ISSN: 3064-9846
Review Article
Science Set Journal of Economics Research

Integrating Natural Capital: A Framework for Valuing Ecosystem Services in Policy and Practice

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Submitted: 19 September 2025 **Accepted:** 26 September 2025 **Published:** 11 October 2025

https://doi.org/10.63620/MKSSJER.2025.1097

Citation: *Hald-Mortensen, C. (2025). Integrating Natural Capital: A Framework for Valuing Ecosystem Services in Policy and Practice. Sci Set J of Economics Res, 4(5), 01-04.*

Abstract

Conventional economic models have historically failed to account for the value of natural capital, leading to the degradation of ecosystems and the services they provide. This paper argues that integrating the valuation of ecosystem services into policy and economic frameworks is essential for sustainable development. Through a literature review and a comparative analysis of three case studies, namely the Catskill watershed management plan, urban greening initiatives, and the Skjern River restoration in Denmark, this study explores practical uses of ecosystem service valuation. The findings reveal that recognizing ecosystems as productive assets can yield significant economic and social returns, from avoiding costly infrastructure to enhancing public health and creating recreational opportunities. Key challenges, including stakeholder opposition and difficulties in quantifying non-market values, are identified. The paper concludes by proposing a brief framework for decision-making that better incorporates regulating, cultural, and provisioning services into local and national planning.

Keywords: Ecosystem Services, Natural Capital, Environmental Valuation, Nature-Based Solutions, Cost-Benefit Analysis.

Introduction

The undervaluation of natural capital represents a market failure of the modern era. This failure stems from the classification of many ecosystem services as public goods—non-excludable and non-rivalrous—which leads to their overexploitation in the absence of defined property rights or regulation [1]. This is the economic mechanism of market failure: the difficulty in establishing excludability for natural resources which leads to the tragedy of the commons.

The resulting degradation manifests as negative externalities, where the social costs of pollution or resource depletion are borne by society at large rather than by the economic actors responsible.

Consequently, the silent infrastructure supporting human well-being and economic stability is eroded. In the early 1990s, New York City provided an seminal example of correcting this failure by opting to invest approximately $1.5 billion in protecting its Catskill watershed rather than constructing a $6 billion water filtration plant [2]. This decision, grounded in a pragmatic cost-benefit analysis, demonstrated that investing in natural capital can be a more efficient and cost-effective strategy than relying solely on engineered solutions.

Despite growing recognition, the integration of nature's value into financial systems remains a major challenge for institution investors and policy-makers. Landmark initiatives like The Economics of Ecosystems and Biodiversity (TEEB) and the Dasgupta Review have issued urgent calls to embed natural capital into economic decision-making, urging governments to treat ecosystems as productive assets on par with produced and human capital [3, 4]. Sir Partha Dasgupta specifically recommend that governments "reconstruct economic measurement systems by incorporating natural capital depreciation," a reform essential for internalizing environmental externalities and safeguarding nature-based assets [5].

Research Questions, Objectives and Methodology

This paper addresses the gap between the theoretical valuation of ecosystem services and their practical implementation in policy. It seeks to answer: How can the values of ecosystem services

be effectively quantified and integrated into policy to foster sustainable development? And, what lessons can be learned from successful case studies regarding stakeholder engagement and governance?

The paper uses a literature review with a comparative case study analysis. It investigates the practical integration of ecosystem service valuation by analyzing three different cases—the Catskill watershed, urban greening initiatives, and the Skjern River restoration—while incorporating economic valuation methodologies and governance frameworks to inform policy design.

Theoretical Framework: Valuing Natural Capital

Valuing ecosystem services requires a conceptual shift from viewing nature as a free input to recognizing it as a form of capital. Natural capital can be seen as an asset stock that yields a flow of valuable services over time [6]. Because these services often lack formal markets, environmental economics has developed a suite of non-market valuation techniques to estimate their economic worth. For instance, the value of recreational services can be inferred using the travel cost method, which uses visitor expenditures to derive a demand curve for a natural site. While the travel cost method captures use values, the valuation of non-use benefits, such as bequest value (the desire to leave resources for future generations), requires different techniques.

For non-use or existence values—the value people place on knowing a species or ecosystem exists—economists employ contingent valuation surveys to elicit willingness-to-pay [7]. The goal of these valuations is not to commodify nature, but to make its contribution to human welfare visible in economic terms.

These valuation exercises are important for designing effective policy instruments to correct market failures. Mechanisms like Payments for Ecosystem Services (PES) create markets where beneficiaries of a service, such as downstream water users, compensate the upstream land managers who provide it. This internalizes the externality by creating a direct financial incentive for conservation [8].

Furthermore, managing for a single ecosystem service often results in unintended trade-offs [9]. Therefore, a holistic approach that acknowledges the interconnections between services is useful for holistic landscape management [10]. The economic contribution of pollinators, for example, underscores the financial risks associated with ignoring ecological dependencies [11, 12].

Case Study Analysis: Valuing Ecosystems in Practice

Empirical evidence from diverse contexts demonstrates the tangible economic returns of investing in natural capital. The short cases analyzed below reveal how valuation can inform policy and lead to economically efficient outcomes.

