

Water Institutions and the Law of One Price

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Abstract

We examine the economics of the water rights and markets in the US West. This is the region of North America where water supplies are most limited in face of rapidly growing demands. The striking feature of water markets is how unlike those for other commodities they appear. In particular, the law-of-one price does not hold. Other agricultural commodities, for instance, empirically do not have systematic price differences that persist over time. This is not the case for water. In water markets, municipal and industrial users typically pay much more than do agricultural agents to acquire and use water. We examine the role of historical property institutions in explaining limited water trading and the lack of the appearance of the law of one price. We explore the efficiency losses of limited trades and the options for adjusting existing rights arrangements.