

# Do institutions affect the expansion of illicit crops?

## Empirical evidence from Colombia\*

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**Abstract** This paper studies the relationship between property rights institutions and the presence of illicit coca leaf plantations. We hypothesize that better structures of property rights result in lower levels of coca plantations since governments are able to exert law enforcement, and households increase potential income out of legal agricultural yield while they are less willing to take part in illegal activities. Furthermore, given specific characteristics of the coca cultivating process, we specify a dynamic model for which common approaches as the OLS and Fixed Effects estimators are biased and inconsistent. Therefore, we use the System GMM estimator, which allows to control for individual specific effects and to introduce lags of endogenous variables as instruments. Additionally, it performs better than similar estimators in the presence of persistent variables. Results suggest that weaker structures of property rights over land have positive effects on the levels of coca leaf plantations. This relation is robust to different specifications, alternative measures of institutions, distinct subsamples and overidentification and serial correlation tests. Additionally, we perform Granger causality test to show that weaker structures of property rights over land Granger-cause an increase in coca leaf plantations whereas the converse causality relationship is rejected.

**Keywords:** Institutions; Property rights; Illicit crops; War on drugs; System GMM.

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# 1 Introduction

The global cocaine market for 2009 was estimated in US\$ 89 billion (2011 US dollars) with 14 to 20.5 million yearly users (United Nations, 2011). The production process takes place in four stages: planting, growing and harvesting of coca leaves, extraction of coca paste, transformation into cocaine base, and finally the conversion of cocaine base into cocaine hydrochloride. The process starts in regions of Bolivia, Colombia and Peru where biological and environmental conditions are optimal for growing the plant and moreover, a culture of coca farming has profound roots in indigenous communities. Most species and varieties of coca plants grow below 1,500 meters, they are perennial, harvested on average four times per year and reach full maturity between 12 and 24 months after sowing the seeds (Bray and Dollery, 1983; Drug Enforcement Administration, 1993; Hanna, 1974; Mejía and Posada, 2008; Morello and Matteucci, 2001; Moreno-Sánchez, Kraybill and Thompson, 2003; Riley, 1993). Figure 1 shows the number of hectares with coca leaf plantations in producing countries. Although most of the harvesting took place in Peru before 1995, in subsequent years there was a shift in production from Bolivia and Peru to Colombia. Two factors that contributed to the reallocation of coca fields were the flight interdiction program implemented between the governments of Peru and the United States, which largely decreased coca paste supply to processing factories in Colombia, and the undermined finances of Colombian guerrillas after the fall of communism (Thoumi, 2002). By 2010, production in Colombia decreased again to 1995 levels due to the implementation of official counter narcotics programs.

Governmental action against the cocaine industry takes place throughout the whole process. Some of the main policies include seizure of raw materials for production, manual and aerial eradication of coca fields, destruction of workshops and laboratories, interdiction of drug shipments, promotion of alternative development and crop substitution programs (Mejía and Posada, 2008). Most of these policies are encouraged and financed jointly by producing and consuming countries. For instance, *Plan Colombia* originated between 1998 and 1999 as a bilateral cooperation program between the governments of Colombia and the United States to fight against illegal drugs and organized crime. The program demanded combined average annual spendings of US\$ 1.7 billion (2011 US dollars) between 1999 and 2005 (National Planning Department, 2006).

Although the implementation of these programs has allowed for important advances in producing countries as finances and capabilities of organized crime have been degraded and coca plantations exhibit decreasing trends, policies such as manual and aerial eradication have not been completely successful and recent studies favor alternatives that focus on increasing households' income from legal activities as for instance the assignment of technical assistance, agricultural loans and more secure forms of property rights (Grossman and Mejía, 2008; Ibáñez, 2010; Mejía and Restrepo, 2008; Moreno-Sánchez et

al., 2003; U.S. Government Accountability Office, 2008).

In particular, better structures of property rights over land have been shown to have positive effects on wages, investment and productivity in legal agricultural activities, which increases potential income in rural households (Besley, 1995; Besley and Burgess, 2000; Deininger, Ayalew and Yamano, 2008; Deininger and Jin, 2006; Demsetz, 1967). On the other hand, weak property rights systems prevent law enforcement and increase social tensions, which generates violence and facilitates illegal recruitment, forced displacement and land appropriation in conflict areas as well as the development of other illegal activities (André and Platteau, 1998; Binswinger, Deininger and Feder, 1995; Collier and Hoeffler, 1998, 2004; Deininger, 2003; Deininger, Jin and Nagarajan, 2007; Fernández, 2010; Velásquez, 2007). Moreover, property rights form part of a broader concept of institutions, defined as the framework and rules under which human interaction develops in societies and one fundamental cause of social and economic outcomes such as poverty, inequality, economic development and growth (Acemoglu, Johnson and Robinson, 2001; Acemoglu, Johnson and Robinson, 2005; Acemoglu and Robinson, 2010; Acemoglu and Verdier, 1998; Besley and Ghatak, 2010; North, 1990; Ostrom, 2009; Rodrik, 1999). Finally, property rights embody a social function and its exercise yields further limitations as they are designed to fulfill collective service as well (Duguit, 1920; Reich, 1964).

Nevertheless, no study has focused on analyzing the relationship between the presence of illicit coca crops and property rights over land. In order to provide a wider understanding of the role of institutions in development and the underlying facts in cocaine production, we investigate whether property rights over land affect the expansion of illicit coca leaf plantations. Moreover, we study the causality linkage between both factors in support for the implementation of feasible policies. we hypothesize that better structures of property rights result in lower levels of coca plantations since governments are able to exert law enforcement, and households increase potential income out of legal agricultural yield while they are less willing to take part in illegal activities.

I provide empirical evidence using subnational-level data from Colombia for the period 2000 to 2008. Data regarding the presence of coca fields is provided by the United Nations Office on Drugs and Crime –UNODC–, which collects the net area used for coca cultivation in each municipality of Colombia<sup>2</sup>. Moreover, we measure property rights institutions with a proxy variable based upon the safeness in land ownership as defined in Colombian legislation. In particular, we use the informality index of property rights over land constructed by Ibáñez and Muñoz-Mora (2010) with data from the cadastral database of the Geographical Institute Agustín Codazzi<sup>3</sup>. The index is a ratio between

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<sup>2</sup>The project Sistema Integrado de Monitoreo de Cultivos Ilícitos –SIMCI– is leaded by the United Nations and the governments of Bolivia, Colombia and Peru. It consists in the identification of illicit coca and opium poppy fields through satellite monitoring

<sup>3</sup>The Geographical Institute Agustín Codazzi –IGAC– is the national authority regarding geography and cadastral information in Colombia. It collects all the cadastral data of the country except for the

cadastral area without legal title over the total cadastral area of a municipality corrected for non-private property. Likewise, we include geographic, political, land and social controls identified in previous studies.

