The Economics of Drug Legalization

Jeffrey Miron
Department of Economics
Harvard University
Introduction

• Drug prohibition is an important policy:
  – Federal, state and local governments spend roughly $41 billion each year to enforce prohibition.
  – Federal, state and local officials make roughly 1.6 million arrests per year; there are hundreds of thousands of persons behind bars on drug charges.
  – Governments forgo $47 billions of dollars in tax revenue that could be collected on legalized drugs.
  – Millions of people are affected in other ways, as discussed later.
Introduction, continued

• Advocates of drug prohibition believe the benefits outweigh the costs. These alleged benefits include:
  – Reduced drug use and abuse;
  – Lower crime;
  – Improved health and productivity;
  – A moral statement that drugs are evil and that society should not tolerate drug use.
Introduction, continued

• Opponents believe drug prohibition causes more harm than drugs themselves. These harms includes:
  – Tens of billions of dollars for enforcement;
  – Increased crime and corruption;
  – Reduced health and productivity for drug users;
  – Numerous other negative side effects;
• Plus, opponents of prohibition argue that, from a moral perspective, prohibition is worse than legalization.
Outline

• Positive Analysis of Drug Prohibition
  – Describe the effects of prohibition, setting aside whether those effects are good or bad.

• Normative Analysis of Drug Prohibition
  – Analyze whether prohibition is a good policy, given the described effects.
The Positive Analysis of Drug Prohibition

• I will compare prohibition to legalization.
• Prohibition means a regime in which production, distribution, sale, possession are criminal offenses;
  – Violations involve jail, fines, forfeiture, etc
  – Enforcement is substantial.
• Legalization means a regime in which the law treats drugs like other goods:
  – Tax and regulatory policies apply, but nothing unique to drugs.
• Many policies are “in between”; defer for now.
Prohibition Does Not Eliminate the Demand or Supply of Drugs

• Most prohibited goods continue to be supplied and demanded, even under strongly enforced prohibitions.

• This seems obvious, but it bears repeating:
  – Many policies, statements by politicians and economists, presume that what happens under a law is what that law directs;
  – This is false; prohibition forces the market underground.
Prohibition Does Not Eliminate the Demand or Supply, continued

• Although prohibition does not eliminate the supply or demand for drugs, it might affect demand and/or supply in important ways.

• The prohibitionist view is that prohibition reduces demand and restricts supply, thereby lowering drug consumption.

• We need to examine this claim
Prohibition Potentially Decreases the Demand for Drugs

• Respect for the law
  – Evidence does not suggest a big effect (speeding laws, certain tax laws, blue laws, sodomy laws)

• Penalties for possession of drugs
  – Many arrests for possession, but:
    – Many users, and even more instances of “possession”
    – Penalties are frequently mild

• Thus, effect of prohibition on demand is plausibly small.
Prohibition Plausibly Reduces the Supply of Drugs

- Black markets suppliers incur costs that do not exist in a legal market
  - Hiding activities
  - Transporting goods in secret
  - Bribing officials
  - Compensating employees for risk of injury, death, incarceration; also for absence of eligibility for Social Security, stigma, etc.
The Effect of Prohibition On Supply Costs is Not Necessarily Large

- Black market suppliers, given that they operate in secret, face low marginal costs of evading a host of cost-increasing government policies
  - income and excise taxation
  - environmental and OSHA regulation,
  - child labor, minimum wage laws
- This provides at least a partial offset.
- Plus, the traffickers are smarter than the government; always a step or two ahead.
Effect of Prohibition on Drug Consumption: Evidence

• Considerable evidence that prohibitions are only moderately effective in reducing consumption.
• Over the past 25 years drug prices have fallen substantially while enforcement has increased dramatically.
• Evidence from alcohol prohibition suggests roughly a 20% decline in alcohol consumption.
• Differences in drug use across countries do not correlate with enforcement of prohibition.
• So, prohibition probably reduces drug consumption to some degree, but both theory and evidence suggest this effect is modest.
Critical Effect of Prohibition is Creating a Black Market for Drugs

• A substantial drug market exists, even if it is smaller than under legalization.
• An underground market is likely to operate differently than a legal market in many respects.
• These are critical for thinking about effects of prohibition.
Effects of Prohibition: Increased Violence

• Prohibition advocates claim that drugs themselves make users violent due to psychopharmacological effects of drugs. – In fact, little evidence supports this view.
• The more likely effect is in the other direction: prohibition increases violence because drug market participants cannot resolve disputes with courts and lawyers; – So, they use violence instead.
Effects of Prohibition: Increased Violence, continued

