

Economics of the Illicit-Drug Market

The efficient allocation of resources has always been a significant topic in economics regardless of the context of the particular allocation. The illicit drug market is no exception. However, this market exhibits some unique economic qualities that need to be called to attention in order for proper consideration to be given for the allocation of resources to control this market. Drug use is often blamed for a wide range of personal and social problems including: loss of productivity, diminished health, moral degradation, excessive violence, the spread of disease, and many others. Accordingly, our policy decisions have reflected our distaste for these consequences, and we have tried to outlaw drug-use altogether. However, as will be shown, the costs associated with these problems are tremendous, and we must now call into question whether or not current forms of prohibition and resource allocation are an effective and efficient means of attacking these problems.

In particular, a major problem that must be called to the attention of policy makers, and the economists who advise on their behalf, is the observation and recognition of a nearly perfectly inelastic supply of drug offenders—dealers—at the street level. In other words, the supply of these offenders in the illicit drug market is not sensitive to the price of crime (punishment), but why should this be such a significant problem?

The absolute grandeur of the problem of the inelastic supply of drug offenders at this level is more clearly felt when you take into consideration the immense costs that are being incurred because of this problem. Specifically, it has been estimated that the direct costs, excluding the opportunity costs, of incarcerating a single person for one year is in

the ballpark of \$30,000- \$40,000, (The Economics of Crime: Lecture Notes, Malone).

These numbers are especially momentous, now, with the realization that the imprisonment of one such member of the illicit drug market, you are, in fact, spending a great deal of resources on something that will undoubtedly have no positive affect, deterrence or otherwise, on the supply of offenders in the market.

This inelasticity can partially be explained by the vertically integrated structure of the illicit drug market, which consequently leads to an extremely competitive market at the street level. In fact, by the time the market has reached the street level, there are no positive profits to be made in the long run. Why then, is the supply of offenders at this level so easily renewed? The answer lies partially with the fact that offenders at this level are typically low-skilled, low-income males, who may deal as a compliment to their legitimate job--or have no desire to acquire a legitimate job-- making them easily replaceable. However, the most powerful incentive for participation lies in the opportunity to move up the ladder where the more lucrative wages are made. As said in an article entitled “Why Drug Dealers Still Live with Their Moms,” from the publication, *Freakonomics*, “criminals, like everyone else, respond to incentives. So if the prize is big enough, they will form a line down the block just hoping for a chance...[P]eople wanting to sell crack vastly outnumber the available street corners” (pg. 105).

Other significant costs associated with this problem have come as a result of past policy decisions attempting to fight the illicit drug problem. For example, in the 1980’s mandatory sentencing on the federal level for crack cocaine offenders was implemented. Similarly, so-called “3-strike laws’ were also implemented at the state level to target habitual offenders, so that harsher sentences would be reached. Also implemented was

the Rockefeller Drug Law in New York, in which, “major pushers—those who sold an ounce or more of heroin—would be liable for a minimum prison term of fifteen years and the possibility of life imprisonment,” (James Q. Wilson, *Thinking About Crime*, The Atlantic Online, pg. 11).

It should be noted that the U.S. imprisons more people than any other developed nation except for China and North Korea, and that all of these policy decisions have lead to an explosion of prisoners in jail, which consequently, now have significant cost implications. More prisoners in jail, for one, will put serious constraints on facility and personnel resources in the corrections sector. Specifically, according to an article by Gary Fields entitled, *Bulging Jails and Tight Budgets Make Job Of Guard Even Tougher*, “The job of a prison guard...is growing harder. Because of tougher sentencing laws and budget constraints, the number of inmates in the U.S. is growing rapidly, far outpacing the hiring of prison officers.”

