

What California needs is a “spec” groundwater market, not fake-markets

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Imagine a market for housing or land where no one is selling because the real estate market is at a standstill due to a deep and protracted economic recession. This situation of a lack of sellers for about two years has repeated itself after every housing boom in California. Unless there is a tier of speculators in the market who are always ready, willing and able to sell at some price, there is a very thin housing market or none at all in many locations. The same predicament occurs with wholesale water in California during droughts, which are normal and occur four out of every five years on average. Few, if any, farmers or cities want to sell water at all during drought.

Nonetheless, economist Matthew Fienup of Cal Lutheran College proclaims that the first so-called groundwater “market” has been established in the agricultural groundwater basin of the Oxnard Plain in Ventura County (“How California Got Its First Groundwater Market, Water Deeply, June 27, 2017). This so-called water market would only work if a farmer has a surplus of water and can trade it, once again, a situation unlikely to occur in a “drought”.

The Ventura groundwater market comes in response to Gov. Jerry Brown’s mandate for the adoption of “sustainable groundwater management plans” to 515 groundwater basins in California by June 30, 2017, even though California experienced a “snow drought”, not groundwater drought, from mid 2012 to mid 2016. The Sustainable Groundwater Management Act allows markets to be used to allocate water within a groundwater basin. This is a “cap and trade” program

that puts a cap on the amount of water that can be traded but only within the water basin (intra-basin trades).

This new groundwater market won't do much to alleviate water shortages due to curtailing inter-regional (inter-basin) water allocations during drought from the State Water Project or federal Central Valley Project. So groundwater markets are a beggar-thy-neighbor policy where a farmer or city has to beg neighbors to sell them water. It is a musical chairs market where someone doesn't get water when the music stops. The first phase of the Ventura market includes only farm irrigators but plans are to eventually include cities.

Previous attempts at water markets have not been successful in alleviating inter-regional water shortages. The state of California went into the water market business from 1991 to 1992. But this did not lessen the structural water deficiency of from 1.6 million acre-feet of water in wet years and 5.1 million acre feet in compounded dry years noted as far back as 2001 by Norris Hundley in his book "The Great Thirst: Californians and Water" (enough water for 3.2 to 10.2 million households or 533,000 to 1.7 million acres of cropland).

An inter-basin water market using home computers was tried in the agricultural Westlands Water District but predictably failed due to nonuse in 2007, coincidentally when a judicial drought occurred due to court ordered curtailments of farm water deliveries to protect fish.

A major logjam for a speculative water market in California is the state Water Code, which provides that sellers must be "rights holders" and the water they sell must be "wet", not "paper water". Moreover, water not used for over five years can be lost under the "use it or lose it" doctrine in the Code.

And water bought and banked in a reservoir by a farmer can be spilled to the sea if the reservoir is filled in a wet year. But in the recent 2016-17 wet water year about 70 percent of all system water still flowed to the sea. Diverting only about 1 percent of that escaped water on a compounded basis that could be purchased by a speculative tier of the water market might be enough to make a difference in critical dry years. Structural water deficiencies can only be made up right now by resorting to statewide water conservation and water policing measures.

Another major impediment to a speculative water market is its perceived legitimacy given the stigmatization of speculators as hoarders, arbitrageurs and profiteers of water that otherwise is considered a “public good” and not a commodity. But Golf courses in Palm Springs are seen as illegitimate even if they use recycled water but curtailing lawn watering that depletes urban water basins is seen as sustainable and justified. In California, it is legitimately perceived water that “runs uphill towards money”.

Protecting farmers from high water prices in peak dry years compared to low prices during peak wet years is not price gouging. Ironically, many of those who demonize farmers as accepting crop and water subsidies also feel the same farmers need protected from speculative water prices with anti-speculation laws and policies.

Australia already has a working water futures market but it is also only based on selling any surplus water available after government water allocations although it also allows trading for paper gains.

The Shanghai Gold Exchange could serve as a model for a speculative California water market because it only delivers actual physical gold, not debt contracts to game the system for investment purposes such as the New York and London gold markets. It is ironic that a Communist regime runs a better market model for a speculative water market than a literal army of academics and think tanks proposing to construct water markets in California.

The New York Stock Exchange designates nominated advisors, called Nomads, to ensure firms are legitimate before giving their stamp of approval to be listed on the exchange. This process could similarly legitimize a speculative water market (the horror: speculators selling water for the Delta Smelt fish or to an urban water replenishment district spreading ground in a wet year).

Presently, California has over-committed the amount of allocated water that can be delivered partly because of the volatility of water flows in wet/dry years and court-ordered diversions of water for fish. Government, or an Initial Public Offering of speculators, would have to buy out water rights and contracts to create a speculative water market. Or maybe a farmer will eventually buy enough land with water rights to create his own "spec" water market, which is what savvy water rights investor [John Vidovich](#) may eventually pull off in the Central Valley.

Current water trading in California is a bureaucratic process that can take up to two years. By then a drought could be over. Bernard Baruch said speculators are those who observe the future and act before it occurs. California continues to run deficits in its state budget, pension funds, road and school funds, water infrastructure (Oroville) and its water allocations.

A speculative market could plug the shortfall in water. But don't look for such a needed market to emerge as long as the intellectual and political classes stigmatize it as illegitimate for their own career and party gain.

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