Furthermore, we study the determinants of the presence of illicit coca plantations focusing on the effect of the informality index of property rights over land. The empirical strategy is driven by several facts. For instance, since coca plants are perennial and reach full maturity between 12 and 24 months after sowing the seeds, there is a source of persistence in the presence of illicit coca plantations as past realizations of areas with coca crops affect the current one. Therefore, in order to control for omitted variables bias, past realizations of the extension of coca leaf plantations need to be considered as explanatory variables. Additionally, Colombian municipalities are heterogeneous which points at the existence of fixed individual effects. Finally, the data available is that of small  $T$  and large  $N$ . Consequently, we propose a dynamic specification following Arellano and Bond (1991) and Blundell and Bond (1998) for which common approaches as for instance the OLS and Fixed Effects estimators are biased and inconsistent (Nickel, 1981; Sevestre and Trognon, 1985). Therefore, we use the System GMM estimator developed by Arellano and Bover (1995) and Blundell and Bond (1998), which allows to control for individual specific effects and to introduce lags of endogenous variables as instruments. Additionally, it performs better than similar estimators in the presence of persistent variables (Blundell and Bond, 1998; Blundell, Bond and Windmeijer, 2000). Moreover, we also use the System GMM estimator in performing Granger causality tests to identify the causality linkage between the presence of illicit coca plantations and the informality index of property rights (Granger, 1969; Granger, 2003; Holtz-Eakin, Newey and Rosen, 1989).

Results suggest that weaker structures of property rights over land have positive effects on the levels of coca leaf plantations since the coefficient is positive and statistically significant at the 1 percent level in all estimates. In particular, with all controls included we find a positive effect of 0.849 percent in coca fields per 1,000 hectares as informal properties in a municipality increase by 1 percent. This relation is robust to different specifications, alternative measures of institutions, distinct subsamples and overidentification and serial correlation tests. Additionally, results on the Granger causality test show that higher levels of the informality index of property rights Granger-cause an increase in coca leaf plantations whereas the converse causality relationship is rejected.

This paper is structured in five sections including this introduction. Section two reviews previous research and describes the economic framework. Section three outlines the identification and empirical strategy, describes the data, and presents the results and causality tests. Section four investigates the robustness of my results, and section five concludes.

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cities of Bogotá and Cali and all the municipalities in the Department of Antioquia

## 2 Institutions, violence and illicit crops

Institutions have become an important factor explaining economic outcomes such as poverty, inequality, economic development and growth (Acemoglu et al., 2001; Acemoglu et al., 2005; Acemoglu and Robinson, 2010; Acemoglu and Verdier, 1998; Besley and Burgess, 2000; Besley and Ghatak, 2010; North, 1990; Ostrom, 2009; Rodrik, 1999). For instance, Acemoglu et al. (2005) develop a theoretical model where the interaction between political institutions, economic institutions and the distribution of resources in society is the fundamental cause of economic performance and therefore social aspects as poverty and inequality. Furthermore, studies on the effects of institutions have been based specifically in property rights institutions. In particular, Acemoglu et al. (2001) study the effects of institutions in economic performance with data at the country level using as a measure of institutions and strength in property rights the risk of expropriation constructed by Political Risk Services<sup>4</sup>. The use of the risk of expropriation as a measure for institution relies on the argument that it is related to other institutional guarantees such as constraints on the executive and respect for civil liberties. Additionally, they argue that institutions are persistent and subject to changes due to structural reforms. The study considers additional controls as distance from the equator, climate, religion, natural resources, current disease environment and current race composition. Results show a positive and significant effect of institutions in per capita output.

The literature regarding the effects of property rights extends to additional social and economic outcomes. For instance, Deininger et al. (2008) use a tobit model to assess the effect of property rights on investment, productivity and land values with data from Uganda at the household level. They measure the strength of property rights as a function of transferability and tenure security, constructing indexes for conditional and unconditional rights. The model considers controls for land quality, education, age and gender of the head of the household, distance to the nearest district town and parcel area. Results show greater marginal effects of unconditional rights on land values and investment compared to conditional rights. Likewise, Besley (1995) uses a panel data model with fixed effects using data from Ghana at the household level to investigate the effects of property rights over land on investment. In this study, property rights are measured according to the level of freedom to exercise rights, as it is based on a survey that asked households whether approval from the lineage was necessary to do so. Additionally, it discriminates among different kinds of rights as to sell, rent, mortgage, pledge, bequeath and give land. The model considers controls for sex, education and age of the head of the household, plot size and geographic characteristics as irrigation, presence of trees and road access. Results support the hypothesis that better land rights have a positive effect on invest-

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<sup>4</sup>Political Risk Services is a U.S. based consultancy firm focused on political risk analysis and country data monitoring

ment. Moreover, Deininger et al. (2007) investigate the effects of improving property rights over land through land reforms with data at individual and household level from India using probit and pooled two-stage-least-squares regressions. Results show positive and significant effects of the implementation of land reforms on income, consumption and physical and human capital. The model considers controls for gender, education of the head of the household and his wife, and initial land endowment. Similarly, Besley and Burgess (2000) use panel data models with fixed effects to study the impacts of enhancing property rights via land reforms on growth and poverty. They use data at state level from India, and the model considers controls for tax revenue and economic and social services provided by the government as for instance irrigation, energy, transport, public health and housing. Results show that implementation of land reforms reduce poverty, rise agricultural wages and increase per capita income.

Likewise, local studies in Colombia have focused particularly in studying the relationship between property rights and violence. For instance, Velásquez (2007) uses data at the municipal level to study the effects of property rights on violence through cross-sectional instrumental variable regressions on massacre rates, attacks made by illegal armed groups and number of forced displaced people, controlling for the extension of properties, per capita budget transfers made by the central government, per capita public expenditures in defense and justice, distance to the capital of the department, number of social organizations and poverty. The measure for property rights is constructed upon the safeness in land ownership as defined in Colombian legislation. This study identifies a double causality relationship between violence and the level of property rights which is instrumented with a lagged value. Results show a negative and significant effect of the level of property rights on the number of attacks made by illegal armed groups and the total number of displaced people. Conversely, Fernández (2010) studies the opposite relationship, namely the effect of violence on property rights using two-stage-least-squares regressions on the level of property rights over land, controlling for suitability of land for farming, soil erosion, presence of land registry offices and average extension of coca fields per municipality. The strength of property rights is measured in the same way as in Velásquez (2007). The endogenous variable, which is violence in this case, is instrumented with past values of the literacy rate and an index of electoral competition which are argued to be correlated with violence and exogenous to property rights. Results show a negative and significant effect of violence and average extension of coca fields on the level of property rights.

Furthermore, the objective of this paper is to study the relationship between an economic institution, namely property rights over land and the presence of illicit coca fields. In particular, we study the determinants of the presence of coca leaf plantations in municipalities of Colombia. Previous studies identify geographic, social, institutional and economic factors that have effects on the presence of illicit coca fields. Specifically, Moreno-Sánchez et al. (2003) study the determinants of coca leaf plantations at a national

level following an ordinary-least-squares approach with time-series data from Colombia. They identify positive and significant effects of the coca base price and total eradicated area, and negative and significant effects of the level of other agricultural prices and the total area with coca fields in Peru and Bolivia. In order to address the nature and life cycle of illicit coca leaf plantations, the model is estimated using lags of the explanatory variables and current levels of the dependent variable. However, it fails to account for persistence in the presence of coca fields as the model does not explicitly model an autoregressive process. Additionally, Ibáñez (2010) estimates a seemingly unrelated bivariate probit model to study the determinants of coca farming decisions in rural households in Colombia. The model considers controls for alternative agricultural legal activities, eradication programs, proportion of coca fields in the municipality, number of hectares per landowner and years cultivating coca, moral standards, participation in communitarian organizations, religion, age, gender and education of surveyed farmers. Results show that the decision of cultivating coca relies on the profit difference between coca growing and other legal activities and finds positive and significant effects of the proportion of coca fields, years cultivating coca and the number of hectares per landowner on the decision of cultivating coca.

