

The Colorado River After 2026: Who Pays for Water Scarcity?

Why the West Should Use Markets and Compensation-Not Agriculture-as the Residual Claimant

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Overview

The Colorado River is approaching one of the most consequential moments in the modern history of Western water law. The existing legal architecture governing the river is colliding with a physical reality that can no longer be ignored. Simply stated, the river is not producing as much water as the legal and economic system has promised to users. The problem is not simply drought. It is a structural mismatch between water supplies and the claims placed upon those supplies. Population growth, agricultural production, tribal water rights, municipal demand, environmental interests, energy production, and interstate commitments all compete for the same resource.

The issue is no longer theoretical. On August 21, 2026, the Department of the Interior finalized the operating framework for the Colorado River after 2026, including substantial reductions for Arizona, California, and Nevada beginning in 2027. Importantly, however, the new framework does not foreclose additional economic arrangements among water users. It establishes federal operating parameters while leaving room for voluntary conservation, water exchanges, transfers, storage of conserved water, and other negotiated arrangements that can move water toward higher-value uses. What happens next will have direct consequences for agricultural water users, land values, cropping decisions, and the economic future of irrigated agriculture throughout the Basin.

The question after 2026, therefore, is not merely who gets how much water. It is more fundamental: How should a scarce resource be allocated when the political boundaries governing the resource do not correspond to the physical boundaries of the resource itself? It's a basic economics problem - if society determines that another use for water has a higher value, the economically rational solution is voluntary reallocation with compensation rather than uncompensated destruction or impairment of an existing legally recognized water right.

The River Was Overpromised

The starting point is the Colorado River Compact of 1922.¹ The Compact divided the river system into an Upper Basin and a Lower Basin and apportioned the exclusive beneficial consumptive use of 7.5 million acre-feet annually to each Basin, subject to its other provisions. The Upper Basin also agreed not to cause the flow at Lee Ferry to fall below 75 million acre-feet during any ten consecutive years. The arrangement was developed using hydrological information from a relatively wet period. The river, however, has not performed as the architects of the system anticipated.

¹ Colorado River Compact, Nov. 24, 1922, 70 Cong. Rec. 324 (1928).

The Department of the Interior reports that average inflow from 2000 through 2024 was approximately 12.9 million acre-feet annually, compared with approximately 18 million acre-feet of estimated average inflow used in developing the Compact. From 2020 through 2024, total Basin consumptive use averaged approximately 13.1 million acre-feet annually. Those numbers tell the real story.

So, the current dispute is not simply a disagreement over how to divide an adequate supply. The Basin is attempting to divide a supply that is frequently smaller than the legal and economic expectations built upon it. That is a fundamentally different problem.

The Law of the River Is Not One Law

There is no single statute or document that determines who receives Colorado River water. Instead, there is an extraordinarily complicated body of federal statutes, interstate compacts, Supreme Court decrees, treaties, contracts, administrative rules, and state water law commonly called the "Law of the River." The Colorado River Compact is its foundation. The Boulder Canyon Project Act, the 1944 treaty with Mexico, the 1948 Upper Colorado River Basin Compact, the Supreme Court's decisions in *Arizona v. California*,² the 2007 Interim Guidelines,³ and subsequent drought-contingency agreements have all added layers to the system.

That complexity matters. Political rhetoric sometimes makes the issue sound as though the federal government can simply announce that everyone must take an equal percentage reduction. Water rights do not work that way.

The Supreme Court's *Arizona v. California* decisions established important priorities and quantified Lower Basin rights. The 1964 decree⁴ allocated the first 7.5 million acre-feet of mainstream water among California, Arizona, and Nevada at 4.4 million, 2.8 million, and 300,000 acre-feet, respectively, while also recognizing federal reserved water rights for certain Indian reservations.

State law matters as well. Western water allocation remains heavily influenced by prior appropriation - the principle commonly summarized as "first in time, first in right. Consequently, a senior water right cannot simply be treated as equivalent to a junior right because a federal agency determines that both uses are socially desirable. That is one reason the Colorado River negotiations are so difficult.

The River Does Not Recognize State Lines

Water flows according to gravity, topography, precipitation, snowpack, geology, and hydrology. Political boundaries are human creations. If the political map of the West were being developed from scratch based solely upon hydrology, there would at least be a strong economic and practical argument for drawing political boundaries around watersheds. But that was never a realistic option. The seven Colorado River Basin states (Arizona, California, Colorado, Nevada, New Mexico, Utah, and Wyoming) were already established states when

² *Arizona v. California*, 373 U.S. 546 (1963).

³ Colorado River Interim Guidelines for Lower Basin Shortages and Coordinated Operations for Lake Powell and Lake Mead, 73 Fed. Reg. 19,873 (Apr. 11, 2008).

