

Formal Water Markets: Why, When, and How to Introduce Tradable Water Rights

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Abstract

In most countries the state owns the water resources and the hydraulic infrastructure, and public officials decide who gets the water, how it is to be used, and how much will be charged for it. But costly inefficiencies in the supply and use of water support a shift from government provision to a market-based approach that is more effective and less wasteful.

Markets can allow rapid changes in allocation in response to changing demands for water and can stimulate investment and employment as investors are assured of access to secure supplies of water. Because of water's unique characteristics, such markets do not work everywhere; nor do they resolve all water-related issues. By designing appropriate water laws and regulations and by strengthening private and public institutions to administer them, formal water markets can effectively address rising demands for groundwater and for water found in rivers, lakes, and canals. Lessons from Chile's experience demonstrate that formal water markets can improve the economic efficiency of water use and stimulate investment.

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