scale and units through normalization (log means)

**Table 2** Parameters  $\alpha$ ,  $\beta$  and price elasticities per sector

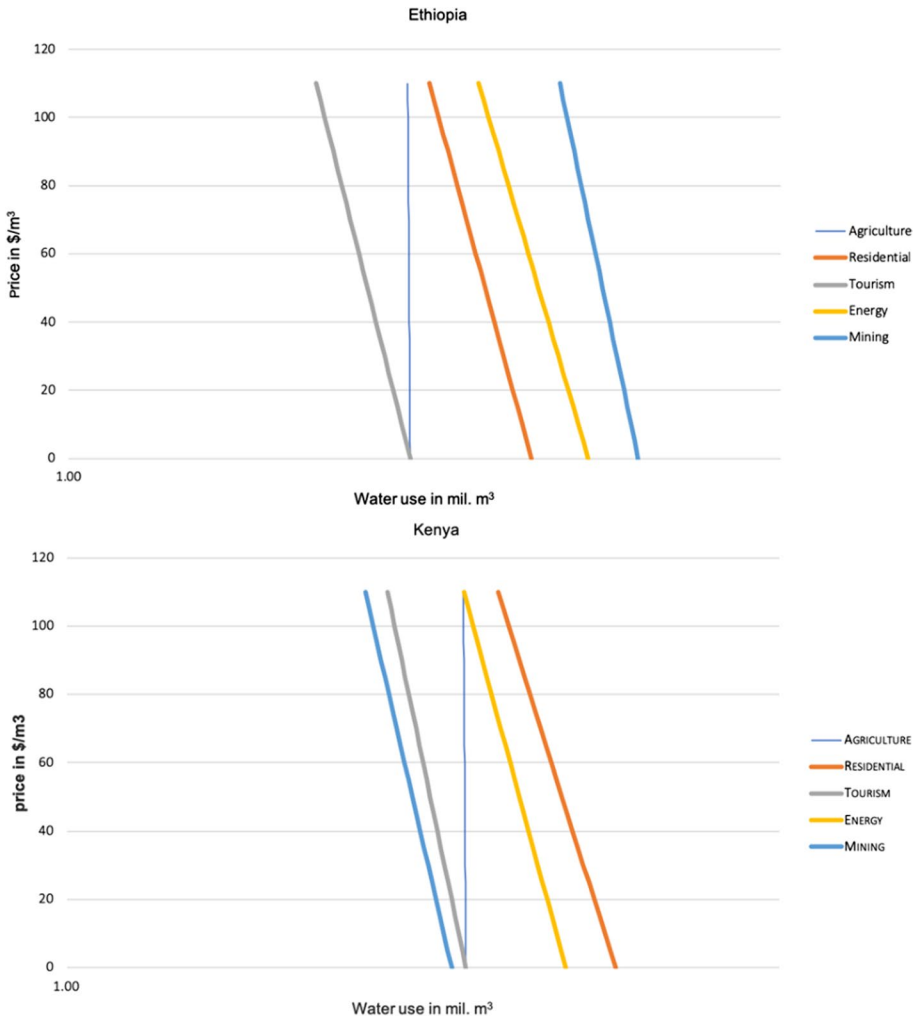
|                                                           | Mining   | Energy   | Tourism  | Residential | Agriculture |
|-----------------------------------------------------------|----------|----------|----------|-------------|-------------|
| Empirical results: $\beta$ parameter for each sector      |          |          |          |             |             |
| Ethiopia                                                  | - 0.0010 | - 0.0014 | - 0.0012 | - 0.0013    | - 0.0000321 |
| Kenya                                                     | - 0.0011 | - 0.0013 | - 0.0010 | - 0.0015    | - 0.0000319 |
| Empirical results: $\alpha$ parameter for each sector     |          |          |          |             |             |
| Ethiopia                                                  | 1.80     | 1.73     | 1.48     | 1.65        | 1.48        |
| Kenya                                                     | 1.54     | 1.70     | 1.56     | 1.77        | 1.56        |
| Empirical results: water price elasticity for each sector |          |          |          |             |             |
| Ethiopia                                                  | - 0.099  | - 0.131  | - 0.096  | - 0.116     | - 0.003     |
| Kenya                                                     | - 0.092  | - 0.120  | - 0.085  | - 0.143     | - 0.003     |

production. In both cases, in case of river/lake depletion, agriculture sector should be the last one to exit the market, since it is valuing water use more than any other sector.

The water price elasticity (Eq. 25, b) sampling distributions tend not to vary significantly between the two countries (Fig. 4). Except of the Ethiopian residential sector's distribution which seems like a normal distribution, the others slightly diverge from the normal distribution at their tails, showing disorders during extreme cases. None of these means is the mode of the distribution as well, although the chasm between those values is not notable. In economic terms, the elasticities for water demand in each sector do not deviate remarkably, letting so similar behavioural patterns to be observed in each sector across the two countries.

The second parameter of the inverse demand curve is the constant term ( $\alpha$ ), which is responsible for the starting point of the demand curve, revealing the stakeholders' WTP per sector. Figure 5 shows the distributions of constant terms of the inverse demand functions and interestingly we can see that in most cases the WTP for water use in energy sector is greater than the corresponding one in agriculture and tourism, which implies greater





**Fig. 3** Water demand curves per sector for each country

profitability in energy sector. Additionally, in terms of WTP, mining sector in Ethiopia, which follows a leptokurtic distribution seems to be the most stable one. The technical inefficiency parameter  $u_{it}$  (Eqs. (19) and (33)) shows how (in)efficiently the water-input is transformed into production output (Fig. 5). Mining and Residential sectors in Ethiopia follow exactly the same distribution with a positive skew to the right. Energy and Tourism in both countries,  $u_{it}$  has two distinct peaks (bimodal distribution), which indicates that in these sectors there are two groups of producers: some of them achieve to maximize their outputs given their inputs, while some others do not with technical inefficiency taking greater values than the former group. However, it is noteworthy that Energy sector is more technically efficient compared with Tourism, since the lowest peak of Tourism is as great as the biggest one of Energy sector.

All the above ‘clues’ derived from the two graphs, justify the proposed framework in terms of selecting a multi-sectorial approach, and introducing the term of technical

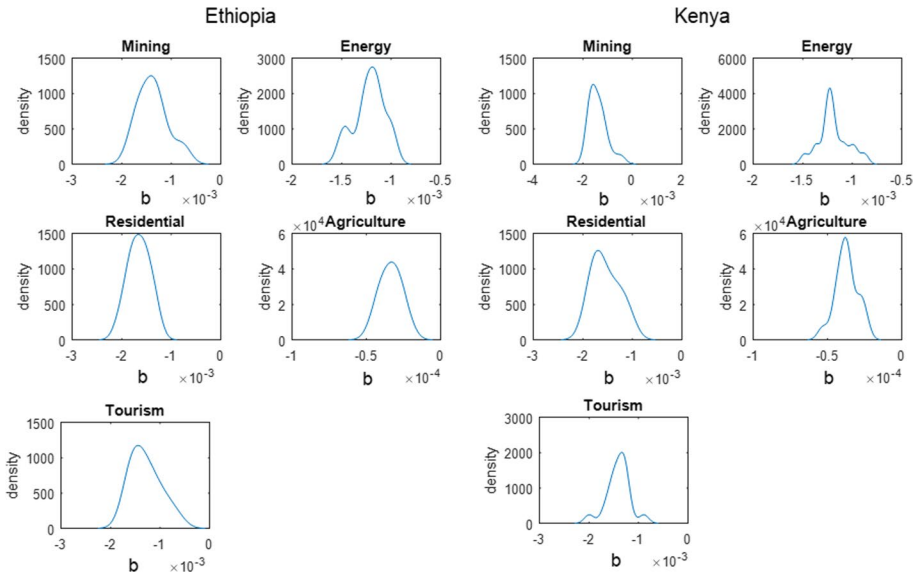


Fig. 4 Sampling distributions of water price elasticities by sector for both countries

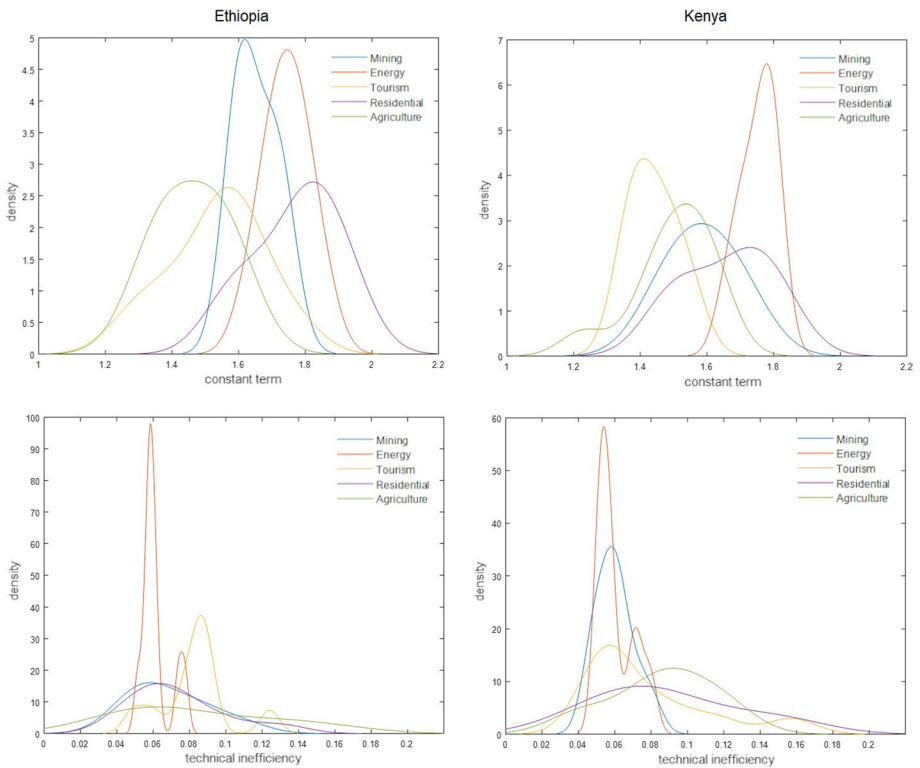


Fig. 5 Sampling distributions of constant terms (up) and technical inefficiency (down) by sector for each country

inefficiency. Those novel elements give a significantly added value compared with the more ‘narrowed’ approaches so far.

## 7.2 Games Under Uncertainty

Historical hydrological data of the basin (e.g. precipitation, runoff of the Omo River to Lake Turkana, and evaporation/ ET), can be used to estimate their corresponding historical volatilities,  $\sigma$ , as in Eqs. (1)–(3), and storage of the lake, as in Eq. (5), while pumping costs per country can be used to represent water tariffs (detailed data and parameters of the solved models can be found in Appendix D, Table D.2). Subsequently, the stochastic optimization hydro-economic model, for both game cases can be solved with the described decoupling method for linear FBSDEs (Sect. 3). For the sake of scale consistency, the optimal water abstraction and the resulting NB are presented via the percentage of the water availability inside the river basin over the total water availability of each of the two countries.

Regarding the game, both players have two available strategies:

- myopic (the country follows short-term water exploitation, without considering the benefits coming from the natural resource sustainable use, i.e. from the river for U and from the lake for D): A myopic strategy amounts to the depletion of the resource that is owned as a common property. In the myopic equilibrium, the marginal benefit of the water use equals current marginal extraction cost, ignoring the water scarcity rents (conventional user costs) that represent instantaneous benefit of foregoing water extraction currently as a means of reducing future extraction costs. Analytically, the NB function is maximized without taking into account the constraint imposed by the resource (state) equation.
- non-myopic (consider natural resource and long-term plan–preservation benefits). In a non-myopic strategy, the marginal benefit of the water use equals current marginal extraction cost plus marginal user cost (as defined above). Analytically, the NB function is maximized subject to the constraint imposed by the resource (state) equation.

### 7.2.1 Non-Cooperative Case

The optimal scenario would be a Non-myopic–Non-myopic combination, where the lake runs out of water after 33 years, while the worst-case scenario in environmental terms is realised when both countries follow a myopic strategy, where the Lake Depletion Time (LDT) is 15 years, accompanied by lack of trust, institutions bridging the limited disposable information, or a limited technical support (Table 3).

Although Kenya on average seems to gain more at the myopic case, the total losses of that strategy surpass the gains, as for fifteen more years it could have an average net benefit equal to  $\$2.2543 \cdot 10^7$ , while from the myopic perspective it is zero. So, if Kenya (D) controls its water use over time (non-myopic), it can increase its total benefits from  $\$743,919,000$  to  $\$1,321,810,000$  no matter what Ethiopia decides, while in the myopic equilibrium it gains only  $\$342,435,000$ . At the same time, Ethiopia (U) has every time higher NBs in the non-myopic strategy. However, Ethiopia’s negative externalities to Kenya in the event of both following the myopic strategy can be seen at the LDT (in half of the time compared to the non-myopic strategies).

**Table 3** Non-cooperative case for myopic and non-myopic combinations

| Downstream<br>(Kenya)- D | Upstream (Ethiopia)- U                                                              |                                                                                     |
|--------------------------|-------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
|                          | Myopic                                                                              | Non-Myopic                                                                          |
| Myopic                   | $NB_u = \$1.5191 \cdot 10^9$<br>$NB_D = \$2.8429 \cdot 10^7$<br>$LDT = 15.49$ years | $NB_u = \$1.4635 \cdot 10^9$<br>$NB_D = \$5.747 \cdot 10^7$<br>$LDT = 23.62$ years  |
| Non-Myopic               | $NB_u = \$1.5188 \cdot 10^9$<br>$NB_D = \$1.5141 \cdot 10^7$<br>$LDT = 22.85$ years | $NB_u = \$1.4637 \cdot 10^9$<br>$NB_D = \$2.2543 \cdot 10^7$<br>$LDT = 33.35$ years |

NB values represent the average value of the economy as long as there is water. Ethiopia's benefit curves are the average of a 200-year period, where there is no sector exit, while Kenya's benefit curves are the average of 15- to 33-year period, until the point, where first all sectors leave, and the lake depletes. Hence, in myopic-myopic combination, the 16<sup>th</sup> year in Kenya is characterized by zero SB and costs, while all the demand for goods and services is met by imports.

The water use of all sectors in both countries (Fig. 6) is characterised by increased rates and faster depletion in the myopic-myopic case, compared to the non-myopic–non-myopic one. Kenya's water use becomes zero at the LDT (15.5 years for the myopic-myopic and 33.4 years for the non-myopic–non-myopic case). Ethiopia's time horizon is 200 years, to indicate the lack of limitations on water reserves of Omo River.

## 7.2.2 Cooperative Case

In this case that the players benefit from their goods' exchange, NBs are higher for both.<sup>9</sup> So, the most crucial concept is relative efficiency. After a three-case numerical exploration of  $\eta_1$  coefficient of Eq. (12), for a number of periods, it seems that the lake does not deplete under the cooperative case. This very promising outcome is important for both countries, because since they trade, there is interest in the sustainable development of the neighbours. Table 4 presents the indicative results of the solutions in terms of maximized NBs and lake depletion times.