Likewise, Rocha and Ramírez (2005) use a logit model to study the determinants of illicit coca crops. They identify positive and significant effects of municipal characteristics such as water availability, territorial extension and conflicts over the use of land, percentage of people living in rural areas, quality-of-life index and violence, and negative and significant effects of tax revenue, credit supply, technical assistance, infrastructure, per capita income and agricultural prices. However, this study fails to account for a source of endogeneity regarding violence as Angrist and Kuegler (2008), Díaz and Sánchez (2004), Fernández (2010) and Vélez (2001) provide evidence for a double causality relationship between the presence of illicit coca crops and violence. Finally, Díaz and Sánchez (2004) study the effects of illegal armed groups on the presence of coca fields in Colombia with data at the municipal level. They follow a matching estimators approach in order to overcome the endogeneity issues regarding the territorial expansion of illegal armed groups and violence. On the determinants of the presence of coca leaf plantations, results show positive and significant effects of illegal armed groups activities, poverty, distance to the capital of the department, water availability and soil erosion. On the other hand, they find negative and significant effects of the Gini coefficient for land prices, educational coverage and altitude. Although it may be useful to handle endogeneity, the matching estimators approach includes a conditional bias term and it is in general not consistent unless particular bias-correction procedures are specified (Abadie and Imbens, 2006).

Moreover, the presence of coca fields has been identified to have effects on different economic outcomes. In particular, Angrist and Kuegler (2008) estimate fixed effects linear and logit two-way error component models with data from Colombia at the house-

hold level and controls for sex, age, household size, marital status and migrant status. Their results show positive and significant effects in self-employment income as well as in homicide rates in coca growing regions. Likewise, Dammert (2008) uses a difference-in-difference approach to estimate outcomes in child labor and schooling in rural Peru through a fixed effects linear regression model controlling for gender and age of the child, and age and education of the head of the household. Results show an increase in child labor and no effects on enrollment rates as a consequence of the shift in coca production from Peru to Colombia. Finally, Vélez (2001) studies the determinants of the territorial expansion of illegal left-wing guerrillas in Colombia using a cross-sectional logit model with data at the municipal level. The model considers controls for illicit crops, mining, presence of the government and police forces, poverty and number of forced displaced people. Results show a positive and significant effect of the presence of illicit crops on the territorial expansion of guerrillas.

### 3 Empirical framework

As we describe in sections 1 and 2, there is evidence pointing at a potential relationship between property rights over land and the presence of illicit coca fields. Specifically, recent studies suggest that mechanisms designed to increase households' income from legal activities can have negative effects on the extension of coca leaf plantations (Grossman and Mejía, 2008; Ibáñez, 2010; Mejía and Restrepo, 2008; Moreno-Sánchez et al., 2003). Moreover, previous literature also shows that more secure forms of property rights increase wages, productivity, investment and human capital in rural households, and reduce social tensions that subsequently generate violence and breeding grounds for illegal activities (André and Platteau, 1998; Besley, 1995; Besley and Burgess, 2000; Binswinger et al., 1995; Collier and Hoeffler, 1998, 2004; Deininger, 2003; Deininger and Jin, 2006; Deininger, Jin et al., 2007; Deininger, Ayalew et al., 2008; Fernández, 2010; Velásquez, 2007).

Likewise, we argue that a causality relationship exists between property rights and the presence of coca leaf plantations. On the one hand, property rights over land are not a volatile economic institution and thus they are persistent over time subject to structural reforms implemented by governments, which results in a subsequent relationship with the initial conditions (Acemoglu et al., 2001; Ibáñez and Muñoz-Mora, 2010). On the other hand, the proliferation of coca fields was fueled by the worldwide boom of drug use in the second part of the last century and a reallocation of coca fields among producing countries. Therefore, as this shift in production is exogenous, a positive effect may imply that weaker structures of property rights create the conditions for an expansion of illicit coca leaf plantations.

Furthermore, most studies on the determinants of coca plantations have used cross-



sectional or time-series specifications as data on the subject has been limited (Rocha and Ramírez, 2005; Moreno-Sánchez et al., 2003; Ibáñez, 2010; Díaz and Sánchez, 2004). However, programs implemented jointly by the United Nations and governments in producing countries have provided additional information that allows to use the time dimension through different individual regions and improve this specification with a panel data approach. Likewise, there is a particular characteristic in the coca harvesting process that has not been explicitly addressed by previous studies. As we point out in section 1, coca bushes are perennial and reach full maturity between 12 and 24 months after sowing the seeds (Bray and Dollery, 1983; Drug Enforcement Administration, 1993; Hanna, 1974; Morello and Matteucci, 2001; Moreno-Sánchez et al., 2003; Riley, 1993). This renders a dynamic nature in the presence of coca fields and its consideration allows for a better understanding of the dynamics of adjustment. Furthermore, failing to control for persistence in the presence of coca leaf plantations raises a source of omitted variables bias.

Additionally, these studies coincide regarding the groups of controls included when studying either the presence of coca plantations, or further outcomes explained by illicit coca crops. A common factor is the use of geographic, political and social controls along with characteristics of the structure of land tenure (Angrist and Kuegler, 2008; Dammert, 2008; Díaz and Sánchez, 2004; Ibáñez, 2010; Moreno-Sánchez et al., 2003; Rocha and Ramírez, 2005; Vélez, 2001). Furthermore, the literature points out a double causality relationship between the presence of illicit coca plantations and violence (Angrist and Kuegler, 2008; Díaz and Sánchez, 2004; Fernández, 2010; Vélez 2001).

In sections 3.1 and 3.2, we describe the dataset we use in this research. All sets of controls follow directly from previous studies on the subject as they correspond to the same analytical framework, albeit adjusted to a municipal level. Furthermore, we explain the details of the econometric model in section 3.3 in which we introduce a linear specification as in Moreno-Sánchez et al. (2003) although in a panel data set up, taking into consideration the dynamic nature in the presence of coca leaf plantations and endogeneity issues regarding violence. Results of the estimations are in section 3.4. Finally, in section 3.5, we perform Granger causality tests following Granger (2003) and Holtz-Eakin et al. (1989).

### 3.1 Data

We use a dataset covering years 2000 to 2008 for 892 municipalities in Colombia to carry out this study. Data regarding the presence of coca fields is provided by the United Nations Office on Drugs and Crime –UNODC–, which collects the net area used for coca cultivation in each municipality of Colombia. Coca fields change mainly due to new plantations, abandonment and reactivation of abandoned fields and eradication

programs, and therefore a cut-off date at the end of each year is used in the estimation of the total area under coca cultivation. Furthermore, there are sources of measurement errors regarding the methodology used by UNODC in estimating these areas that need to be highlighted. On the one hand, albeit satellite images are corrected for cloud cover, dates of acquisition and other potential limitations, mountain slopes and recognition of abandoned fields imply further difficulties. On the other hand, the cut-off date at the end of the year rules out short term coca fields that may have produced throughout the year. These drawbacks are partially handled with auxiliary information from the Colombian Government and verification overflights (United Nations, 2011).