Regulating Services: Urban Cooling and Public Health

Urban green infrastructure offers a potent nature-based solution to the urban heat island (UHI) effect. Large urban parks can reduce ambient air temperatures by 1–4 °C, mitigating heat-related health risks and lowering energy consumption for cooling [13, 14]. The economic value of these benefits can be partially captured through hedonic pricing models, which show that proximity to well-maintained green spaces measurably increases property values. This uplift in real estate prices reflects the public's willingness-to-pay for the aesthetic, recreational, and health benefits that these ecosystems provide [15].

Beyond climate regulation, intact ecosystems serve as a buffer against disease. A 2022 study confirmed that higher tree diversity in forests reduced tick abundance and infection rates with the bacteria causing Lyme disease [16]. This finding supports the "dilution effect" theory, where biodiversity provides a valuable, though often unpriced, public health service [17]. Furthermore, the value of intact ecosystems as a prophylactic measure against disease is framed as a potential cost-effective, preventative public health investment.

Cultural and Provisioning Services: Ecotourism and Ecological Restoration

The economic value of cultural ecosystem services can be seen in the global ecotourism market, projected to reach $761 billion by 2030 [18]. In the United States, recreational fishing alone contributed $138 billion in sales and supported over 692,000 jobs in 2022 [19].

The Skjern River Project, Denmark’s largest nature restoration project to date, was carried out from 1999 until the end of 2003. The Skjern River project exemplifies how restoring an ecosystem can diversify a local economy. Subsequently, the revival of the native salmon population created new revenue streams from angling tourism, providing a sustainable economic alternative to the intensive agriculture that had previously degraded the river. This project converted a negative environmental externality (nitrogen pollution) into a positive economic opportunity, The result of the cost-benefits analysis is sensitive to the choice of discount rate. At 3%, the Skjern River Project appears to be a good investment for society, with a net present value of nearly DKK 238 millions [21].

Beyond fishing, the restored river system now attract multiple birdwatchers, sport fishermen and nature tourists annually, reinvigorating local businesses such as lodges, restaurants, and guiding services. Natural capital improved significantly: floodplains now improve water quality and store carbon. Biodiversity metrics rose sharply, with over more bird species and numerous amphibians and invertebrates recolonizing the area. The project’s success illustrates how targeted investments in ecological infrastructure can enhance multiple ecosystem services, both recreational, provisioning, and regulatory, simultaneously.

Synthesis and Discussion

The short cases demonstrate that integrating ecosystem service valuation into decision-making is not only feasible but also economically prudent. They serve as useful, real-world illustrations of the natural capital framework in action.

The Catskill case represents a direct substitution of high-cost manufactured capital with self-regulating natural capital. This approach recognized the forest's capital stock as a productive asset that yields a flow of water purification services, delivering a higher return on investment than the engineered alternative. Similarly, urban greening shows how investing in distributed

stocks of natural capital—city parks and trees—generates a portfolio of service "dividends," including climate regulation, public health benefits, and direct financial returns through increased property values.

The Skjern River project, in contrast, is an example of restoring depleted natural capital. The river's initial channelization degraded the capital stock, causing the flow of valuable provisioning and regulating services to decline. The restoration initiative was a targeted investment to rebuild that capital. This intervention restored the ecosystem's functionality, which in turn revived the flow of cultural (recreation) and provisioning (fisheries) services, generating economic value for the local community. A primary barrier, however, remains the difficulty in valuing "hidden" or undiscovered services. This highlights the importance of preserving option value—the value of safeguarding resources for potential future use.

Another economic challenge is discounting, where future benefits are valued less than present ones. High discount rates can make long-term conservation projects appear economically unviable, creating a bias toward short-term exploitation over long-term sustainability.

Conclusion and Policy Recommendations

Ecosystems provide critical infrastructure for economic stability and human well-being. Treating them as externalities has led to systemic risk and the inefficient allocation of resources. This paper's review of the short cases results in key policy recommendations grounded in economic principles:

1. Integrate natural capital into national accounts to ensure macroeconomic indicators reflect environmental degradation.
2. Incentivize private investment through market-based instruments like PES schemes.
3. Strengthen stakeholder engagement to ensure efficient and equitable outcomes in land-use planning.
4. Prioritize green infrastructure in Urban Development to maximize returns on public investment through bundled ecosystem services.
5. While the travel cost method captures use values, the valuation of non-use benefits, such as bequest value (the desire to leave resources for future generations), requires different techniques.

Yet, to move from pilot projects to systemic change, institutional reform is essential. Ministries of finance, planning, and environment must jointly develop fiscal frameworks that reflect the depreciation or enhancement of natural capital stocks. Environmental valuation cannot remain the domain of specialists—it must be embedded into mainstream policy appraisal, budgeting, and infrastructure design.

Furthermore, trade-offs between ecosystem services need to be explicitly evaluated. Restoration projects that increase water retention may reduce available farmland, while afforestation can affect open-habitat biodiversity. Navigating these tensions requires participatory planning, adaptive governance, and long-term monitoring.

Ultimately, mobilizing public and private capital at scale is not only about conservation but also about safeguarding the productive base of our economies. Treating nature as an asset, rather than a constraint, reframes the policy challenge as one of strategic investment.

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