Apparently, for all possible outcomes given the preferences of Ethiopia, NB are outstandingly greater than the non-cooperative case (Fig. 7—indicatively for the least possible rate of  $\eta_1$ ), not to mention the sustainability of the lake (LDT=never). Thus, indisputably the cooperative is the best strategy, and the more beneficial for both players as  $\eta_1$  increases.

In this graph, Ethiopia realises the upcoming benefits coming from giving up a considerable amount of water in exchange of food supply produced by the downstream country. In response (reaction), Kenya significantly increases its water use over the years, to increase production. Moreover, the total water use of both countries in the cooperative case is less compared to the non-cooperative (Kenya's peak in the 20<sup>th</sup> year is seven times less than Ethiopia's maximum use).

<sup>9</sup> As Ricardo showed 200 years ago, even if e.g. Ethiopia, can produce all goods and services cheaply than Kenya, they can still trade under conditions where both get benefited.

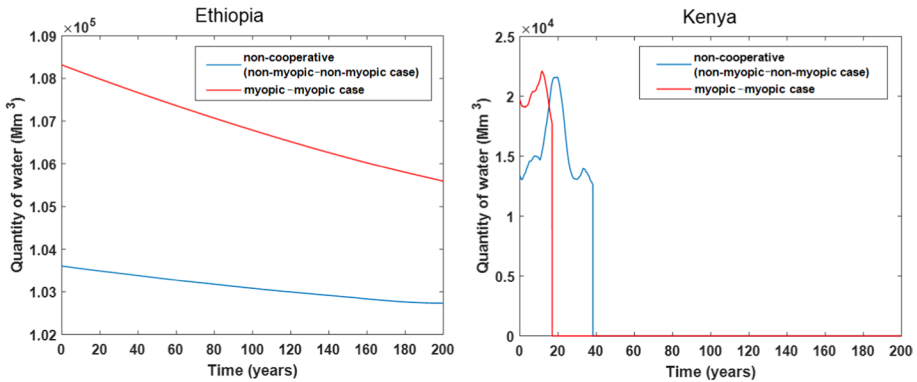


Fig. 6 Total water use for the two extreme strategy-combinations

Table 4 Cooperative case: a numerical simulation of different  $\eta$  values to optimize NB

| Cooperative Case:<br>Optimal<br>( $\eta_1 = 0.7$ ) | Cooperative Case:<br>Optimal<br>( $\eta_1 = 0.8$ ) | Cooperative Case:<br>Optimal<br>( $\eta_1 = 0.9$ ) |
|----------------------------------------------------|----------------------------------------------------|----------------------------------------------------|
| $NB_u = \$24.075 \cdot 10^9$                       | $NB_u = \$30.992 \cdot 10^9$                       | $NB_u = \$39.74 \cdot 10^9$                        |
| $NB_D = \$3.8182 \cdot 10^7$                       | $NB_D = \$4.0333 \cdot 10^7$                       | $NB_D = \$4.0388 \cdot 10^7$                       |
| LDT = Never                                        | LDT = Never                                        | LDT = Never                                        |

### 7.3 Uncertainty Effects

As analysed, the impact of altering the volatility of the hydrological variables, will affect both water stocks and NBs. The comparative results for the non-cooperative and cooperative cases, are presented in Table 5, for the maximum observed historical changes.

In the non-cooperative case (Fig. 8a, b), Kenya tries to adjust its water consumption due to the increased outflow volatility (so to save water). In the cooperative case, no country changes its behaviour, as there is no risk of drought due to mutual assistance. Ethiopia’s water consumption (Fig. 8c, d) tends to zero, indicating the short-term planning. In cooperation, the behaviour is almost the same, allowing the trades, and NBs are also higher compared to the non-cooperative case. That difference would be enough to motivate both countries to keep on trading even under extremes. Although runoff decreased (Fig. 8e,f), NBs and water consumption do not change significantly. Under cooperation, even with uncertain runoff, Ethiopia and Kenya can continue to use almost the same water quantity, unlike to the non-cooperative case, where Kenya slightly reduces its water use, to gain \$2,002,000 more, but the lake depletes earlier than the BAU scenario.

In the studied basin, the life-dependance between water resources and survival (not just economy) is well described in the demand curves. This mandates a rational and sustainable water resources management that will lead to overall optimum results. Having scientific support from integrated and sophisticated tools that will provide detailed estimations of water availability, demand per sector, production, costs and economic benefits, as well as the interactions and responses of the “game players”, is crucial (Loucks 2021). The results also indicated the most vulnerable sectors for each country, and this can be generalised

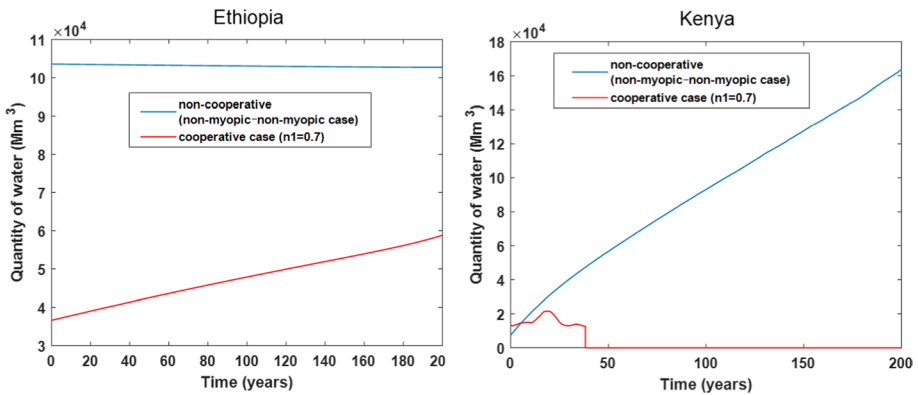


Fig. 7 Total water use in for the best non-cooperative case versus the cooperative case (for the lower  $\eta_1$ )

easily, having thus significant policy implications: It can assist decisions on what sector will be prioritized or not (exiting the market, as shown), and how the others will respond in order to maximize their benefits. In this particular case, we see that under any conditions, cooperation seems to be a win–win sustainable strategy, for both countries, environment, and economy. Furthermore, in case of river/lake depletion, agriculture sector that values water more compared to the other sectors would be the last one to exit the market. The technically efficient and inefficient sectors are also an important output that should be considered in policy-making, as it directly indicates the ‘stability’ of each sector, their ability to transform the water inputs into production outputs, and how uniform this is among the different producers per sector (Song et al. 2018; Lombardi et al. 2019; Tsionas and Mallick 2019). While there is no one-size-fits-all approach for how to exploit these findings for maximizing the overall benefits, cooperation seems to be a necessary initial condition to build on it and achieve sustainable growth. The results are in agreement with previous studies, showing the importance of cooperation, mutual investments and shared economic benefits, especially important for downstream countries (Vinca et al. 2021). Dinar (2009) argues that under increased water supply variability, cooperation should be preferred to address the risks, and this is now proved. An international agreement would strengthen this strategy, because at the time any trade-offs depend on governmental decisions. Hydrological uncertainties put into risk most cooperative decisions: Dinar et al. (2010) found a bell-shaped relationship between water supply variations and cooperation agreements; Ansink and Ruijs (2008) also demonstrate that a decrease in average river flows reduces the stability of an agreement, while an increase in variance may have both positive and negative effects.

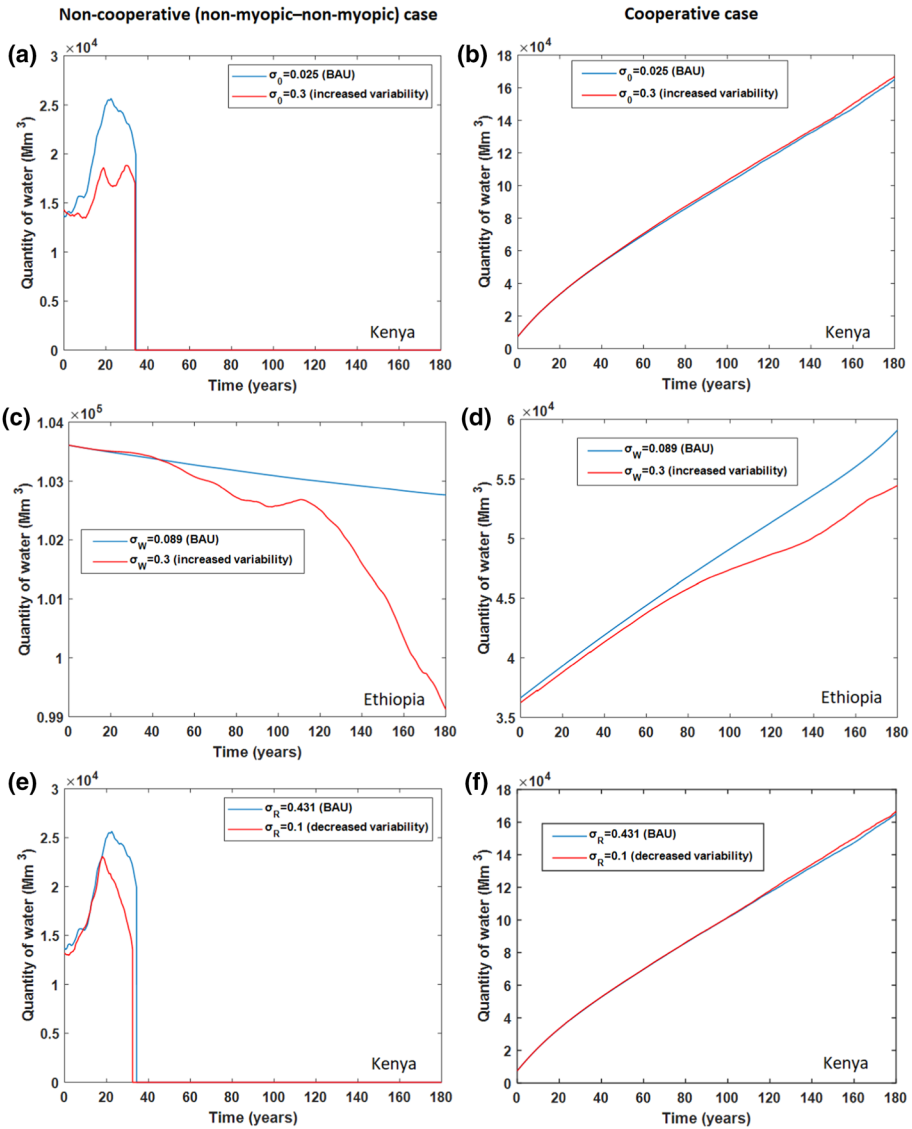
## 8 Conclusions

In this work, a framework for scarce transboundary water resources management was presented. Game theory, hydro-economics, and econometrics were combined to explore the optimal strategies in environmental and economic terms, while the whole system was tested under hydrological uncertainty.

**Table 5** Hydrological variability impacts on NBs and LDT

| Hydrological changes                                     | Non-Cooperative Case                                                          | Cooperative Case<br>( $\eta_1 = 0.7$ )                                               | Comments                                                                                                                                                                                                                                                                                                         |
|----------------------------------------------------------|-------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Increase of outflow volatility<br>$\sigma_O = 0.3$       | $NB_u = \$1.639 \cdot 10^9$<br>$NB_d = \$2.6384 \cdot 10^7$<br>$LDT = 33.27$  | $NB_u = \$24.269 \cdot 10^9$<br>$NB_d = \$3.8216 \cdot 10^7$<br>$LDT = \text{Never}$ | Significantly impacts Kenya's water stock (the levels of the lake vary, increasing the chances of droughts/floods). Its NBs in the cooperative case are slightly higher compared to the non-cooperative. The most significant change is on Ethiopia's NBs                                                        |
| Increase of precipitation volatility<br>$\sigma_W = 0.3$ | $NB_u = \$1.7031 \cdot 10^9$<br>$NB_d = \$1.3903 \cdot 10^7$<br>$LDT = 18.94$ | $NB_u = \$4.4280 \cdot 10^9$<br>$NB_d = \$2.8968 \cdot 10^7$<br>$LDT = 99.57$        | Different impact for U,D: Ethiopia gains more when it does not trade (more water = more consumption, less water = consumes as it needs, limiting runoff to Kenya). Kenya depends on the trades, so it adjusts its water use                                                                                      |
| Decrease of runoff variability<br>$\sigma_R = 0.1$       | $NB_u = \$1.6390 \cdot 10^9$<br>$NB_d = \$2.5545 \cdot 10^7$<br>$LDT = 31.60$ | $NB_u = \$24.091 \cdot 10^9$<br>$NB_d = \$3.4510 \cdot 10^7$<br>$LDT = \text{Never}$ | Here a decrease in the runoff to the lake is considered (by 0.331 compared to the BAU) imposing a sharpened water scarcity in the future. The results are similar to the first (outflow) uncertainty case, regarding Ethiopia, while Kenya adjusts its water use, but it can be sustained only under cooperation |

\*The three types of hydrological uncertainty are presented as independent cases to show which one affects more the NBs and the water stocks (sensitivity), however combinations can be also explored



**Fig. 8**  $\sigma_0$  variability’s effects on Kenya’s water use (first row),  $\sigma_W$  variability’s effects on Ethiopia’s water use (second row),  $\sigma_R$  variability’s effects on Kenya’s water use (third row): Comparison of non-cooperative non-myopic–non-myopic (left column), and cooperative case (right column)

The conceptual framework is quite simple, while the analytical solution is provided, to make possible its replication. It is based on the principles of water balance, marginal and total costs, net and social benefits, while a novel element was the stochastic consideration of its hydrological components. The stochastic Stackelberg differential game approach was successfully applied and enabled the evaluation of numerous potential strategies. The econometric model’s contribution is also deemed essential for planning, as it provided production functions for all sectors for both countries, which was expressed as their social



benefits, and the derived water demand curves. A novel mathematical approach was demonstrated to address the endogeneity issues of the production functions' inputs, combining different tools, in order to provide a realistic representation of the problem. As said in the previous section, the findings that can be derived from the results of the technical inefficiency in water use, and the participation of all the five sectors of the economy, could not be obtained with any previous approach. The management insights that a policymaker can consider from the results are very important both in the short- and long-term planning. The conceptual hydro-economic model, with the game cases under uncertainty that we presented, completes the integrated character of the proposed framework. The present paper provides a case-study specific application of the developed framework, which however, can be easily modified (e.g. assuming more water sources, more or different sectors, decentralized water management decision allowing more interactions, etc.). The novel character of this contribution is based on its detailed hydro-economic/ econometric and sophisticated mathematical modelling, which identifies easily the most solid and "win-win" management strategies, supporting thus sustainable decision-making and planning. In the future, we aim to further test the developed methodology in other contexts and case studies, compare and potentially generalize the findings.

