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ISSUES AND TRENDS
IN WESTERN WATER MARKETING.

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1988

ISSUES AND TRENDS IN WESTERN WATER MARKETING

Steven J. Shupe*

The transfer of water entitlements is playing an increasingly significant role in meeting water demand projections in the western United States. Expanding municipalities, private developers, recreationalists, speculators, and other interests have been purchasing water rights in areas where new sources of developed water are scarce and expensive. This article looks at issues and trends emerging in the field of water marketing in the West. It is compiled from excerpts from the "1987 Year in Review" issue of the Water Market Update, a monthly newsletter tracking the business activities, legal developments, and public interest aspects of water transfers and use.

Water transactions in 1987 showed the breadth and complexity of activities that fall under the general term, "water marketing". Most significant is that water marketing in 1987 represented the movement of far more paper than water--most purchasers are buying water rights for future use rather than obtaining actual water to meet today's needs. This reflects the fact that western water markets are generally being driven by the perception of future demands rather than by immediate water shortages: e.g., Albuquerque is holding out a standing offer to buy senior water rights that it will not need to use until after

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the year 2025 [February p.1]**; a number of Colorado Front Range cities are purchasing irrigation shares to supply anticipated growth in the next century [November p. 2-4]; Arizona developers are identifying 100-year supplies in order to meet requirements of current state laws.

The prospective nature of water rights purchases makes the future character and prices associated with water marketing uncertain. 1987 saw some cities already trying to unload surplus water entitlements they previously bought as a result of overly optimistic growth projections. [July p.1] Also, 1987 prices in several active trading areas fell significantly below past prices which had been inflated in anticipation of growing demands. For example, water rights prices in northeastern Colorado currently stand at \$1,000 per acre foot (af), down from a high in 1981 of about \$3,000/af. [April p. 11] Phoenix area groundwater rights also showed a price decline in 1987, while irrigation district shares that had been bought a few years ago in central Utah for more than \$1,000/share are now trading for less than one-fourth of this amount. [September p.2]

These examples of price declines do not indicate that water marketing is slowing down, only that the forces driving water reallocation are complex and sometimes unpredictable. This complexity is also reflected in the fact that marketing water in

** Each month and page citation refers to the specific reports in the 1987 Volume 1 of WATER MARKET UPDATE where additional information on this topic was reported. For copies of back issues, write Water Market Update, PO Box 2430, Santa Fe, NM 87501. (505) 983-9637.

the West and elsewhere is not simply the buying and selling of water entitlements. Water marketing can involve the financing of on-farm conservation measures in order to salvage water for additional use. [October p.2] It can mean innovative water banking in which surplus surface waters are stored underground during wet years for future exchange during droughts. [March p.3] Water marketing may involve a dry year option in which farmers agree to defer irrigating during droughts in return for monetary payments from thirsty cities. [June p.8] It can mean selling excess reservoir storage space or releasing dammed water to maintain downstream recreation and water quality. [September p.9] Water marketing can incorporate water rate structures to promote household conservation [September p.6], and it can involve creative financing to purchase municipal supplies [December p.12]. Additional water marketing concepts are expected to arise from across the nation as water quantity and quality problems become increasingly acute.

Major Controversies

Many of the various forms of water marketing during the past year carried a strong measure of controversy. Local communities worried about their tax and economic bases. Downstream users grew concerned over losing return flows. Recreational interests became worried about how transfers will affect the flow regime. People in other areas grew concerned about precedents set by proposals that could eventually have an impact in their regions.

Marketing proposals often created internal divisions within interest groups and communities as well. For example, some environmental advocates in 1987 promoted water marketing as a way of reducing the need for new dams, while others expressed concern that widespread marketing will eventually result in the public having to pay to protect free-flowing waters. Also, water marketing pitted neighbor against neighbor in rural communities when some farmers decided to cash in on municipal offers to purchase senior irrigation rights, to the potential detriment of the remaining farmers.

1987 saw many of these controversies, as well additional conflicts, come into play in various transactions and transfer proposals. Three issues of particular importance rose to the surface during the past year:

1. The effect of water right transfers on rural communities.
2. Off-reservation leasing of Indian waters.
3. The appropriate role of federal and state governments in water marketing.

