

# REFLECTIONS ON WATER POLICY AND SCHOLARSHIP IN ECONOMICS

**Emery Castle**

Oregon State University Professor Emeritus

On July 1, 1954 I went to Oregon State University as an assistant professor in the Department of Agricultural Economics. My assignment was to teach farm management and production economics as well as develop a research program in water resources economics and policy. I soon was appointed by my department head to be a member of the regional Committee on the Economics of Water Resources Development. This committee was composed of economists from departments of agricultural economics in land grant institutions in the western states. It was my good fortune to associate on this Committee with S.V. Ciriacy-Wantrup, Maurice Kelso, Mark Regan, Roy Huffman, William Folz, and Stephen Smith.

The Committee on the Economics of Water Resources Development was made possible by a foundation grant to the Western Agricultural Economics Council, which consisted of agricultural economics department heads in the western states. The council created three committees in addition to the one concerned with water. The other committees were concerned with range resources, farm management, and marketing.

The Committee on the Economics of Water Resource Development did not confine its attention strictly either to economics or academic issues. Representatives from several academic disciplines other than economics participated – in particular, political science, engineering, and the law. Public policy issues pertaining to water were discussed in depth. Government agency people were invited to give papers and engage in these discussions. Many asked to attend on a regular basis. Some did so and commented that the committee activities were an excellent means of professional improvement. My service on this committee (approximately seven years) influenced my entire professional career. It helped me identify important problems which were used to develop my research program at Oregon State. As a result of the committee experience, I came to recognize the need for insights of disciplines in addition to economics. The experience helped me realize there were intellectual challenges uniquely associated with public service.

A case can be made that engineers and lawyers were the dominant professional workers concerned with early water

resource development in the west. Although it may not have been its intent, Congress gave economics an important role in water policy when it wrote the following words into the Flood Control Act of 1936: “If the benefits to whomsoever they may accrue are in excess of the estimated costs . . . ” (49 statute 1570, 33 U.S.C. Sec. 701a (1952)). Benefit-cost analysis was thereby given an important place in water policy and it was up to economists to develop the technique. Great strides were made in providing a conceptual framework for benefit-cost analysis from the end of World War II in 1945 to the end of the second Eisenhower administration in 1960.

My experience with the Committee on the Economics of Water Resources Development provided two focal points for all of my subsequent professional work on water. One was concerned with finding ways of valuing market and non-market water uses on a comparable basis. The motivation for this work was to discover ways to expand the scope of economic analysis. The other focal point involved a conscious effort on my part to be active throughout my career in some type of public policy work on resources and the environment at either the state or the federal level. At the state level, I served as a member of the Water Resources Board of Oregon and later on Oregon’s Environmental Quality Commission. At the federal level, there was active involvement with a significant number of federal government agencies concerned in one way or another with resources and the environment.

It was during the late 1950s that I became acquainted with Charles “Chuck” Warren, a fisheries biologist in the Department of Fisheries and Wildlife at Oregon State. He provided me with a wonderful education about many non-market uses of the water resources of Oregon, and encouraged me to study them from an economic perspective. He convinced me, long before it became common place in the economics literature, that it was possible for people to obtain satisfaction from knowing a resource existed even though they were unable to experience it directly. It was Charles Warren who encouraged me to attempt to place an economic value on the salmon-steel head sports fishery of Oregon, and he also helped me obtain one of the first grants made to an

economist by the Water Pollution Control Administration, a predecessor of the Environmental Protection Agency (EPA). The grant provided for a study of the economics of water quality in Yaquina Bay, Oregon. These early research efforts on the evaluation of the economic value of non-market water uses made it possible to attract several young economists to the study of water economics, including Herbert Stoevener, William Brown, Joe Stevens, and Adam Sokoloski. The estimation of market values for non-market water uses has developed far beyond anything we imagined possible at that time, and much of what we did then now seems naïve. Yet it was exciting to be among the first to make empirical estimates of market values for resources that were allocated and used outside regular markets. This research made me aware of the importance of the institutional context affecting both market and non-market uses, a neglected subject fundamental to treating market and non-market uses in a comparable way.