A limitation of this study is that we were not able to present in detail all models used, given the length of the paper. However, the mathematical expressions presented in the main text and the Appendices allow the replication of the modelling framework. Another limitation is that we analysed the five economic sectors—same for both Kenya and Ethiopia. In our case, this was not a big assumption, because the two countries have similar characteristics in terms of their economic development. If the framework is applied in other contexts, then the sectors considered can be easily modified. Integrated modelling needs integrated data—a challenge for any integrated assessment. The data used are presented in detail in Appendix D. While the aim of this work was to demonstrate the proposed framework, rather than a case-study application, it is worthy to mention some specific conclusions: The analysis proved the vital role of water resources to any continuation and development of the economic activities. It is well known that as the price of a good rises, buyers will choose to buy less of it, and as its price falls, they buy more: as water price increases over time due to water scarcity, the demand for all economic sectors reaches zero sequentially. The way this finding was proved (showing also the ordering of the sectors who will reach zero) is a novel element, and combined with the examined game strategies, it is proved that under any circumstances, cooperation is the overall optimal strategy. Under cooperation scenario, the upstream country realises the upcoming benefits coming from giving up a considerable amount of water to the downstream country, in exchange of their produced food supply, over time. The reaction of the downstream country is the increment of its water use to increase production. So over time, it turns out to be more profitable for both countries the case where the downstream one uses more water than the upstream, which currently seems utopic. A swift in selfish and opportunistic mindsets is required, so both countries can secure a future water availability, sustainable access to the input resource-driver of their economic growth, and exploit the mutual benefits of cooperation and collaboration.

## Appendix A

### Non-Cooperative Case

#### Upstream

The Hamiltonian for the j-exit stage is:

$$\begin{aligned}
 H_j^U \left( W_{jt}^U, w_{jt}^U, \dots, w_{5t}^U, \lambda_{jt}^U \right) &= \sum_{i=j}^5 \left[ \frac{a_i^U}{b_i^U} w_{it}^U - \frac{1}{2b_i^U} \cdot (w_{it}^U)^2 - \left( k_2^U - k_1^U W_{jt}^U \right) w_{it}^U \right] \\
 &+ \lambda_{jt}^U \left[ W_{jt}^U - \sum_{i=j}^5 w_{it}^U \right], \quad j = 1, 2, \dots, 5
 \end{aligned}
 \tag{A1}$$

where  $\lambda_{jt}^U$  is the j-exit stage adjoint variable that represents water scarcity rents for U country. The necessary conditions for the optimality are given as follows:

$$\frac{\partial H_j^U}{\partial w_{it}^U} = \frac{a_i^U}{b_i^U} - \frac{1}{b_i^U} w_{it}^U - \left( k_2^U - k_1^U W_{jt}^U \right) - \lambda_{jt}^U \quad i = j, \dots, 5, \quad j = 1, 2, \dots, 5 \tag{A2}$$

$$d\lambda_{jt}^U = \left[ -\frac{\partial H_j^U}{\partial W_{jt}^U} + r\lambda_{jt}^U \right] dt = \left[ -k_1^U \sum_{i=j}^5 w_{it}^U + r\lambda_{jt}^U \right] dt \tag{A3}$$

The first optimality condition gives:

$$w_{it}^U = a_i^U - b_i^U \left( k_2^U - k_1^U W_{jt}^U \right) - b_i^U \lambda_{jt}^U, \quad i = j, \dots, 5 \tag{A4}$$

Then substituting to the state equation (Eq. 4), we have:

$$dW_{jt}^U = \left[ -k_1^U \left( \sum_{i=j}^5 b_i^U \right) W_{jt}^U + \left( \sum_{i=j}^5 b_i^U \right) \lambda_{jt}^U + W_t - \sum_{i=j}^5 a_i^U + k_2^U \sum_{i=j}^5 b_i^U \right] dt \tag{A5}$$

while substituting to the adjoint Eq. (A3) we have

$$d\lambda_{jt}^U = \left\{ -\left( k_1^U \right)^2 \left( \sum_{i=j}^5 b_i^U \right) W_{jt}^U + \left[ k_1^U \left( \sum_{i=j}^5 b_i^U \right) + r \right] \lambda_{jt}^U - k_1^U \sum_{i=j}^5 a_i^U + k_1^U k_2^U \sum_{i=j}^5 b_i^U \right\} dt \tag{A6}$$

Setting  $A_j^U \triangleq \sum_{i=j}^5 a_i^U$  and  $B_j^U \triangleq \sum_{i=j}^5 b_i^U$  we obtain the forward-backward stochastic differential equations system (FBSDEs):

$$\begin{aligned}
 dW_{jt}^U &= \left[ -k_1^U B_j^U W_{jt}^U + B_j^U \lambda_{jt}^U + W_t - A_j^U + k_2^U B_j^U \right] dt, \\
 d\lambda_{jt}^U &= \left[ -\left( k_1^U \right)^2 B_j^U W_{jt}^U + \left( k_1^U B_j^U + r \right) \lambda_{jt}^U - k_1^U A_j^U + k_1^U k_2^U B_j^U \right] dt, \\
 W_{00}^U &= w_0, \quad \lim_{t \rightarrow \infty} \lambda_{jt}^U = 0, \quad j = 1, 2, \dots, 5
 \end{aligned}
 \tag{A7}$$

To solve the above system of FBSDEs we impose a solution of the form:

$$\lambda_{jt}^U = N_{jt}^U W_{jt}^U + M_{jt}^U, \quad i = j, \dots, 5 \tag{A8}$$

where  $N_{jt}^U$  and  $M_{jt}^U$  are stochastic processes to be determined. Taking differentials, we have:

$$d\lambda_{jt}^U = W_{jt}^U dN_{jt}^U + N_{jt}^U dW_{jt}^U + dM_{jt}^U = W_{jt}^U dN_{jt}^U + dM_{jt}^U + \left\{ [B_j^U (N_{jt}^U)^2 - k_1^U B_j^U N_{jt}^U] W_{jt}^U + B_j^U N_{jt}^U M_{jt}^U + [W_t - A_j^U + k_2^U B_j^U] N_{jt}^U \right\} dt \tag{A9}$$

while from the backward equation of the system (Eq. A7) we have:

$$dN_{jt}^U = \{ [ (k_1^U B_j^U + r) N_{jt}^U - (k_1^U)^2 B_j^U ] W_{jt}^U + (k_1^U B_j^U + r) M_{jt}^U - k_1^U A_j^U + k_1^U k_2^U B_j^U \} dt \tag{A10}$$

Sufficient conditions for the last two relationships to be equivalent are:

$$dN_{jt}^U = \left[ -B_j^U (N_{jt}^U)^2 + (2k_1^U B_j^U + r) N_{jt}^U - (k_1^U)^2 B_j^U \right] dt, \tag{A11}$$

$$\lim_{t \rightarrow \infty} N_{jt}^U = 0$$

which is a Backward Riccati Equation (BRE) that can be solved numerically for  $N_{jt}^U$

And.

$$dM_{jt}^U = \left[ (-B_j^U N_{jt}^U + k_1^U B_j^U + r) M_{jt}^U - (W_t - A_j^U + k_2^U B_j^U) N_{jt}^U - k_1^U A_j^U + k_1^U k_2^U B_j^U \right] dt$$

$$\lim_{t \rightarrow \infty} M_{jt}^U = 0, \quad j = 1, 2, \dots, 5 \tag{A12}$$

Substituting the linear solution form of Eq. (A8) to the forward equation of the FBSDEs system:

$$dW_{jt}^U = \left[ (-k_1^U + N_{jt}^U) B_j^U W_{jt}^U + B_j^U M_{jt}^U + W_t - A_j^U + k_2^U B_j^U \right] dt, \tag{A13}$$

$$W_{00}^U = w_0$$

Which is a forward linear SDE that can be solved for  $W_{jt}^U$ . Then the backward adjoint variable  $\lambda_{jt}^U$  follows from Eq. (A8) and the optimal water use  $w_{jt}^U$  follows from the optimality condition (Eq. A4).

### Downstream

The maximization function, as described in the main text (water balance concept) and also shown in Fig. 2, it subjects to water balance of U, the runoff in D, water stock of D (state equation), and the water use of D. For the (j,k)-th exit-stage, we have the Hamiltonian:

$$\begin{aligned}
 H_{jk}^D(S_{jk}, w_{jkt}^D, \dots, w_{j5t}^D, \lambda_{jkt}^D) &\triangleq \sum_{l=k}^5 \left[ \frac{a_l^D}{b_l^D} w_{jlt}^D - \frac{1}{2b_l^D} \cdot (w_{jlt}^D)^2 \right] \\
 &- (k_2^D - k_1^D S_{jkt}) \sum_{l=k}^5 w_{jlt}^D + \lambda_{jkt}^D \left[ W_t - \sum_{i=j}^5 w_{it}^U - \sum_{l=k}^5 w_{jlt}^D + R_t - O_t \right], \tag{A14} \\
 j, k &= 1, 2, \dots, 5
 \end{aligned}$$

where  $\lambda_{jkt}^D$  is the (j,k)-th exit stage adjoint variable that represents water scarcity rents for D. The necessary conditions for optimality are given as follows:

$$\frac{\partial H_{jk}^D}{\partial w_{jlt}^D} = \frac{a_l^D}{b_l^D} - \frac{1}{b_l^D} \cdot w_{jlt}^D - (k_2^D - k_1^D S_{jkt}) - \lambda_{jkt}^D = 0, \quad l = k, \dots, 5, j, k = 1, 2, \dots, 5 \tag{A15}$$

$$d\lambda_{jkt}^D = \left[ -\frac{\partial H_{jk}^D}{\partial S_{jkt}} + r\lambda_{jkt}^D \right] dt \iff d\lambda_{jkt}^D = \left[ -k_1^D \sum_{l=k}^5 w_{jlt}^D + r\lambda_{jkt}^D \right] dt \tag{A16}$$

From the first condition we have that:

$$w_{jkt}^D = a_l^D - b_l^D (k_2^D - k_1^D S_{jkt}) - b_l^D \lambda_{jkt}^D, \quad l = k, \dots, 5, \text{ and } j, k = 1, 2, \dots, 5 \tag{A17}$$

Setting again  $A_j^U \triangleq \sum_{i=j}^5 a_i^U$  and  $B_j^U \triangleq \sum_{i=j}^5 b_i^U$ , the water storage state Eq. (5), and the adjoint equation Eq(A16) are reformulated as:

$$\begin{aligned}
 dS_{jkt} &= \left[ -k_1^D B_k^D S_{jkt} + B_k^D \lambda_{jkt}^D + W_t - \sum_{i=j}^5 w_{it}^U + R_t - O_t - A_k^D + k_2^D B_k^D \right] dt \\
 d\lambda_{jkt}^D &= \left\{ -(k_1^D)^2 B_k^D S_{jkt} + (k_1^D B_k^D + r)\lambda_{jkt}^D - k_1^D A_k^D + k_1^D k_2^D B_k^D \right\} dt \tag{A18} \\
 S_{000} &= s_0, \quad \lim_{t \rightarrow \infty} \lambda_{jkt}^D = 0, \quad j, k = 1, 2, \dots, 5
 \end{aligned}$$

To solve the above system of FBDEs we impose a solution of the form:

$$\lambda_{jkt}^D = N_{jkt}^D S_{jkt} + M_{jkt}^D \tag{A19}$$

where  $N_{jkt}^D$  and  $M_{jkt}^D$  are stochastic processes to be determined. Taking differentials in Eq. (A19), we have:

$$\begin{aligned}
 d\lambda_{jkt}^D &= S_{jkt} dN_{jkt}^D + N_{jkt}^D dS_{jkt} + dM_{jkt}^D \\
 &= S_{jkt} dN_{jkt}^D + dM_{jkt}^D + \left\{ [B_k^D (N_{jkt}^D)^2 - k_1^D B_k^D N_{jkt}^D] S_{jkt} + B_k^D N_{jkt}^D M_{jkt}^D \right. \\
 &\quad \left. + \left[ W_t - \sum_{i=j}^5 w_{it}^U + R_t - O_t - A_k^D + k_2^D B_k^D \right] N_{jkt}^D \right\} dt \tag{A20}
 \end{aligned}$$

while from the backward equation of the system (Eq. A18) we have:

$$d\lambda_{jkt}^D = \left\{ (k_1^D B_k^D + r) N_{jkt}^D - (k_1^D)^2 B_k^D \right\} S_{jkt} + \left[ k_1^D B_k^D + r \right] M_{jkt}^D - k_1^D A_k^D + k_1^D k_2^D B_k^D \tag{A21}$$

A sufficient condition for the latter to be equal is given by

$$dN_{jkt}^D = \left[ -B_k^D \left( N_{jkt}^D \right)^2 + \left( 2k_1^D B_k^D + r \right) N_{jkt}^D - \left( k_1^D \right)^2 B_k^D \right] dt, \lim_{t \rightarrow \infty} N_{jkt}^D = 0 \tag{A22}$$

which is a BRE that can be solved numerically for  $N_{jkt}^D$ . Also:

$$dM_{jkt}^D = \left[ \left( -B_k^D N_{jkt}^D + k_1^D B_k^D + r \right) M_{jkt}^D - \left( W_t - \sum_{i=j}^5 w_{it}^U + R_t - O_t - A_k^D + k_2^D B_k^D \right) N_{jkt}^D - k_1^D A_k^D + k_1^D k_2^D B_k^D \right] dt$$

$$\lim_{t \rightarrow \infty} M_{jkt}^D = 0 \tag{A23}$$

which given the above solution is a backward linear first-order SDE that can be solved for  $M_{jkt}^D$ . Substituting the linear solution form of Eq. (A19) to the forward equation of the FBS-DEs system (Eq. A18), we get:

$$dS_{jkt} = \left[ \left( -k_1^D + N_{jkt}^D \right) S_{jkt} + B_k^D M_{jkt}^D + W_t - \sum_{i=j}^5 w_{it}^U + R_t - O_t - A_k^D + k_2^D B_k^D \right] dt$$

$$S_{000} = s_0, \quad j, k = 1, 2, \dots, 5 \tag{A24}$$

which is a forward linear SDE that can be solved numerically for  $S_{jkt}$ . Thus, the backward adjoint variable  $\lambda_{jkt}^D$  follows from the linear transformation of Eq. (A19) and the optimal water use  $w_{jlt}^D$  follows from the optimality condition Eq. (A17).

## Cooperative Case

### Upstream

For the (j,k)-th exit stage we have the augmented Hamiltonian:

$$H_{jk}^U \left( w_{jt}^U, S_{jkt}, \lambda_{jkt}^D, w_{jkt}^U, \dots, w_{5kt}^U, \mu_{jkt}, \nu_{jkt}, \xi_{jkt} \right)$$

$$\triangleq \sum_{i=j}^5 \left[ \frac{a_i^U}{b_i^U} w_{it}^U - \frac{1}{2b_i^U} \cdot (w_{it}^U)^2 - (k_2^U - k_1^U w_{jt}^U) w_{it}^U \right]$$

$$+ \eta_1 S_{jkt} + \eta_2 + \mu_{jkt} \left[ W_t - \sum_{i=j}^5 w_{it}^U \right] + \nu_{jkt} \left[ W_t - \sum_{i=j}^5 w_{ikt}^U \right]$$

$$+ R_t - O_t - A_k^D + B_k^D (k_2^D - k_1^D S_{jkt}) + B_k^D \lambda_{jkt}^D$$

$$+ \xi_{jkt} \left\{ -k_1^D [A_k^D - B_k^D (k_2^D - k_1^D S_{jkt})] + (r + k_1^D B_k^D) \lambda_{jkt}^D \right\} \tag{A25}$$

where  $(\mu_{j\kappa}, \nu_{j\kappa}, \xi_{j\kappa})$  is the vector of the associated adjoint variables.