ISSUE 1: RURAL EFFECTS OF WATER TRANSFERS

In 1987, controversies arose in several states over the potential effect of water right transfers on rural areas. Concerns were expressed in farming communities in the Arkansas River basin of southeastern Colorado [February p.9], in the Warm Springs Valley north of Reno [June p.10], and in western Arizona

[July p.10] regarding specific municipal water rights purchases. Fears over the long term effects of water marketing on rural areas also were reported in parts of California and New Mexico. [October p.10, November p.12] Although the concerns are varied, common ones expressed include erosion of the local tax base, insufficient water for remaining irrigators, land use effects of dried up acreage, the impact on farm-related businesses, and a general loss of the cultural integrity of rural communities.

Rural advocates undertook to reduce the effect of water transfers in 1987 through a number of strategies. One approach was to go to court to protect the interests not only of the remaining water users but of the general rural community. In southeastern Colorado, this approach resulted in a settlement in which the purchasing city agreed to leave specified amounts of water in the river for local irrigators and agreed to pay for the revegetation of the acreage from which it had transferred water rights. [February p.9] A similar adjudicatory strategy was pursued by northern New Mexicans who objected to neighbors selling their water rights to a proposed resort development. The district court judge struck down the proposed water transfer based upon its potential effect on other water users as well as on the general public welfare. [January p.9]

Another strategy that was explored in 1987 for protecting rural areas involves buying water rights by a local entity to prevent purchase by customers outside the region. The Kern County Water Agency in central California held hearings on this

idea, proposing to impose a "zone of benefit" tax on property within the county in order to fund the purchase of water rights that might otherwise be transferred away from the county. [October p.10] In New Mexico, the concept of Water Trusts was explored as a way for community members to band together to purchase water rights for continued use within the area. [November p.12]

Area-of-origin legislation was another strategy pursued in several states by rural advocates during the past year as a means of mitigating the effects of water transfers. Although the efforts were not always successful (e.g., failure of a transfer moratorium bill in Arizona and a transfer tax bill in Colorado), some measure of benefit was achieved. For instance, the Arizona legislature enacted HB-2462 this past summer that deems municipally-held water ranches in rural counties "taxable property" for the purposes of calculating a county's revenue share and levy limit. [May p.4]

As the new year gets underway, rural communities are assessing the strategies asserted in 1987 and other ways of protecting themselves from the potential effects of water transfers. In many communities, there is a reluctant acceptance that rural political strength may be insufficient to stop water marketing altogether. But through coordinated efforts among the rural areas, dialogue with purchasing municipalities, and planning rural advocates are hopeful that they can ensure that water transfers destroy neither the economic viability nor the

cultural heritage of their communities.

ISSUE 2: INDIAN WATER LEASING

1987 was a critical year regarding the issue of Indian water leasing. Two major Indian water rights settlement bills reached Congress, each with provisions allowing for the off-reservation leasing of tribal waters in order for the tribes to raise money for economic development. One involved the settlement of the water claims of the five mission bands who are members of the San Luis Rey Indian Water Authority north of San Diego [May p.7], while the other implemented the Colorado Ute Indian Water Settlement. [August p.7] Initially, it appeared that the bills might pass with the leasing provisions intact since the local non-Indian interests had approved the concept and the federal government was favorably inclined towards tribal water marketing [March p.7]. As the months passed, however, off-reservation leasing of Indian waters met with increasing resistance from the western states. (For background on Indian water leasing and Congressional approval, see January p.6.)

Although the issues are complex, the basic positions expressed in 1987 can be summarized as follows. A number of Indian tribes view water leasing as a potential short term means of raising capital for establishing long term economic activities on reservations. The federal government sees water marketing as a promising way for Indian tribes to obtain economic development funds without tapping heavily into the federal treasury. Many

western states fear that tribal water marketing unfairly shifts the federal financial responsibility owed to Indian tribes onto states and local water users. They also fear that if a precedent is set allowing for tribal water marketing, numerous western tribes will request payments from non-Indians who have historically used water to which the tribes are legally entitled--or worse yet, begin reallocating that water to the highest bidder.

Many representatives of federal, tribal, and state interests are attempting to break through suspicions and fears in order to negotiate water leasing agreements that are satisfactory to all. During the closing months of 1987, amendments to the leasing provisions of the San Luis Rey Indian Water Settlement Act were reached that should enable final passage of the act. [December p.7] In Arizona, Phoenix and other local water interests agreed to a negotiated settlement regarding water rights of the Salt River Pima-Maricopa Indian Community that included a 99-year lease to Phoenix of tribal water entitlements. [December p.6] Also in late 1987, the Assiniboine and Sioux Tribes of the Fort Peck Indian Reservation initiated a study of water leasing options that can be undertaken jointly with the state of Montana in accordance with the compact they reached in 1985.