• Abundant evidence supports the “Prohibition causes violence view.”
  – History of alcohol prohibition, drug prohibition
  – Comparisons across countries
  – Experience with other prohibited commodities like gambling, prostitution
  – More detailed, micro evidence on the causes of “drug-related” violence.
Effects of Prohibition: Income-Generating Crime

- Prohibition raises drug prices, which implies more theft, robbery, other income-generating crime.
- Prohibition diverts police effort from deterrence of non-drug crime.
- The evidence is consistent with this view, although not as clear cut as with violence.
  - For example, drug prices were declining in the 1980s yet crime was increasing.
Effects of Prohibition:
Redistributions to Criminals

• In a legal market, some of the income generated accrues to the government as taxes.
• In a black market, there are no taxes:
  – This income accrues to suppliers as profits.
• This effect of prohibition is not a cost in the economic sense; it is a redistribution.
  – But one most people would oppose.
Effects of Prohibition: Diminished Quality Control

- In black markets, consumers cannot sue manufacturers over faulty goods, or generate bad publicity, or complain to government agencies.
- Manufacturers cannot advertise, so their ability to capture the benefits of high quality are limited.
- Manufacturers prefer pure forms of the drugs, since these are easier to smuggle.
Diminished Quality Control, continued

• All these factors mean quality control is poor in a black market;
  – more overdoses and accidental poisonings per unit of drug consumption.

• Many examples illustrate this:
  – Industrial alcohol during Prohibition; paraquat; heroin overdoses, etc.
Effects of Prohibition: Corruption

- Disputes between market participants and politicians or law enforcement cannot be resolved with campaign contributions, lobbying, or legal procedures.
- Bribes and coercion are likely instead.
- Substantial evidence confirms that prohibition breeds corruption, both in U.S. and abroad.
Effects of Prohibition: Other

• Added restrictions on civil liberties because it’s difficult to prevent consensual crime.
• Increased use of racial profiling.
• Increased HIV and other blood-borne diseases, due to high prices, restrictions on clean needles
• Limitations on medicinal uses of marijuana, opiates, hallucinogens
• Complications for foreign relations, trade, immigration, security.
Summary of the Positive Analysis

• Prohibition probably reduces consumption of drugs, but theory does not dictate a large effect, nor does empirical evidence confirm a large effect.
  – Main effects plausibly on casual consumers.
• Prohibition has many other effects; these occur whether or not prohibition reduces drug consumption to a substantial degree.
The Normative Analysis of Drug Prohibition

• Virtually all the effects of prohibition are undesirable.

• There can be reasoned disagreement about magnitudes, perhaps about a few “signs.”

• But, assuming my analysis is correct, little question that most effects are bad:
  – increased crime and violence, transfers to criminals, reduced quality control, more HIV, worsened race relations, added corruption, restrictions on drugs as medicine, diminished civil liberties, insurrection in foreign countries, etc.
The Normative Analysis of Drug Prohibition, continued

• The potential exception to this claim – that most effects of prohibition are bad—is any reduction in drug use caused by prohibition.

• This effect might not be large, as discussed.

• And, if we are confident the effect is essentially zero, then the normative analysis is trivial:
  – Prohibition is all cost and no benefit.

• If the effect of prohibition on consumption is more than trivial, however, then the normative analysis rests on how one views drug use and policies that might affect drug use.
Four Perspectives on Policy and Drug Consumption

- The right question is not whether drug consumption is “good” or “bad”;
- It is whether a policy does more harm than good, taking into account all its effects;
- So, there are really two separate, sub-questions:
  - Should policy attempt to reduce drug consumption at all?
  - If yes, is prohibition the best approach?
Policy and Drug Consumption, I: Rational Drug Consumption

• The standard economic model says that people consume drugs because they think drugs make them better off:
  – For self-medication
  – To look cool
  – Because they enjoy being intoxicated
  – Or “whatever”

• In the rational model, it does not matter whether consumption is addictive or negatively affects health or productivity.

• If rational people choose to accept these risks, they must think the benefits exceed the risks.
• If all drug consumption is rational, then reducing drug consumption (via prohibition or via other policies) is a **cost** rather than a benefit.

• The reasonable scenario is that at least some drug use fits this model.

• Thus, one cost of prohibition is any reduction in drug use by persons who would use legal drugs responsibly.

