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by

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[*] Peter Berck is Professor of Agricultural and Resource Economics. I would like to thank Atanu Dey for able research assistance. The remaining errors are mine.

A Note on the Environmental Costs of Aggregates

The opening of a new quarry for aggregates will change the pattern of transportation of aggregates in the area served by the quarry. In this note, we will show that, so long as aggregate producers are cost minimizing, the new pattern of transportation requires less truck transport than the pattern of transportation that existed before the opening of the new quarry. Since the costs of providing aggregates falls, it is reasonable to assume that the price of delivered aggregates also will fall. This note also shows that the demand expansion effect is of very small magnitude. Since the demand increase from a new quarry is quite small, the dominant effect is that the quarries are on average closer to the users of aggregates and, as a result, the truck mileage for aggregate hauling decreases. To summarize the effects of a new quarry project:

a) The project in itself will not significantly increase the demand for construction materials in the region through market forces, which include the downward pressure on pricing.

b) Truck traffic (i.e. vehicle miles traveled) in the region will not increase and may decrease as a result of the project.

As a result, the effect of a new quarry project will be to reduce the air emissions from aggregate trucking. The reduction in emissions should be included as a positive impact of a quarry project in any analysis of the environmental consequences of a new quarry.

The remainder of this note provides a brief description of the economics of construction materials and explains why these points must be true.

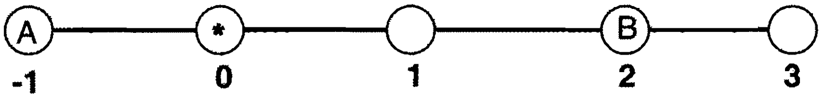
Based upon the available evidence, a project would decrease haul distances for aggregates and would therefore decrease emissions from trucks, rather than increase them.

There are two economic facts that are important to understand in evaluating the likely addition or subtraction to truck traffic from a new quarry. One is the economics of location. The second is the demand for aggregates, which is the quantity of aggregates used as a function of price.

That a new site leads to smaller haul distance is a matter of geometry and economics. Transportation is a major element in the cost of delivered aggregate, so new sites are chosen, within the limits placed by the natural availability of aggregates, to minimize transport costs.

An example should make this fact clear. Consider diagram 1. Circles represent aggregate-using projects of equal size. The five projects shown are located at miles marked –1, 0, 1, 2, and 3. Two of the project sites are marked with the letters A and B, and they are potential locations for aggregate production. The location at mile 0 is an existing aggregate production site and it is marked by an asterisk (*). The scale is in miles. For simplicity, each project uses one unit of aggregate.

Diagram 1



With only one aggregate production site at mile 0, the miles traveled to supply the five projects is seven: zero miles for project at mile 0, one mile for each for the projects at mile –1 and 1, two miles for the project at 2 and three miles for the project at 3 for a total of 7 miles. If an additional aggregate production site is started at A, the miles traveled decreases to six, because there is no transportation required for the aggregate-using project at A and all other projects are served by the original site. However, if the new site is placed at B instead of being placed at A, transport distance falls to three miles because then two projects have aggregate production at their location and thus have zero transportation requirements, and the three remaining sites each require a one-mile transport. Each aggregate production site supplies 2.5 units of aggregates, that is, half the total required by the five projects. Since cost depends on distance and, markets minimize costs, the free market system always will choose a point like B, the one with the lowest cost. In this case it is also the lowest transport distance.

Other forms of industrial organization lead to higher prices being charged for aggregates, but the effect of additional suppliers is to lower prices and haul distances. Appendix A elucidates the case where the price depends upon the delivered costs of the second most efficient producer.

The second issue for the siting of aggregate production is the possibility that lower delivered costs lead to more projects or more use of aggregates in existing projects. The degree to which decrease in the price of a good, in this case construction material, leads to an increase in the quantity of that material used is described by the elasticity of demand. The elasticity of demand is the percent increase in use caused by a one percent decrease in price.

A search of the economic literature found no articles estimating a positive elasticity of demand for aggregates. A review by the Susan Kohler[†] finds that only population and not price is correlated with aggregate usage. In other words, a reduction in the price of aggregate does not lead to an increase in demand for it.