The necessary conditions for optimality for the maximization problem of U are given below:

$$\frac{\partial H_{jk}^U}{\partial w_{ikt}^U} = \frac{a_i^U}{b_i^U} - \frac{1}{b_i^U} \cdot w_{ikt}^U - \left( k_2^U - k_1^U w_{jt}^U \right) - \mu_{jkt} - \nu_{jkt} = 0, \quad i = j, \dots, 5, j, k = 1, 2, \dots, 5 \tag{A26}$$

$$d\mu_{jkt} = \left[ -\frac{\partial H_{jk}^U}{\partial W_{jt}^U} + r\mu_{jkt} \right] dt \iff d\mu_{jkt} = \left[ -k_1^U \sum_{i=j}^5 w_{it}^U + r\mu_{jkt} \right] dt \tag{A27}$$

$$dv_{jkt} = \left[ -\frac{\partial H_{jk}^U}{\partial S_{jkt}} + rv_{jkt} \right] dt \iff$$

$$dv_{jkt} = \left\{ -\eta_1 + k_1^D B_k^D v_{jkt} + (k_1^D)^2 B_k^D \xi_{jkt} + rv_{jkt} \right\} dt \tag{A28}$$

$$d\xi_{jkt} = \left[ -\frac{\partial H_{jk}^U}{\partial \lambda_{jt}^D} + r\xi_{jkt} \right] dt \iff d\xi_{jkt} = \left[ -B_k^D v_{jkt} - k_1^D B_k^D \xi_{jkt} \right] dt,$$

$$\xi_{000} = 0 \tag{A29}$$

From the first optimality condition (Eq. A26) we have:

$$w_{ikt}^U = a_i^U - b_i^U \left( k_2^U - k_1^U W_{jt}^U \right) - b_i^U \mu_{jkt} - b_i^U v_{jkt}, \quad i = j, \dots, 5, j, k = 1, 2, \dots, 5 \tag{A30}$$

It can be easily seen that the adjoint variables of both Eqs. (A28) and (A29) satisfy the system of FBSDEs:

$$d\xi_{jkt} = -\left[ k_1^D B_k^D \xi_{jkt} + B_k^D v_{jkt} \right] dt,$$

$$dv_{jkt} = \left\{ (k_1^D)^2 B_k^D \xi_{jkt} + (r + k_1^D B_k^D) v_{jkt} - \eta_1 \right\} dt$$

$$\xi_{000} = 0, \quad \lim_{t \rightarrow \infty} v_{jkt} = 0, \quad j, k = 1, 2, \dots, 5 \tag{A31}$$

In order to solve this FBSDEs system we are looking for solutions  $(\xi_{jkt}, v_{jkt})$  that satisfy the linear transformation:

$$v_{ikt} = N_{jkt} \xi_{jkt} + M_{jkt}, \quad j, k = 1, 2, \dots, 5 \tag{A32}$$

where  $N_{jkt}$  and  $M_{jkt}$  are stochastic processes to be determined. Taking differentials in Eq. (A32) we get:

$$dv_{ikt} = N_{jkt} d\xi_{jkt} + \xi_{jkt} dN_{jkt} + dM_{jkt} = \xi_{jkt} dN_{jkt} + dM_{jkt} - \left[ \left( B_k^D N_{jkt}^2 + k_1^D B_k^D N_{jkt} \right) \xi_{jkt} + B_k^D N_{jkt} M_{jkt} \right] dt \tag{A33}$$

While the backward equation of Eq. (A31) may be written as

$$dv_{ikt} = \left\{ \left[ r + k_1^D B_k^D \right] N_{jkt} + (k_1^D)^2 B_k^D \right\} \xi_{jkt} + (r + k_1^D B_k^D) M_{jkt} - \eta_1 \tag{A34}$$

Sufficient conditions for the latter to be equivalent are provided by

$$\begin{aligned}
 dN_{jkt} &= [B_k^D \cdot N_{jk}^2 + (2k_1^D B_k^D + r)N_{jkt} + (k_1^D)^2 B_k^D] dt, \\
 \lim_{t \rightarrow \infty} N_{jkt} &= 0, \quad j, k = 1, 2, \dots, 5
 \end{aligned}
 \tag{A35}$$

which is a BRE that can be solved numerically for  $N_{jkt}^D$  and by

$$\begin{aligned}
 dM_{jkt} &= \left[ (B_k^D N_{jt}^U + r + k_1^D B_k^D) M_{jkt} - \eta_1 \right] dt, \\
 \lim_{t \rightarrow \infty} M_{jkt} &= 0, \quad j, k = 1, 2, \dots, 5
 \end{aligned}
 \tag{A36}$$

which given the above solution is a backward linear first-order SDE that can be easily solved for  $M_{jkt}$ .

Substituting the linear solution form of Eq. (A32) to the forward equation of the FBSDEs system Eq. (A31), we obtain:

$$\begin{aligned}
 d\xi_{jkt} &= [-B_k^D (N_{jkt} + k_1^D) \xi_{jkt} - B_k^D M_{jkt}] dt, \\
 \xi_{000} &= 0, \quad j, k = 1, 2, \dots, 5
 \end{aligned}
 \tag{A37}$$

which is a forward linear SDE that can be solved for  $\xi_{jkt}$ . Then the backward adjoint variable  $v_{jkt}$  follows from the linear transformation of Eq. (A32).

Given the obtained solution  $(\xi_{jk}, v_{jk}), j, k = 1, 2, \dots, 5$ , of the FBSDEs system, as described above, we may put in use Eq. (A30) to derive that U's water resources state Eq. (4) and adjoint variable of Eq. (A27) form the subsequent system of FBSDEs:

$$\begin{aligned}
 dW_{jt}^U &= [-k_1^U B_j^U W_{jt}^U + B_j^U \mu_{jkt} + B_j^U v_{jkt} + W_t - A_j^U + k_2^U B_j^U] dt, \\
 d\mu_{jkt} &= [-(k_1^U)^2 B_j^U W_{jt}^U + (k_1^U B_j^U + r) \mu_{jkt} + k_1^U B_j^U v_{jkt} - k_1^U A_j^U + k_1^U k_2^U B_j^U] dt, \\
 W_{00}^U &= wr_0, \quad \lim_{t \rightarrow \infty} \mu_{jkt} = 0, \quad j, k = 1, 2, \dots, 5
 \end{aligned}
 \tag{A38}$$

To find a solution process pair  $(W_{jt}^U, \mu_{jk}) j, k = 1, 2, \dots, 5$ , for this system of FBSDEs, we impose the linear transformation:

$$\mu_{jkt} = \Lambda_{jkt} W_{jt}^U + \Xi_{jkt}, \quad j, k = 1, 2, \dots, 5
 \tag{A39}$$

where  $\Lambda_{jk}$  and  $\Xi_{jkt}$  are stochastic processes to be determined. Taking differentials in Eq. (A39) we have that:

$$\begin{aligned}
 d\mu_{jkt} &= \Lambda_{jkt} dW_{jt}^U + W_{jt}^U d\Lambda_{jkt} + d\Xi_{jkt} = W_{jt}^U d\Lambda_{jkt} \\
 &+ d\Xi_{jkt} + \left\{ [B_j^U \Lambda_{jkt}^2 - k_1^U B_j^U \Lambda_{jkt}] W_{jt}^U \right. \\
 &\left. + B_j^U \Lambda_{jkt} \Xi_{jkt} + B_j^U v_{jkt} \Lambda_{jkt} + [W_t - A_j^U + k_2^U B_j^U] \Lambda_{jkt} \right\} dt
 \end{aligned}
 \tag{A40}$$

while the backward Eq. (A38) may be reformulated as:

$$d\mu_{jkt} = \left\{ [-(k_1^U)^2 B_j^U + (k_1^U B_j^U + r) \Lambda_{jkt}] W_{jt}^U + (k_1^U B_j^U + r) \Xi_{jkt} + k_1^U B_j^U v_{jkt} - k_1^U A_j^U + k_1^U k_2^U B_j^U \right\} dt
 \tag{A41}$$

Sufficient conditions for the latter to be equivalent are given as follows:

$$d\Lambda_{jkt} = \left[ -B_j^U \Lambda_{jkt}^2 + \left( 2k_1^U B_j^U + r \right) \Lambda_{jkt} - \left( k_1^U \right)^2 B_j^U \right] dt, \tag{A42}$$

$$\lim_{t \rightarrow \infty} \Lambda_{jkt} = 0, \quad j, k = 1, 2, \dots, 5$$

which is a BRE that can be solved numerically for  $\Lambda_{jkt}$ ,  $j, k = 1, 2, \dots, 5$ , and

$$d\Xi_{jkt} = \left\{ \begin{aligned} & \left[ -B_j^U \Lambda_{jkt} + \left( k_1^U B_j^U + r \right) \right] \Xi_{jkt} - B_j^U v_{jkt} \Lambda_{jkt} - \left[ W_t - A_j^U + k_2^U B_j^U \right] \Lambda_{jkt} \\ & + k_1^U B_j^U v_{jkt} - k_1^U A_j^U + k_1^U k_2^U B_j^U \end{aligned} \right\} dt, \tag{A43}$$

$$\lim_{t \rightarrow \infty} \Xi_{jkt} = 0, \quad j, k = 1, 2, \dots, 5$$

which given the above solution is a backward linear first-order SDE that can be easily solved for  $\Xi_{jkt}$ ,  $j, k = 1, 2, \dots, 5$ .

Substituting the linear transformation of Eq. (A39) to the forward equation of the FBS-DEs system Eq. (A38) we deduce that:

$$dW_{jt}^U = \left\{ \left[ -k_1^U B_j^U + B_j^U \Lambda_{jkt} \right] W_{jt}^U + B_j^U \Xi_{jkt} + B_j^U v_{jkt} + W_t - A_j^U + k_2^U B_j^U \right\} dt, \tag{A44}$$

$$W_{00}^U = w_0^U, \quad j, k = 1, 2, \dots, 5$$

which is a forward linear SDE that can be solved for  $W_{jt}^U$ ,  $j = 1, 2, \dots, 5$ . Then the backward adjoint variable  $\mu_{jkt}$ ,  $j, k = 1, 2, \dots, 5$  follows readily from the linear transformation of Eq. (A39).

Given now the solutions  $(\xi_{jk}, v_{jk}), (W_{jt}^U, \mu_{jkt}), j, k = 1, 2, \dots, 5$ , of the FBSDEs systems Eq. (A31) and Eq. (A38), respectively, together with Eq. (A30) to write equivalently the Hamiltonian FBSDEs state system of the downstream country as:

$$dS_{jkt} = \left[ \begin{aligned} & -k_1^U B_j^U W_{jt}^U - k_1^D B_k^D S_{jkt} + B_k^D \lambda_{jkt}^D + B_j^U \mu_{jkt} + B_j^U v_{jkt} + W_t - A_j^U + k_2^U B_j^U \\ & + R_t - O_t - A_k^D + k_2^D B_k^D \end{aligned} \right] dt, \tag{A45}$$

$$d\lambda_{jkt}^D = \left[ -\left( k_1^D \right)^2 B_k^D S_{jkt} + \left( r + k_1^D B_k^D \right) \lambda_{jkt}^D - k_1^D A_k^D + k_1^D k_2^D B_k^D - \eta_1 \right] dt,$$

$$S_{000} = s_0, \quad \lim_{t \rightarrow \infty} \lambda_{jkt}^D = 0, \quad j, k = 1, 2, \dots, 5$$

Imposing once again a solution  $(S_{jkt}, \lambda_{jkt}^D), j, k = 1, 2, \dots, 5$ , that satisfies the linear transformation:

$$\lambda_{jkt}^D = \Pi_{jkt} S_{jkt} + \Sigma_{jkt}, \quad j, k = 1, 2, \dots, 5 \tag{A46}$$

To determine the stochastic processes  $\Pi_{jkt}$  and  $\Sigma_{jkt}$ , we take differentials in Eq. (A46) we have that:

$$d\lambda_{jkt}^D = \Pi_{jkt} dS_{jkt} + S_{jkt} d\Pi_{jkt} + d\Sigma_{jkt} = S_{jkt} d\Pi_{jkt} + d\Sigma_{jkt} + \left\{ \begin{aligned} & \left[ B_k^D \Pi_{jkt}^2 - k_1^D B_k^D \Pi_{jkt} \right] S_{jkt} + B_k^D \Pi_{jkt} \Sigma_{jkt} - k_1^U B_j^U W_j^U \Pi_{jkt} \\ & + \left[ B_j^U \mu_{jkt} + B_j^U v_{jkt} + W_t - A_j^U + k_2^U B_j^U + R_t - O_t - A_k^D + k_2^D B_k^D \right] \Pi_{jkt} \end{aligned} \right\} dt, \tag{A47}$$



while the backward Eq. (A45) may be written equivalently as:

$$d\lambda_{jkt}^D = \left\{ \left[ -(k_1^D)^2 B_k^D + (r + k_1^D B_k^D) \Pi_{jkt} \right] S_{jkt} + (r + k_1^D B_k^D) \Sigma_{jkt} - k_1^D A_k^D + k_1^D k_2^D B_k^D \right\} dt \tag{A48}$$

Sufficient conditions for the latter to be equivalent are provided by:

$$d\Pi_{jkt} = \left[ -B_k^D \left( \Pi_{jk}^U \right)^2 + (2k_1^D B_k^D + r) \Pi_{jkt}^U - (k_1^D)^2 B_k^D \right] dt, \tag{A49}$$

$$\lim_{t \rightarrow \infty} \Pi_{jkt} = 0, \quad j, k = 1, 2, \dots, 5$$

which is a BRE that can be solved numerically for  $\Pi_{jkt}, j, k = 1, 2, \dots, 5$ , and by:

$$d\Sigma_{jkt} = \left\{ \begin{array}{l} [-B_k^D \Pi_{jkt} + (k_1^D B_k^D + r) \Sigma_{jkt}] \\ - \left[ -k_1^U B_j^U W_j^U + B_j^U \mu_{jkt} + B_j^U v_{jkt} + W_t - A_j^U + k_2^U B_j^U + R_t - O_t - A_k^D + k_2^D B_k^D \right] \Pi_{jkt} \\ - k_1^D A_k^D + k_1^D k_2^D B_k^D \end{array} \right\} dt, \tag{A50}$$

$$\lim_{t \rightarrow \infty} \Sigma_{jkt} = 0, \quad j, k = 1, 2, \dots, 5$$

which given the above solution is a backward linear first-order SDE that can be easily solved for  $\Sigma_{jkt}, j, k = 1, 2, \dots, 5$ .

