

# There is no putting the Genie back in the bottle: Why water trade needs improvement, not abandonment

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Water trade in Australia's Murray-Darling Basin quickly became the pin-up poster for enthusiasts of environmental markets in the 1980s and 1990s. But the successes of water markets didn't just happen by accident. Rather, hard-working legislators and bureaucrats at state and national levels partnered with some of the brightest resource economists of the time to take advantage of the [wider interest in improving national competitiveness](#). Ultimately, this has generated one of the most active water markets in the world with short and long-term trade between 2012 and 2019 estimated to be worth more than [\\$12 billion collectively](#).

Water markets have accurately been credited with radically assisting water users to adjust to a variable climate and redistribute risks, especially in agriculture. But the [recent review of water markets by the ACCC](#) also highlights that markets are only as good as the governance structures that circumscribe them. This has led some to argue that water markets should be [abandoned altogether](#) and [water should be re-attached to land](#), as was the case prior to the 1980s/90s.

But why throw out the baby with the tradable water?

Water is a complex product to market, but complexity has never been a reason to rule out the use of markets. After all, governments can hardly claim to have a monopoly on managing complexity or being blessed with the foresight to consistently pick winners. Also, there is ample evidence that the [environmental degradation](#) that is being witnessed in streams in the Murray-Darling is a direct result of government's allocation and enforcement policies, not the water market. Nonetheless, the current water market is far from perfect and more can be done.

Thirty years ago, when water trade was formally sanctioned a decision was made to only crudely account for third-party effects when water rights move between owners. This was premised on the idea that keeping [transaction costs](#) reasonably low (i.e. reducing the costs of just using the market) would stimulate more trades and thus more gains from trade. Provided water conveyance losses were approximately calculated and as long as the buyer and seller were hydraulically connected then a trade could occur. That approach has basically worked to create a vibrant market, but it has also meant that the hydrological impacts of shifting water rights in time and space are not always accurately measured. This becomes more important as climates become drier and competition for water intensifies.

In the initial phases of trade, one manifestation of downplaying third party impacts was the activation of dormant or inactive water rights, called [sleeper and dozer rights](#). Without trade, those rights were basically underpinning other flows because they were never called upon; dams spilled to create an

environmental flow because the water entitlements were not being drawn down by the owners. Not surprisingly, as owners of sleeper and dozer rights sold their rights to others who then used them, dams spilled less often.

In later phases of trade, irrigation farmers began to be more judicious about their water use on farms, recognizing that water they did not 'waste' could then be sold. The fact that some of the 'wasted' water was in fact spilling downstream to others was not measured, so when a trade occurred there was no guarantee that others were not harmed. This phenomenon has worsened since governments started subsidizing irrigation infrastructure to make farms 'leak less', while [miscalculating return flows](#).

Nonetheless, the current crude measurement is not a deal breaker. [Technology does exist](#) to remotely measure return flows and improve on the accuracy with which any third party impacts are estimated. What is needed is the political will to support more accurate measurement of the stock, flow and use of water and progressively build this information back into the market architecture.

An additional set of challenges to water markets has arisen because of the different conceptualizations of various 'traders' in the markets. In particular, there is enthusiasm in some quarters for portraying water [trading by non-farmers as a perverse form of profit taking](#). Such traders are also routinely blamed for [higher water prices](#).

There are two elements to this rhetoric that warrant attention. First, there is the long-standing argument that city and town dwellers are innately [wasteful](#) and exploitative users of water and urban utilities should thus be barred from accessing water from irrigators and driving up prices. This approach is often accompanied by supplementary concerns about national [food security](#), should water be diverted from agriculture. Second, there is an equally emotive argument that speculators (usually portrayed as city dwellers or international interests) simply buy water rights to then resell at a later date and thus [needlessly profit at the expense of farmers](#).

In practice neither of these arguments withstand even cursory scrutiny. Most cities in Australia have [reduced their per capita water consumption](#) over time and the volume required to supplement city growth are [miniscule in comparison to agricultural use](#). The value of water generated in cities also far outweighs what it could produce in agriculture, especially when we have a surplus of food production and the nation faces an obesity crisis (not malnutrition). In the case of 'speculators', having diverse interests involved in the water market generates more liquidity and this has benefited all sellers, including farmers. There is also no simple dichotomy between speculators and farmers, even if the former were to be demonized. How do we distinguish between a farmer who chooses not to grow a crop in a dry year, instead opting to sell water at a high price, against others who are selling at the same price? And is a retired farmer to be banned from selling her water allocation?

Unfortunately, what these types of arguments disguise is a well-known flaw in the market that needs urgent attention. Currently, water markets and water marketing are relatively opaque sciences, [especially given the dollar values involved](#). [Efforts to make market information more transparent](#) have been too slow in coming and this gives some market participants an unearned edge over others. It also means that many water buyers and sellers are obliged to use brokers whose behavior is not subject to oversight. Again, these are not deal breakers and do not justify a return to the past and tying water to land but they do deserve the attention of government now.

With respect to the role of intermediaries, like water brokers, there should be some degree of licensing and accreditation in place. [There's a good reason](#) why few industries remain in Australia where intermediaries are given responsibility for managing others' assets without some formal accreditation or oversight required. However, unlike the broader financial services market, the water market is probably not sufficient in size to warrant a FASEA-style intervention; rather, state-based registration and licensing should be feasible and desirable, at least for now.

States also have a role to play in improving market information. Often there is a proclivity to assume that [national intervention is required](#) in water to bring better outcomes, but this approach has exposed serious gaps in the knowledge of water affairs in Canberra. Intimate knowledge about water and its management resides at the level of the states and this is not about to change.

There is also no simple decoupling of water management and water markets. State bureaucrats know as much about markets and governance as do Federal agencies and have no less sense of public duty than their national counterparts. Rather than seeking to overlay national 'expertise' to improve market transparency, a more desirable approach would be for national agencies to monitor and report the achievements of states and attach this to credible incentives. This approach worked well in the [early phases of water reform](#) in Australia but has shifted to a 'Canberra knows best' ethos. This has resulted in the advancement of national political interests rather than water management and water marketing expertise.