



Replies by Mason Gaffney to Questions from Senator Len Jordan of Idaho Before Hearing of Joint Economic Committee of Congress

By Dr. Mason Gaffney

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REPLIES BY MASON GAFFNEY TO QUESTIONS FROM SENATOR LEN JORDAN OF
IDAHO BEFORE HEARING OF JOINT ECONOMIC COMMITTEE OF CONGRESS,
SEPTEMBER 23, 1969

1. Are you aware that water rights in the west are granted by the State and that the so-called "right" is a permit to use the water only so long as it is used beneficially?

The truth is more subtle than you suggest. The requirement of "beneficial use" is vague, and in practice is elastic. Practice varies between drowning rice with 15 acre feet per acre per year,, and saving orange groves that need 1 & 1/2 just to stay alive. Each to the law is a "beneficial" use.

It is commonly observed by crop specialists and extension agents that many farmers with superior water rights would be better off to use less water. That is worse than waste. Think what that means. They could release surplus water to service lands that are now dry, and also raise more crops on lands presently irrigated. Yet the law calls this sloshing on soggy ground a "beneficial" use just because something is growing on the land.

2. The Reclamation fund now receives \$185 million a year in revenues, reserved in the Treasury to help finance the Reclamation program. Since the annual revenues are far in excess of the cost of program features allocated to irrigation--the only interest-free aspect of the Reclamation program--then why is it an "outstanding outrage" that no interest is charged to such projects in the west where the fund originates?

I think you are saying that reclamation should be locally financed: Idaho pay for Idaho projects. Or perhaps it is a little broader: a new Confederate States of Inter-mountain America. That is all right if you are willing to let New York tax money be spent 100% in New York, and so on. That would mean an end to the Bureau of Reclamation as we know it today. Is that really what you want? The western attitude on this was framed around an idea that

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federal lands in western states really should be given to the states. The Reclamation Fund was a device toward this end. I used to believe there might be some sense in that, but later I thought about it. It makes no more sense than letting Kentucky have Fort Knox. National property is national property,, be it land or gold bullion.

If there were just 20 citizens in, say, Oregon, it would be clear as crystal that the nation had no obligation to cede its resources to the control of those who happened to get there first, or to own the private fee simple land in Oregon. When there are a million Oregonians, it is easier to get confused as more variables enter the picture, but the basic principle holds true.

Now you make a second point, that when there is a surplus in an earmarked fund then it should be invested without -interest. Any economist would then reply that the earmarking was folly.

But let me suggest an easy way out. If the U.S. Congress is really bound by past mistakes so that it cannot release funds that have been trapped in unproductive blind alleys, then hold the unspent surplus as long as you can. Invest it during the interim in mortgages to finance the housing the American people really need. Or invest it in anything that yields a high return--there are plenty of outlets today. Or just hold idle cash, if you want. That will not earn anything for the government, but at least it will avoid wasting real resources. In effect it will constitute a diffused loan to everyone who holds cash, extended through the medium of reduced inflation. Almost anything is better than wasting real resources.

Remember, we have left the era when economists would smile on any investment because it stirred up idle money and had alleged multiple benefits. That notion is as dead as the 4&1/2% mortgage. The economy is gasping for disposable capital. You cannot recover the frozen concrete of yesteryear, but you do not have to go on making the same mistakes year after year. Congress can and must find ways to marshal dispensable capital to meet the crisis of today.

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3. Multiple-purpose irrigation projects are authorized today, and recreation is one of the multiple-purposes for which Reclamation projects are built today. Nevertheless, you appear to assume, on page 20, that **these** alternative purposes are not taken into account. Would you please comment on this?

Yes, many multi-purpose projects include recreation among their benefits. If my statement gave the other impression, I thank you for clarifying it. I have enjoyed boating on some lovely little jewels of lakes behind **power** dams; and I am not one who regards such artificial recreations as inherently inferior to natural wilderness experience. It all gets down to cases. Which is worth more to more people?

Today there is a growing number of cases where the destruction - of the scenic natural canyon is a large cost relative to the other values involved. The Pelton Dam case, for example,, is one where the economic issue was pretty clearly one of the Izaak Walton League vs. the Portland General Electric. The Upper Colorado dams have exercised the Sierra Club as you know better than I; the growing membership of that club suggests the share of the population devoted to wilderness recreation will rise in the future. The AEC is catching the devil, as you know. Open space, environmental quality, ecology--these are all popular catchwords today. That is why I chose the example of "Canyon X". I do not object to including recreational benefits among project benefits. I would object to excluding them. My point here is that the destruction of natural recreational and amenity values should be included among costs. That includes the full cost of environmental deterioration. When we consider how sensitive people everywhere have

become to this issue, I probably understated it.

