Political Economy of Illegal Drugs

Pierre Kopp

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Whether we like it or not, illegal drugs are widely consumed and a huge source of revenue for criminals and an expenditure for governments throughout the world as they attempt to police their misuse. Examining the thorny issue of drugs within an economics framework is an exercise that is not only timely but also helpful.

This book attempts such an analysis with admirable rigour and originality. Analysing the behaviour of drug consumers and sellers, Pierre Kopp explores in detail the difficulties of implementing successful drug policies. He considers the role of organized crime, the laundering of drug money and the complexities of tracking organized criminals.

Policy-makers around the world searching for ways to contain the drug problem will welcome this book. It will also be of great interest to students and researchers of applied microeconomics, criminology and, in particular, the economics of crime.

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Note on the text

Throughout the book, when discussing policy-makers, drug dealers and drug users, we have referred to them as 'he', although we are aware that there can be female policy-makers, drug dealers and drug users.

Introduction

Why write an economics study that discusses drug trafficking and consumption? Of course, intuitively, the word 'drug' evokes an image of enormous sums of money, but an economist's work should not be reduced to an accountant's inventory of cash flow. The economic approach consists in examining the consequences that drugs circulating on the market have on consumer and dealer behaviour. Effectively, drugs are psychotropics that influence the perception of the individuals who consume them, but they are also forms of merchandise, which are exchanged in the marketplace and have particular characteristics.

There is never a drug debate that does not very quickly begin to discuss the pros and cons of prohibition. For some, the intrinsic harm of drugs justifies their being banned; the existence of illegal markets is a result, regrettable of course, but one that a more repressive policy could do away with. For others, it is precisely repressive public intervention that is the root of all evil because it plunges the consumer into the midst of a web of transactions which are not only illegal, but are, above all, dangerous. The dogged opposition between these two theses explains the recurrent nature of drug policy debates. We should note, in passing, that it is in fact the societal debate which, by focusing on the violent nature of the functioning of these illegal markets, has invited economists to discuss the characteristics of market functions, and it is not the latter who have invited themselves to a debate where their presence has been requested by nobody.

The controversy on the root of the evil created by drugs dates back to an old and deep opposition between different economic approaches, notably liberal and interventionist. In order to determine when intervention is justified, it is possible to adopt a fairly simple rule that the most liberal authors would not contest. Consider as established that individuals are the best judges of their own well-being. Then, as long as an individual's actions affect only his well-being, and not that of other members of society, he must be free to act as he wishes. The rule is clear, but putting it into practice is less so.

First, is a drug-consuming individual still the best judge of his well-being? As Gary Becker has argued (Becker and Murphy, 1988), the

inclination for drugs could certainly be considered as rational. We could then consider that the individual arbitrates between present satisfaction obtained from drugs and the future inconveniences of such consumption. From this perspective, the drug consumer would permanently optimize his behaviour, taking into account the signals sent by such market intermediaries as price, intensity of repression (when drugs are banned), or availability of health care programmes. On the other hand, we could consider that, far from being rational, the drug consumer is under-informed or irrational, concluding that at the time of taking drugs for the first time he is unable to measure the future consequences of this action and thereafter is no longer able to stop. The principle of consumer sovereignty would thus cease to be applicable, and we should implement an active paternalistic type of policy that would protect the consumer from himself. To decide whether the drug consumer is really the best judge of his well-being or whether he has lost the attributes of his sovereignty, due to the drugs, is thus a far from trivial question. The answer essentially depends upon our representation of the entry conditions to the career of drug consumer.

Second, does drug consumption affect only the drug consumer? If that were the case, there would be no need for public intervention, except that designed to protect the consumer from himself, as mentioned earlier. Here the question is different; if the behaviour of some people affects that of others, then without doubt there are good reasons for public powers to regulate access to drugs. The question is extremely thorny. Literature on drugs tends to rather quickly present the risks run by drug consumers as externalities. The question is not without importance as the presence of an externality is generally a good reason to insist upon state intervention.

Nobody doubts that most drugs have negative consequences for those who consume them.