Moreover, in this study we follow Acemoglu et al. (2001) in measuring institutions with a proxy variable relying on the strength of property rights. In particular, we use an informality index of property rights over land constructed by Ibáñez and Muñoz-Mora (2010) using data from the cadastral database of the Geographical Institute Agustín Codazzi. The construction of this index is based upon two different land ownership categories defined in Colombia, namely *formal property* and *informal property*<sup>5</sup>. Ownership is said to be *formal* when it involves the title registration and cadastral identification of the property and it is *informal* when there is only the cadastral identification. *Formal* ownership is the most secure form of property rights over land<sup>6</sup>. Furthermore, Ibáñez and Muñoz-Mora (2010) calculated a corrected cadastral area in each municipality by filtering out of the dataset all non-private properties such as indigenous and Afro-Colombian territories, state owned land and natural reserves, and constructed the index as the proportion of *informal property* out of the corrected cadastral area.

$$\text{Informality index land property} = \frac{\text{Area of informal properties}}{\text{Corrected cadastral area}}$$

The bureaucratic procedure for updating cadastral databases with information of legal titles issued by registry offices yields one limitation of the informality index of property rights. This is important as timing in updates varies across municipalities and within areas in a municipality as well. This source of measurement error cannot be eliminated in the scope of this study and therefore the conclusions we derive from this research have to be interpreted considering this limitation.

Likewise, we also consider an alternative measure for institutions. Acemoglu et al. (2005) provide a theoretical background for the relationship among economic and political institutions. Therefore, we use the municipal development index as a proxy variable to measure political institutions. The municipal development index is constructed by the

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<sup>5</sup>The definition of *formal property* and *informal property* in Colombian legislation parallels the concepts of *de jure* and *de facto* property rights described by Ostrom and Schlager (1992). This is, *formal property* is given full lawful recognition by legal instrumentalities whereas *informal property* originates as a claim by land users

<sup>6</sup>Land formalization programs led by the Ministry of Agriculture and the National Institute for Rural Development aim mainly at issuing registry titles to owners of *informal properties*

National Planning Department each year and it is intended to be a measure of general performance of the municipal government in social and financial aspects. It considers social variables such as energy, water and sewerage coverage, poverty, literacy rates and schooling coverage, and financial variables such as tax revenue.

Furthermore, we use the homicide rate per 100,000 inhabitants as a proxy variable for violence. This data is provided by the Presidential Program on Human Rights and International Humanitarian Law, which collects the number of homicides per municipality in Colombia.

Moreover, we consider four sets of additional controls in the dataset. First, we use a time-invariant geographic vector with data on altitude, distance to the nearest main national market<sup>7</sup>, distance to the capital of the department, suitability of land for farming and soil erosion. This data is provided by the Geographic Institute Agustín Codazzi.

Second, we use a political vector with information regarding state action carried out in each municipality. In particular, it has data for public per capita expenditures in education, health and justice and the number of agricultural loans per 1,000 inhabitants. Information for public expenditures is provided by the National Planning Department and information on agricultural loans by the Banco Agrario de Colombia, a state owned bank focused on rural development and agricultural banking.

Third, we use a vector of two land variables. The first component is the land quality Gini index, which is a Gini index based upon the minimum number of hectares a rural household needs in order to produce enough resources for long-term wellbeing<sup>8</sup>. A second component is the number of hectares per landowner. Data to construct these variables is provided by the Geographic Institute Agustín Codazzi.

Finally, we consider a vector of social variables. Its first component is health coverage, which is provided by the Minister of Health and Social Protection. Up to 2004, the Minister reported health coverage for people living with insufficient basic needs. From 2005 on, the report is for health coverage of the subsidized health care system. The second component is the proportion of people living in rural areas in each municipality which is constructed with data from the National Department of Statistics.

## 3.2 Descriptive statistics

Table 1 presents average summary statistics for time-varying variables per year. The average yearly proportion of coca fields per 1,000 hectares declines up to year 2002 when it stabilizes with few variations per year between 2002 and 2008. This can be seen not only

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<sup>7</sup>The main national markets in Colombia are Bogotá, Medellín, Cali and Barranquilla, which concentrate 29% of the total population as of 2010

<sup>8</sup>The number of hectares a rural household needs in order to produce enough resources for long-term wellbeing varies from one municipality to another. It is determined by the National Institute for Rural Development according to environmental, social and economic characteristics of each municipality

in the national average but in the standard deviation which also stabilized from year 2002 on. Moreover, the average informality index in property rights over land shows a yearly small reduction for the period covered. This is of no surprise, since the formalization process is progressive and slow and it is not expected for a property with a legal title to suddenly lose it. However, there is an increase between the years 2004 and 2005 which may be due to actualization processes in cadastral databases that change total areas in municipalities as a result of the application of improved measurement techniques.

Moreover, the average municipal development index shows an upward trend for the period 2000 to 2008 with exceptions for the years 2003 and 2007. These two years correspond to the last year in office for current municipal incumbents which may provide a political explanation for this phenomena. Furthermore, the average homicide rate shows a downward trend with high levels of variability among municipalities. Additionally, a remarked difference can be identified for two different periods as the homicide rate ranged between 52 and 60 for the period 2000-2003 to a range between 33 and 40 homicides per 100,000 inhabitants for the period 2005-2008 with a middle point at 44 in 2004.

Average public per capita expenditures in education and justice present no trend for the period 2000-2008 and a high variability among municipalities can be identified in the standard deviations. However, average public per capita expenditures in health show a remarked increase for the last four years. Moreover, the average number of agricultural loans per 1,000 inhabitants presents no trend for the first half of the period covered with a similar situation in the second half. Nevertheless, it ranges between higher levels in the last years.

Moreover, the average land quality Gini index and the average number of hectares per landowner exhibit few changes in the period 2000 to 2008. This is an expected situation since changes in the structure of land tenure are those of long-term, usually as a result of land reforms. Finally, average health coverage presents an upward trend for the period covered in the dataset. However, it is important to notice that this upward trend splits for the periods 2000-2004 and 2005-2008, this is due to the change in measurement methodology followed by the Minister of Health and Social Protection. Finally, the proportion of people living in rural areas presents a downward trend for the years 2000-2004 followed by an increase in the year 2005 and no trend for the rest of the period. An important factor in changes of this rurality index is the forced displacement caused in rural areas of Colombia because of violence, which resulted in massive migrations from rural to urban areas in the first part the decade. The national census carried out in 2005 may be the cause of the sudden increase that is identified this year. Finally, heterogeneity across municipalities can be seen in all time-varying variables by comparing means and standard deviations.

Furthermore, table 2 presents summary statistics for time-invariant geographic characteristics. These variables exhibit the same behavior as all time-varying variables regarding

heterogeneity across municipalities.

Table 3 summarizes means and standard deviations for all variables taking averages over the period of study. The first column presents statistics for municipalities that never had illicit coca plantations, the second column for those municipalities that ever had illicit crops and the third column presents the respective differences. Furthermore, the difference in the informality index is negative and statistically significant, pointing at a higher level of informality in municipalities that ever had illicit crops. This is also true for the homicide rates. On the other hand, the municipal development index shows the converse situation, this is, higher levels of municipal development in municipalities that never had illicit coca plantations.

Moreover, table 4 shows transition probabilities on the presence of coca fields. It shows that 97.77% of the municipalities where there were no coca fields at a given period remained without them for the next period. Respectively, 85.98% of the municipalities where there were coca fields at one period remained holding coca crops the next period. Furthermore, table 5 presents tabulations on the presence of illicit fields. It shows that on average 13.91% of the municipalities in Colombia had illicit coca fields and 21.64% ever had them. Likewise, 64.31% of the municipalities that ever had coca fields, had them during all the periods subject of study.