Substituting the linear transformation Eq. (A46) to the forward equation of the FBSDEs system Eq. (A45), we obtain:

$$dS_{jkt} = \left\{ \begin{array}{l} B_k^D [\Pi_{jkt} - k_1^D] S_{jkt} + B_k^D \Sigma_{jkt} - k_1^U B_j^U W_{jt}^U + B_j^U \mu_{jkt} + B_j^U v_{jkt} \\ + W_t - A_j^U + k_2^U B_j^U + R_t - O_t - A_k^D + k_2^D B_k^D \end{array} \right\} dt, \tag{A51}$$

$$S_{000} = s_0, \quad j, k = 1, 2, \dots, 5$$

which is a forward linear SDE that can be solved for  $S_{jkt}, j, k = 1, 2, \dots, 5$ . Then the backward adjoint variable  $\lambda_{jkt}^D, j, k = 1, 2, \dots, 5$ , follows immediately from the linear transformation of Eq. (A46). Clearly, the optimal water abstraction policies  $w_{jkt}^U, w_{jkt}^D, j, k = 1, 2, \dots, 5$ , of U and D follow from Eqs. (A30) and (A17), respectively.

## Appendix B

### Econometric Modeling

#### Copula Approach

As mentioned, copulas will determine the joint distribution of the endogenous regressors and the composed errors that capture their dependencies (Nelsen, 2006). In this sub-section we scrutinise this concept, taking the function  $\varphi()$  as given, while in Sect. 6.2 we elaborate on the dynamic latent productivity.

To this end, let  $F(x_1, \dots, x_p, \varepsilon)$  be the joint distribution of  $(x_1, \dots, x_p)$  and  $\varepsilon_i$ . Since the information contained in the correlation between  $(x_1, \dots, x_p)$  and  $\varepsilon_i$  is also contained in its joint distribution, and if this is known to belong to a class of parametric density, then

consistent estimates of the model parameters can be obtained by simply maximizing the log-likelihood function derived from  $F(x_1, \dots, x_p, \epsilon)$ . Thus, there is no need for resorting to instruments nor to consistently estimate the parameters of the model. However, in practice  $F(x_1, \dots, x_p, \epsilon)$  is typically unknown. Following Park and Gupta (2012) and suggesting a copula to determine this joint density, we can capture the dependence in the joint distribution of the endogenous regressors and the composed errors. More precisely, suppose the joint distribution of  $(x_1, \dots, x_p, \epsilon)$  with joint density  $f(x_1, \dots, x_p, \epsilon)$ , and let  $f_j(x_j)$ ,  $F_j(x_j)$ , for  $j = 1, \dots, p$ ,  $g(\epsilon)$  and  $G(\epsilon)$  denote the marginal density and Cumulative Distribution Function (CDF) of  $x_j$  and  $\epsilon$ , respectively. Also,  $C$  denotes the ‘‘copula function’’ defined for  $(\xi_1, \dots, \xi_{p+1}) \in [0, 1]^{p+1}$  by:

$$C(\xi_1, \dots, \xi_{p+1}) = P(F_1(x_1) \leq \xi_1, \dots, F_p(x_p) \leq \xi_p, G(\epsilon) \leq \xi_{p+1}) \tag{B1}$$

so that the copula function is itself a CDF.

Moreover, since  $F_j(x_j)$  and  $G(\cdot)$  are marginal distribution functions, each component  $U_j = F_j(x_j)$  and  $U_\epsilon = G(\epsilon)$  has a uniform marginal distribution (Li and Racine 2007).<sup>10</sup> Let  $c(\xi_1, \dots, \xi_p)$  denote the PDF associated with  $C(\xi_1, \dots, \xi_p)$ , then by Sklar’s theorem (Sklar 1959), we have:

$$f(x_1, \dots, x_p, \epsilon) = c(F_1(x_1), \dots, F_p(x_p), G(\epsilon))g(\epsilon)\prod_{j=1}^p f_j(x_j) \tag{B2}$$

Thus, Eq. (B1) shows that the copula function completely characterizes the dependence structure of  $(x_1, \dots, x_p, \epsilon)$ , and  $c(\xi_1, \dots, \xi_p) = 1$  if and only if  $(x_1, \dots, x_p, \epsilon)$  are independent of each other. To obtain the joint density, we need to specify the copula function; here the Gaussian copula is used<sup>11</sup>:

Let  $\Phi_{\Sigma, p+1}$  denote a  $(p + 1)$ -dimensional CDF with zero mean and correlation matrix  $\Sigma$ . Then the  $(p + 1)$ -dimensional CDF with correlation matrix  $\Sigma$  is given by:

$$C(w; \Sigma) = \Phi_{\Sigma, p+1}(\Phi^{-1}(U_1), \dots, \Phi^{-1}(U_p), \Phi^{-1}(U_\epsilon)),$$

where

$$w = (U_1, \dots, U_p, U_\epsilon) = (F_1(x_1), \dots, F_p(x_p), G(\epsilon)) \tag{B3}$$

The copula density is:

$$c(w; \Sigma) = (det(\Sigma))^{-1/2} \times exp\left\{-\frac{1}{2}(\Phi^{-1}(U_1), \dots, \Phi^{-1}(U_p), \Phi^{-1}(U_\epsilon))' (\Sigma^{-1} - I_{p+1})(\Phi^{-1}(U_1), \dots, \Phi^{-1}(U_p), \Phi^{-1}(U_\epsilon))\right\} \tag{B4}$$

And the log-likelihood function is:

$$logL(\theta, \Sigma) = \sum_{i=1}^n \sum_{t=1}^T \left\{ Inc(F_1(x_{1,it}), \dots, F_p(x_{p,it}), G(\epsilon_{it}; \theta); \Sigma) + \sum_{j=1}^p lnf_j(x_{j,it}) + lng(\epsilon_{it}; \theta) \right\} \tag{B5}$$

<sup>10</sup> Many producers use their own strategies to maximize profits. The individualistic behaviour of each can be described by modelling the marginals. Copulas can model marginals and multivariate probabilities.

<sup>11</sup> Other copula functions such as Frank, Plackett, Clayton, and Farlie-Gumbel-Morgenstern can also be used, but here we used the Gaussian as the most generally robust and wellness of performance (Song 2000; Danaher and Smith 2011).

where  $\theta = (\beta', \bar{\lambda}, \bar{\sigma}^2)'$  and the form of  $c(\cdot)$  is given in Eq. (22). Notice that the first term in the summation of Eq. (B5) is derived from the copula density and reflects the dependence between endogenous variables and composed errors. In addition, since the marginal density  $f_j(x_j)$  does not contain any parameters of interest, the second term in the summation of Eq. (B5) can be dropped from the log-likelihood function. Finally, it is clear that if there is no endogeneity problem, Eq. (B5) collapses to the log-likelihood function of the standard stochastic frontier models.

By maximizing the log-likelihood function, consistent estimates of  $(\theta, \Sigma)$  can be obtained, and this can be done as we described by the algorithm below:

**Estimation of  $F_j(x_j), j = 1, \dots, p;$  and  $G(\varepsilon; \theta)$**

Since  $F_j(x_{ji})$  are unknown and we have an observed sample of  $x_{ji}, j = 1, \dots, p; i = 1, \dots, n;$  in the first step, we can estimate  $F_j(x_{ji})$  by

$$\tilde{F}_{nj} = \frac{1}{nT + 1} \sum_{i=1}^n 1(x_{j,it} \leq x_{0j}), j = 1, \dots, p \tag{B6}$$

where  $1(\cdot)$  is an indicator function. Note that we used the rescaling factor  $1/(nT + 1)$  rather than  $1/nT$  to avoid difficulties arising from the potential unboundedness of the  $lnc(F_1(x_{1,it}), \dots, F_p(x_{p,it}), G(\varepsilon_{it}; \theta); \Sigma)$  as some of the  $F_j(x_j)$  tend to one. To estimate  $G(\varepsilon_{it}; \theta)$ , note that its density  $g(\varepsilon_{it}; \theta)$  is given in Eq. (20) and by definition,  $G(\varepsilon_{it}; \theta) = \int_{-\infty}^{\varepsilon_{it}} g(s; \theta) ds$ , thus  $G(\varepsilon; \theta)$  can be estimated using numerical integration, and let  $\hat{G}$  denotes the estimator of  $G(\varepsilon; \theta)$ .

**Maximization of the Log-Likelihood Function**

Maximization of the log-likelihood function of Eq. (B5) where  $F_j(x_j)$  and  $G(\varepsilon_{it}; \theta)$  are replaced by their estimates  $\tilde{F}_j(x_j)$  and  $\tilde{G}(\varepsilon_j; \theta)$ , respectively:

$$(\hat{\theta}, \hat{\Sigma}) = \underset{\theta \in \Theta, \Sigma}{argmax} \sum_{i=1}^n \left\{ lnc(\tilde{F}_1(x_{1i}), \dots, \tilde{F}_p(x_{pi}), \tilde{G}(\varepsilon_i; \theta); \Sigma) + lng(\varepsilon_i; \theta) \right\} \tag{B7}$$

**Estimating Technical Inefficiency**

Once the parameters have been estimated, the ultimate goal is to predict the technical inefficiency values (term  $u_i$ ). This can be calculated based on Jondrow et al. (1982):

$$\hat{u}_{it} = \hat{E}(u_{it} | \varepsilon_{it}) = \frac{\hat{\sigma} \hat{\lambda}}{1 + \hat{\lambda}^2} \left[ \frac{\varphi\left(\frac{\hat{\lambda} \hat{\varepsilon}_{it}}{\hat{\sigma}}\right)}{1 - \Phi\left(\frac{\hat{\lambda} \hat{\varepsilon}_{it}}{\hat{\sigma}}\right)} - \frac{\hat{\lambda} \hat{\varepsilon}_{it}}{\hat{\sigma}} \right] \tag{B8}$$

where  $\hat{\varepsilon}_{it} = y_{it} - \varphi(x_{it}, z_{it}; \hat{\beta})$  and  $\hat{\beta}, \hat{\lambda}$  and  $\hat{\sigma}^2$  are the parameter estimates obtained from the approach discussed above.

### Local Likelihood Estimation

The functional form  $\varphi(x_{it}, z_{it}; \beta)$  was left unspecified so far. By all means, any parametric form can be used, but here we focus on non-parametric estimation by the local likelihood method. We use the simpler notation  $\varphi(x_{it}; \beta)$  as the extension to the case of exogenous covariates is straightforward. Since we have a multivariate covariate, we use the method of local linear estimation. This means that all parameters of the model become functions of  $x$ , and they are denoted by  $\theta(x)$ . We denote the conditional density of  $y$  given  $x$  by  $p(y|x) = g(y;\theta(x))$ , where  $\theta(x) \in \mathbb{R}^k$  is unknown and we define  $q(y;\theta(x)) = \log g(y;\theta(x))$ . For example, a standard frontier would take the form:

$$y_{it} = m(x_{it}) + v_{it} - u_{it},$$

where

$$v_{it} | x_{it} \sim iN(0, \sigma_v^2(x_{it})), u_{it} | x_{it} \sim iN(0, \sigma_u^2(x_{it})). \tag{B9}$$

Then:

$$\theta(x) = [m(x), \sigma_v^2(x), \sigma_u^2(x)]' \tag{B10}$$

Our fundamental departure from the standard model is the introduction of productive performance or technical efficiency:

$$y_{it} = m(x_{it}, z_{it}) + v_{it} + \omega_{it} - u_{it} \tag{B11}$$

where the productivity process is:

$$\omega_{it} | x_{it}, \omega_{i,t-1} \sim iN(r(\omega_{i,t-1}, x_{it}, z_{it}), \sigma_\omega^2(\omega_{i,t-1}, x_{it}, z_{it})) \tag{B12}$$

In this specification,  $r(\omega_{i,t-1}, x_{it}, z_{it})$  is a non-parametric productivity mean process, and  $\sigma_\omega^2(\omega_{i,t-1}, x_{it}, z_{it})$  is the variance. For ease in notation, we omit explicit dependence on  $z$  and we continue to denote  $\theta(x) \in \mathbb{R}^k$  with

$$\theta(x) = [m(x), r(\omega_{-1}, x), \sigma_v^2(x), \sigma_u^2(x), \sigma_\omega^2(\omega_{-1}, x)]' \tag{B13}$$

where  $\omega_{-1}$  denotes the lagged value of productivity. As productivity is latent special problems are introduced into the analysis.

There is a multivariate kernel which satisfies:

$$\int K(u)du = 1, \int uu' K(u)du = \mu_2 I_d \tag{B14}$$

To fix notation, we start with the analysis of the simpler model in Eq. (B11). The conditional local linear log-likelihood is given by<sup>12</sup>:

$$\log L(\theta_o, \Theta_1) = \sum_{i=1}^n \sum_{t=1}^T q(y_{it}, \theta_o + \Theta_1(x_{it} - x)) K_H(x_{it} - x) \tag{B15}$$

<sup>12</sup> We include  $z_{it}$  in the kernel functions because, in this instance, they represent important environmental variables that help in modeling heterogeneity. For ease in notation we redefine  $x = [x', z']'$ .

where  $\theta_o, \Theta_1$  is a vector ( $k \times 1$ ) and matrix ( $k \times d$ ) respectively,  $H$  is a bandwidth matrix which is symmetric, positive definite and  $K_H(u) = |H|^{-1}K(H^{-1}u)$ . We choose a multivariate product kernel so that  $K(u) = \prod_{j=1}^d K_j(u_j)$  in which case  $\int uu' K(u)du = (\int u_1^2 K_1(u_1)du_1)I_d$ . The local linear estimator is  $\hat{\theta}(x) = \hat{\theta}_o(x)$  where  $\hat{\theta}_o(x)$  and  $\hat{\Theta}_1(x)$  maximize the log-likelihood  $L(\theta_o, \Theta_1)$  with respect to  $\theta_o, \Theta_1$ .

For the model with latent productivity  $\omega_{it}$  as in Eq. (B12) the likelihood function is

$$L(\theta_o, \Theta_1) = \int_{\mathbb{R}^{nT}} \left\{ \prod_{i=1}^n \prod_{t=1}^T g(y_{it}, \omega_{it}, \theta_o + \Theta_1(\Lambda_{it} - \Lambda)) \cdot K_H(\Lambda_{it} - \Lambda) \right\} d\omega \tag{B16}$$

where  $\Lambda_{it} = [x'_{it}, \omega_{i,t-1}]', \Lambda = [x', \omega_{-1}]'$ , and

$$g(y, \omega; \theta(\Lambda)) = \frac{2}{\sigma(x)} \varphi\left(\frac{y_{it} - \varphi(x_{it}; \beta(x)) - \omega_{it}}{\sigma(x)}\right) \Phi\left(-\frac{\lambda(x)}{\sigma_v(x)}(y - \varphi(x_{it}; \beta(x))) - \omega_{it}\right) \cdot \frac{1}{\sigma_\omega(x, \omega_{-1})} \varphi\left(\frac{\omega_{it} - r(x_{it}, \omega_{i,t-1}; \gamma(x, \omega_{-1}))}{\sigma_\omega(x, \omega_{-1})}\right) \tag{B17}$$

Moreover,  $\gamma(x, \omega_{-1})$  denotes the localized parameters in the  $r()$  function of Eq. (37). For ease in notation, we define  $\theta(x, \omega_{-1}) = [\beta(x)', \gamma(x, \omega_{-1})']' \in \mathbb{R}^k$ . In Eq. (B16) there is an  $nT$ -dimensional integral which cannot be evaluated analytically, which is obvious from the definition of Eq. (42). The computation relies in two steps:

*Step 1:* Integrate out  $\{\omega_{it}\}$  from Eq. (B16) using a Sequential Monte Carlo (SMC) algorithm (Pitt and Shephard 1999).