It, however, in economic terms, does not concern externalities, as it is not a third party who is affected by drug taking but the consumer himself. The problems that the consumers inflict upon themselves, therefore, in no way constitute a good reason to diverge from the principle of letting people decide for themselves. However, drugs affect not only those who take them, but also third parties. Under the influence of drugs, individuals can commit crimes, and markets are often known for their violence. If it is established that the consumption of some affects the well-being of others, there is good reason to abandon the rule that advocates respecting individual choice to consume. The problem is that it is not easy to assign a specific reason for externalities characteristic of the drug market. For some, the case is clear; it is the psychoactive nature of the products consumed that modifies the consumer's behaviour and instigates violence or behaviour that is dangerous to others. For others, it is because drugs are not permitted that markets are violent. Does the danger of drugs to third parties stem from the drugs or the laws that prohibit them? Once again, our

apparently simple rule, which is supposed to serve as a guide of whether or not to set up public intervention which deprives the citizen of the right to exercise his freedom of choice, turns out not to be particularly helpful.

Thus, we can observe that the rational discussion of benefits and disadvantages of intervention to regulate drug use does not have a simple conclusion. Its outcome depends too restrictively upon each one's opinion of the relative weight to be accorded to the individual rights of the citizen and the State's role in permitting a clear outcome. In this sense, any discussion relating to drug legislation cuts into those debates that have been agitating society for at least two centuries and do not appear destined for rapid solution. This is why the approach in this book focuses more on a discussion of drug policy as it is actually implemented as opposed to attempting a comparison of the theoretical merits of drug policy extremes such as total prohibition or total legalisation. The fact that it seems to be impossible to determine, in normative terms, what the drug laws should be does not remove the obligation to examine the consequences of existing laws and the possibilities of modifying them in order to improve social well-being. In any given institutional framework, generally that of drug prohibition, the public policy-maker must choose a public drug policy. Discussing the strategic basis for this and its consequences constitutes, in our eyes, a more exciting task than re-opening the debate that juxtaposes prohibition and legalization.

Anyway, can we really talk about 'drug policy'? In many countries so-called drug policy is in fact the uncoordinated aggregate of sometimes incoherent measures. Often, for example, the actions of the Minister of Health and Welfare and those of the Interior Minister turn out to be contradictory. Henceforth, we will place under the term 'public policy' a set of laws, regulatory dispositions or measures, the coherence of which we do not prejudge.

In other respects, a purely economic analysis of drug policy can often appear to be somewhat simplistic. Standard economic theory generally considers that the economist's work is done once he has identified the sources of inefficiency in a public policy. Of course, some go further and compare the benefits of different corrective therapies. Rare are those who question the feasibility of the solutions proposed. This delicate problem of policy implementation recommended by economists reveals the limits to the territory covered by this discipline. Ascertaining the conditions of implementing a proposed public policy demands verifying its compatibility with the existing institutional framework. Moreover, one must also question whether or not a political majority exists to uphold it, and anticipate its potential adverse effects. Of course, economic analysis reduced to its most simple expression, the analysis of rational choices, can handle all of these tasks. A less ambitious conception of the science of economics would limit itself to recommending a multi-disciplinary study of conditions of implementation, choosing between a plea for collaboration,

of uncertain outcome, with other social sciences, and economic reductionism within a range even more disputable.

Finally, the best evaluation of any given public policy is not necessarily the bearer of change. Such a view, certainly somewhat cynical, but nourished by the practice of evaluation, leads to the attitude that it is not a good idea to count on the reasoned evaluation of drug policies having a great effect. Sociologists have long since abandoned the overly optimistic instrumentalist position, which envisions the well-meaning public policy-maker, warned by a perfectly neutral evaluator of the flaws in his policy, correcting them without any resistance. The virtuous loop between evaluation and change is infinitely more complex. This is why practitioners generally consider that the first merit of evaluation is to force the actors to sit down at the table and clarify their position. The virtue of evaluation is not to guide change in a normative sense but to set off an administrative dynamic that serves as a catalyst for transformation. The position of those sociologists who are most impassioned by political science is even more draconian. For them, evaluation is but one of many facets of political competition. One evaluates only to use the result of the evaluation in the struggle for power. The benefit of evaluation would then be to force the competing political teams to clarify their projects. Transparency thus imposed by competition would then favour the elimination of the most obviously incoherent proposals.