⁴ *Arizona v. California*, 376 U.S. 340 (1964).

the Colorado River Compact was negotiated in 1922. The Compact therefore had to work around existing political boundaries rather than creating political boundaries around the watershed.

The solution was ingenious. Instead of redrawing the map, the Compact created a legal map over the political map. The Upper and Lower Basins were defined according to the river system rather than simply according to state boundaries. Portions of Arizona, New Mexico, and Utah, for example, are associated with both the Upper and Lower Basins. That arrangement was necessary, but it also illustrates the fundamental problem. A state can be politically unified while its water resources are divided between different hydrological systems. Conversely, a single river Basin can span multiple sovereign states. The river's geography simply does not conform to the political map.

The Compact Was an Interstate Property-Rights Agreement

It would be unfair, however, to criticize the 1922 Compact simply because it did not create a perfect hydrological government.

The Compact was designed to solve a very real problem. Western states were concerned that California's rapid development would allow it to establish senior water rights before the Upper Basin states had an opportunity to develop their own economies. The Compact was, in large part, an effort to prevent a race among the states to appropriate the river before someone else did. Thus, the Compact was essentially an interstate property-rights agreement.⁵ Rather than allowing the first state to develop the river to capture the entire economic resource, the states agreed prospectively to divide the system. That was an extraordinary accomplishment for its time. But the Compact did not solve the Basin-versus-state problem. It merely managed it. And now, more than a century later, the system is being tested by declining supplies and increasing demand.

What Happens After 2026?

The 2007 Interim Guidelines expire at the end of 2026. The Department of the Interior has now established a ten-year Decision Framework extending through 2036, but it does not lock the Basin into a single set of operating rules for the entire decade.⁶ Instead, the framework anticipates operating guidelines in two-year periods, allowing the rules to be adjusted as hydrologic and other conditions change. For 2027 and 2028, Arizona, California, and Nevada will collectively reduce their Colorado River use by 1.25 million acre-feet annually.

But that should not be mistaken for a permanent solution. If reservoir conditions deteriorate, reductions could become substantially larger. The post-2026 framework contemplates reductions up to 3 million acre-feet annually in later years depending on hydrological conditions. Three million acre-feet is an enormous quantity of water.

⁵ The Bureau of Reclamation describes the Compact as the “cornerstone” of the Law of the River and explains that the states were attempting to prevent California from establishing priority rights before the other states could develop. U.S. Bureau of Reclamation, *Law of the River* (last updated Feb. 9, 2026).

⁶ U.S. Department of the Interior, *Interior Department Finalizes Plans for 2027–2028 Colorado River Operations* (Aug. 21, 2026).

Observation: For agriculture, these reductions will affect planting decisions, land values, irrigation investments, crop choices, farm profitability, and the economic viability of entire agricultural regions.

The Colorado River debate has therefore moved well beyond environmental policy. It is now an agricultural economic issue.

Agriculture Cannot Simply Be Declared the Problem

One of the most troubling aspects of the current debate is the tendency to treat agricultural water use as something that can simply be eliminated whenever urban demand increases. The problem is that much of the modern water debate begins with an assumption that is rarely stated so bluntly: agriculture is the residual claimant. When water supplies prove inadequate, agricultural use is expected to contract so that municipal, industrial, and environmental demands can be satisfied. In other words, the claim is that agricultural water use, particularly irrigation, is itself a principal contributor to the West's water-supply problem and consequently places substantial pressure on irrigated agriculture to bear reductions necessary to accommodate competing demands. That approach ignores economics and places substantial pressure on irrigated agriculture to bear reductions necessary to accommodate competing demands.⁷

Colorado River agriculture produces food, feed, fiber, and specialty crops. It supports processing industries, transportation, farm equipment, labor, land values, and rural communities. More importantly, the economic value of water varies dramatically depending upon where it is used, what crop is being produced, what technology is available, and what alternative uses exist. That does not mean agriculture should be immune from reductions. It means reductions should be economically rational. If society wants water moved from agriculture to municipal, industrial, environmental, or other uses, there is a fundamental economic principle available - pay for it. A farmer who voluntarily conserves water, changes crops, improves irrigation efficiency, fallows acreage, leases a water right, or permanently retires a portion of a right should not be treated as an obstacle to progress. The farmer owns (or possesses) a legally recognized interest in a valuable economic resource. Markets should be permitted to recognize that value.

Conservation is Not the Same as Confiscation

There is an enormous difference between conservation and confiscation. Suppose a government agency says: "You must stop using 20 percent of your water because the government needs that water elsewhere." The economic loss falls primarily on the water user. But if a city, state, federal program, water district, environmental organization, or other beneficiary pays a farmer to reduce consumptive use by a verified amount, the transaction is voluntary. That distinction is fundamental. A functioning water market can allow higher-value uses to acquire water from lower-value uses while compensating the parties whose rights are modified.