*Step 2:* Maximize the resulting expression using numerical optimization techniques.

For reasons of computational convenience and without sacrificing generality we assume:

$$\omega_{it} = \rho\omega_{i,t-1} + \xi_{it}, \{\xi_{it}\} \sim ii.i.d.N(0, \sigma_\xi^2) \tag{B18}$$

We will still need the SMC algorithm in step 1 (Appendix B), for which we used  $10^6$  particles per likelihood evaluation, and a standard conjugate gradients algorithm for maximization. Our results were insensitive to using  $10^5$  or  $10^7$  particles per likelihood evaluation.

## Appendix C

### Sequential Monte Carlo

The particle filter methodology can be applied to state space models of the general form:

$$y_T \sim ip(y_T | x_T), \quad s_t \sim ip(s_t | s_{t-1}) \tag{C1}$$

where  $s_t$  is a state variable. For general introductions see Gordon (1997), Gordon et al. (1993), Doucet et al. (2001) and Ristic et al. (2004). Given the data  $Y_T$  the posterior distribution  $p(s_T | Y_T)$  can be approximated by a set of (auxiliary) particles  $\{s_t^{(i)}, i = 1, \dots, N\}$  with

probability weights  $\{w_t^{(i)}, i = 1, \dots, N\}$  where  $\sum_{i=1}^N w_t^{(i)} = 1$ . The predictive density can be approximated by:

$$p(s_{t+1}|Y_t) = \int p(s_{t+1}|s_t)p(s_t|Y_t)ds_t \sim ieq \sum_{i=1}^N p(s_{t+1}|s_t^{(i)})w_t^{(i)} \tag{C2}$$

and the final approximation for the filtering density is:

$$p(s_{t+1}|Y_t) \propto p(y_{t+1}|s_{t+1})p(s_{t+1}|Y_t) \sim ieqp(y_{t+1}|s_{t+1}) \sum_{i=1}^N p(s_{t+1}|s_t^{(i)})w_t^{(i)} \tag{C3}$$

The basic mechanism of particle filtering rests on propagating  $\{s_t^{(i)}, w_t^{(i)}, i = 1, \dots, N\}$  to the next step, viz.  $\{s_{t+1}^{(i)}, w_{t+1}^{(i)}, i = 1, \dots, N\}$  but this often suffers from the weight degeneracy problem. If parameters  $\theta \in \Theta \in \mathfrak{R}^k$  are available, as is often the case, we follow Liu and West (2001) parameter learning takes place via a mixture of multivariate normals:

$$p(\theta|Y_t) = \sum_{i=1}^N w_t^{(i)} N(\theta|\alpha\theta_t^{(i)} + (1 - a)\bar{\theta}_t, b^2 V_t) \tag{C4}$$

where  $\bar{\theta}_t = \sum_{i=1}^N w_t^{(i)} \theta_t^{(i)}$ , and  $V_t = \sum_{i=1}^N w_t^{(i)} (\theta_t^{(i)} - \bar{\theta}_t)(\theta_t^{(i)} - \bar{\theta}_t)'$ . The constants  $a$  and  $b$  are related to shrinkage and are determined via a discount factor  $\delta \in (0, 1)$  as  $a = (1 - b^2)^{1/2}$  and  $b^2 = 1 - [(3\delta - 1)/2\delta]^2$ (see also Casarin and Marin 2007). Andrieu and Roberts (2009), Flury and Shephard (2011) and Pitt et al. (2012) provide the Particle Metropolis-Hastings (PMCMC) technique which uses an unbiased estimator of the likelihood function  $\hat{p}_N(Y|\theta)$  as  $p(Y|\theta)$  is often not available in closed form.

Given the current state of the parameter  $\theta^{(j)}$  and the current estimate of the likelihood, say  $L^j = \hat{p}_N(Y|\theta^{(j)})$ , a candidate  $\theta^c$  is drawn from  $q(\theta^c|\theta^{(j)})$  yielding  $L^c = \hat{p}_N(Y|\theta^c)$ . Then, we set  $\theta^{(j+1)} = \theta^c$  with the Metropolis—Hastings probability:

$$A = \min\left\{1, \frac{p(\theta^c)L^c}{p(\theta^{(j)})L^j} \frac{q(\theta^{(j)}|\theta^c)}{q(\theta^c|\theta^{(j)})}\right\} \tag{C5}$$

otherwise we repeat the current draws:  $\{\theta^{(j+1)}, L^{j+1}\} = \{\theta^{(j)}, L^j\}$ .

Hall et al. (2014) propose an auxiliary particle filter which rests upon the idea that adaptive particle filtering (Pitt et al. 2012) used within PMCMC requires far fewer particles than the standard particle filtering algorithm to approximate  $p(Y|\theta)$ . From Pitt and Shephard (1999) we know that auxiliary particle filtering can be implemented easily once we can evaluate the state transition density  $p(s_t|s_{t-1})$ . When this is not possible, Hall et al. (2014) present a new approach when, for instance,  $s_t = g(s_{t-1}, u_t)$  for a certain disturbance. In this case we have:

$$p(y_t|s_{t-1}) = \int p(y_t|s_t)p(s_t|s_{t-1})ds_t \tag{C6}$$

$$p(u_t|s_{t-1};y_t) = p(y_t|s_{t-1},u_t)p(u_t|s_{t-1})/p(y_t|s_{t-1}) \tag{C7}$$

If one can evaluate  $p(y_t|s_{t-1})$  and simulate from  $p(u_t|s_{t-1};y_t)$  the filter would be fully adaptable (Pitt and Shephard 1999). One can use a Gaussian approximation for the first-stage proposal  $g(y_t|s_{t-1})$  by matching the first two moments of  $p(y_t|s_{t-1})$ . So in some way we find that the approximating density  $p(y_t|s_{t-1}) = N(E(y_t|s_{t-1}), V(y_t|s_{t-1}))$ . In the second stage, we know that  $p(u_t|y_t, s_{t-1}) \propto p(y_t|s_{t-1}, u_t)p(u_t)$ . For  $p(u_t|y_t, s_{t-1})$  we know it is

multimodal so suppose it has  $M$  modes are  $\hat{u}_t^m$ , form  $m = 1, \dots, M$ . For each mode we can use a Laplace approximation.

Let  $l(u_t) = \log [p(y_t | s_{t-1}, u_t) p(u_t)]$ . From the Laplace approximation we obtain:

$$l(u_t) = l(\hat{u}_t^m) + \frac{1}{2} (u_t - \hat{u}_t^m)' \nabla^2 l(\hat{u}_t^m) (u_t - \hat{u}_t^m) \tag{C8}$$

Then we can construct a mixture approximation:

$$g(u_t | x_t, s_{t-1}) = \sum_{m=1}^M \lambda_m (2\pi)^{-d/2} |\Sigma_m|^{-1/2} \exp \left\{ \frac{1}{2} (u_t - \hat{u}_t^m)' \Sigma_m^{-1} (u_t - \hat{u}_t^m) \right\}, \tag{C9}$$

where  $\Sigma_m = -[\nabla^2 l(\hat{u}_t^m)]^{-1}$  and  $\lambda_m \propto \exp \{ l(u_t^m) \}$  with  $\sum_{m=1}^M \lambda_m = 1$ . This is done for each particle  $s_t^i$ . This is known as the Auxiliary Disturbance Particle Filter (ADPF). An alternative is the independent particle filter (IPF) of Lin et al. (2010). The IPF forms a proposal for  $s_t$  directly from the measurement density  $p(y_t | s_t)$  although Hall et al. (2014) are quite right in pointing out that the state equation can be very informative. In the standard particle filter of Gordon et al. (1993) particles are simulated through the state density  $p(s_t^i | s_{t-1}^i)$  and they are re-sampled with weights determined by the measurement density evaluated at the resulting particle, viz.  $p(y_t | s_t^i)$ . The ADPF is simple to construct and rests upon the following steps, for  $t = 0, \dots, T - 1$  given samples  $s_t^k \sim ip(s_t | Y_{1:t})$  with mass  $\pi_t^k$  for  $k = 1, \dots, N$ :

1. For  $k = 1, \dots, N$  compute  $\omega_{t+1}^k = g(y_{t+1} | s_t^k) \pi_t^k$ ,  $\pi_{t+1}^k = \omega_{t+1}^k / \sum_{i=1}^N \omega_{t+1}^i$ .
2. For  $k = 1, \dots, N$  draw  $s_{t+1}^k = \sum_{i=1}^N \pi_{t+1}^i \delta_{s_t^i}^k(ds_t)$
3. For  $k = 1, \dots, N$  draw  $\delta_{s_t}^k = g(u_{t+1} | s_t^k, y_{t+1})$  and set  $s_{t+1}^k = h(s_t^k; u_{t+1}^k)$
4. For  $k = 1, \dots, N$  compute

$$\omega_{t+1}^k = \frac{p(y_{t+1} | s_{t+1}^k) p(u_{t+1}^k)}{g(y_{t+1} | s_t^k) g(u_{t+1}^k | \tilde{s}_t^k, y_{t+1})}, \pi_{t+1}^k = \frac{\omega_{t+1}^k}{\sum_{i=1}^N \omega_{t+1}^i}. \tag{C10}$$

It should be mentioned that the estimate of likelihood from ADPF is:

$$p(Y_{1:T}) = \prod_{t=1}^T \left( \sum_{i=1}^N \omega_{t-1}^i \right) \left( N^{-1} \sum_{i=1}^N \omega_t^i \right) \tag{C11}$$

### Particle Metropolis Adjusted Langevin Filters

Nemeth et al. (2014) provide a particle version of a Metropolis Adjusted Langevin algorithm (MALA). In Sequential Monte Carlo we are interested in approximating  $p(s_t | Y_{1:t}, \theta)$ . Given that:

$$p(s_t | Y_{1:t}, \theta) \propto g(y_t | x_t, \theta) \int f(s_t | s_{t-1}, \theta) p(s_{t-1} | Y_{1:t-1}, \theta) ds_{t-1} \tag{C12}$$

where  $p(s_{t-1} | Y_{1:t-1}, \theta)$  is the posterior as of time  $t - 1$ . If at time  $t - 1$  we have a set of particles  $\{s_{t-1}^i, i = 1, \dots, N\}$  and weights  $\{w_{t-1}^i, i = 1, \dots, N\}$  which form a discrete approximation for  $p(s_{t-1} | Y_{1:t-1}, \theta)$  then we have the approximation:

$$\hat{p}(s_{t-1}|y_{1:t-1}, \theta) \propto \sum_{i=1}^N w_{t-1}^i f(s_t|s_{t-1}^i, \theta) \tag{C13}$$

See Cappé et al. (2005) and Andrieu et al. (2010) for reviews. From (B13) Fearnhead (2007) makes the important observation that the joint probability of sampling particle  $s_{t-1}^i$  and state  $s_t$  is:

$$\omega_t = \frac{w_{t-1}^i g(y_t|s_t, \theta) f(s_t|s_{t-1}^i, \theta)}{\xi_t^i q(s_t|s_{t-1}^i, y_t, \theta)} \tag{C14}$$

where  $q(s_t|s_{t-1}^i, y_t, \theta)$  is a density function amenable to simulation and:

$$\xi_t^i q(s_t|s_{t-1}^i, y_t, \theta) \sim ieqcg(y_t|s_t, \theta) f(s_t|s_{t-1}^i, \theta) \tag{C15}$$

and  $c$  is the normalizing constant in (B12).

In the MALA algorithm of Roberts and Rosenthal (1998)<sup>13</sup> we form a proposal:

$$\theta^c = \theta^{(s)} + \lambda z + \frac{\lambda^2}{2} \nabla \log p(\theta^{(s)} | Y_{1:T}) \tag{C16}$$

where  $z \sim iN(0, I)$  which should result in larger jumps and better mixing properties, plus lower autocorrelations for a certain scale parameter  $\lambda$ . Acceptance probabilities are:  $a(\theta^c | \theta^{(s)}) = \min \left\{ 1, \frac{p(Y_{1:T} | \theta^c) q(\theta^{(s)} | \theta^c)}{p(Y_{1:T} | \theta^{(s)}) q(\theta^c | \theta^{(s)})} \right\}$

Using particle filtering it is possible to create an approximation of the score vector using Fisher's identity:

$$\nabla \log p(Y_{1:T} | \theta) = E[\nabla \log p(s_{1:T}, Y_{1:T} | \theta) | Y_{1:T}, \theta] \tag{C17}$$

which corresponds to the expectation of:

$$\nabla \log p(s_{1:T}, Y_{1:T} | \theta) = \nabla \log p(|s_{1:T-1}, Y_{1:T-1} | \theta) + \nabla \log g(y_T | s_T, \theta) + \nabla \log f(s_T | s_{T-1}, \theta)$$

over the path  $s_{1:T}$ . The particle approximation to the score vector results from replacing  $p(s_{1:T} | Y_{1:T}, \theta)$  with a particle approximation  $\hat{p}(s_{1:T} | Y_{1:T}, \theta)$ .

With particle  $i$ -th at time  $t-1$ , we can associate a value  $\alpha_{t-1}^i = \nabla \log p(s_{1:t-1}^i, Y_{1:t-1} | \theta)$  which can be updated recursively. As we sample  $\kappa_i$  in the APF (the index of particle at time  $t-1$  that is propagated to produce the  $i$  th particle at time  $t$ ) we have the update:

$$\alpha_t^i = \alpha_{t-1}^{\kappa_i} + \nabla \log g(y_t | s_t^i, \theta) + \nabla \log f(s_t^i | s_{t-1}^i, \theta) \tag{C18}$$

To avoid problems with increasing variance of the score estimate  $\nabla \log p(Y_{1:t} | \theta)$  we can use the approximation:

$$\alpha_{t-1}^i \sim iN(m_{t-1}^i, V_{t-1}) \tag{C19}$$

The mean is obtained by shrinking  $\alpha_{t-1}^i$  towards the mean of  $\alpha_{t-1}$  as follows:

$$m_{t-1}^i = \delta \alpha_{t-1}^i + (1 - \delta) \sum_{i=1}^N w_{t-1}^i \alpha_{t-1}^i \tag{C20}$$

<sup>13</sup> The benefit of MALA over Random-Walk-Metropolis arises when the number of parameters  $n$  is large. This happens because the scaling parameter  $\lambda$  is  $\lambda \propto n^{-1/2}$  for Random-Walk-Metropolis but it is  $\lambda \propto n^{-1/6}$  for MALA, see Roberts et al. (1997) and Roberts and Rosenthal (1998).



where  $\delta \in (0, 1)$  is a shrinkage parameter. Using Rao-Blackwellization one can avoid sampling  $\alpha_i^j$  and instead use the following recursion for the means:

$$m_t^i = \delta m_{t-1}^{k_i} + (1 - \delta) \sum_{i=1}^N w_{t-1}^i m_{t-1}^i + \nabla \log g(y_t | s_t^i, \theta) + \nabla \log f(s_t^i | s_{t-1}^{k_i}, \theta) \quad (C21)$$

which yields the final score estimate:

$$\nabla \widehat{\log p}(Y_{1:t} | \theta) = \sum_{i=1}^N w_t^i m_t^i \quad (C22)$$

As a rule of thumb Nemeth et al. (2014) suggest taking  $\delta = 0.95$ . Furthermore, they show the important result that the algorithm should be tuned to the asymptotically optimal acceptance rate of 15.47% and the number of particles must be selected so that the variance of the estimated log-posterior is about 3. Additionally, if measures are not taken to control the error in the variance of the score vector, there is no gain over a simple random walk proposal.

