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Emerging Markets in Water: A Comparative Institutional Analysis of the Central Valley and Colorado-Big Thompson Projects

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Description / Abstract

Water trading is a potential means to improve the productivity of developed water supplies and reconcile competing uses. Economic theory suggests that markets evolve in response to changes in supply and demand. This prediction is at odds with observed disparities in the pace of market development in regions facing similar pressures on scarce water resources. A dramatic example of this disparity is found in the regions served by the California Central Valley Project and the Colorado-Big Thompson Project. This article argues that the differences in market activity in the two areas can be explained largely by the underlying water allocation institutions. The article identifies key institutional features that affect the transaction costs of water trading and examines the roots of the institutional differences. The institutions governing market transactions today are largely a function of pre-existing property rights and political battles to build consensus and obtain federal financing for the projects. The article highlights the path-dependent nature of water allocation institutions and trading, but also suggests that complex inter-regional markets could still develop in California given ever-increasing competition for scarce water resources and advances in information technology that lower market transaction costs.

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