4. In an area that has annual precipitation of **only** a few inches of moisture a year--and that normally in the non-growing season--do you **regard** efforts to develop an assured water supply as "premature" or "preemptive"?

They could be, yes. It all comes down to cases. New York City tapped the Delaware River prematurely, in a humid area. San

Francisco grabbed the Tuolumne River about 50 years too soon, in a more arid climate. Los Angeles grabbed the Feather River--or thought it did--somewhat less prematurely. But you understand these premature preemptions were not necessarily so from the viewpoint of the actors involved. San Francisco was just greedy, but Los Angeles has to grab water prematurely because if they do not someone else will. They should have gotten more of the Colorado River or the Kern, or the Kings,, but these were spoken for. The problem is that the water is not priced, and so the licensees on these nearer rivers are under no pressure to release water needed by others. On the contrary, the more they use, the stronger their rights become.

5. Are you aware of the century-old western water laws based on the right to appropriate surplus streamflow? In view of this established legal doctrine, what is your advice to States in the semi-arid zone which are located on the headwaters of major river systems, where much of the streamflow originates? Is it to let all the water flow downstream, where it can be put to use only by downstream areas, thereby preempting future use by the watershed areas of origin?

Our subject here is Federal policy. But your question brings out the motives that our century-old western water law forces on all agencies below the Federal levels, namely, grab everything in sight before someone else does. Looters in riot areas are merely replaying on a small scale what the law advises water appropriators to do on a grand scale. I do not condemn the individual actors in this mob scene; I do not praise them, either. Greed is human, but not admirable. Enlightened public policy takes account of human greed; but leadership rises above it. What we need now is leadership to reconcile interstate rivalry on a much higher level than in the past.

My advice to the states is to act together and change the rules by which water is allocated among states. The guiding principle should be to maximize the joint net benefits over time; and to distribute the gains equitably. Economists have outlined the mechanics of such plans. When the idea catches fire, as it will, you will find a good start on the basic thinking already exists.

SUPPLEMENTARY QUESTIONS

2. Because of their complexity and importance, there are a number of assertions in your statement which I would like you to elaborate on:

At the bottom of page 1, you assert: "The use of zero-interest for all costs that ingenuity can allocate to 'irrigation' benefits of a project is an outstanding outrage. The use of zero rent on public sites and waters is equally outstanding." Could you develop this point for me using an example of what you mean?

Nearly every Federal project exemplifies the point. The projects serve to allocate public resources to a limited number of private beneficiaries, below cost. The public's perception that something of value has been given away is low, even when the something is easy to understand, like construction cost. It is lower yet when the thing is less tangible, like an interest subsidy. It is lowest of all when the thing involves no cash outlay of any kinds and no visible price tag. That is the way with public waters and sites. I have never seen them entered as cost items in project studies, even though they are the basic input.

The matter is glossed over partly by the longstanding and continuing confusion over who "owns" raw water. The welter of conflicting claims and self-serving assertions and indecisive judicial equivocation is a mare's nest that lets everyone indulge his conceits. The conceit favored by local landowners is that they "own" water within striking distance, and should not pay to get it (even though they do not want to own a clear fee, for that would be locally taxable as real property). Their political clout, and the ignorance of socially minded groups, lets them get away with it.

There is also great unresolved confusion over state and federal claims. It is often unclear which sovereign would have the right to sell or rent water or damsite. This confusion aids those who aim to appropriate the resources to their private gain.

The paper develops the point by listing five social damages that result from giveaways:

- abatement of pressure to put resources to their best use

- creation of pressure to develop water prematurely, pre-emptively
- creation of a privileged class
- misallocation of water
- underpricing and waste of water

Let me mention some examples.

Most of California's water allocation from the Colorado River goes not to Los Angeles but through a Federal project to Imperial Valley where it is lavished extravagantly. Giving the Federal project the benefit of the doubt, grant it shows a benefit:cost ratio above one. Now let us add to its cost the cost premium that Los Angeles is planning to lay out to secure water from the costliest alternative source--say the Eel River, or desalinization. I.e.. let us make Imperial Valley pay for its water what the raw water is worth, and add that to the denominator of the benefit:cost ratio. Then the ratio falls far below one,, and the "favorable" project turns out to be submarginal.