While it is a theoretical possibility that the quantity of aggregates demanded (that is, the quantity used in projects) is responsive to price, two facts about construction make this unlikely. First, the cost of aggregates is usually a tenth or less of the cost of a project. Second, the building of projects -- housing, roads, and commercial construction -- is not very sensitive to the costs of producing them.

[†] *Map Sheet 52. Aggregate Availability in California.* by Susan L. Kohler. California Department of Conservation. California Geological Survey. Sacramento. 2002.

Although we have not found literature on the elasticity of demand for either public projects or contract construction, there is an empirical literature on the elasticity of demand for housing[‡]. In these studies, a one percent change in the price leads to about a half percent change in the quantity of housing consumed. Public projects, like roads, are budgeted, often from specials funds, like road taxes. In that case, a one percent decrease in the costs of *all* projects in a taxing jurisdiction would lead to a one percent increase in the quantity of roads built. Since aggregates are very expensive to ship, the quarry being considered likely would only change the costs of nearby road construction, perhaps for just one county.

For example, Monterey County has a population of 400,000 while the state population is 33.9 million people.[§] Assuming that road construction is roughly proportional to population, about 1.2 percent of road construction would be in Monterey. So, if a new quarry in Monterrey decreased the price of aggregates in Monterrey by 1 percent and left the price the same in the rest of the state, then the average price in the whole state would fall by about 0.01 percent, which is negligible. A project that affects only a small part of a taxing jurisdiction has only a small effect on that jurisdiction's costs and can have no major affect on the quantity of services supplied by that jurisdiction.

We know of no evidence of elasticities for construction work as high as one. We estimate the elasticity of demand for projects using aggregates to be much less than one, likely under a half in the private sector and near zero in the public sector.

Given that projects will be built, there is some possibility of substituting of other structural materials for aggregates in buildings. However these substitute materials too would be trucked. The realistic possibility for roads is that there are no materials to substitute for aggregates. I do not believe this pathway to greater use of aggregates in building would be triggered by the transport savings from a new aggregate source or that it would result in an increase in net truck miles.

[‡] Hanushek, Eric A., John Quigley. "What is the price elasticity of housing demand?" *Review of Economics and Statistics.* August, 1980.

[§] Population figures are for the year 2000.

Since a change in price of aggregates does not lead to either a substantial substitution of other materials for aggregates or a substantial increase in the quantity of projects, the demand for aggregates is very inelastic. This inelasticity of demand is exactly the reason that the State of California can use a fixed per-capita consumption rate for forecasting the need for construction materials.

An example will make clear how the transport advantage and elasticity of demand arguments fit together. Let us consider a new quarry that, through its transportation advantage over existing quarries, would save 12.5 miles of trucking on each and every project in the study area. We shall assume that the average truck haul pre-project was 25 miles.

According to the *Map Sheet 52: Aggregate Availability in California,* the cost of construction aggregate doubles every 25-35 miles from the point of production. The following calculations are carried out assuming that a 25 mile haul doubles the cost. Assuming that a unit of aggregate costs $1 at the production site, then its delivered cost at a project site 25 miles away is $2. If the haul distance were to be reduced to 12.5 miles due to a new quarry, then half of the transportation costs – or $0.50 – would be saved. This represents a cost savings of 25 percent in the delivered cost of aggregate and is entirely due to a 50 percent decrease in miles traveled.

The only way for a new quarry to influence the quantity of construction is through the price of aggregates. This example presents the competitive case, where the delivered price decreases by the full amount of the transport cost savings. In the competitive case, the effect on the quantity of construction will be extremely moderate, as demonstrated below. (Appendix A presents a less than perfectly competitive example.)

In keeping with the fact that the cost of aggregate accounts for less than 10 percent of the total cost of a construction project, a price reduction of 25 percent on aggregate is a cost saving of 2.5 percent or less on the project. Let us assume a very liberal price elasticity of demand for construction of 0.5. In other words, 2.5 percent reduction in the cost of construction would lead to 1.25 percent increase in the quantity of construction demanded. This increased quantity of delivered aggregate leads to additional truck haul miles. The number of increased miles from the increased aggregate sales is 1.25 percent of the original quantity times the new haul distance which is 50% of the original distance. Therefore, the percentage increase in truck haul miles occasioned by a decrease in aggregate price will be 0.625 percent because the new aggregate location is only half as far away.