⁷ See, e.g., Griggs, *Beyond Drought: Water Rights in the Age of Permanent Depletion*, 62 Kan. L. Rev. 1263 (2014); *The Political Cultures of Irrigation and the Proxy Battles of Interstate Water Litigation*, 57 Nat. Resources J. 1 (2017).

Clearly, there are legitimate safeguards that must accompany such markets. Seniority, return flows, third-party impacts, groundwater interactions, tribal rights, and state-law restrictions cannot simply be ignored. But those are reasons to design better markets. They are not reasons to reject markets.

Litigation Doesn't Create Water

The worst possible long-term strategy would be to turn the Colorado River into an endless sequence of lawsuits among the seven Basin states. Litigation can resolve legal questions. It cannot create an acre-foot of water. Arizona may challenge federal authority. California may defend senior rights. Upper Basin states may resist mandatory reductions. Tribes may assert reserved rights. Agricultural districts may defend contractual and statutory entitlements. Those disputes are legitimate. But winning a lawsuit does not cause snow to fall in the Rocky Mountains.

The Basin therefore needs a political and economic settlement that recognizes the existing legal hierarchy while creating incentives for voluntary reallocation. So what does that path forward look like? Consider the following:

- The federal government should not use emergency administrative authority as a substitute for rewriting interstate compacts or judicial decrees. If the states believe the permanent allocation of the river should change, they should negotiate an agreement and obtain whatever congressional and judicial approvals are required. The rule of law matters most when the circumstances are difficult.
- Water users should have greater ability to buy, sell, lease, bank, and conserve water, subject to appropriate protections for existing rights and third parties. If water is genuinely scarce, its price should communicate that scarcity. A market price is not an enemy of agriculture. It is a mechanism for determining whether water is more valuable in one use than another.
- If cities need agricultural water, they should not simply demand it. They should buy it. Public and private beneficiaries should compensate agricultural producers for measurable reductions in consumptive use. Conservation then becomes an economic opportunity rather than an economic penalty. That approach also creates an incentive for innovation. Farmers will invest in conservation when the value of the conserved water exceeds the cost of conserving it. That is exactly how markets are supposed to work.
- Conservation is necessary, but conservation alone cannot solve a structural shortage. The West needs additional storage, groundwater recharge, wastewater reuse, improved conveyance, desalination where economically and environmentally justified, and other technologies that increase the amount of usable water. But every proposed project should be subjected to rigorous cost-benefit analysis. Not every billion-dollar water project is a good investment simply because it produces water. The economic question should always be what an additional acre-foot costs and what is that acre-foot worth?
- Perhaps most importantly, the seven states should exercise substantially greater responsibility for managing the river as an integrated hydrological and economic system, with the federal government primarily serving as referee and enforcer.



Thus, the Basin should have mechanisms for determining how much water is actually available; how much water each sector consumes; how conservation is measured and credited; how water can be transferred; how agricultural water can voluntarily be acquired for municipal uses; how new storage is financed; how tribal water rights are integrated; and how shortages are allocated. This adapts the concept of federalism to the physical reality of the resource.

The Real Challenge After 2026

The post-2026 controversy demonstrates why the Basin-versus-state distinction matters. If the answer is simply that the states get certain amounts of water, that treats water as though it were a mineral deposit sitting underneath each state's soil. It isn't. Water is both a fugitive and migratory economic resource within a single hydrological system. Thus, the long-term answer is to make the management system function as though the Basin were the relevant economic unit. That means interstate water markets, compensated conservation, water banking, transparent measurement of consumptive use, infrastructure investment, agricultural-to-urban transfers, groundwater integration, recycling, and (where economically justified) new water supplies. This allows states to retain their sovereignty, farmers to retain their property rights, and cities can continue to grow to the extent that they are willing to pay the real economic cost of the water that growth requires. And the federal government can retain its legitimate role without becoming the permanent allocator of every acre-foot.

Conclusion

There is a temptation to frame the Colorado River fight as a battle between farmers and cities, Upper Basin and Lower Basin, or states with senior rights and states with junior rights. But that is too simplistic. The real issue is scarcity. When a resource is scarce, somebody bears the cost. The only question is whether that cost will be allocated through law, politics, markets, or some combination of all three. A rational system should use all three. Law should protect property rights and enforce interstate agreements. Politics should determine legitimate public priorities. Markets should communicate the economic value of water and compensate those who voluntarily relinquish or conserve it.

The objective should be a water-allocation system in which water can move voluntarily toward higher-value uses, existing legal rights are respected, conservation is compensated, new supplies are encouraged when economically justified, and the federal government serves as referee rather than permanent allocator of the river.

This is the real challenge beginning after 2026.

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