Of course, the marginal likelihood is:

$$p(Y_{1:T} | \theta) = p(y_1 | \theta) \prod_{t=2}^T p(y_t | Y_{1:t-1}, \theta) \quad (C23)$$

where

$$p(y_t | Y_{1:t-1}, \theta) = \int g(y_t | s_t) \int f(s_t | s_{t-1}, \theta) p(s_{t-1} | Y_{1:T-1}, \theta) ds_{t-1} ds_t \quad (C24)$$

provides, in explicit form, the predictive likelihood.

## Appendix D

### Data Mentioned in Results Section

The Environmental Indices derived from the factors presented in Sect. 7, as well as the parameters of the hydro-economic model (same section) were obtained from official databases.

The Eora global supply chain database consists of a Multi-Region Input–Output table (MRIO) model that provides a time series of high-resolution Input–Output (IO) tables with matching environmental and social satellite accounts for 190 countries (35 types of EI air pollution, energy use, greenhouse gas emissions, water use, land occupation, N and P emissions, etc.). 16 IO tables, each for the period 2000–2017 for Ethiopia and Kenya were used. Additional data, as well as pumping costs and hydrological timeseries were collected from scientific journals, official reports, governmental websites, and other forms of grey literature databases, including: African development bank, including African development bank, ILO (International Labor Organization) and the World Bank Group: Climate Change Knowledge Portal For Development Practitioners and Policy Makers, the United Nations Statistics Division, Food and Agriculture Organization of United Nations (FAOSTAT, AQUASTAT), Unesco World Heritage list, OpenDataSoft, Environment and Climate Change Data Portal, and offices of national statistics.

See Tables 6 and 7.

**Table 6** Description of Indices of Ecosystem Services

| ES services     | Indicator                                | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Units               | Source                                                                                                |
|-----------------|------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-------------------------------------------------------------------------------------------------------|
|                 | GVA (Gross Value Added) per sector       | Represents the contribution of labor and capital to the production process. Gross value added at basic prices is defined as output valued at basic prices less intermediate consumption valued at purchasers' prices. Although the outputs and inputs are valued using different sets of prices, for brevity the value added is described by the prices used to value the outputs. From the point of view of the producer, purchasers' prices for inputs and basic prices for outputs represent the prices actually paid and received. Their use leads to a measure of gross value added that is particularly relevant for the producer. Net value added is defined as the value of output less the values of both intermediate consumption and consumption of fixed capital | \$                  | Input-OutputTables<br><a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a> |
|                 | Gross Fixed Capital Formation per sector | Gross fixed capital formation is measured by the total value of a producer's acquisitions, less disposals, of fixed assets during the accounting period plus certain additions to the value of non-produced assets (such as subsoil assets or major improvements in the quantity, quality or productivity of land) realized by the productive activity of institutional units                                                                                                                                                                                                                                                                                                                                                                                                | \$                  | <a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a>                       |
|                 | Employment Per sector                    | Persons in employment are defined as all those of working age who, during a short reference period, were engaged in any activity to produce goods or provide services for pay or profit. They comprise employed persons "at work", i.e. who worked in a job for at least one hour; and employed persons "not at work" due to temporary absence from a job, or to working-time arrangements (such as shift work, flexitime and compensatory leave for overtime)                                                                                                                                                                                                                                                                                                               | Abs Value           | ILO (International LABOR Organization)                                                                |
| Provis services | WFN: Total Water Footprint per sector    | Total water use which includes:<br>WFN: Total water footprint—Green<br>WFN: Total water footprint—Blue<br>WFN: Total water footprint—Grey                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Mm <sup>3</sup> /yr | Input-Output<br><a href="http://www.worldmrio.com">http://www.worldmrio.com</a>                       |
|                 | Energy Use (Total) per sector            | Natural Gas, Coal, Petroleum, Nuclear Electricity, Hydroelectric Electricity, Geothermal Electricity, Wind Electricity, Solar, Tide and Wave Electricity, Biomass and Waste Electricity                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | TJ                  | Input-Output<br><a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a>       |
| Regul Ser-vices | Water Quality                            | Nitrogen Emissions exportable to water bodies from agriculture and household waste water                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Gg                  | Input-Output<br><a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a>       |

**Table 6** (continued)

| ES services      | Indicator                                                                        | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Units              | Source                                                                                       |
|------------------|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|----------------------------------------------------------------------------------------------|
|                  | Fertilizers: Total Nitrogen and Phosphate (N and P <sub>2</sub> O <sub>5</sub> ) | Proportions of consumption of fertilizers (by nutrient group) per unit of agricultural land area are calculated by UNSD using available consumption and land use data from FAOSTAT                                                                                                                                                                                                                                                                                                                                                                                                                                              | kg/ha              | Food and Agriculture Organization of United Nations (FAOSTAT)                                |
| Provis. services | Agricultural Area                                                                | Agricultural area, this category is the sum of areas under “Arable land”, “Permanent crops” and “Permanent pastures”                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 10 <sup>3</sup> ha | Food and Agriculture Organization of United Nations (FAOSTAT)                                |
| Provis. services | Raw Materials per Sector                                                         | For agriculture total biomass and for mining-quarries total construction material and total fossil fuel                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | t                  | Input–Output <a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a> |
| Provis. services | Permanent Crops                                                                  | Permanent crops is the land cultivated with long-term crops which do not have to be replanted for several years (such as cocoa and coffee); land under trees and shrubs producing flowers, such as roses and jasmine; and nurseries (except those for forest trees, which should be classified under “forest”). Permanent meadows and pastures are excluded from land under permanent crops                                                                                                                                                                                                                                     | 10 <sup>3</sup> ha | Food and Agriculture Organization of United Nations (FAOSTAT)                                |
| Provis. services | Arable Land                                                                      | Arable land is the land under temporary agricultural crops (multiple-cropped areas are counted only once), temporary meadows for mowing or pasture, land under market and kitchen gardens and land temporarily fallow (less than five years). The abandoned land resulting from shifting cultivation is not included in this category. Data for “Arable land” are not meant to indicate the amount of land that is potentially cultivable                                                                                                                                                                                       | 10 <sup>3</sup> ha | Food and Agriculture Organization of United Nations (FAOSTAT)                                |
| Provis. services | Crop Production                                                                  | Crop statistics are recorded for 173 products, covering the following categories: Crops Primary, Fibre Crops Crop statistics are recorded for 173 products, covering the following categories: Crops Primary, Fibre Crops Primary, Cereals, Coarse Grain, Citrus Fruit, Fruit, Jute & Jute-like Fibres, Oilcakes Equivalent, Oil crops Primary, Pulses, Roots and Tubers, Treenuts and Vegetables and Melons. Data are expressed in terms of area harvested, production quantity, yield and seed quantity. The objective is to comprehensively cover production of all primary crops for all countries and regions in the world | t                  | Input–Output <a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a> |

**Table 6** (continued)

| ES services       | Indicator                          | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Units              | Source                                                                                                |
|-------------------|------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|-------------------------------------------------------------------------------------------------------|
| Regul Ser-vices   | Forest                             | Forest area is the land spanning more than 0.5 hectares with trees higher than 5 m and a canopy cover of more than 10 percent, or trees able to reach these thresholds in situ. It does not include land that is predominantly under agricultural or urban land use. Forest is determined both by the presence of trees and the absence of other predominant land uses. The trees should be able to reach a minimum height of 5 m (m) in situ. Areas under reforestation that have not yet reached but are expected to reach a canopy cover of 10 percent and a tree height of 5 m are included, as are temporarily unstocked areas, resulting from human intervention or natural causes, which are expected to regenerate. Includes: areas with bamboo and palms provided that height and canopy cover criteria are met; forest roads, firebreaks and other small open areas; forest in national parks, nature reserves and other protected areas such as those of specific scientific, historical, cultural or spiritual interest; windbreaks, shelterbelts and corridors of trees with an area of more than 0.5 ha and width of more than 20 m; plantations primarily used for forestry or protective purposes, such as: rubber-wood plantations and cork, oak stands. Excludes: tree stands in agricultural production systems, for example in fruit plantations and agroforestry systems. The term also excludes trees in urban parks and gardens | 10 <sup>3</sup> ha | Food and Agriculture Organization of United Nations (FAOSTAT)                                         |
| Provis. ser-vices | Total Area Equipped For Irrigation | Area equipped with irrigation infrastructure to provide water to the crops. This includes areas equipped for full and partial control irrigation, spate irrigation areas, and equipped wetland or inland valley bottoms                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | 10 <sup>3</sup> ha | Food and Agriculture Organization of United Nations (FAOSTAT)                                         |
| Provis. ser-vices | Total Fisheries Production         | Total fisheries production measures the volume of aquatic species caught by a country for all commercial, industrial, recreational and subsistence purposes. The harvest from mariculture, aquaculture and other kinds of fish farming is also included                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | t                  | Food and Agriculture Organization of United Nations (FAOSTAT)                                         |
|                   | Temperature                        | The yearly mean historical rainfall and temperature data can be mapped to show the baseline climate and seasonality yearly, and for rainfall and temperature                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | °C                 | The World Bank Group Climate Change Knowledge Portal- For Development Practitioners and Policy Makers |

**Table 6** (continued)

| ES services      | Indicator                 | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Units | Source                                                                                                         |
|------------------|---------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|----------------------------------------------------------------------------------------------------------------|
|                  | Rainfall                  | Yearly Mean historical rainfall                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | mm    | The World Bank Group<br>Climate Change Knowledge Portal-<br>For Development Practitioners and<br>Policy Makers |
| Habitat services | Biodiversity and Habitats | <p>A “proximity-to-target methodology” is used to assess how close each country is to an identified policy target. Country scores are determined by how close or far countries are to targets. Scores are standardized (i.e., on a scale of 0 to 100) for comparability, weighting, and aggregation</p> <p>The Environmental Performance Index (EPI) is constructed through the calculation and aggregation of 20 indicators reflecting national-level environmental data. These indicators are combined into nine issue categories, each of which fit under one of two overarching objectives. The two objectives that provide the overarching structure of the EPI are Environmental Health and Ecosystem Vitality. Biodiversity &amp; Habitats belongs to the Ecosystem Vitality which measures ecosystem protection and resource management. These two objectives are further divided into nine issue categories that span high-priority environmental policy issues, including air quality, forests, fisheries, and climate and energy, among others. The issue categories are extensive but not comprehensive. Underlying the nine issue categories, 20 indicators are calculated from country-level data and statistics</p> <p>In this case the Biodiversity and Habitat category includes four indicators: Critical Habitat Protection, Terrestrial Protected Areas (National Biome Weight), Terrestrial Protected Areas (Global Biome Weight), and Marine Protected Areas. The targets are: 100% for Critical Habitat Protection; 17% for Terrestrial Protected Areas (National Biome Weights); 17% for Terrestrial Protected Areas (Global Biome Weights); 10% for Marine Protected Areas. (c.f</p> <p><a href="http://archive.epi.yale.edu/our-methods/biodiversity-and-habitat">http://archive.epi.yale.edu/our-methods/biodiversity-and-habitat</a>)</p> | %     | Environment and Climate Change Data Portal                                                                     |

**Table 6** (continued)

| ES services      | Indicator                   | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | Units           | Source                                                                                                |
|------------------|-----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------------------------------------------------------------------------------------------------|
| Regul Ser- vices | Terrestrial Protected Areas | <p>The definition of a “protected area”, as adopted by the International Union for Conservation of Nature (IUCN), is “an area of land and/or sea especially dedicated to the protection and maintenance of biological diversity, and of natural and associated cultural resources, and managed through legal or other effective means”. (IUCN 1994. Guidelines for Protected Areas Management Categories. IUCN; Gland; Switzerland and Cambridge; UK). Protected areas increase with time and are not deleted from subsequent years. Only protected areas that are “nationally designated” are included in this indicator. The status “designated” is attributed to a protected area when the authority that corresponds, according to national legislation or common practice (e.g. by means of an executive decree), officially endorses a document of designation. The designation must be for conservation of biodiversity, not single species and not fortuitous de facto protection arising because of some other activity (e.g. military). Hence, a number of United States Marine Managed Areas as well as permanent fisheries closures are excluded. Data are adjusted to account for transboundary protected areas (protected areas that transcend international boundaries) to ensure that the appropriate area/extent from the total area for that site is attributed to the country in which it is contained. Similar adjustments have been made where a protected area transcends both marine and terrestrial environments. The size of the protected area (its “extent”) is the officially documented total area provided by the national authority or as listed by the World Database on Protected Areas and may be generated from spatial (GIS) boundary data (see source for details). Many protected areas can contain proportions of both the marine and terrestrial environment, and the size of the protected area extent that falls into each environment is not always available. The table also includes some protected areas for which the year (date of establishment/designation) is unavailable. If no update is received for a given year, the total number and size of the protected area is assumed to be equal to the previous year’s values</p> | Km <sup>2</sup> | World Database on Protected Areas (WDPA) website at: <a href="http://www.wdpa.org/">www.wdpa.org/</a> |

**Table 6** (continued)

| ES services | Indicator                                  | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Units           | Source                                                                                                                                                    |
|-------------|--------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
|             | Access to Electricity                      | Access to electricity is the percentage of population with access to electricity. Electrification data are collected from industry, national surveys and international sources                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | % of population | World Bank, Sustainable Energy for All (SE4ALL) database                                                                                                  |
|             | People Using Basic Drinking Water Services | The percentage of people using at least basic water services. This indicator encompasses both people using basic water services as well as those using safely managed water services. Basic drinking water services is defined as drinking water from an improved source, provided collection time is not more than 30 min for a round trip. Improved water sources include piped water, boreholes or tubewells, protected dug wells, protected springs, and packaged or delivered water                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | % of population | World Bank, from WHO/ UNICEF Joint Monitoring Programme (JMP) for Water Supply, Sanitation and Hygiene ( <a href="http://washdata.org">washdata.org</a> ) |
|             | International Tourism, Number of Arrivals  | International inbound tourists (overnight visitors) are the number of tourists who travel to a country other than that in which they have their usual residence, but outside their usual environment, for a period not exceeding 12 months and whose main purpose in visiting is other than an activity remunerated from within the country visited. When data on number of tourists are not available, the number of visitors, which includes tourists, same-day visitors, cruise passengers, and crew members, is shown instead. Sources and collection methods for arrivals differ across countries. In some cases data are from border statistics (police, immigration, and the like) and supplemented by border surveys. In other cases data are from tourism accommodation establishments. For some countries number of arrivals is limited to arrivals by air and for others to arrivals staying in hotels. Some countries include arrivals of nationals residing abroad while others do not. Caution should thus be used in comparing arrivals across countries. The data on inbound tourists refer to the number of arrivals, not to the number of people traveling. Thus a person who makes several trips to a country during a given period is counted each time as a new arrival | Abs Value       | World Bank, World Tourism Organization, Yearbook of Tourism Statistics, Compendium of Tourism Statistics and data files                                   |