Furthermore, can we seriously discuss drug policy without distinguishing between the different products? On the one hand, we can recognize that what is justified in the case of cannabis is perhaps not so in the case of heroin. On the other, current practice is in fact characterized by fairly uniform public drug policies which cover all products, the subtle distinction between products often being relegated to the background. We will adopt this attitude, although it is somewhat frustrating, treating drugs in general and not distinguishing between the products, except to make certain qualifications. In any case, what are the best criteria for distinguishing between the products? A necessarily too rapid inventory underlines how much each discipline adopts a taxonomy of drugs adapted to the questions it raises. Neurobiologists point out common actions of the different substances on the neuro-receptors that constitute in their eyes, a rational basis for a multi-substance drug policy. They do point out, however, the differences in intrinsic dangers among the various products. Certainly, in the laboratory, cocaine appears to provoke more serious problems than cannabis, but cannabis is more often associated with tobacco, which that produces numerous cancers. What should we conclude in relation to the dangers posed by the two products? It seems to us, then, that a classification of products by level of danger is of little assistance in designing public policy. On the contrary, Freudian psychoanalysts defended the idea that the specific characteristics of the products were secondary, addiction being a pathology unrelated to the product, which represents only a symptom.

This thesis partly explains the initial opposition of this profession in some countries, such as France, to surrogate treatments. What is the use of treating the symptom? The most formalistic lawyers uphold the opposition between legal and illegal substances. Historians remind us that some countries tolerate cannabis more than alcohol, and at certain periods cocaine was legal in several developed countries. Economic analysis, as we apply it, distinguishes between the products when the impact on the social cost of a measure varies in relation to the product considered.

Finally, when we evaluate a public policy in general we should be mindful of the strategic objective it indicates. Most often the public policy-maker is careful to keep from overtly announcing the objectives assigned to a drug policy. Is it a question of eradicating drugs, reducing consumption, banning their circulation, or limiting the negative consequences of consumption? We should note that public drug policy often consists of a combination of measures aimed at different objectives, brought under the umbrella of a general presentation intended to artificially unify this heterogeneity. Such heterogeneity in fact is not necessarily to be condemned. It is logical that different sectors of society have very different needs for public policies which the State cannot avoid. The evaluation of a public policy often consists, therefore, in testing the effectiveness of announced measures, then trying to evaluate their effects, and finally verifying if the effects observed follow the direction of the announced strategy. Economic evaluation of public policy diverges somewhat from this schema of evaluation. This, in fact, is what makes it both interesting, as well as irritating.

In fact, unlike other disciplines economic analysis claims the right to discuss the value of strategic objectives chosen by the public policy-maker. Even more importantly, mainstream economic analysis of public policy does not do away with the complexities involved in specifying the nature of the objective that the policy-maker should assign to the policy. Economic theory, such as is usually used by economists, considers that good policy must facilitate more efficient allocation of resources: that which allows the achievement of a given result with the least cost. Good public policy thus must correct the inefficient allocation of resources by the markets. Such a description generally suffices to discredit the economic approach among those who are afraid of seeing a public drug policy reduced to correcting markets in the direction of greater efficiency. It is interesting to note that this policy might be reformulated in an equivalent manner in the following format: the efficient policy for drugs is that which allows minimization of the social cost that the drugs impose on the collectivity. This formulation is generally better accepted. Without insisting here on this point, let us point out once more how much this normative obsession constitutes the specificity of economic evaluation of public policies. Where other evaluation methodologies are content with measuring the space between the objectives and the results, or are transformed into accompanying a learning process of change in public organizations,

economic analysis claims the right to test the public policy in view of an objective which it judges unavoidable: collective well-being, meaning the efficient allocation of resources or the minimization of the social cost (no matter what the formulation), and not that advanced by the public policy-maker who is supposed to represent the democratic majority.

The aim of this book, then, is to introduce the reader to the economic evaluation of public policies. When, for example, the public policy-maker increases police presence in the street, this increases the probability of the arrest of dealers and consumers. The cost of drugs increases and the consumer can react by reducing his consumption, by changing products or by adopting another form of use. The effect of public action therefore depends upon the complex interaction between market and consumer behaviour. Other than seeing therein a means of satisfaction *pro domo* for the economists whose profession it is to study this type of interaction, the reader will easily understand how an adequate understanding of consumer and dealer behaviour represents a prerequisite for the examination of their activity on the market.

