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Do We Need  
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Markets?  
YES, BUT...

## Do We Need Water Markets? YES, BUT...

Do we need water markets? When I mentioned the topic of this session to a resource economist from another state recently, he responded, "Why are you talking about that subject now? You already have active water markets in New Mexico." And, indeed, he is right. Sales of water rights occur quite frequently in most basins in our state. Some states, California and Arizona most prominently, have instead experienced major public debate and even turmoil in the last decade or two associated with the creation of water markets that had not previously existed, and with their operation when they do. In quiet contrast, water markets in New Mexico seemingly have evolved without effort and certainly without much public debate until recently. To those economists who are evangelic proponents for water markets, New Mexico is even frequently cited when they are asked to name a place where water markets work well. Why, then, if we already have working water markets, are we finally discussing this topic here in New Mexico?

At one level of meaning, of course, the answer to this last question is simple. While we do have active markets **for water rights** in New Mexico, we don't truly have markets **for water itself**, and the water banking proposals before us focus on sales of

"wet water." While the sale of a water right conveys legal title to use water from a stream or groundwater basin, that right does not necessarily produce "wet water" as the colloquial phrase "paper water" aptly connotes. It is the capacity to move "wet water" that is the target of the current legislation. But there is also a second, possibly heretical, level of meaning at which the topical question for this session can be interpreted. Should we be buying and selling water in the marketplace *in any form*? I suspect that at least some of the current resistance to water banking is associated with basic misgivings or even outright hostility to the notion of marketing water as a commodity in any fashion whatsoever. The quiet evolution of markets for water rights has obscured this underlying distrust of the marketplace's treatment of water purely as a commodity like any other and may have lulled some of us into the presumption that water itself could also be as readily bought and sold as are water rights.

I submit that New Mexicans are not of one mind about the pros and cons of markets for either water or water rights. For many, the monetization of water is a comfortable concept which is readily assimilated, while for some others it is even so unpalatable as to be sacrilegious from religious, cultural or naturalistic perspectives. And, even many of those who willingly accept water as essentially just another commodity are still alarmed at what existing markets for water rights are doing to the pattern of water use in our state as rights

move from irrigated agriculture to municipal ownership and from rural regions to urban areas. New Mexico has never explicitly adopted a clear public policy about the desirable institutional role for water markets in our state or even truly had a vigorous public debate on the subject. Although this underlying disagreement has surfaced intermittently in administrative hearings by the state engineer, occasionally in the courts, and indirectly in the legislature under the rubric of "public welfare," none of these venues have adequately grappled with the subject from a policy perspective. In fact, I think it is fair to say that we have been avoiding that debate.

While I personally endorse the general concept of water banking and believe that productive discussion on specific bills to enable it is important, I believe that a more valuable and fundamental dialogue about markets and the public welfare needs to focus on the water reallocation process in our state and the institutional role of markets in accomplishing that reallocation. My comments, then, address this more basic form of our question rather than the proposed water banking legislation specifically.

As an economist who has studied the emergence of water markets in the western U.S. for many years, I have developed a qualified answer to our question which is "YES, BUT..." Although I dislike qualified answers, I also generally subscribe to the view of the late Steve Reynolds who said, and I paraphrase, "For every complex question, there is a simple answer... and it is wrong." Let me briefly step back from the particular debate of the current day and share with you a few of the reasons underlying the positive cast to my answer along with the qualifications that I place upon it. Let's begin with the YES portion of my answer, that is, the positive functions and features of markets. I will only highlight two of those functions, though there are others we could easily come up with if we worked on it.

YES. The most obvious function provided by water markets is their *capacity to accommodate change*. In a simpler society, as a wise man once said, "If one neighbor needed more water and a second neighbor could get by with less, the two could go sit under an apple tree and work out a mutually agreeable solution." Water markets were unnecessary. In today's complex society and economy, we

should still strive for more neighborliness in our approach to water issues. But, practically speaking, water markets allow the development of specialists (realtors, lawyers, hydrologists, appraisers and others) who have detailed knowledge to which one individual cannot generally aspire.

Water markets also *establish an explicit price reflecting the relative scarcity of water*. For example, this first figure is the historical pattern of prices for water rights reported by Phil Soice for the Middle Rio Grande region while the second figure is a similar pattern of prices for the Santa Fe region, also reported by Phil. Note the differences over time and across regions. It is this variation in the price of water rights, or for water itself, that provides an important signal that water is becoming relatively more scarce over time and among basins as the economic demand for water grows at different rates and the available supply differs among basins. This price signal encourages conservation on the demand side and the offer of new water on the supply side. Parenthetically, I would note that the prices paid for water rights in New Mexico are generally not a part of the public record as are virtually all other dimensions of a water rights transfer, including its quantum, its ownership, the place and use *from* which it is being transferred and the place and use *to* which it is being transferred.

In my opinion, these two functions of water markets alone justify their institutional existence and provide the principal reasons that I believe they are a valuable social tool when they work well. Certainly, as with all human institutions, they are never perfect, have flaws and usually can stand significant improvement. Across the West in particular, there are differences from basin to basin and state to state as to how well individual marketplaces for water and water rights fulfil these two functions. For reasons of time, I won't go into specific examples of market failures or imperfections. But, to my point of view, market flaws are reasons for improving the marketplace through such devices as water banks rather than limiting the applicability of water markets.