In this example, the new quarry saves 50 percent of truck trip miles through location and contributes 0.625 percent of new truck trip miles from demand increase. This leads to a net decrease of 49.375 percent in truck miles. The following Table 1 summarizes the net reduction of truck haul miles for three different scenarios – the new aggregate project site located at 12.5, 6.25, and 2.5 miles from a construction site.

Table 1

Distance to New Quarry (miles)	**Decrease in haul miles (%)**[**]	**Decrease in delivered aggregate cost (%)**	**Decrease in construction cost (%)**	**Increase in construction quantity (%)**	**Increase in haul miles from additional construction(%)**[††]	**Net decrease in miles hauled (%)**
12.5	50	25	2.5	1.25	0.62	**49.4**
6.25	25	37.5	3.75	1.85	0.46	**74.5**
2.5 miles	90	45	4.5	2.25	0.22	**89.8**

There is a general rule to be deduced from the example: The percent decrease in cost for the delivery of aggregates equals the percent decrease in miles driven, while the increase in the use of aggregates equals the elasticity of demand for a final product (such as roads) times the cost share of aggregates in making the product times the decrease in cost. Since the elasticity of demand for a final product is much less than one, and the cost

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[**] This decrease is with respect to the pre-project haul miles.
[††] This increase is with respect to the pre-project haul miles.

share of aggregates in making the product is about 8 percent, a new quarry must decrease truck miles and decrease NOX and other emissions from trucks.

Appendix A

Spatial Models with Imperfect Competition

When a producer has a price advantage over other producers because of lower transport costs, the producer can exploit that advantage by charging consumers a price greater than its marginal cost. Marginal cost is the cost of producing one incremental unit.
In this appendix, I will briefly investigate one model of spatial competition that is derived from a classical model of Hotelling [‡‡]

In Hotelling's model, two stores (which are analogous to production sites) can relocate at no cost and then compete based on price. Since consumers are some distance from the store, they see the price of a product as the amount they pay for the product plus the cost of travel. They go to the store with the least total cost (cost of product plus cost of travel). The stores seek to make the most money they can make. The price the consumer will pay is the largest price that the store the consumer goes to can charge without losing the customer to the other store.[§§] In Hotelling's model, the two stores will locate next to each other, split the market in half, and charge the competitive price. While the pricing rule of the Hotelling model may well apply to aggregates, the assumption of complete location flexibility is not applicable.

Returning to the model of diagram 1, shown above., I now consider the effects on pricing of adding one aggregate production site with competition in prices. Consider the case where both aggregate production sites and aggregate-using projects exist at location A and *. The production site at * would be willing to supply the project at location A at its marginal cost of production (mc) plus the cost of transport for one mile, for a total of mc + 1 c. This is higher than the marginal plus transport costs that production site A has for

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[5] Hotelling, Harold. 1929. "Stability in Competition." Economic Journal 39:41-57

[6] Salop, Steven C. 1979. "Monopolistic Competition with Outside Goods." *The Bell Journal of Economics.* Salop models the competition between stores in terms of quantity, so that the price for consumers near a store is determined as a monopolist would determine price. With a very low elasticity of demand as is true for aggregates, the price competition model of Hotelling seems more appropriate.

supplying the project at A. However, the site at A can charge up to mc+c without losing the customer. The site charges mc+c while its costs are mc and makes c units of pure profit. The site at * prices in the same way—a price just high enough to avoid the site at A from taking the customer. For the sites to the right of *, the prices are mc+2, mc+3, and mc+ 4. In each case, this is the highest price site * can charge without losing the customer to site A.

In this model, one of the best places for a new site would be at B. The new site would sell ½ unit to the project between it and * at a price of mc + c, a whole unit to the project located at B at a price of mc + 2c (the price at which the site at * would be willing to supply aggregate), and a whole unit to the project located to its right at a price of mc + 3c. The result of adding the new site would be that the price for each project to the right of the project at * fell by c.

With competitive (marginal cost) pricing as described in the body of the note, the addition of the new site at B would result in the prices paid by projects decreasing by four, while with imperfect competition as described in this appendix, the new site would result in the prices paid by projects decreasing only by three. Compared to the competitive case cited above, the imperfect competition example results in smaller changes in prices and therefore a larger decrease in truck traffic.