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Honorable George Radanovich, Chairman

Hearing Regarding
Assessing the Impacts of the Central Valley Project Improvement Act

Testimony of

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Mr. Chairman and members of the subcommittee, thank you for the opportunity to appear before you today and provide Metropolitan's views regarding implementation of the Central Valley Project Improvement Act (CVPIA). My name is Timothy Quinn and I serve as Deputy General Manager for State Water Project Resources for the Metropolitan Water District of Southern California (Metropolitan). Mr. Chairman, you have asked me to address the water transfer provisions of CVPIA, Section 3405(a). I was active in the negotiations regarding these provisions in 1992 and have been actively engaged in developing voluntary water transfer agreements on behalf of Metropolitan for the past two decades.

Metropolitan has long been a strong advocate of voluntary water transfers as a means of better managing California's scarce water resources and meeting the dry-year water needs of Southern California. Prior to the passage of CVPIA – and even for some years after – there were relatively few opportunities to acquire water through voluntary water transfers. California had not developed a policy framework for this potentially powerful water management tool and, quite frankly, opposition to water transfers, especially to urban Southern California, was widespread.

For these reasons, Metropolitan strongly supported inclusion of provisions in CVPIA to promote the transfer of Central Valley Project (CVP) water from willing sellers to willing buyers. These provisions were incorporated in Section 3405(a) of the Act. Section 3405(a), for the first time, provided for the transfer of CVP water from willing CVP sellers to willing non-CVP buyers subject to certain conditions. These conditions included the following:

- Transfers involving more than 20 percent of a CVP contractor's water subject to long-term contract required approval by the CVP contractor;
- Transfers outside the CVP were subject to a right-of-first-refusal by entities within the CVP service area;
- Transfers were required to be structured in a manner that avoids adverse impacts on CVP operations, groundwater conditions in the CVP service area, and CVP contracting districts;
- Transfers were limited to conserved water – that is, reductions in consumptive use or water that would otherwise be irretrievably lost to beneficial use; and
- Transfers to non-CVP buyers were required to make additional payments to the Restoration Fund: Section 3405(a)(1)(B) required higher repayments to the federal treasury (with the funds going to the Restoration Fund) for water being transferred to non-CVP water users than if the water were used for CVP agriculture; Section 3407(d) required an additional restoration assessment on transfers of $25 per acre foot (AF) (in 1992 dollars).

Overall, the water transfer provisions of CVPIA provided the first comprehensive policy regarding water transfers in California. As such, these provisions represented a significant policy step at the time. However, ultimately, the water transfer provisions of CVPIA had little *practical* impact on water management. In fact, while Metropolitan has acquired considerable amounts of water through voluntary water transfers from non-CVP suppliers since the passage of CVPIA, we have never utilized the CVPIA water transfer provisions. From Metropolitan's perspective, there are two primary reasons for the absence of voluntary transfers of water from CVP sellers to non-CVP buyers.

The first reason is the inclusion of the assessments on water transfers noted above. At the time, there were credible policy arguments for these charges on voluntary transfers of CVP water outside the project. With respect to the Section 3405(a)(1)(B) charge, the policy rationale of the Congress was that it would allow the water to be transferred outside the project, but

not the subsidy provided by the federal taxpayer. If water was to be transferred outside the project, this provision essentially required the water to be repaid at full cost without any taxpayer subsidy. Similarly, the charge in Section 3407 (d) represented a policy desire to maximize funds available for environmental restoration.

Despite these policy rationales, these CVPIA provisions function in the market place as an excise tax on voluntary water transfers. They represent payments that must be made if water is used in a particular way (i.e., in a transfer), but not if the water remains in its original use. Like any tax on business transactions, these assessments discourage trade – indeed, in this case they were so high as to be prohibitive. The additional $25/AF restoration charge in Section 3407(d) by itself would likely have been large enough to substantially discourage water transfer activities under the Act. When combined with the additional charges of Section 3405(a)(1)(B), the end result is an excise tax equal to as much as 25 to 75 percent of the market price for water, which in the past decade for large-scale transactions has ranged from $50 to $125/AF.

The existence of these taxes on market activity by themselves does not explain the complete absence of any transfer of CVP water outside the project. The second primary reason for this outcome is that after passage of the CVPIA, other opportunities for acquiring water through voluntary transfers did open up. Prior to passage of the CVPIA, there were very few opportunities to acquire water through a voluntary market. At the time, given the paucity of available market opportunities elsewhere, Metropolitan reasoned that access to new potential sources of CVP transfer water – even if heavily taxed – was better than having no access whatever. However, following passage of CVPIA, Metropolitan was fortunate to develop mutually beneficial transactions with agricultural water districts in the Colorado River Basin and in the San Joaquin and Sacramento Valleys. None of these transactions involve CVP contract water and none are subject to the water transfer taxes contained in CVPIA.

It turns out that the water market in California functions like markets everywhere. And in a market context, the substantial assessments on voluntary water transfers in CVPIA simply render CVP contract water noncompetitive in the marketplace. Rather than consider transfers of CVP water, non-CVP buyers quite naturally have sought other sources of supply that are not so heavily taxed. Ironically, despite the passage of the water transfer provisions of CVPIA, CVP contract water remains isolated within the CVP service area and largely unaffected by market forces. While the goal of these provisions was in large part to raise additional funds for environmental restoration, this has, of course, not occurred. Not a single penny has been made available to the Restoration Fund under either Section 3405(a)(1)(B) or Section 3407(d).

Metropolitan continues to believe that greater reliance on market forces is good policy for California water management. Market incentives provide both environmentally sound alternative sources of supply to meet the dry year water needs of the state economy (both urban and agricultural) and they promote more efficient water use. While we supported the passage of CVPIA in 1992 with these assessments on water transfers, experience since then strongly suggests that significantly reducing or eliminating these taxes on water transfers would improve the management of this scarce resource in California. Accordingly, if the Congress should consider modifications to CVPIA in the future, Metropolitan would strongly encourage consideration of significant reductions in or elimination of the water transfer tax provisions of Sections 3405 (a)(1)(B) and 3407(d).

Mr. Chairman, this concludes my testimony and I would be happy to answer any questions the members of the Subcommittee may have.