Additionally, table 6 presents correlation coefficients for relevant variables. Three important facts to note are first, the proportion of coca fields per 1,000 inhabitants has a positive and significant correlation with the informality index in property rights over land as well as with the homicide rate. Conversely, it has a negative and significant correlation with the municipal development index. Second, the homicide rate has no significant correlation with the informality index and a negative and significant correlation with the municipal development index. And finally, the informality index has positive or negative significant correlations with all other controls except for the homicide rate and public per capita expenditures in education and justice.

Furthermore, figure 2 presents a map of Colombia at the municipal level describing the presence of coca fields and the informality index of property rights. It shows quartiles of the average informality index and whether there were coca fields in a municipality in any year for the period 2000-2008. Notably, the south-west and central regions, which are on the fourth quartile of the informality index hold most of the illicit coca fields identified during the period subject of study, and the converse applies for regions in lower quartiles of the informality index. This relationship can be seen in figure 3 as well, which presents a linear fit between the proportion of illicit coca fields per 1,000 hectares and 100 quantiles of the informality index of property rights over land.

Finally, table 7 describes between and within variations for all time-varying variables in the dataset. The proportion of coca fields per 1,000 hectares presents similar variations between municipalities and within each municipality although the variation within each

municipality is higher. Moreover, for the informality index of property rights over land, the variation within each municipality was notably smaller than the variation between municipalities. An expected situation due to the slow progress in formalization programs.

### 3.3 Estimation strategy

In this paper we study the determinants of the presence of illicit coca plantations. In particular, we focus on the effects of the informality index of property rights over land. As we argue in section 1, this relationship is characterized by several relevant facts. First, the process is dynamic in the sense that past realizations of the proportion of area in a municipality with illicit coca fields may affect the current one since coca plantations are perennial and reach full maturity between 12 and 24 months after sowing the seeds (Bray and Dollery, 1983; Drug Enforcement Administration, 1993; Hanna, 1974; Morello and Matteucci, 2001; Moreno-Sánchez et al., 2003; Riley, 1993). Failing to account for characteristics of persistence in the presence of coca fields may yield a source of omitted variable bias. Second, heterogeneity among municipalities is an indicator of the existence of fixed individual effects, which argues against cross-sectional regressions and favors a panel data set up that allows to use the variation over time to estimate the parameters and rule out other sources of potential omitted variables bias. Third, there is empirical evidence suggesting that one control, violence, holds a double causality relationship with the presence of illicit coca fields (Angrist and Kuegler, 2008; Díaz and Sánchez, 2004; Fernández, 2010; Vélez, 2001). Fourth, there is no evidence to assume that idiosyncratic disturbances do not have patterns of heteroskedasticity and serial correlation. Finally, the data available is that of small  $T$  and large  $N$  with 9 time periods covering years 2000 to 2008 and 892 municipalities.

Given these considerations, we follow Holtz-Eakin, Newey and Rosen (1988), Arellano and Bond (1991), Arellano and Bover (1995) and Blundell and Bond (1998) and propose a linear specification of the following form:

$$y_{it} = \alpha y_{it-1} + \delta p_{it} + \gamma h_{it} + \mathbf{x}'_{it}\beta + \varepsilon_{it} \quad (1)$$

Where the subindex  $i$  stands for the municipality and  $t$  for the time period. The dependent variable  $y$  represents the proportion of illicit coca fields and its first lag is introduced as explanatory variable,  $p$  is the informality index of property rights over land,  $h$  is the homicide rate, a proxy variable for violence and therefore it is known to be endogenous. Finally,  $\mathbf{x}$  is a vector of geographic, political, land and social controls. The parameter of interest is  $\delta$  and it is expected to be positive.

Furthermore, the disturbance term has two orthogonal components. A fixed effect  $\mu_i$

and an idiosyncratic shock  $v_{it}$ , such that:

$$\begin{aligned}\varepsilon_{it} &= \mu_i + v_{it} \\ E[\mu_i] &= E[v_i] = E[\mu_i v_i] = 0\end{aligned}\tag{2}$$

As it is pointed out by Baltagi (2008), beyond the consideration of endogeneity issues with  $h$ , the introduction of a lag of the dependent variable in (1) yields a situation known as *dynamic panel bias*. For instance, since  $y_{it}$  is a function of  $\mu_i$ ,  $y_{it-1}$  is also a function of  $\mu_i$  and thus it is correlated with the error term. This implies that the OLS estimator is biased and inconsistent (Sevestre and Trognon, 1985). Furthermore, although the within transformation<sup>9</sup> for the Fixed Effects estimator removes  $\mu_i$ , the idiosyncratic shock  $v_{it-1}$  is correlated with  $y_{it-1}$  and therefore in the transformed model  $(y_{it-1} - \bar{y}_{i.-1})$  will be correlated with  $(v_{it} - \bar{v}_{i.})$ . This renders the Fixed Effects estimator to be biased and inconsistent as well (Nickel, 1981).

Two approaches that follow the generalized-method-of-moments developed by Hansen (1982) to overcome the *dynamic panel bias* are the Difference GMM estimator, proposed by Holtz-Eakin et al. (1988) and Arellano and Bond (1991) in which the data is converted using the first-difference transformation<sup>10</sup> in order to remove the fixed effects, and the System GMM estimator, developed by Arellano and Bover (1995) and Blundell and Bond (1998), where instead of transforming the regressors, the instruments are transformed so as to make them exogenous to the fixed effects. Specifically, System GMM not only estimates the equations in first-differences but it also estimates the equations in levels, instrumented with lagged first-differences of the corresponding variables. Therefore, the first set of moment conditions exploited by the System GMM estimator are those of the first-difference transformation, namely<sup>11</sup>:

$$\begin{aligned}E[y_{it-s}\Delta\varepsilon_{it}] &= 0; \text{ for } t = 3, \dots, T, 2 \leq s \leq t-1 \\ E[w_{is}\Delta\varepsilon_{it}] &= 0; \text{ for } t = 3, \dots, T, 1 \leq s \leq T \text{ and any exogenous covariate } w \\ E[w_{it-s}\Delta\varepsilon_{it}] &= 0; \text{ for } t = 3, \dots, T, 2 \leq s \leq t-1 \text{ and any endogenous covariate } w\end{aligned}\tag{3}$$

Additionally, an identifying assumption is required to make the first-differences of the explanatory variables exogenous to the fixed effects even if the fixed effects are correlated

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<sup>9</sup>The within transformation takes the levels equation  $y_{it} = \alpha y_{it-1} + \beta x_{it} + \mu_i + v_{it}$  and subtracts out the average over time  $\bar{y}_{i.} = \alpha \bar{y}_{i.-1} + \beta \bar{x}_{i.} + \mu_i + \bar{v}_{i.}$ . The resulting model is of the form  $(y_{it} - \bar{y}_{i.}) = \alpha(y_{it-1} - \bar{y}_{i.-1}) + \beta(x_{it} - \bar{x}_{i.}) + (v_{it} - \bar{v}_{i.})$

