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R SHEET ON WATER MARKETS

March 2018

BACKGROUND

In the coming decades, water scarcity will be a major challenge for the western United States. However, the current restriction of water only to “beneficial uses” exacerbates the problem. However, water markets can do much to help cope with these challenges.

Markets promote frugality. When water is scarce, users must reduce waste, make do with less and find substitutes. The price of water serves as a signal to users about its scarcity. However, when water prices are kept artificially low—as is often the case—people act as if it is plentiful and are less likely to conserve. By contrast, higher prices create incentives for individuals and businesses to find more efficient ways to meet their water needs.

The ability to sell “saved” water also provides a substantial incentive to use water more efficiently. When every unused gallon represents a potential profit opportunity, the incentive to find new ways to conserve water increases dramatically. Finally, water storage can be used as insurance to protect against extended dry periods.

CURRENT DEBATE

In the western United States, a form of “prior appropriation” system is used to determine water rights, at least for surface water. Water rights give their owner the ability to use a set amount of water each year, from a particular place and for a particular use, and are based on historical use. States maintain a list of recognized “beneficial uses” of water, and each water right must be designated for one of those beneficial uses. When there is not enough water for all rights holders (e.g. in times of drought), older or “senior” rights are given priority over newer, “junior” ones.

While the prior appropriation system does allow water rights to be traded, many states impose unnecessary restrictions that make efficient trading difficult, if not impossible. These mean that significant quantities of this precious commodity are not available for their most valuable use. Market reforms aimed at increasing efficiency could free up large amounts of water and would help alleviate the growing stresses on its availability

SUMMARY

- Water markets are an important tool to deal with scarcity and can encourage conservation.
- Currently, costly and time-consuming approval processes for water transfers keep water from going to its best uses.
- Some states impose a “use-it-or-lose-it” doctrine on water rights holders that discourages conservation.
- Water storage is a commonsense way to make up for shortages during drought.

ACTION ITEMS

Eliminate change-of-use restrictions

Currently, water rights holders may still face a daunting regulatory approval process even when they simply want to change between one beneficial use and another. Some states impose outright prohibitions on certain types of water-use changes.

However, changes within a beneficial use category are unlikely to harm other rights holders and can actually make water availability better for junior ones without requiring regulatory pre-approval. Specific bans on transferring water from one beneficial use to another should therefore be eliminated.

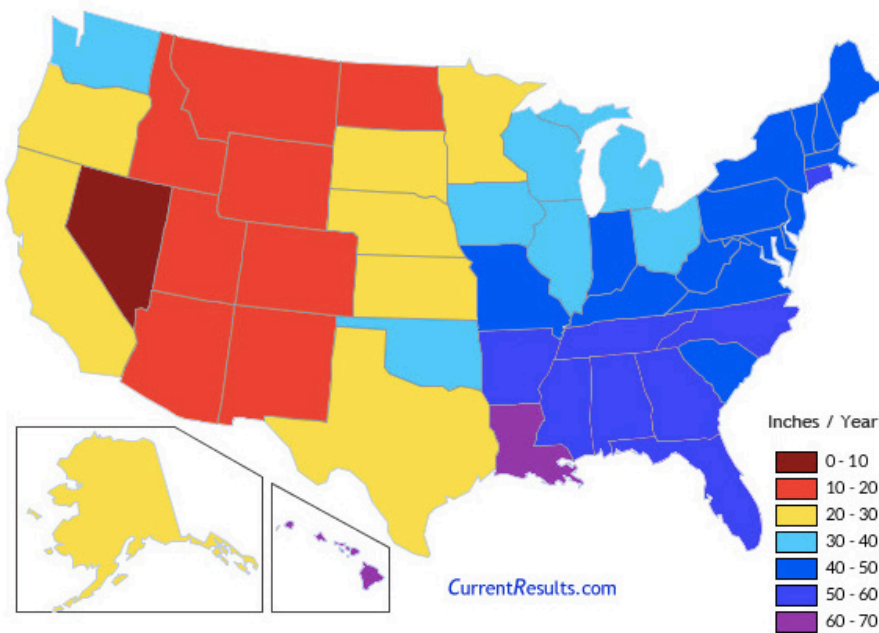
Recognize storage as a “beneficial use” of water

Over the coming decades, parts of the western United States may experience more drought because of sporadic rainfall. Longer periods of drought may be punctuated by periods of heavier-than-usual precipitation. Water storage will be a crucial tool in adapting to this change. However, many states do not currently recognize storage as a “beneficial use” and thus formally recognizing it as such would allow for greater planning and flexibility.

End “use-it-or-lose-it” for water

Many states currently incorporate a “use-it-or-lose-it” doctrine into their water rights. Under this system, a water right

ANNUAL STATE PRECIPITATION AVERAGES



SOURCE: CurrentResults.com

owner who does not use all of their water will forfeit the unused amount. The unintended result of this policy is that individuals who use water more efficiently cannot benefit financially and instead may be punished for doing so. The “use-it-or-lose-it” doctrine undermines water conservation and should therefore be abandoned.

Eliminate amorphous third-party considerations

Before a water transfer can be approved, most states require regulators to determine if the transfer would harm other rights holders or impose environmental harms. While these requirements can be legitimate, many states impose additional, amorphous requirements for approval. A state may require, for example, that a transfer be in the “local public interest” or that it consider “projected economic impacts” on the broader community. In practice, these mandates can add significantly to the cost of a transfer without any apparent benefit. These vague and subjective requirements should be removed from the approval process.

Create or expand an expedited approval process

California and Oregon both have expedited processes for short-term leases (as opposed to permanent transfers), but California has only approved 34 such transfers while Oregon has approved nearly 2000. The difference is that California’s “expedited” process is still as extensive as the regular one in other states. In order for these expedited processes to be useful, they must be made to work quickly in reality—not just on paper.

Use water banks to facilitate water transfers

A transaction clearinghouse or “water bank” can help overcome informational problems in a historically limited market by matching buyers and sellers, setting prices and performing other administrative or technical services. A water bank can be particularly useful in cases where a buyer seeks water from multiple sellers.

CONTACT US

For more information on this subject, contact the R Street Institute, 1212 New York Ave. NW, Suite 900, Washington, DC 20005, feedback@rstreet.org.

For a more detailed discussion of each of the listed reforms and state-by-state comparisons, see Josiah Neeley, “Water Markets as a Response to Climate Change,” R Street Policy Study No. 131, February 2018. Available to read and download here: http://bit.ly/rstreet_watermarkets.



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