As noted, my motivation for studying the valuation of market and non-market water uses was to expand the scope of economic analysis. Benefit-cost analysis is a special case of economic analysis and does not encompass the whole of it, a distinction it is important to maintain. Benefit-cost analysis was invented to assist in the economic analysis of water projects and came to be required of all federal water investment projects. A positive benefit-cost ratio became a necessary condition for the funding of such projects. A requirement to calculate a benefit-cost ratio is now being considered for environment investments and regulations. The water experience demonstrated that a few otherwise worthy projects failed to qualify because they could not meet the benefit-cost test. Indeed, those familiar with field conditions in the water area know there were many highly questionable projects that passed the benefit-cost test as calculated by the operating agencies. The main purpose of the benefit-cost test was for it to serve as a winnowing device, but it did not serve that purpose well. A benefit-cost analysis of a possible investment or regulation requires numerous economic judgments about a wide range of factors, and when done competently, is never a routine exercise. The water experience suggests that a blanket benefit-cost requirement may not improve the decision process unless the administration of such a requirement is taken very seriously. If it is taken seriously, the transaction costs associated with its mandated use may be quite high.

Even though there are many practical problems associated with a mandatory benefit-cost test, research which expands the scope of economic analysis is useful. It is important, however, to keep the presuppositions

underlying such work in the open. The prices resulting from existing markets typically are the standards by which non-market goods and services are judged. Yet market prices are a function of the institutional and situational context in which the markets operate. Particular market prices may not provide an appropriate standard of comparison for a wide range of reasons in particular circumstances. This is coming to be recognized in some of the recent literature on benefit-cost analysis which places an increased emphasis on discovering the economic value of preferences, rather than using market prices for this purpose (Randall). So far as I know, the computational requirements of doing this have not been investigated. Computational requirements will be of great importance if benefit-cost analysis is made mandatory.

Involvement in public policy work at both the state and federal level has been the second focus stemming from my service on the regional water committee. This involvement has made my research more relevant and my work in the classroom more realistic. It has also made me conscious of how hazardous it is in resource economics to apply general solutions to particular cases. The context in which particular policy problems and issues arise is almost always different than what is assumed when general issues are analyzed. Further, research of actual situations (particular, as contrasted to general situations) must deal with conditions that are unique to the situation being analyzed. A knowledge of the resource economics literature is exceedingly useful in policy work if applied skillfully, but my experience suggests mechanical and routine applications are to be avoided. It is mechanical and routine applications of the principal corpus of resource economics that has resulted in the criticism that resource economics policy research yields highly predictable conclusions. It is my experience that when the institutional and natural conditions surrounding conflict situations are provided for in economic analysis, the results are seldom predictable.

My public policy work has permitted me to contrast serving as an analyst at the state with that of serving at the federal level. A body of literature on this subject would be useful, but if such literature exists it has escaped my attention. Some differences are obvious and some are subtle. For example, states are often more innovative than the federal establishment, but this will not be the case when there are powerful political forces that support the status quo. Nevertheless, the more local the situation, usually the more circumscribed the options. Thus, the analyst at the national level may adopt the maximization of welfare for the nation as an objective and analyze problems accordingly. At the state level, federal regulations often must be accepted, and the best solution

may involve how to use any remaining flexibility constructively. The tools of analysis are usually the same but the context is very different. Water economics textbooks almost always assume a national point of view. I do not recommend otherwise, but the analyst at other than the federal level needs to make allowances for this.

My experience as a member of the Water Resources Board of Oregon as well as a member of Oregon's Commission on Environmental Quality is at variance with some writings concerning the value of public hearings in conflict resolution. When controversial issues arise in resource management, our democratic government generally provides all interested parties an opportunity to be heard. I have attended many late night sessions listening to a parade of witnesses present a range of pro and con arguments. An agency may delegate this responsibility to a hearing officer who then provides decisionmakers with a summary as well as a transcript of the testimony. In a democratic society there is political value in such a practice. The opportunity to be heard on any and all matters that affect one clearly is one of the advantages of living in a democratic society. Yet the substantive value of public hearings have been questioned by many, and the attitude exists within agencies, as well as in the academic profession, that testimony from public hearings is of little value except as a way of judging political pressures. My experience leads me to dissent vigorously. I cannot recall a single controversial case on which I had to make a decision, where the public hearings did not result in some important substantive matters being brought into the open, even though several government agencies had analyzed the situation and submitted reports. I have concluded it is very difficult, if not impossible, to find a ready substitute for grass roots involvement in such matters.