Where these proposals go in the future depends upon a number of factors and attitudes found in Washington D.C. as well as in the West. As 1988 unfolds, it is uncertain whether off-reservation leasing will play an important role in regional

water markets or if the whole concept will die in Congress. One point remains clear, however. Regardless of the outcome of the off-reservation leasing controversy, Indian water rights will continue to assert a powerful influence in the future of western water resources.

ISSUE 3: THE ROLE OF GOVERNMENT

Throughout 1987, the concept of water marketing was discussed by federal officials, state legislators, and other parties interested in defining the proper role of government in emerging water markets. Some argued that government should take a passive role and allow the market to function freely without intervention. Others lobbied for laws and policies that either promoted private marketing (such as reducing transaction costs) or put constraints on transfers (e.g., area-of-origin protection bills). Some legislators even considered ways in which the state could become an active player itself in water marketing.

Many people expected the U.S. Department of the Interior to take a clear stance in 1987 on water marketing and transfers. A number of critical marketing questions face Interior because of the extensive irrigation water it supplies through the Bureau of Reclamation projects. [January p.5] A particularly crucial issue is who should benefit from the increased revenues generated when federally supplied water is transferred from irrigation to municipal use.

No clear answers were provided by the Department of the Interior during 1987 regarding this and other water marketing questions. On October 1, however, Interior announced the proposed restructuring of the Bureau of Reclamation and the shifting of its focus from construction to comprehensive management. [November p.8] In reports released concurrently with the announcement, Interior came out cautiously in favor of water marketing and directed the bureau to establish policies and procedures, particularly relating to the marketing of conserved waters.

State officials also grappled with trying to define the role of water marketing in their jurisdictions. The Western Governors Association, following extensive staff input, came out in July with a Management Directive that was relatively neutral regarding the role of water marketing in state water policy. [August p.11] It did, however, encourage the Department of the Interior to promote voluntary transfers of federally supplied water.

Individual state legislatures also addressed water marketing issues. Whereas legislation to inhibit water marketing generally failed, a number of bills passed that promote water transfers. For example, Oregon enacted a bill that allows irrigators to sell water salvaged through conservation techniques. [June p.4] California legislators voted to facilitate water transfers in the Imperial and Coachella valleys of southern California by removing the potential of liability from entities that reduce return flows to the Salton Sea. [October p.4] A number of state legislators,

including those in New Mexico, Nebraska, and Wyoming, began assessing how the state could become directly involved in water acquisitions and sales. [April p.5, July p.5, November p.4]

A Preview of 1988

1988 promises to be an important year in water marketing and transfers. New proposals, major deals, policy decisions, and other events will take place during the year that will help shape the future of water reallocation. Although no predictions are certain, the following list reflects areas where important decisions and actions are likely to occur in 1988.

- * The Senate Committee on Energy and Natural Resources where crucial debates and votes will influence the course of off-reservation leasing of Indian waters.
- * The Arizona legislature where private developers, municipalities, and rural lobbyists will vie for and against legislative packages in order to further their respective positions in controlling Arizona's water future.
- * The San Francisco Bay-Sacramento Delta region where water quality hearings, Bureau of Reclamation marketing plans, and state legislation in 1988 will help determine the future extent of water exports to a thirsty Southern California.
- * The Colorado River basin where one or more private entrepreneurs, Indian tribes, and upper basin

states will fight the entrenched "Law of the River" to promote interjurisdictional marketing of water entitlements to lower basin customers.

- * The Board room of the Central Utah Water Conservancy District as it cuts a final deal for purchasing more than 100,00 af of water rights in the Salt Lake City area.
- * El Paso, Texas, which may consider innovative water transfer and exchange proposals following the New Mexico state engineer ruling on the city's interstate groundwater applications.
- * The headquarters of the U.S. Department of the Interior in which policy decisions need to be made regarding the role of federally-supplied waters and federal facilities in western water markets.
- * Oklahoma, where water marketing pressures will quickly build if the state supreme court affirms its ruling that undermines existing water transfers to non-riparian lands.
- * Western Nevada where cooperative water transfer and exchange arrangements will be pursued by various entities to overcome water disputes and to prevent future water supply crises.