Written for economists who are looking for concrete illustration of the use that can be made of classic microeconomic tools, this work is also addressed to policy-makers. Some will find pleasure in delving into the detail of some presentations using formal mathematical language; others will discover that their train of thought may be maintained by skipping over the more technical parts. By providing a better understanding of drug policy and offering a framework for discussion wherein the merits of different proposals can be compared, this work should prove a useful instrument for evaluating public drug policy. Finally, when the success of a policy depends upon the interaction between individual behaviour, prices, and markets, there is no doubt in our mind of the importance of economic analysis.

Overview

The first chapter analyses the flow of drugs. The suppliers constitute the primary actors in drug markets. Producers, importers, wholesalers, and retailers form a chain of distribution. The behaviour of each of these actors affects not only drug price, but also allocation of the value created by the different protagonists. In other respects, the organizational methods of supply determine the conditions under which drugs are distributed, the degree of violence on the drug markets, and the influence of organized crime. Each of the supplier groups (importers, retailers, criminal organizations) adopts strategies that differ greatly from those of a classical legitimate firm. Uncertainty, limited rationality, opportunism, and betrayal create specific strategies, a thorough understanding of which is the key to an efficient public policy.

Also, the most frequently proposed hypotheses about the behaviour of

drug suppliers are too often deficient. The major traffickers are invested with a power of monopoly that guarantees price control and makes them, unwittingly, play a regulatory role, as the monopoly rations the supply. The small resellers are often presented as being representatives of a class of new businessmen in full enrichment phase. In underlining the strong competition that reigns between the suppliers, and by drawing attention to the high flexibility of the organizations in the drug supply network, we interpret, in a unique manner, some of the difficulties facing repressive public policy when it attempts to eradicate drug supply.

At the end of the drug chain, laundering the money represents a crucial and necessary step. Only the biggest criminal organizations use the more sophisticated instruments offered by the international financial system to launder their profits. The other smaller traffickers content themselves with unrefined and less costly methods. The analytical schema of laundering strategies becomes coherent after revising, downward, the sums produced for laundering as estimated by those wishfully called the best experts in the area.

Chapter 2 is devoted to drug addiction. If addicted consumers react paradoxally to the price signals engendered by public policy, then it is the efficiency of the latter that should be questioned. For some, drug consumers are not responsible economic agents, but individuals whose economic behaviour has become abnormal as a result of their affinity for drugs. This thesis poses problems because it repudiates the value that the act of consumption represents for the individual. In short, drug consumption disappears behind addiction. Yet, demand for drugs cannot be reduced to a choice that is imposed upon a subject who lacks free will. We ought, therefore, to understand the motivation for an individual's initial choice in favour of drugs and then describe how an individual, even though he has become a regular consumer, nevertheless preserves a palette of choices that he uses to try to optimize his drug consumption in an environment full of temptations, where the main variables are income, price, dependence, and the pleasure that drugs procure.

The question of whether economic analysis can help to define the framework of good drug policy is at the heart of Chapter 3. In the sphere of drugs, where ideology and moral judgements are omnipresent, it is worth knowing what kind of policy an economic approach, based on research into policy effectiveness, would favour: that is, minimization of the social costs generated by drug consumption and trafficking, or the sum of the increased negative externalities and utility procured for those who consume drugs. Taking an interest, admittedly in rather abstract terms, in the form of an optimal drug policy allows us to indirectly bring to light the economic cost (sometimes exorbitant) of any policy that deviates from this norm. In concrete terms, society must be aware that by deviating from optimal drug policy it is wasting resources. Unfortunately, a quick review of the literature illustrates that although mainstream normative analysis

performs well in evaluating the marginal effects of drug policy (new treatment or inroads into criminal policy) it is incapable of clearly indicating which of the two important regimes (prohibition or legalization) should be recommended. The stream of analysis called 'Law and Economics', as initiated by Coase (1937), consists of an interesting approach, distinct from traditional normative analysis.

In Chapter 4, the issue is no longer to decide whether we should prohibit or legalize drugs, but to determine which public policy should be retained within an institutional framework where prohibition is a fact. So, from a normative point of view, governments should therefore implement public policies aimed at maximizing social welfare, i.e. minimizing the social cost of drugs.

