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8:45 A.M. PDT.**

### Panel Remarks

- I. I'm very pleased to be part of this conference on "Water and Economic Growth."
  - A. From its inception, the Bay Area Economic Forum has focused on water policy and its role in economic growth.
  - B. As everyone here knows, water policy has been one of the toughest, most contentious subjects in the state.
    1. And I think one of the main contributions we at the Forum have been able to make is to help change the nature of that debate.
  - C. The Forum's focus on water policy and growth is very natural, of course.
    1. For one thing, it's obvious that California couldn't have grown to be the seventh largest economy in the world and home to over 30 million people without its intricate water supply systems.
    2. For another, it's obvious that those systems have been under tremendous strain—
      - a. —enough strain to have led users to lose confidence in the reliability of the system.
  - D. But debates about how to reform these systems often weren't very fruitful.
    1. We heard lots of talk about adding to long-run supply by building new, but very costly, facilities.
    2. We heard about reallocating existing supplies merely by taking water from some users and giving it to others.

3. And we also saw people get more and more entrenched in their positions:
    - a. economic interests against environmental concerns,
    - b. agricultural users against nonagricultural users,
    - c. and the old Northern California-Southern California split.
- II. This is the context in which the Forum undertook one of its first projects, "Using Water Better"—a study and proposal for reforming California water policy.
- A. The main thrust was that the system *itself* virtually guaranteed an inflexible and inefficient allocation of water.
    1. To address these problems, the Forum proposed a *market-based* approach to water allocation.
  - B. We pointed out that, in principle, this approach would be fairly straightforward to implement—
    1. —but, in practice, it would require changes that were not only fundamental, but in some cases, politically difficult.
    2. One such change is defining water rights to include clear ownership and freedom to sell the water.
  - C. With the market-based approach, we not only gain flexibility and efficiency, but also better reliability, both in the short run and the long run.
    1. In the short run, it's the users, rather than administrative fiats, who determine where the water is most productive.
      - a. In most cases this would involve a small fraction of the overall supply being transferred voluntarily from agricultural to non-agricultural users.
    2. In the longer run, water prices themselves will provide the economic incentives and rationale for adding to overall storage capacity and transportation infrastructure.
  - D. Now, a market-based approach doesn't mean that *everything* is decided in the market. On the contrary, there are important dimensions where

regulation will play a significant role.

1. One area is setting environmental quality standards and ensuring that sufficient water is reserved to meet them.
2. Another is setting rates for storage and conveyance, since these involve the use of public facilities.
3. A third is guarding against overpumping of ground water, which in most instances is a communal good.

III. I'm encouraged that this type of a framework has gained more acceptance, and I believe it has changed the dynamics of the discussion.

A. It has helped break the gridlock on reforming water policy by defusing tensions, especially among environmental, industrial, and urban interests.

B. This allowed a coalition to develop that was important in successfully convincing President Bush to sign the Central Valley Improvement Act in October 1992.

1. The Act made a number of changes, including increasing water allotments for environmental purposes.
2. But the key provision marked a fundamental shift in the direction toward market-based systems:
  - a. This provision allowed individual water users to sell their water to willing buyers in other parts of the state.
  - b. The Act puts many restrictions on these sales, but allowing trading to occur will help make the system more flexible and efficient.

C. The first transfer using the provisions of the Act took place last July:

1. The buyer was the Metropolitan Water District,
2. and the seller was a San Joaquin dairy farmer who, as a state assemblyman, had opposed the Act.

D. The economists among us were especially encouraged, because the characteristics of the deal were just as we had expected.

1. The farmer sold only a portion of his water allotment and will continue to operate his dairy.
  - a. And the sale price of the water was higher than the farmer originally paid, but much less than any other sources available to the Metropolitan Water District.
2. In other words, it was a win-win situation--just the sort of outcome we'd expect from voluntary trading.
  - a. The bad news is that the transfer took almost two years to complete.
    - (1) To be effective in helping short-run swings in water supply, future deals must move more swiftly.

IV. It's also encouraging to see that water policy reform has gained some momentum.

- A. Last summer, the Forum and others sent letters to President Clinton and Governor Wilson urging the creation of standards for the Bay-Delta.
  1. The continued lack of standards, we argued, was creating uncertainty and jeopardizing the state's economy.
    - a. Fundamentally, it was delaying the development of a water market.
- B. The *L.A. Times* commented that the letter writers formed an "unusual" alliance in that we combined representatives from both ends of the state who historically have been at odds over water policy issues.
- C. But, at least in part because of the prodding of this "unusual" alliance, the Clinton and Wilson administrations reached a compromise last December that established standards for the next three years.
- D. In fact, I think that, within the framework for reform to ensure reliability of water, the coalition isn't at all unusual.
  1. Rather, it was the old split along north-south lines that now seems irrational and counterproductive.
  2. The new coalition seems much more natural since it combines parties who share similar interests, not just similar zip codes--

3. --interests in ensuring that water allocations are efficient and flexible.

V. California has only just begun to take these necessary reform steps.

A. But I'm optimistic that we've changed the nature of the debate in a way that will make future steps more rational and effective.

B. I hope those steps will move us towards a more market-based system and the important advantages to be gained from it—

1. —not only greater confidence for all water users that there'll be a reliable source of water in the future,
2. but also a better way to deal with a crucial part of our state's and region's economic growth.

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