**Table 6** (continued)

|                        |                                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |   |                                                                                                                                                                                               |
|------------------------|-------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Regul<br>Ser-<br>vices | Renew-<br>able<br>Elec-<br>tricity<br>Pro-<br>duction | <p>Electricity production refers to gross production, which is the sum of the electrical energy production by all the generating units/installations concerned (including pumped storage) measured at the output terminals of the main generators. Renewable electricity production (%) refers to the proportion of total electricity produced that comes from a renewable origin. Electricity production refers to gross electricity production, which is the sum of the electrical energy production by all the generating units/installations concerned (including pumped storage) measured at the output terminals of the main generators. This includes the consumption by station auxiliaries and any losses in the transformers that are considered integral parts of the station. Renewable electricity production was calculated as the sum of electricity produced from hydro, geothermal, solar, wind, tide, wave and ocean sources. All electricity production from combustible fuels is considered non-renewable; therefore electricity produced from burning biomass or renewable waste is not included as renewable electricity in this table. However, this has been observed to be a relatively negligible proportion of electricity production in most cases</p> | % | <p>United Nations Statistics Division, Energy Statistics<br/> <a href="http://unstats.un.org/unsd/energy/yearbook/default.htm">http://unstats.un.org/unsd/energy/yearbook/default.htm</a></p> |
|------------------------|-------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|



**Table 6** (continued)

| Regul<br>Ser-<br>vices | CO <sub>2</sub> |                                                                 | Gg | Input–Output<br><a href="http://www.worldmrio.com/country">http://www.worldmrio.com/country</a> |
|------------------------|-----------------|-----------------------------------------------------------------|----|-------------------------------------------------------------------------------------------------|
|                        |                 | Public electricity and heat production                          |    |                                                                                                 |
|                        |                 | Other Energy Industries                                         |    |                                                                                                 |
|                        |                 | Manufacturing Industries and Construction                       |    |                                                                                                 |
|                        |                 | Domestic aviation                                               |    |                                                                                                 |
|                        |                 | Road transportation                                             |    |                                                                                                 |
|                        |                 | Rail transportation                                             |    |                                                                                                 |
|                        |                 | Inland navigation                                               |    |                                                                                                 |
|                        |                 | Other transportation                                            |    |                                                                                                 |
|                        |                 | Residential and other sectors                                   |    |                                                                                                 |
|                        |                 | Fugitive emissions from solid fuels                             |    |                                                                                                 |
|                        |                 | Fugitive emissions from oil and gas                             |    |                                                                                                 |
|                        |                 | International aviation                                          |    |                                                                                                 |
|                        |                 | International navigation                                        |    |                                                                                                 |
|                        |                 | Production of minerals                                          |    |                                                                                                 |
|                        |                 | Cement production                                               |    |                                                                                                 |
|                        |                 | Lime production                                                 |    |                                                                                                 |
|                        |                 | Production of chemicals                                         |    |                                                                                                 |
|                        |                 | Production of metals                                            |    |                                                                                                 |
|                        |                 | Production of pulp/paper/food/drink                             |    |                                                                                                 |
|                        |                 | Production of halocarbons and SF <sub>6</sub>                   |    |                                                                                                 |
|                        |                 | Refrigeration and Air Conditioning                              |    |                                                                                                 |
|                        |                 | Foam Blowing                                                    |    |                                                                                                 |
|                        |                 | Fire Extinguishers                                              |    |                                                                                                 |
|                        |                 | Aerosols                                                        |    |                                                                                                 |
|                        |                 | F-gas as Solvent                                                |    |                                                                                                 |
|                        |                 | Semiconductor/Electronics Manufacture                           |    |                                                                                                 |
|                        |                 | Electrical Equipment                                            |    |                                                                                                 |
|                        |                 | Other F-gas use                                                 |    |                                                                                                 |
|                        |                 | Non-energy use of lubricants/waxes (CO <sub>2</sub> )           |    |                                                                                                 |
|                        |                 | Solvent and other product use: paint                            |    |                                                                                                 |
|                        |                 | Solvent and other product use: degrease                         |    |                                                                                                 |
|                        |                 | Solvent and other product use: chemicals                        |    |                                                                                                 |
|                        |                 | Solvent and other product use: other                            |    |                                                                                                 |
|                        |                 | Enteric fermentation                                            |    |                                                                                                 |
|                        |                 | Manure management                                               |    |                                                                                                 |
|                        |                 | Rice cultivation                                                |    |                                                                                                 |
|                        |                 | Direct soil emissions                                           |    |                                                                                                 |
|                        |                 | Manure in pasture/range/paddock                                 |    |                                                                                                 |
|                        |                 | Indirect N <sub>2</sub> O from agriculture                      |    |                                                                                                 |
|                        |                 | Other direct soil emissions                                     |    |                                                                                                 |
|                        |                 | Savanna burning                                                 |    |                                                                                                 |
|                        |                 | Agricultural waste burning                                      |    |                                                                                                 |
|                        |                 | Forest fires                                                    |    |                                                                                                 |
|                        |                 | Grassland fires                                                 |    |                                                                                                 |
|                        |                 | Decay of wetlands/peatlands                                     |    |                                                                                                 |
|                        |                 | Other vegetation fires                                          |    |                                                                                                 |
|                        |                 | Forest Fires-Post burn decay                                    |    |                                                                                                 |
|                        |                 | Solid waste disposal on land                                    |    |                                                                                                 |
|                        |                 | Wastewater handling                                             |    |                                                                                                 |
|                        |                 | Waste incineration                                              |    |                                                                                                 |
|                        |                 | Other waste handling                                            |    |                                                                                                 |
|                        |                 | Fossil fuel fires                                               |    |                                                                                                 |
|                        |                 | Indirect N <sub>2</sub> O from non-agricultural NO <sub>x</sub> |    |                                                                                                 |
|                        |                 | Indirect N <sub>2</sub> O from non-agricultural NH <sub>3</sub> |    |                                                                                                 |
|                        |                 | Other sources                                                   |    |                                                                                                 |

**Table 6** (continued)

|       |                 |                                                                |
|-------|-----------------|----------------------------------------------------------------|
| Regul | NO <sub>2</sub> | Public electricity and heat production                         |
| Ser-  |                 | Other Energy Industries                                        |
| vices |                 | Manufacturing Industries and Construction                      |
|       |                 | Domestic aviation                                              |
|       |                 | Road transportation                                            |
|       |                 | Rail transportation                                            |
|       |                 | Inland navigation                                              |
|       |                 | Other transportation                                           |
|       |                 | Residential and other sectors                                  |
|       |                 | Fugitive emissions from solid fuels                            |
|       |                 | Fugitive emissions from oil and gas                            |
|       |                 | Memo: International aviation                                   |
|       |                 | Memo: International navigation                                 |
|       |                 | Production of minerals                                         |
|       |                 | Cement production                                              |
|       |                 | Lime production                                                |
|       |                 | Production of chemicals                                        |
|       |                 | Production of metals                                           |
|       |                 | Production of pulp/paper/food/drink                            |
|       |                 | Production of halocarbons and SF <sub>6</sub>                  |
|       |                 | Refrigeration and Air Conditioning                             |
|       |                 | Foam Blowing                                                   |
|       |                 | Fire Extinguishers                                             |
|       |                 | Aerosols                                                       |
|       |                 | F-gas as Solvent                                               |
|       |                 | Semiconductor/Electronics Manufacture                          |
|       |                 | Electrical Equipment                                           |
|       |                 | Other F-gas use                                                |
|       |                 | Non-energy use of lubricants/waxes (CO <sub>2</sub> )          |
|       |                 | Solvent and other product use: paint                           |
|       |                 | Solvent and other product use: degrease                        |
|       |                 | Solvent and other product use: chemicals                       |
|       |                 | Solvent and other product use: other                           |
|       |                 | Enteric fermentation                                           |
|       |                 | Manure management                                              |
|       |                 | Rice cultivation                                               |
|       |                 | Direct soil emissions                                          |
|       |                 | Manure in pasture/range/paddock                                |
|       |                 | Indirect N <sub>2</sub> O from agriculture                     |
|       |                 | Other direct soil emissions                                    |
|       |                 | Savanna burning                                                |
|       |                 | Agricultural waste burning                                     |
|       |                 | Forest fires                                                   |
|       |                 | Grassland fires                                                |
|       |                 | Decay of wetlands/peatlands                                    |
|       |                 | Other vegetation fires                                         |
|       |                 | Forest Fires-Post burn decay                                   |
|       |                 | Solid waste disposal on land                                   |
|       |                 | Wastewater handling                                            |
|       |                 | Waste incineration                                             |
|       |                 | Other waste handling                                           |
|       |                 | Fossil fuel fires                                              |
|       |                 | Indirect NO <sub>2</sub> from non-agricultural NO <sub>x</sub> |
|       |                 | Indirect NO <sub>2</sub> from non-agricultural NH <sub>3</sub> |
|       |                 | Other sources                                                  |

Table 6 (continued)

|                                                       |                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                |                                                                                                                                                                                                                               |
|-------------------------------------------------------|-------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Regul<br>Ser-<br>vices                                | Total<br>Annual<br>Fresh-<br>water<br>With-<br>draw-<br>als | Annual freshwater withdrawals refer to total water withdrawals, not counting evaporation losses from storage basins. Withdrawals also include water from desalination plants in countries where they are a significant source. Withdrawals can exceed 100 percent of total renewable resources where extraction from non-renewable aquifers or desalination plants is considerable or where there is significant water reuse. Withdrawals for agriculture and industry are total withdrawals for irrigation and livestock production and for direct industrial use (including withdrawals for cooling thermoelectric plants). Withdrawals for domestic uses include drinking water, municipal use or supply, and use for public services, commercial establishments, and homes. Data are for the most recent year available for 1987–2002                                                                                                                                                   | 10 <sup>9</sup> m <sup>3</sup> | Food and<br>Agriculture<br>Organization,<br>AQUASTAT data                                                                                                                                                                     |
| Regul.<br>Ser-<br>vices                               | Floods<br>and<br>Droughts                                   | Number of floods/droughts events                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | (–)                            | The Emergency Events Database—Université catholique de Louvain (UCL)—CRED, D Guha-Sapir, <a href="http://www.emdat.be">www.emdat.be</a> , Brussels, Belgium <a href="http://emdat.be/emdat_db/">http://emdat.be/emdat_db/</a> |
| Cul-<br>tural<br>and<br>amen-<br>ity<br>ser-<br>vices | Cultural-<br>Natural-<br>Mixed<br>Heritage<br>Sites         | <i>To be included on the World Heritage List, sites must be of outstanding universal value and meet at least one out of ten selection criteria</i><br>These criteria are explained in the Operational Guidelines for the Implementation of the World Heritage Convention which, besides the text of the Convention, is the main working tool on World Heritage. The criteria are regularly revised by the Committee to reflect the evolution of the World Heritage concept itself<br>Access to an improved water source refers to the percentage of the population with reasonable access to an adequate amount of water from an improved source, such as a household connection, public standpipe, borehole, protected well or spring, and rainwater collection. Unimproved sources include vendors, tanker trucks, and unprotected wells and springs. Reasonable access is defined as the availability of at least 20 L a person a day from a source within one kilometer of the dwelling | (–)                            | UNESCO World Heritage Centre—World Heritage List                                                                                                                                                                              |

**Table 7** Parameters of the hydro-economic model

| Symbol     | Description                                                                                                | Parameter value                                                      |
|------------|------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------|
| $B^u$      | Vector of the absolute values of the slope of the water demand for $i$ sector in the upstream area         | [833.33; 31,152.65; 769.23; 714.29; 1,000] Mm <sup>3</sup> /\$       |
| $A^u$      | Vector of the intercepts of the water demand for $i$ sector in the upstream area                           | [1,233.33; 46,105.92; 1,269.23; 1,235.71; 1,800] Mm <sup>3</sup> /\$ |
| $B^d$      | Vector of the absolute values of the slope of the water demand for $i$ sector in the downstream area       | [909.09; 1,000; 31,347.96; 769.23; 666.67] Mm <sup>3</sup> /\$       |
| $A^d$      | Vector of the intercepts of the water demand for $i$ sector in the downstream area                         | [1,400; 1,560; 48,902.82; 1,307.69; 1,180] Mm <sup>3</sup> /\$       |
| $k_1^U$    | Cost of pumping in the upstream area 1Mm <sup>3</sup> of water per Mm <sup>3</sup> of volume of the river  | 0.066 \$/m <sup>3</sup>                                              |
| $k_2^U$    | The intercept of the pumping cost equation for the upstream area                                           | 0.33 \$/m <sup>3</sup>                                               |
| $k_1^D$    | Cost of pumping in the downstream area 1Mm <sup>3</sup> of water per Mm <sup>3</sup> of volume of the lake | 0.61 \$/m <sup>3</sup>                                               |
| $k_2^D$    | The intercept of the pumping cost equation for the downstream area                                         | 2.03 \$/m <sup>3</sup>                                               |
| $s_0$      | Initial storage of the lake                                                                                | 292,500 Mm <sup>3</sup>                                              |
| $R_0$      | Initial runoff rate                                                                                        | 16,666.155 Mm <sup>3</sup>                                           |
| $O_0$      | Initial outflow rate                                                                                       | 22,788.644 Mm <sup>3</sup>                                           |
| $w_0$      | Initial precipitation                                                                                      | 6.8308·10 <sup>5</sup> Mm <sup>3</sup>                               |
| $wr_0$     | Initial renewable water resources                                                                          | 4.43·10 <sup>7</sup> Mm <sup>3</sup>                                 |
| $\sigma_R$ | Volatility of runoff                                                                                       | 0.431                                                                |
| $\sigma_O$ | Volatility of outflow                                                                                      | 0.025                                                                |
| $\sigma_W$ | Volatility of precipitation                                                                                | 0.089                                                                |

**Authors Contribution Statement** All authors contributed to the study conception and design. Material preparation, data collection and analysis were performed by Nikolaos Englezos, Xanthi Kartala, Phoebe Koundouri and Mike Tsionas. The first draft of the manuscript was written by Angelos Alamanos and all authors commented on previous versions of the manuscript. All authors read and approved the final manuscript.

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**Availability of Data and Materials** Available upon request.

## Declarations

**Conflict of interest** None.

**Ethical Approval** Not applicable.

**Consent to Participate** Not applicable.

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