Are there general conclusions to be drawn from an experience that has spanned nearly a half century? If one had it to do over again, would a career in resource economics and policy be the path chosen? What were the principal rewards, as well as disadvantages, of the choice that was made and the accidents that occurred?

I am not certain that natural resource economics and policy would be chosen by me again as a major area of emphasis. There are many other subjects in which I have an interest, and I might choose one of them. Nevertheless, there were characteristics of my work, which begin with water, that I would very much want to duplicate if I were to come this way again. These would include the opportunity to work with people of great breadth and depth, such as Sigfreid Ciriacy-Wantrup, Charles Warren, and Gilbert White. It would include the opportunity to engage in, and benefit from, the insights to be found in the literature of disciplines other than the one chosen for major emphasis. And it would include the opportunity to spend an entire career with one foot in an intellectual discipline, and the other in the application of that discipline to practical problem solving. Provision would also need to be made for the excitement that comes from the making of decisions in administration and in public policy. Now that the matter has been put in this way, I do not know where else I could find an opportunity that would provide all the benefits that have come my way as a result of my involvement with water.

#### **AUTHOR**

**Emery Castle** - B.S. 1948 & MS 1950 Kansas State University; Ph.D. 1952 Iowa State University; economist 1952-54 Federal Reserve Bank of Kansas City; 1954-75 Oregon State University (professor, department head, dean of faculty, graduate dean); 1975-86 vice president, president, Resources for the Future; 1986-93 Oregon State University (chair, University Graduate faculty of Economics); 1993-present Oregon State University Professor Emeritus.

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## EARLY FEDERAL GUIDELINES FOR WATER RESOURCE EVALUATION

**Henry P. Caulfield, Jr.**

Emeritus Professor of Political Sciences  
Colorado State University

Federal guidelines for water resource project evaluation spring from the Flood Control Act of 1936 wherein the Congress of the United States (U.S.) directed that flood control projects should be undertaken “if the benefits to whomsoever they may accrue are in excess of the estimated costs, and if the lives and social security of people are otherwise adversely affected.” The application of this legislative provision has been far wider than to just flood control projects. Either by statute or by administrative order, the general purport of this provision has been made broadly applicable to all water resources projects of the Corps of Engineers, Bureau of Reclamation, and the Soil Conservation Service.

The seeming import of this provision was to orient policy toward economics. The normative theoretical branch of the discipline of economics that had been developed up to then and has been subsequently further developed, known as “welfare economics,” became the intellectual underpinning for this endeavor. Professor Pigou’s “Economics of Welfare,” first published in 1922, was the takeoff point in this general development of economic thought. The opportunity afforded by the Congress to apply this normative theory to the field of water and related land resource use and development was apparently welcomed by economists, and it has been substantially exploited by them within the federal government with outside support from academic economists.

The first interdepartmental product of this interest of economists in trying to implement the statute of 1936 was popularly known as the Green Book, a report of the Subcommittee on Benefits and Costs (B/C) of the Federal Inter-Agency River Basin Committee (FIARBC). Bearing the title “Proposed Practices for Economic Analysis of River Basin Projects,” this report embodying Pigouvian theory was published in 1950 (green was the color of the cover). With slight additions and changes, a revised edition was published in 1958.

The “Proposed Practices . . .” set forth “criteria and principles” of “general economic welfare” for “application

by agencies within the framework of their particular programs and responsibilities.” Thus goals or objectives other than “general economic welfare,” defined as economic efficiency from a “comprehensive public viewpoint,” were still recognized as relevant. For example, the proposed practices were intended to apply to economic analysis within the 160-acre rule in Reclamation Law to implement the “family farm” concept. This rule, it was understood, reflected an objective other than “general economic welfare” as defined.

The “Proposed Practices . . .,” moreover, called for identification of all beneficial or adverse effects of a project in both tangible (i.e., monetary) terms or intangible terms. An “intangible” beneficial effect of a flood control project, an effect which the Congress clearly had in mind when it established flood control as a national, largely nonreimbursable project purpose, is the saving of human life. However, because of the subsequent great weight that has been given by the Office of Management and Budget (formerly the Bureau of the Budget) and the Congress to a B/C ratio in terms of tangible values (e.g., savings in property damage) and to a ratio of 1.0/1 or greater as the basic criterion of authorization and funding of a water development project, all other goals were made secondary. For example, regional development per se (that is provision of settlement opportunities or improvement of underdeveloped areas, a major objective of the Congress in passage of the Reclamation Act of 1902 and the Tennessee Valley Authority (TVA) Act of 1933) was made secondary to the goal of national economic efficiency.