Notwithstanding this lengthy practice of treating externalities, normative economic analysis encounters real difficulties playing its role of aiding decision-making, the reason being that conventional economic analysis ties the reduction of social costs to intermediate objectives. Classical analysis of externality correction is inspired by the work of C. Pigou (1920) and the study of crime economics developed by G. Becker (1968), both of which aim at minimizing social costs. However, the former proposes accomplishing this by bringing society to an optimal level of consumption of illegal drugs, while the latter suggests attaining this result by reducing criminal activity to an optimal level. Nothing proves that the orientation of a public policy toward attaining an optimal level of one or the other of these variables (consumption and crime) guarantees maximization of collective well-being, or, in other words, minimization of the social cost of drugs. All of the difficulties where drugs are concerned stem from the fact that the level of social cost – that is, the severity of the harm inflicted on society by drugs – does not depend exclusively on either the level of consumption or on the level of activity of the illegal market. The means of suppression can in itself affect welfare in more important ways than in the trivial sense of tax distortion.

Departing from the view that drug policy cannot be reduced to the search for a hypothetical optimal consumption level any more than an efficient crime level, Chapter 5 tries to define the normative objective which should be established in public drug policy? The search for efficiency seems shocking when applied to the area of social policy. It is, however, intertwined with the objective of social drug cost minimization, and thus solidly establishes the basis for those policies entitled 'harm reduction'. Minimization of social drug cost is thus the main objective of drug policy. The objective of economic efficiency may be attained by an infinite variety of allocations of social resources. If we limit ourselves to the examination of arbitration between two groups of individuals – the non-consumers of drugs and the drug consumers – the heart of the problem when creating a drug policy lies in determining whether the principal beneficiaries of the policy should be the first or the second group. In

practice, there exist many groups of actors concerned by drug policy. Thus, the public policy-maker must subtly negotiate the fact that any public action relating to social cost, even a neutral one, benefits certain groups and penalizes others. Second, the same public action may affect external factors generated by drugs and thus the social cost, in two directions. We should then calmly accept the fact that public policy is not only a vector of efficiency, but also a powerful factor in regulating the distribution of wealth.

Chapter 6 deals with the implementation of public drug policy. The conventional approach for reducing externalities is based on the hypothesis that repression increases the price paid by the consumer of drugs, and is thus a motivation to reduce consumption. Action aimed at demand constitutes the key to all anti-drug policies geared toward reducing consumption, but effectiveness critically depends on the degree of demand elasticity of drug consumers: that is, on the consumer reaction to price change. We will see that not only can the particularities of drug price-demand elasticity intervene and thwart the expected effectiveness of the repressive policy. The drug suppliers' organizational methods can also play a negative role in policies aimed at reducing consumption. Briefly, from the supply side and the demand side, there exist valid reasons to conclude that increase in repression does not necessarily engender a decrease in consumption.

Drug policy is the result of a combination of several instruments, particularly repression and treatment. How can we most efficiently combine these two instruments? Economic analysis supplies the rule, and the observation of implemented policies emphasizes how far away governments are from it. A multiple equilibrium approach explains why a sub-optimal public policy can prevail for a long time.

Chapter 7 continues the previous discussion in regard to the fight against organized crime and money laundering. It is fairly apparent that policies implemented run up against several obstacles, but, without it being a real consolation, we can say that the theories put forward really do advance our thinking. In matters of organized crime, on the other hand, we remain more skeptical about the range of the analyses undertaken. According to hypotheses we consider to be unrealistic, various authors have argued that the presence of organized crime is not necessarily more destructive to collective well-being than its absence (Buchanan 1974). Whether it is about controlling mafia activity or the participation of banks in laundering, modern economic theory uses agency models. In this context, we illustrate the difficulties of the Principal, the State, to calibrate a system of incitation that forces the agents (the banks or the mafia) to submit to its objective function. In the banking area, we observe a marked difference between the European model in which banks cooperate in the struggle against laundering following the adoption of rules (Cooter 1995) and the Anglo-Saxon model in which the legal responsibility of the bank

(corporate liability) forces them to participate in the reform of the banking system. The Continental system produces results that are difficult to measure, and while in vogue in the US, it has important weaknesses: in some cases it is optimal to not survey the activities of bank personnel (Arlen 1994).

Part I

Behaviour and strategies