<sup>10</sup>The first-difference transformation is performed by multiplying  $y_{it} = \alpha y_{it-1} + \beta x_{it} + \mu_i + v_{it}$  by  $\mathbf{I}_N \otimes \mathbf{M}_\Delta$  with  $\mathbf{I}_N$  being an identity matrix of order  $N$  and  $\mathbf{M}_\Delta$  a matrix with diagonal of  $-1$ s and a sub-diagonal of  $1$ s to the right. The transformation yields  $\Delta y_{it} = \alpha \Delta y_{it-1} + \beta \Delta x_{it} + \Delta v_{it}$ . Although the term  $y_{it-1}$  in  $\Delta y_{it-1}$  is still correlated with  $v_{it-1}$  in  $\Delta v_{it}$ , longer lags of the regressors are orthogonal to the error term and can be used as instruments (see Roodman (2009b) for additional details)

<sup>11</sup>We do not include orthogonality conditions corresponding to predetermined or weakly exogenous variables as no covariate is considered as such in the model. See the appendix for a further explanation on orthogonality conditions regarding predetermined variables

with the variables in levels (Arellano and Bover, 1995; Blundell and Bond, 1998). This is<sup>12</sup>:

$$\begin{aligned} E[\Delta y_{it-1} \varepsilon_{it}] &= 0; \text{ for } t = 3, \dots, T \\ E[\Delta w_{it} \varepsilon_{it}] &= 0; \text{ for } t = 2, \dots, T \text{ and any exogenous covariate } w \\ E[\Delta w_{it-1} \varepsilon_{it}] &= 0; \text{ for } t = 3, \dots, T \text{ and any endogenous covariate } w \end{aligned} \quad (4)$$

Moreover, if these additional moment conditions are valid, the System GMM estimator outperforms the efficiency of the Difference GMM counterpart, specially when explanatory variables are persistent or the number of time series observations is small relative to the number of individuals (Blundell and Bond, 1998; Blundel et al., 2000).

Furthermore, although both estimators are consistent and use the first-difference transformation to remove sources of potential omitted variables bias, the System GMM estimator is preferable in the proposed framework for a number of reasons. First, as the additional moment conditions given by (4) are overidentifying restrictions, they can be assessed empirically by using standard tests of overidentification and serial correlation and therefore achieve a substantial gain in efficiency (Blundell and Bond, 1998). Second, since the specification considers a set of time-invariant geographic controls, these explanatory variables would disappear when performing the first-difference transformation required for the Difference GMM estimator. By using the System GMM estimator, time-invariant covariates can be considered in the model. Therefore, we use System GMM to estimate the parameters in (1).

However, when implementing the System GMM estimator, the number of instruments grows exponentially with the number of time periods in the panel and thus the gain in efficiency due to further orthogonality conditions comes with additional costs. The proliferation of instruments causes three difficulties. First, a bias in coefficient estimates because instruments over-fit instrumented variables (Ziliak, 1997; Windmeijer, 2005). Second, an increase in the likelihood of false-positive results in the Hansen test of overidentification restrictions (Andersen and Sørensen, 1996; Bowsher, 2002). Finally, a downward bias in coefficient standard errors when performing the two-step GMM estimation (Windmeijer, 2005). In order to overcome these difficulties, we reduce the instrument count by using a collapsed instruments matrix (Christiaensen, Demery and Kuhl, 2011; Heid, Langer and Larch, 2012; Beck and Levine, 2004; Roodman, 2009b). Furthermore, we employ Windmeijer (2005) finite-sample correction for standard errors. For additional specificities on the empirical strategy we provide a detailed explanation of the System GMM estimator in the Appendix.

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<sup>12</sup>In order to exploit these additional moment conditions the dataset is stacked with both the transformed and the untransformed observations. This is done by multiplying the original dataset by  $\mathbf{M} = (\mathbf{M}_\Delta \mathbf{I})'$  which yields an augmented dataset of the form  $\mathbf{X}_i = (\Delta \mathbf{x}_i \mathbf{x}_i)'$ ,  $\mathbf{Y}_i = (\Delta \mathbf{y}_i \mathbf{y}_i)'$  for each individual  $i$ . Information for all covariates is in matrix  $\mathbf{x}$  and  $\mathbf{M}_\Delta$  is the matrix used in the first-difference transformation, a matrix with diagonal of  $-1$ s and a sub-diagonal of  $1$ s to the right (see Roodman (2009b) for further details)



### 3.4 Results

We estimate three different characterizations of the model. In the most parsimonious version we do not consider the homicide rate as explanatory variable. This allows to observe the effect of informality without the influence of violence and serves as a baseline analysis on the relationship between property rights and the presence of illicit coca fields. A second characterization introduces violence. However, even though Angrist and Kuegler (2008), Fernández (2010), Sánchez and Díaz (2004) and Vélez (2001) provide evidence to consider endogeneity concerns in the relationship between coca leaf plantations and violence, we do not control for endogeneity. The final characterization controls for endogeneity matters regarding the homicide rate.

As the lag of the presence of illicit coca fields is endogenous by construction, it is instrumented with (collapsed) lags 2 and further in all estimations. Furthermore, the homicide rate is handled in the same manner when instrumented. The usefulness of these instruments is supported by overidentification and serial correlation tests, which we discuss in detail in sections 4.1 and 4.2. Likewise, as autocorrelation tests and robust estimates of the standard errors assume no contemporaneous correlation across individuals, all estimates consider time dummies.

Table 8 shows the results for the first characterization of the model. Three relevant facts are important to highlight. First, the effect of the informality index in the presence of coca fields per 1,000 hectares is positive and highly significant in all regressions. Second, as more controls are considered in the model there is a moderate reduction in the magnitude of the coefficient of the informality index. Furthermore, the geographic controls seem to have the strongest decreasing effect since after their introduction the coefficient hardly diminishes. This stands for a strong relationship between the informality index in property rights and the presence of coca plantations. Finally, the coefficient of the lag of the dependent variable is smaller than 1 in all regressions, a condition pointed out by Blundell and Bond (1998) so that the dynamic process converges. In addition, the coefficient is positive and highly significant. This is relevant in assessing the specification of the model.

Table 9 presents the results for the second characterization of the model. A first relevant fact is that the coefficient of the informality index in property rights barely changes compared to the parsimonious characterization. It remains both positive and highly significant in all regressions and the magnitudes are mildly smaller. As in the previous estimates, the strongest decreasing effect in the magnitude of the coefficient is brought about by the introduction of geographic controls. Likewise, the coefficient of the homicide rate is also positive and significant in all regressions. Finally, the coefficient of the lag of the dependent variable remains smaller than 1.

Table 10 shows the results for the model where endogeneity issues concerning the

homicide rate are handled. Several facts are important to mention regarding this characterization. First, results for the informality index are robust to the instrumentation of violence as the coefficient is still positive and highly significant in all regressions. Second, the magnitude of the coefficient of the informality index increases and reaches similar but higher levels than those of the first characterization. Third, as in the previous two cases, the introduction of geographic controls yields the most important reduction in the magnitude of the coefficient of the informality index. Likewise, the consideration of further controls causes less decreasing effect. Fourth, the coefficient of the lagged value of the dependent variable presents similar values as in previous characterizations of the model. It is a positive and highly significant coefficient smaller than 1. In addition, the effect of violence in the presence of coca fields is higher when controlling for endogeneity issues and the coefficient is still positive and significant in all regressions. Finally, the usefulness of instruments for the homicide rate and lagged value of the dependent variable is supported by overidentification and serial correlation tests. On the other hand, column (5) of this table renders significant coefficients for 9 of the explanatory variables considered in the specification. we now focus on the interpretation of signs and magnitudes of the coefficients for relevant variables.