The Green Book (1950 or 1958) was never adopted by the Federal Inter-Agency River Basin Committee or its successor committees, due to continuing interagency disagreements largely over inclusion of “secondary benefits” in Reclamation project reports. However, the basic philosophy and many of the criteria and principles of the Green Book, explicitly or implicitly, were

embodied in Budget Circular A-47 issued by the U.S. Bureau of the Budget on December 31, 1952. Its most fundamental standards and procedures were these:

1. The most economical means of meeting needs in a region were to be set forth as an important consideration in reviewing of proposed projects.
2. The relative economy of alternative means available on a national basis for meeting needs was to be set forth for consideration.
3. Benefits and costs, in total and separately for each purpose, were to be set forth. Where benefits and costs could not be estimated in monetary terms, their relative significance was to be stated in as precise and quantitative terms as possible; and lastly, in the words of the circular itself:
4. "While it is recognized that a comparison of estimated benefits with estimated costs does not provide a precise measure of the absolute merits of any particular program or project, one essential criterion in justifying any program or projects will, except in unusual cases where adequate justification is presented, be that its estimated benefits to whomsoever they may accrue exceed its estimated costs."

In contrast to the Green Book, which called for the application of its criteria and principles within the framework of an agency's particular programs and responsibilities, "A-47" called for analyses of proposed water projects in terms of its standards and procedures by sponsoring departments and agencies and then an indication of where a requirement of law or official agency views were at variance.

The Bureau of the Budget attempted rigorously to apply "A-47" to all projects presented to it for review in the 1950s. This effort led to great dissatisfaction with "A-47" within the Congress beginning about 1956. Few, if any, in the Congress called for abandonment of benefit-cost analysis *per se*, but there was a widespread call for its "liberalization." Democrats in the Congress declared that the Eisenhower administration had a "no new starts policy."

"Policies, Standards, and Procedures in the Formulation, Evaluation and Review of Plans for Use and Development of Water and Related Land Resources," an interdepartmental agreement approved by President Kennedy for application by the federal departments concerned and the Bureau of the Budget, replaced Budget Bureau Criteria A-47 on May 15, 1962.

Published by the Congress, the agreement became known as Senate Document 97. It was prepared by the Interdepartmental Staff Committee, ad hoc, U.S. Water Resources Council. The author was the chairman. Key participants were Eugene Weber and Nathaniel Bach of the Corps of Engineers, and Harry Steele of the Department of Agriculture. Weber and Bach, I believe, were involved also in preparation of the Green Book. Bach had transferred to the headquarters of the Army Corps of Engineers from the Bureau of Agriculture Economics of the Department of Agriculture.

The basic objective in the formulation of plans, according to Senate Document 97, was to provide the "best use, or combination of uses, of water and related land resources to meet all foreseeable short or long-term needs." In pursuit of this basic objective, full consideration was to be given to the following multiple objectives and "reasoned choices made between them when they conflict":

1. Development Water and related land resource development and management was taken to be essential to economic development and growth for all the various multiple purposes including outdoor recreation and fish and wildlife enhancement.
2. Preservation Proper stewardship of the nation's natural bounty was taken to require preservation in "particular instances" of open space; green space; wild areas of rivers, lakes, beaches and mountains; and areas of unique natural beauty, historical, and scientific interest. (Wild areas of rivers had already been officially proposed in the interdepartmental comprehensive study of the Arkansas, Red, White River Basin Study, at the urging of Irving Fox representing the Department of the Interior.)
3. Well-Being of People Hardship and basic needs of particular groups was to be of concern, but development for the benefit of the few or the disadvantage of the many was to be avoided. In accordance with this objective, socioeconomic policy requirements established by the Congress were to be observed (e.g., the 160-acre rule in relation to federal supply of water for irrigation and "preference clauses" relating to the sale of federal power to public and rural electric cooperatives). Also, "well-being of people" was an objective that could take into account the saving of life by a flood control project while savings from property damage would be taken to be a benefit in furtherance of the developmental objective.