The Kaweah River collects runoff from Sequoia National Park and waters certain lands in Tulare and Kings Counties, California. Terminus Dam, federally financed, now regulates the flow. The Kaweah exemplifies every diseconomy that flows from the giveaway of public resources free of charge. The waters are allocated in a clumsy, uneven, uneconomical way to which a few words can hardly do justice. I submit a close study of the Kaweah as an exhibit.

b, On page 2, you state that because of government policy of "giving away" damsites" (presumably to power companies) and **water** hogs, many capital investments are undertaken prematurely. Would you elaborate on the reasoning behind this assertion?

1, What are the costs to society of "premature development"? You state that our income tax law encourages this premature development. Could you describe this process, perhaps by using an example?

With rising population and exploding demands, waters once deemed remote or too variable look better all the time. This is a continuous process. Everyone today is familiar **with** it.

Everyone has learned too, that if you wait until you need the water, someone else will be in it. He won't have needed it yet either, but knowing how greedy others can be he will have exercised prudent precautionary foresight and sound judgement to protect his legitimate interests. The appropriation doctrine will not let you just hold raw water. You must develop it, however uneconomically. When the prospective future value has a present discounted value equal to or greater than your cost for some development, which the law will accept as preemptive, you lay out that cost, even though the water is submarginal for current use.

The cost to society is that scarce capital is invested unproductively. Housing is tight; buyers are paying 10% to finance houses; and we are freezing national capital into concrete yielding 3%, zero %, and negative returns. California has become the half-finished state, having started more universities than it can finish, more highways, more Feather River Projects, more new cities--yet people keep allocating capital to pay for new starts, not for productive use but to preempt water from their fellows.

Let me refer you to the appendix I am submitting on taxes. The basic idea here is that land does not depreciate, so the cost of buying land should not be depreciable,, much less expensable. The costs incurred to preempt premature water are essentially costs of land acquisition. The appropriative law and custom say, in effect, "Spend money to develop this water now and you may enjoy its future benefits just as though you owned it." But the private developer can expense current operating losses and depreciate capital costs. Thus he writes off costs of acquiring a water resource which does not depreciate. In fact it appreciates.

If a state or local government is the preemptive developer, its taxpayers deduct the necessary increased taxes from current taxable income, even including taxes used to build capital improvements. The benefits come in the form of enhanced land values, lightly taxed.

c. On page 6, you state that development of water facilities proceeds faster than development on the land can accommodate **the** water development hence wasting the water develop. "sterilizing", you go on to state that Federal tax law encourages this by making water conservation investments "expensible, -". Would you elaborate on the economic effects of **this** process?

Some detailed effects of unbalanced development have been - treated at length in the Kaweah River study which I am submitting as an appendix.

To elaborate on this' on a broad canvass could involve surveying 200 years of westward expansion in U.S. history. In 1836 the canals Cot -far ahead of private land settlement. Trunks tended to get ahead of - feeders. Marginal areas got ahead of central areas. Then **when** the whole grand fabric of a new society **was** just beginning to emerge, our great-great-grandfathers ran out of capital. They could neither continue the canals nor improve the land they tapped. They had started more than they could finish, and the system collapsed in a credit crisis. Their descendants did it again **with** railroads, in 1857, 1873, and 1893. Our fathers did it **with** roads and city streets and water works and utilities in 1929. We **are** pretty far down the same route in 1969. We are having to **slow** down and stretch out program after program. Over commitment is the word of the day. We do not have the capital to finish what **we** have already begun, and 1969 interest rates reflect the greatest capital shortage of the 20th century.

Mason Gaffney
October, 1969

There are several ways by which states can get together. Ideally, the way is through the Congress of the United States. Unfortunately, deliberations here have long been dominated by efforts to have Congress abandon residual Federal property rights. This has blinded everyone to the constructive role Federal power might play in helping maximize national benefits from interstate waters.

6. What is inherently uneconomical about building upstream storage works to store water that otherwise would waste to the sea in the snowmelt runoff and thus provide available water for use in water-short areas for all purposes in storage and distribution systems that will last for many generations?

Nothing. It is a question of when, where, how much, and so on. Please do not tag me as an enemy of water conservation. The whole process fascinates me, and my emotions are on the side of storing and playing with every drop. The point is, don't spend the last dollar to save the last nickel's worth of water.