As the subject of study in this paper, the coefficient of the informality index in property rights was expected to be positive, a result that is confirmed in all estimates. This validates the hypothesis that weaker institutions, measured as weaker structures of property rights over land have a positive effect on the levels of coca leaf plantations. As the informality index of property rights and the dependent variable are proportions, the coefficient of 0.849 is to be interpreted as a positive effect of 0.849 percent in coca fields per 1,000 hectares as informal properties in a municipality increase by 1 percent.

Furthermore, the coefficient of the homicide rate is positive and significant in all regressions. This finding confirms the results from other empirical studies that found a positive effect of violence on the presence of coca fields (Angrist and Kuegler, 2008; Díaz and Sánchez, 2004; Fernández, 2010; Vélez, 2001). As the homicide rate can be read as a percentage as well, the interpretation of the magnitude of the coefficient follows directly from the previous case. Results show a positive effect of 0.007 percent in coca fields per 1,000 hectares as the homicide rate per 100,000 inhabitants increases by 0.01.

On the other hand, geographic characteristics as distance to the nearest main national market and distance to the capital of the department have positive and significant effects on the presence of coca leaf plantations. This is an expected outcome as far-off municipalities are more likely to be subject of illegal activities and confirms the findings by Díaz and Sánchez (2004) concerning the effect of the distance to the nearest main national market on the presence of illicit plantations.

Furthermore, the number of agricultural loans per 1,000 inhabitants shows a negative and significant effect on the presence of illicit coca plantations which confirms the findings

by Rocha and Ramírez (2005). Agricultural loans are aimed at promoting legal farming and therefore provide an alternative source of income to peasants that otherwise would be growing coca fields. Ibáñez (2010) finds a similar relationship, as her results show that the decision of cultivating coca relies on the profit difference between coca growing and other legal activities.

Likewise, the number of hectares per landowner, a measure of the average plot size per municipality, shows a negative and significant effect on the presence of illicit coca plantations. This also confirms the findings by Ibáñez (2010) on the effect of the number of hectares per landowner on coca growing decisions in rural households.

Moreover, health coverage shows a negative and significant effect on the proportion of illicit coca plantations. This is an expected result as similar relationships for other social characteristics such as educational coverage and quality-of-life index are in Díaz and Sánchez (2004) and Rocha and Ramírez (2005). On the other hand, the proportion of people living in rural areas shows positive and significant effects on the proportion of illicit coca fields confirming the same result in Rocha and Ramírez (2005).

Finally, the one year lag of the dependent variable presents a positive and significant effect on its current value. There are two important facts regarding this result. First, the maturity of coca plantations is reached between 12 and 24 months after the seeds are sown and therefore it is likely for a coca growing peasant to pursue further periods of harvest at least for the year following the sowing time. Second, it confirms the findings by Ibáñez (2010) on the effect of years cultivating coca on the coca growing decisions in rural households. Moreover, the coefficient is smaller than 1 which is a necessary condition for the process to converge (Blundell and Bond, 1998).

### 3.5 Causality tests

We study whether there exists a causal relationship between informality in property rights over land and the presence of illicit coca leaf plantations. we do so by performing standard Granger causality tests which were originally designed for time-series but have recently been extended to panel data analysis (Granger, 1969; Granger, 2003; Holtz-Eakin, Newey and Rosen, 1989). The causality linkage is studied upon the following two models:

$$y_{it} = \alpha y_{it-1} + \sum_{j=0}^2 \delta_j p_{it-j} + \varepsilon_{it} \quad (5)$$

$$p_{it} = \delta p_{it-1} + \sum_{j=0}^2 \alpha_j y_{it-j} + \varepsilon_{it} \quad (6)$$

Where, as in section 3.3, the subindex  $i$  stands for the municipality and  $t$  for the time period,  $y$  represents the proportion of illicit coca fields while  $p$  is the informality index

of property rights over land. Although these models could be estimated using different consistent estimators as for instance Difference GMM, we estimate the models following a System GMM approach to rule out *dynamic panel bias* and gain a substantial efficiency. Furthermore, the first-difference transformation used in the estimation allows for fixed-individual effects. Therefore, conditions analogous to those given by (2), (3) and (4) are assumed to be satisfied in both cases. The test of weather informality in property rights does not Granger-cause an increase in coca leaf plantations is a test of the joint hypothesis  $\delta_0 = \delta_1 = \delta_2 = 0$  after estimating model (5). The converse relationship is tested in the same way for the model specified in (6) and the joint hypothesis  $\alpha_0 = \alpha_1 = \alpha_2 = 0$ . we do this with standard  $F$ -tests.

Table 11 presents results for the estimation of model (5) including one and two lags of the informality index of property rights. In both cases the F test for no Granger causality is rejected which implies that higher levels of the informality index of property rights Granger-cause an increase in coca leaf plantations. Respectively, table 12 presents results for the System GMM estimation of model (6) including one and two lags of the proportion of coca fields per 1,000 hectares. In this case, the F test of no Granger causality is not rejected at any level of significance which yields no causality in this direction. Moreover, the Hansen test for the specification of both models is not rejected in any case. The same is true for the Difference-in-Hansen test, which tests the validity of the additional orthogonality conditions for the System GMM estimation given by the moments analogous to those in (4) for each model. The instruments used for the endogenous variables are also supported by Arellano-Bond tests of serial autocorrelation as (collapsed) lags 2 and further are used as instruments in each case. See the Appendix for further details on the validity of the System GMM estimation.

Although Granger causality does not necessarily implies true causality as third party variables may affect both series, the test provides an insight in the causality linkage between the presence of illicit coca plantations and informality in property rights.

## 4 Robustness analysis

### 4.1 Overidentification tests

The usefulness of the generalized-method-of-moments procedure requires the instruments to be exogenous. This is true if the set of orthogonality conditions given by (3) and (4) are fulfilled. Therefore, we investigate the validity of my approach by performing the Hansen test of overidentification restrictions (Hansen, 1982). The null hypothesis of the test is a correct specification of the model and the validity of the orthogonality conditions. If either of these two assumptions is questionable the test is rejected.

Tables 8, 9 and 10 report the  $p$ -value for the Hansen test of overidentification re-

strictions. Interestingly, the null hypothesis of correct specification and validity of the orthogonality conditions is never rejected. Moreover, the latter characterization of the model in which we control for endogeneity concerns with the homicide rate shows a remarkable improvement in the results of the test, which stands for a refined specification. Likewise, as it can be seen in table 13, the use of political institutions as an alternative measure for institutions is robust to this analysis as well.

### Testing for subsets of instruments

In addition to the Hansen test of overidentification restrictions where the full set of orthogonality conditions is considered, we use the Difference-in-Hansen test for subsets of instruments (Newey, 1985). This test computes the increase in the statistic of the Hansen test whenever a given subset of suspect instruments is added to the specification, i.e., the statistic of the Difference-in-Hansen test is the difference between the statistic of the Hansen test with the full set of instruments and the statistic of the Hansen test without suspect instruments. The null hypothesis of the test is the joint validity of the orthogonality conditions corresponding to a determined subset of suspect instruments. Furthermore, we perform the Difference-in-Hansen test for the System GMM suspect instruments given by (4). This is particularly important in assessing the additional conditions required for the use of the System GMM estimator as this estimator is more efficient than its Difference GMM counterpart only if the orthogonality conditions in (4) are valid.