Comprehensive river basin plans were to be formulated initially to include all units and purposes which satisfy national economic efficiency criteria in terms of tangible benefits and costs:

1. Tangible benefits must exceed project economic costs.
2. Each separable unit or purpose must provide benefits at least equal to its costs.
3. The scope of the development must be such as to provide the maximum net benefits.
4. There is no more economical means, evaluated on a comparable basis, of accomplishing the same purpose or purposes which would be precluded from development if the plan were undertaken.

The discount rate to be used in calculating the present value of benefits and costs was the weighted average of the “coupon rates” on outstanding long-term federal bonds. In the 1960s this about 3 1/4 percent.

Thus Senate Document 97 clearly provided that optimum plans in terms of criteria of national economic efficiency (assuming one agrees with the provision on the discount rate) were to be presented for consideration within the Executive Branch and to the Congress. In addition, however, such optimum plans were to provide baselines from which alternative plans reflecting intangible values reflecting different objectives could be judged, e.g., by determining the developmental benefits forgone if preservation of a scenic river is relevant as an alternative to multiple purpose development. And, according to Senate Document 97, when major differences arise among technically possible plans conceived as desirable for a river basin on the basis of intangible benefits and costs, in comparison to optimum plans based on tangible benefits and costs, alternative plans giving expression to these major differences are to be presented for consideration within the Executive Branch and to the Congress.

Regional, state, and local points of view or objectives were to be considered as well as national points of view in terms of criteria of national economic efficiency or other national policy. A comparison of differences arising from these various points of view was also to be included in reports.

Finally, Senate Document 97 provided that general and specific judgments were to be made upon comprehensive plans, programs, and project proposals as a basis for recommendation to the Congress. Review aimed at arriving at such judgments was to be based upon the provisions of Senate Document 97 itself, applicable laws, their legislative intent, and executive policies and orders as well as recognized technical standards. In contrast to

“A-47” no requirement was set forth that projects, generally, must have a benefit-cost ratio greater than 1.0 to 1 as a basis for recommendation to the Congress. On the other hand, Senate Document 97 did not bar the Bureau of the Budget from adopting such a benefit-cost ratio requirement as its own administrative standard. And this requirement was the unwritten rule since the promulgation of Senate Document 97 on May 15, 1962.

Before President Kennedy approved the agreement published as Senate Document 97, the Council of Economic Advisors established a three man group of distinguished academic economists led by Kenneth Arrow to review the agreement. Approval was given subject to a committee to further study of the discount rate.

The Water Resources Council created by the Water Resources Planning Act of 1965 proposed in July 1968 to amend Senate Document 97 to change the formula for determination of the discount rate used in the calculation of benefits and costs. This precipitated a new congressional call for “liberalization” supported by various developmental interest groups. Raising the discount rate, which would be the effect of the formula change, would result in a lower B/C ratio and make infeasible borderline projects that formerly were considered feasible. After extensive consultation by the author with key members of the Congress and its staff and their implicit acceptance, the council adopted and President Johnson approved, in December 1968, a new formula for the annual determination of the discount rate based upon the “yield rate” on outstanding long-term federal bonds rather than the “coupon rate.” This action initially changed the discount rate then from 3 1/4 percent to 4 5/8 percent.

After this action (and in view of the obligation of the Council under Section 103 of the Water Resources Planning Act of 1965 to promulgate its own “Principles, Standards, and Procedures” for application by all federal water and related land planning agencies and all reviewing agencies within the executive branch), the council began to direct its attention to this much larger task of replacing Senate Document 97 in its entirety.

Harry Steele, an Assistant Director of the Water Resource Council staff, directed this effort. The basic concept of multiobjective planning was retained but many changes were made. Several revisions of principals and standards for plans were developed. Many hearings were held both in Washington and the field. Various interest groups, the Bureau of the Budget, and the Congress expressed very divergent opinions.

Early in the 1980s, the Reagan administration abolished the active program of the Water Resources Council, including the Federal-State River Basin Commissions that had been created in the 1960s under the Water Resources Planning Act.

#### **AUTHOR**

**Henry P. Caulfield, Jr.** is Emeritus Professor of political Sciences, Colorado State University. Formerly he was Assistant Director and Director of the Resources Program staff, Office of the Secretary, Department of the Interior (1961-1965); Executive Director Water Resources Council (1966-1969).

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