• This is the same argument made for legality of alcohol, cigarettes, cars, down-hill skiing, Ben and Jerry's ice cream, and myriad other “risky” products.
Policy and Drug Consumption, II: Paternalism

• Paternalism says that drug users are myopic, or have self-control problems, or are otherwise irrational; they consume drugs despite their own best interests.
• Thus, in this view, policy should discourage drug use to protect people from themselves.
• Myopia/Irrationality/Self-Control problems certainly exist.
• But this does not necessarily imply a role for policy.
Paternalism: Objection I

• The paternalistic view opens a Pandora’s box of government interventions:
  – The determination of what is “myopic” might reflect majority preferences, not objective concerns; for example, marijuana versus alcohol.
  – The paternalistic perspective can be readily distorted to justify all manner of interventions; for example, banning “evil” books.
  – One person’s myopia is another person’s rational calculation; for example, exercise of religion.
Paternalism: Objection II

- Underlying assumptions (that drug use is addictive, or harmful, or myopic) are exaggerated, and not different from many legal goods.
- Plus, policies that deter drug use might cause substitutions toward other goods (e.g., alcohol) that are as bad or worse.
Paternalism: Objection III

• Even granting all the assumptions, these imply some type of intervention, not necessarily prohibition.

• Question is whether benefits achieved by a policy intervention exceed the costs of the policy itself:
  – Prohibition has at best modest benefits in reducing overall drug consumption, so modest effects in reducing myopic drug consumption.
  – Prohibition has enormous costs

• Thus, there is no reason to believe the benefits of prohibition exceed its costs, even granting the existence of myopia and the legitimacy of paternalism.

• Consistency also argues against prohibition.
Policy and Drug Consumption, III: Externalities

• Even if drug use is individually rational, it might generate negative externalities:
  – Adverse effects on unborn children
  – Traffic or industrial accidents
  – Extra publicly funded health care

• Drug use can indeed generate externalities.

• But, again, this does not necessarily imply a role for policy, especially not prohibition.
Externalities: Objection I

- Magnitude of externalities is highly exaggerated
  - Health effects, Productivity, Driving accidents
- Externalities little different, sometimes smaller, than those of other goods
  - Alcohol, Tobacco, Saturated Fat
- Policies that deter drug use might increase consumption of other goods that generate externalities.
- And calculating net externalities is tricky
  - Social Security and Medicare
  - Income taxes
Externalities: Objection II

• Policy choice must balance the costs and benefits of policy
  – Prohibition has large costs/externalities itself
  – All those discussed above, plus any reduction in rational drug consumption
    – Prohibition generates only moderate reductions in drug use.
• So, the reduction in externalities caused by prohibition is unlikely to exceeds its costs, even granting that externalities exist.
• Consistency also argues against prohibition.
Policy and Drug Consumption, IV: Morality

- According to some, drug use is inherently immoral, so policy should prohibit drugs to make the “right” moral statement even if the prohibition has substantial costs.
- This view has a certain “internal” consistency:
  - if one believes that prohibition is the only policy that takes a sufficiently strong moral stand against drugs, then presumably one is lead to support that policy.
Morality: Objection I

• But, unless one puts infinite weight on this moral statement, one should presumably recognize the other effects of prohibition.

• And, prohibition’s consequences are “immoral:”
  – Increased violence, more children infected by HIV, restrictions on medicine for the sick, diminished civil liberties, reduced respect for the law, less personal accountability, etc.

• Thus, there is no a good “moral” case for prohibition;
  – Quite the opposite.
Normative Analysis: Summary

• Virtually all the effects of prohibition are undesirable.
  – The only possible exception is any reduction in drug consumption achieved by prohibition

• Even that is partly a cost, not a benefit.

• So, even if policy should attempt to reduce drug consumption, prohibition is likely the worst policy for achieving that end, given the broad range of negative side-effects.
Alternatives to Prohibition, I

- There are many alternative approaches to reducing drug consumption:
  - Subsidized Treatment
  - Harm Reduction Policies
  - Sin taxes
  - Public health campaigns
  - Age restrictions
  - Medicalization
  - Decriminalization
  - Some Drugs Only (marijuana)
Alternatives to Prohibition, II

• Virtually all of these are preferable to prohibition:
  – They do not generate black markets
• But, each requires its own analysis, and each has the potential for negative side effects
• “Laissez-faire” may well be the best tradeoff.
Conclusions

• Policies have a range of consequences, intended and unintended
• Rational policy analysis should consider all the consequences, not just the ones that feel or sound good.
• In the case of drug prohibition, most consequences are negative;
• So, there is little reason to believe the benefits of prohibition outweigh the costs.