Results for the  $p$ -value of the Difference-in-Hansen test are reported in tables 8, 9 and 10 for the model with the informality index, and in table 13 for the model with the municipal development index. The null hypothesis of joint validity of the orthogonality conditions given by (4) is not rejected in any case. Additionally, as in the case of the Hansen test of overidentification restrictions, results of the Difference-in-Hansen test largely improve in the latter characterization of the model in which the homicide rate is instrumented.

## 4.2 Autocorrelation tests

We also investigate the validity of the instruments by looking for autocorrelation in the idiosyncratic shocks  $v_{it}$ . This is important as the presence of serial correlation renders some specific lags invalid as instruments (Arellano and Bond, 1991). Since the full disturbance  $\varepsilon_{it}$  is presumed to be serially correlated because of the presence of the fixed effects  $\mu_i$ , we use Arellano and Bond (1991) test for serial correlation which is applied to the residuals after the first-difference transformation, namely  $\Delta v_{it}$ .

Results for the Arellano and Bond (1991) test for serial correlation of order 1 and 2 are reported in tables 8, 9 and 10 for the model with the informality index as a measure

of economic institutions, and in table 13 for the model with the municipal development index as a measure of political institutions. The null hypothesis of the tests is no serial correlation of order 1 and 2 respectively. Notably, in all results the null hypothesis of no serial correlation of order 1 is rejected and the converse applies to serial correlation of order 2. This supports the validity of the specification of the model and usefulness of lags 2 and further as instruments for endogenous variables (Arellano and Bond, 1991).

### 4.3 Political institutions

We investigate the robustness of my results using an alternative measure for institutional features. In particular, we follow the theory developed by Acemoglu et al. (2005) on the dynamic interaction between political and economic institutions and based on this relationship we use a proxy variable for political institutions. The underlying rationale of the theory is that political institutions such as a democratic process to elect the head of the executive determine further economic institutions such as property rights over land.

As we point out in section 3.1, the municipal development index is a measure of performance for local governments and is constructed upon results on social and financial matters. Therefore, we argue that a higher municipal development index implies a more efficient set of political institutions at the local level. Moreover, following a similar postulate as that in the beginning of section 3 in the case of property rights over land, political institutions persist over time subject to structural reforms implemented by the constituent (Acemoglu et al., 2001). Hence, it follows that political institutions are a potential exogenous determinant of the presence of illicit coca leaf plantations.

In table 13, results show a negative and significant effect of the municipal development index on the presence of illicit coca plantations. Additionally, as more controls are considered there is a moderate reduction in the absolute value of the magnitude of the coefficient and the highest decreasing effect is brought about by the introduction of geographic controls. These results confirm the outcome of section 3.4 so that weaker institutions, whether political or economic, yield higher levels of coca leaf plantations per 1,000 hectares. All regressions correspond to the latter characterization of the model, in which the lag of the dependent variable and the homicide rate are considered endogenous and instrumented with (collapsed) lags 2 and further. Finally, overidentification and serial correlation tests validate the usefulness of the selected instruments.

### 4.4 Alternative samples

We also analyze the robustness of my results by using two alternative subsamples. First, we consider only municipalities located in departments (states) that ever had illicit coca plantations. This allows to study the relationship between property right institutions and coca crops only in those regions that have been characterized for having crops, which

may correspond either to environmental or strategical features, as these regions may facilitate for instance transport of coca leaves. Second, we include only municipalities that are located below 1,500 meters, which is the optimal altitude for growing the plant. This second subsample rules out municipalities that are not expected to have illicit crops.

Table 14 presents results for the System GMM estimation using both subsamples. The coefficient of the informality index of property rights over land is positive and statistically significant in all estimates, which supports results from section 3.4. All regressions correspond to the latter characterization of the model, in which the lag of the dependent variable and the homicide rate are considered endogenous and instrumented with (collapsed) lags 2 and further. Similarly, overidentification and serial correlation tests validate the usefulness of the selected instruments.

## 5 Concluding remarks

In this paper, we explore the relationship between property rights over land and the presence of illicit coca leaf plantations. Previous literature outlines this relationship in two respects. On the one hand, it shows that more secure forms of property rights increase wages, productivity, investment and human capital in rural households, and reduce social tensions that subsequently generate violence and breeding grounds for illegal activities (André and Platteau, 1998; Besley, 1995; Besley and Burgess, 2000; Binswinger et al., 1995; Collier and Hoeffler, 1998, 2004; Deininger, 2003; Deininger and Jin, 2006; Deininger, Jin et al., 2007; Deininger, Ayalew et al., 2008; Fernández, 2010; Velásquez, 2007). On the other hand, it suggests that mechanisms attempting to increase households' income from legal activities can have negative effects on the extension of coca leaf plantations (Grossman and Mejía, 2008; Ibáñez, 2010; Mejía and Restrepo, 2008; Moreno-Sánchez et al., 2003). Moreover, we also exploit the exogenous shift in coca production from Bolivia and Peru to Colombia and characteristics of persistence in property rights institutions to imply a causal relationship. This is, weaker structures of property rights create the conditions for an expansion in illicit coca leaf plantations.

Furthermore, given specific characteristics of the coca cultivating process, we specify a dynamic model for which common approaches as the OLS and Fixed Effects estimators are biased and inconsistent (Nickel, 1981; Sevestre and Trognon, 1985). Therefore, we use the System GMM estimator which allows to control for individual specific effects and to introduce lags of endogenous variables as instruments. Additionally, it performs better than similar estimators in the presence of persistent variables (Arellano and Bover, 1995; Blundell and Bond, 1998; Blundell et al., 2000). Likewise, we perform Granger causality tests to study the causality linkage between property rights and the presence of coca plantations (Granger, 1969; Granger, 2003; Holtz-Eakin et al., 1989).

Results suggest a positive effect between weaker structures of property rights over land

and levels of coca leaf plantations. Specifically, we find an effect of 0.849 percent in coca fields per 1,000 hectares as informal properties in a municipality increase by 1 percent. The relation is robust to different specifications, alternative measures for institutions, distinct subsamples and overidentification and serial correlation tests. Moreover, Granger causality tests show that higher levels of the informality index in property rights Granger-cause an increase in coca leaf plantations whereas the converse causality relationship is rejected.

Overall, these results point at the design of counter narcotics policies based on the assignment of more secure forms of property rights over land, as this can have a negative impact on the extension of illicit coca leaf plantations. Interestingly, by implementing such policies, a reduction in the presence of coca plantations may come along with gains in economic performance, and reductions in poverty and inequality which is expected under better institutions. However, although enhancing property rights is in principle feasible for producing countries, its implementation yields further difficulties, particularly in violent regions where control of the state is not complete. Therefore, additional studies on land reform and alternative ways to improve property rights should accompany the implementation of further policies.

Finally, we identify two limitations concerning the data for this study. First, there exists a source of measurement errors for the informality index in property rights and the presence of illicit coca plantations. Both follow respectively from the methodologies used by Colombian cadastral authorities and the United Nations Office on Drugs and Crime. Second, there is a potential inconsistency for certain municipalities regarding data for the informality index and coca crops as estimations for areas under coca cultivation do not discriminate for instance for indigenous and Afro-Colombian territories, state owned land and natural reserves. These lands are not considered when constructing the informality index in property rights over land as more secure forms of property rights are not feasible unless special procedures are implemented to subtract particular properties out of them. This could be controlled by considering spacial meta-data from UNODC estimations and cadastral information. Innovative alternatives to overcome these difficulties and then redo the estimations may provide more robust results.



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