



NOVEMBER 2015

Water markets would alleviate shortages

BY ARTHUR B. LAFFER

We've all read the daily stories highlighting the drought's impact on California's economy and environment. Wells have run dry, forcing some Central Valley communities to shower in church parking lots. Farmers are fallowing land. In many areas of the state, over-pumping groundwater is causing the ground to sink.

California faces a serious, long-term water crisis. But the policies being pursued in Sacramento only focus on the short-term. Does anyone really think that Californians can permanently change water-use patterns by fining businesses, farmers and residents who use too much water?

There's no panacea to California's water problem. But there are some commonsense first steps that must be taken to alleviate this vexing challenge that impacts families, businesses, farmers and the environment. One such step is the creation of a statewide water market.

In 2012, I co-authored a book, "*Eureka!: How to Fix California*," where I argued that a robust water market would ensure better distribution of scarce resources in times of drought. I also contended that the price of water was (and is) too low. I added that politicians and bureaucrats must get out of the water rate-setting business because their involvement helps to create a system that skews the market, promotes inefficiency and waste and benefits some special interests at the expense of the public.

In a statewide water market, prices would adjust to balance increasing demand with unpredictable supply. The market would allow parties in one part of the state needing water to purchase it from sellers in another area. Higher water prices would encourage conservation by making waste or inefficient use of water more expensive. The higher cost of water would also attract private investment, incentivizing groups to bring new water-saving technologies to market.

A true water market would mean that everyone – farmers, government agencies and individuals – would face the same incentives to conserve water. In order for the benefits of a market to be realized, however, we need

California faces a serious, long-term water crisis. But the policies being pursued in Sacramento only focus on the short-term.

to make public information on water use and availability and create a real market where willing sellers and buyers know the true market price of water. Such transparency would promote rational decision making and conservation.

In 1978, Gov. Jerry Brown's Commission on Water Rights released a report that evaluated existing Water Rights Law and suggested four topics that require modernization – one of which was “efficiency in water use.” The report stated, “The market approach to water use efficiency is distinguishable from the regulatory approach in that the market approach stresses incentives for efficient water use while the regulatory approach restricts conduct inconsistent with efficient use.” Later, the report adds, “A property rights system in water which permits voluntary transfers encourages the shift in resources from lower-value uses to higher-value uses.”

Today, 36 years after Gov. Brown's commission discussed the impact that a market approach would have on the efficient movement of water from lower-value to higher-value uses, a statewide water market still does not exist.

The reasons why California doesn't have a statewide water market are complex and multi-faceted, but the fact that a deeply entrenched status quo benefits from the current system cannot be ignored.

California's current method of water distribution is a complex system of storage and conveyance governed by an arcane system of water rights. Created in the mid-1800s, the water rights system functions on a first-come, first-served allotment premise that rewards those who can claim water first – a farmer, a municipality or a business. This system may have worked when California had 5 or 10 million people, but certainly not for a state rapidly approaching 40 million and grappling with the impacts of changing climate, industries and ecosystems.

Concerns about the impacts on disadvantaged communities and the environment shouldn't hinder water transfers. Both could benefit from a properly structured market. Commonsense provisions to ensure that communities with challenging economic situations would not go without water could easily be put in place. Current and future water set-asides for the environment should remain priorities, as well.

In spite of the drought and the havoc it has caused, California remains a land of opportunity. Reforming the existing water system won't be easy. But the Golden State's 21st-century economy shouldn't be constrained by a 19th-century water allocation system. California can be golden again, and creating a statewide water market is an important first step to help California regain its luster.

Having experienced decade after decade of consistent water shortages in California, can we really afford to wait any longer to implement a water market?

Arthur B. Laffer is head of the Laffer Center at Pacific Research Institute. He is the co-author of “Eureka!: How to Fix California!” (Pacific Research Institute, 2012).