BUT. To move to the qualifications in my YES, BUT answer, in my view, we must look instead to competing values rather than imperfections in the marketplace, and here I speak more as a New Mexican than as an economist. Markets are one of the principal engines of economic growth and

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Figure 1. Middle Rio Grande Basin Water Right Purchase Prices. Reprinted by Permission of V. Phillip Soice, President, Southwest Water Consultants, Inc., Santa Fe, NM

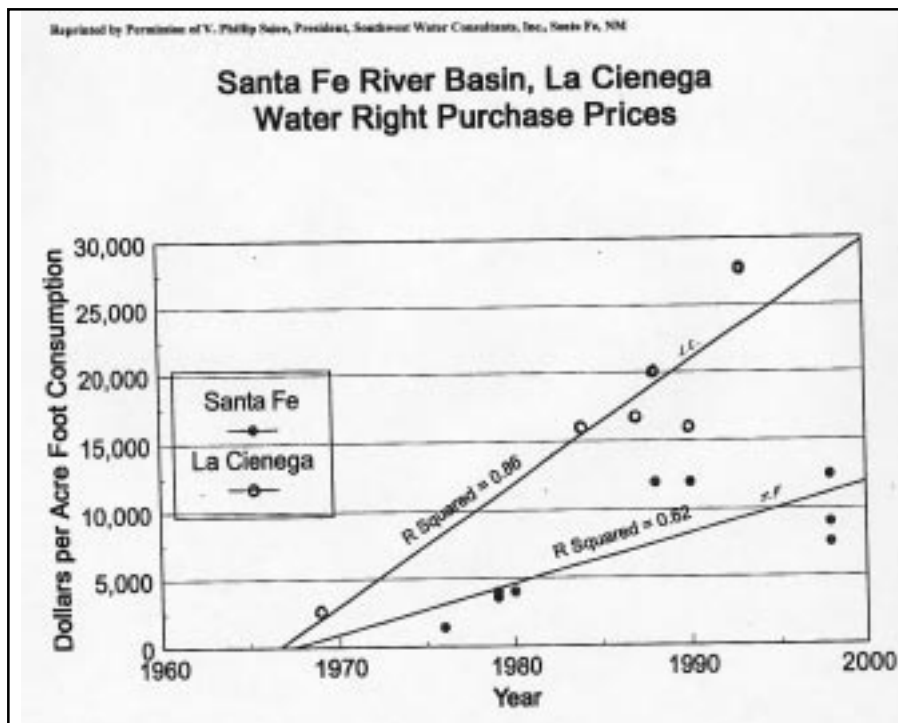


Figure 2. Santa Fe River Basin, La Cienega Water Right Purchase Prices. Reprinted by Permission of V. Phillip Soice, President, Southwest Water Consultants, Inc., Santa Fe, NM

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improvement. By moving water from uses which have lower economic value to those which have higher economic value, markets increase the material well-being of society and send us price signals at the same time. But material improvement is but one social goal among many. There are other essential values in life besides material improvement whether they be found in the market defying sweep of Central Park in the heart of New York City, the family ties poignantly captured in the movie "Straight Story," the beauty of a Puccini aria or the compassion of a Mother Teresa. Even MasterCard recognizes that reality if you've been watching their current advertising campaign.

Markets have limited utility in the face of such competing values and can even destroy such values through greed and excessive competition. Just as the Constitution uses checks and balances to prevent too much concentration of power in one branch of government, so too must society use alternative institutions to check and balance the role of the marketplace. The institutions of education, religion, culture, family, neighborhood, community, place and government, to name a few, have each lined up at one time or another in successful opposition to the force of the marketplace and will do so again. I don't share the lament of some that the power of the marketplace in water affairs is overwhelming and inevitable. California and Arizona would not have had such great difficulty creating markets for water if they were inevitable.

The marketplace is only dominant to the extent that we collectively wish and allow it to be so. Markets are in the ascendancy now globally precisely because collectively we have chosen to accept its consequences due to our current preoccupation with material improvement. If we want to create alternative outcomes to what the market would create, we can do it. Perhaps, we are painfully beginning to do just that at the World Trade Organization conference in Seattle. Time will tell. The task of defining and implementing non-market outcomes may not be easy, but why should it be? As I have said, markets are engines of economic growth and relinquishing any degree of economic improvement in the short-run, or even long-run if necessary, should not be done without careful consideration.

So, how does this discussion bear upon water institutions in New Mexico? To the extent we want

water to be used to accommodate change and improve our material well being, I have already indicated that I believe markets are a fundamentally necessary institution in helping us reach that goal. To the extent that we wish to balance and check material goals, other institutional vehicles are available to us whether they be water trusts, county zoning and regulation, implementable public welfare criteria or even more fundamental shifts in our collective valuation of water outcomes. Determination of when, where and how we draw lines between market facilitated outcomes and non-market preservation or enhancement of other goals is not an easy task. And, it is compounded by the fact that interstate markets for water are now upon us and will likely become stronger. By dictum of the U.S. Supreme Court, we can only limit **interstate** water transactions to the extent we apply the same limitations **intrastate** in the interest of public welfare and the conservation of water. And, public policy in New Mexico, locally and statewide, remains ill-defined with respect to the location of these lines of demarcation between market determined and non-market determined outcomes.

YES, I think we need water markets, BUT I also think we need a much broader vision of New Mexico's future and numerous other institutions to help realize that vision. I hope we will begin to accelerate the public discussion about how to merge the various institutions that govern our water affairs so that we can more effectively move ahead of the curve of events and shape those events rather than simply responding to them as they arise. It is past time to do so.