7. Are you aware of the fact that Reclamation projects are individually authorized; that this program in the water-short west has a backlog of \$5 billion in authorized projects?

That is what I mean by overcommitment. This authorized backlog means that Congress has been promising things it cannot deliver. Spreading promises around thin leads to Spreading capital around thin, starting more than we can finish in a reasonable time.

8. Did you know that much of the so-called "waste water" from irrigation returns to the river system or to underground aquifers and is re-used by other water users?

That is basic, of course. Few uses are 100% consumptive. I surmise you are intimating that upstream users should get some credit or preference on this account, since their return flows are available below them. Sometimes that is right. In the Kaweah case,, upstream

reallocation was (and is) the overreaching need, and a side-benefit would be better use of return flows.

The law has always had a special slot for "non-consumptive"

uses. The law is 100 years behind the practical problems of today, alas. The corpus of water is not the only attribute of water that is involved. Power generation consumes elevation, control of timing, reservoir storage space, and so on. What we need is a much more sophisticated law that can tune in on what is relevant.

If you try to defend all waste on the basis of return flows and deep percolation, however, you cannot do it. The best initial use of virgin water is as likely to yield good return flows as the ones we have today. It is a matter of the individual case. Even the upstream use is not always better. If return flows are heavily salted or polluted, the use can be worse than 100% consumptive, it can ruin the water not withdrawn. Return flows and percolation from the Fresno Irrigation District ruined a great area beneath it by saturating it, and drainage problems are common below irrigated land.

9. You have mentioned that dear water from Federal projects would encourage economy not just of water but of land. Is it your idea to charge more for the water than the cost of the water projects, making farming prohibitive so that you could build hamburger stands in the desert instead of water supply systems?

It is a good idea to earn a profit or economic rent from developing desert water, yes. The cost of importing northern water to Los Angeles exceeds \$100 per acre foot. Water occurring naturally down there costing \$2 per acre foot to develop obviously can yield a high rent.

It is obvious to most economists that it should, as well, so it will not be wasted.

You suggest that farming cannot survive free competition for its water. Many economists have encouraged that idea. I think it is overdrawn. Sloppy farming cannot survive competition. It should not,

But it does not need to go on being *sloppy*. And there are millions of acres of farm land where water would be very productive if only it could be pried loose from the sloppy farmers.

This whole farm vs. city bit is a red herring. Plenty of cities are wasting water, San Francisco is a notorious water hog which has withheld a big share of the Tuolumne River from more productive agricultural alternatives for 60 years.

On the whole, the legitimate needs of cities are small relative to farm needs, and the farmers' fear that they cannot compete is exaggerated. Putting market prices on water would as its main effect promote much more efficient farm use of water.

The worst thing farmers could do to themselves would be to choke the growth of cities, which complement them.

10. Most people and particularly those of southern California recognize the economic contributions of the Boulder Canyon Project which ended a massive flood threat to the Imperial Valley, stabilized some of the world's best agricultural areas, provided power and municipal water which made possible the tremendous growth that has occurred in southern California during the past quarter century. Is this national asset an example of what you have referred to as one of the "tombstones of civilization"?

The economist does not say "If one project is bad, all are bad", or "If some is Good, then more is better". The point of economics is to break down decisions into components and dimensions and increments, to keep waste from hiding behind the skirts of productivity. So Boulder Canyon could be a Good project without its justifying others. But it is not above examination.

I will not try in a few words to evaluate this complex project. It has been some years since I studied it. I suggest, though, that you are describing it uncritically.

One of the things that interested Los Angeles in the Colorado River was the precarious standing of their claim on it. There are sources nearer, and totally intrastate, that would have supported the area's

growth. The Colorado **was** irresistable because Los Angeles saw a last chance to convert a precarious claim into a firm right, as against six other states and the Imperial Valley. As a result the project was probably premature, if nothing else. And now look at the colossal waste inspired as the other states claim Federal aid to tap the Colorado, each in its **own** costly way.

If there is so basic a fault in this jewel of Federal dams, what does that suggest of the others?

3-1. What has been your experience with water resource development in the west and reclamation and irrigation projects in general?

Several years of research, primarily,, and a number of published studies. I enjoy an unfair advantage over many others in the field in that I have no vested interest in the matter other than as citizen and member of a profession whose job it is to develop and apply criteria of the public interest.

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