

Draft Discussion Paper: Facilitate Efficient Water Markets and Water Right Transfers with a New Regulatory Structure

NOTE: This paper was created only for the purposes of generating discussion to inform potential legislative recommendations. None of the topics described are proposed or endorsed by Ecology.

Summary

We have heard from some stakeholders that improving and facilitating water market activity could help address concerns over speculation, monopoly power, and transferring water rights out-of-basin. Additionally, enhancing water markets could help reallocate water to those who need it and to higher economic value uses. After looking at water markets in other states and countries, there are certain elements that could be adopted in our state to enhance water markets while addressing some of the concerns with our current system.

Governments involved in water markets typically seek to facilitate and regulate water markets with the goal of reducing barriers to trade, enhancing transparency, and protecting against the negative impacts of water trading. There are usually a number of government and quasi-government entities from the federal, state/territory, and local level that are involved in setting water trading rules, monitoring and reporting of water sales, and enforcing fair and competitive market practices. Generally, these water market systems offer a method for managing water that allows flexible reallocation of water supplies and for water to be purchase/allocated for environmental streamflows. However, there are concerns in some water markets over water availability during drought, high prices from foreign investment, and the need for additional regulation and enforcement of price reporting and manipulation.

Washington State could adapt some of the concepts from these water market structures to the existing water law in our state to help address negative effects from our current system. Some of these concepts that support markets for transferring water could be embedded with an oversight structure that has new/different regulatory responsibilities and capabilities. Specifically, these changes could include:

- Creating and operating a centralized trading platform for standardized reporting and efficient approval of water transfers.
- Transparency for the public through reporting and price discovery for water rights sales.
- Basin/region-specific standards to set water trading standards to reflect local hydrology and potential negative effects of concern, such as out-of-basin transfers and investment speculation.

These changes would require substantial modifications to Ecology's or other agencies' capacity and may involve other existing or new state-government entities to properly implement.

Background

Markets have emerged as a means of responding to increased water scarcity and facilitating improvements in the overall economic value of water allocation. To maximize the value of water supplies, markets have to operate competitively. Competitive markets require low barriers to entry, low transaction costs, symmetrical information, clear rules of exchange, enforceable property rights, and effective governance structures. In Washington State there are also concerns that existing water markets may result in negative externalities, such as out-of-basin transfers and investment speculation.

We have investigated other states and countries with elements of a water market system that could be adapted to our state. One prominent example of water markets being used widely for water management by the government is in Australia. The Australian government takes an active role in facilitating and overseeing these water markets with the goal of reducing barriers to trade, enhancing

transparency, and protecting against the negative impacts of water trading. To achieve these goals water markets are both encouraged and regulated in a number of ways by different levels of government. Ensuring these outcomes from water markets often takes a substantial effort from at least nine different federal, state/territory, and local government entities¹.

Even with robust regulatory oversight, water management in Australia has experienced problems. Recently, Australia has been experiencing a major drought that has caused water prices to increase. Foreign investors, who own over 10% of water entitlements in Australia, have also become a focus of irrigators who think that the open water market has allowed these investors to further drive up prices². Furthermore, the Australian Competition and Consumer Commissions has reviewed the function of their water markets and recommended changes needed for additional oversight, stricter rules, and tighter enforcement around price reporting and manipulation³.

Discussion

We have heard from some stakeholders that restricting water right transfers and use of the trust water rights program (TWRP) will have negative tradeoffs and won't adequately address speculation. Instead, it has been suggested that the state should actively support water markets that can provide greater benefits than the potential negative tradeoffs of speculation. Washington State could adapt some concepts from water market structures in other states and countries to the existing water law in our state to address these concerns.

We have identified three major concepts that could be adapted to promote and oversee water markets in Washington State that could help address speculation while providing greater benefits from water markets. These concepts include operating a centralized trading platform, increasing transparency and oversight of water right sales/transfers, and establishing basin-wide or regionally connected plans that set specific standards for water right trading. These measures could facilitate reducing barriers to trade, enhancing transparency, and protecting against the negative impacts of water trading in Washington State.

The first concept that could be adapted to Washington State is the creation and operation of a centralized trading platform. Having a common place for buyers and sellers of water rights to connect could help reduce barriers to trading and transferring of water rights. A key function of the Australian water market system is that it allows users to easily trade/transfer annual water allocations, analogous to short-term leases, in Washington's current system. A centralized trading platform could efficiently provide the necessary information to quickly review short-term leases and other water right transfers. It could also utilize a mechanism, such as the TWRP, to reduce the fear of relinquishment for water users who don't need/aren't using their full water right allotment. Promoting water markets in this way can help reallocate water on a short-term basis from users that are not planning to use their water to those who need more. It can also compensate those with lower value economic uses of water when they transfer their water to higher value uses, increasing overall economic value and tax revenue. This platform could also be used to buy water rights for environmental purposes to enhance streamflows.

Another concept that could be adapted to Washington State is enhancing transparency for the public through price reporting and discovery of water transactions. This could include a standard method to

¹ <https://www.mdba.gov.au/water-management/managing-water/water-markets-trade?msclkid=1ba42a79a96c11ecb4be052002b88840>.

² <https://www.abc.net.au/news/rural/2019-03-25/foreign-owned-water-entitlement-register-reveals-key-countries/10923384?msclkid=f1074deea0d11ec892302d0cb016b80>.

³ https://www.accc.gov.au/system/files/Murray-Darling%20Basin%20-%20water%20markets%20inquiry%20-%20Final%20report_0.pdf.

report water market prices and make them transparent to the public. Transparency in prices reduces the transaction cost of determining a fair price to trade/transfer water, helping more willing buyers and sellers to trade/transfer water. It also creates a more competitive water market and could address the potential for price gouging that can accompany water right investment speculation. A government entity or third party could also be contracted to help with price discovery by actively researching and updating current water right sales activity and making it available to the public. This concept works well with a centralized trading platform, which offers a standard method to report and track water market prices and transactions.

A third function of this new water market regulatory structure could include developing basin-specific or regional (for hydrologically connected water systems) standards for water right transfers and trades. These standards could address the locations, amounts, use types, and prices allowed for water right transfers. Input from Tribes, local governments, and stakeholders could be used to develop these standards to account for location-specific hydrology, water supply and demand profiles, and other concerns. This could include establishing standards to account for the negative effects of out-of-basin transfers and investment speculation by private entities. In this way, the potential negative externalities of water right transfers, out-of-basin transfers, and speculation could be limited while allowing greater flexibility for water reallocation.