These more draconian policy decisions and the harsher sentences reached because of them, coupled with the fact that fewer opportunities for parole are being given, are also yielding other serious cost repercussions. Most notably, they have given rise to a very large aging criminal population. In an article published in the New York Times entitled *To More Inmates, Life Term Means Dying Behind Bars*, Adam Liptak notes, “thousands of lifers are going into prisons each year, and in many states few are ever coming out, even in cases where judges and prosecutors did not intend to put them away forever.” Keeping in mind that the estimated costs of incarcerating an offender for merely one year is between \$30,000- \$40,000, we can begin to comprehend the severity of the monetary crisis this situation presents. To further exacerbate the situation, one

must also call to attention the reality that an aging population of prisoners will undoubtedly generate higher medical costs than a younger criminal population. One might also consider the claim that prisoners become less violent or threatening to society with age. Thus, the marginal benefit of incarcerating an individual may decrease significantly with an aging population, despite the drastic increase in marginal costs that are likely to occur. Accordingly, it cannot be ignored that HIV, an extremely costly disease to diagnose and treat, is epidemic among prison populations and, hence, only worsens the monetary crisis now being felt by correction institutions.

With all these costs in mind, there must be some other alternative to incarcerating illicit drug offenders, right? One such proposal has been made by Gary S. Becker, an advocate of the concept of the “rational criminal”—one who makes decisions to offend by weighing the costs and benefits through rational thought—in which the utilization of fines as a form of punishment for all non-violent crimes, including those associated with the illicit drug market, as a more efficient means of punishment. As Becker puts it,

Fines are preferable to imprisonment and the other types of punishment because they can deter crimes effectively if criminals have sufficient financial resources—if they are not ‘judgement proof’... Moreover, fines are more efficient than other methods because the cost to offenders is also revenue to the state (The Economic Way of Looking At Behavior, pg. 391).

Becker, however, believes that the fines implemented in the U.S. are too small to serve as adequate deterrents of crime.

The concept of implementing fines to deal with the illicit drug problem, as well as other forms of non-violent crime, is still a fresh idea today. In an article from the National

Organization for the Reform of Marijuana Laws (NORML) entitled, *Chicago Considers Marijuana Decriminalization Plan*, a plan is proposed to “ticket rather than criminally arrest adults found in possession of small amounts of marijuana,” which would annually raise \$5 million in city revenue. The article also calls to attention the claim that, “enforcing criminal law needlessly burdens ... taxpayers and wastes police time and resources.” However, major opposition to decriminalization policies like these take the stance as quoted, “Some people will read that the fines downgrade our concern about the issue,” (NORML pg. 1).

Consequently, one might ask why the issue at hand shouldn't be trivialized in light of the immense costs associated with confronting the problem. However, once it is noted that the illicit drug market, a so-called market for “Victimless Crime”, also imposes many daunting social costs and considerable negative externalities, it is nearly impossible to consider trivialization of the issue. First and foremost, because the market for illegal substances is, in fact *illegal*, society experiences a significant loss of revenue in the black market for these goods. More specifically, the black market for these goods is international, and the U.N. National Drug Control has estimated that from \$200-\$400 Billion per year change hands in these illicit drug markets, staggeringly, making this black market larger than the world's oil and gas industries combined. It has also been estimated that 2% of global GDP can be accounted for in the drug market, and that 40% of the revenues received from these drug markets is received by organized crime, (Malone).

Other non-trivial social costs linked with the illicit drug market include public health costs. As was previously mentioned among prison populations, the use of drugs is

also strongly correlated with diseases such as AIDS, Hepatitis, and numerous sexually transmitted diseases, whether they be transferred via unsanitary methods of drug consumption, habit-induced prostitution, or otherwise. Additionally, foregone productivity resulting from incapacitation, addiction, or premature death also serves to be a substantial social cost stemming from the illicit-drug market.

In addition to the daunting social costs associated with the illicit drug-market, there also exist considerable negative externalities that cannot be ignored. Plainly, it has been said that “crime attracts crime,” so to speak. The crime being “attracted” in this statement is what we economists more commonly refer to as negative externalities. Regardless of the terminology, it can be shown that an area exhibiting a high rate of illicit-drug use/trafficking may, consequently, enter into a downward spiral of unfortunate events in which the area becomes increasingly worse off, simply due to the negative externalities associated with this market.

Arguably, the most noteworthy negative externality associated with the illicit-drug market is its ability to attract and facilitate violence. As Jeffrey A. Miron and Jeffrey Zweibel effectively explain in an excerpt from their work, “The Economic Case Against Drug Prohibition,” from the Fall 1995 *Journal of Economic Perspectives*,

Because participants in the illegal drug trade cannot use the legal and judicial system, the marginal benefits to using violence to resolve disputes increases...Additionally, the marginal cost of violent acts is likely to be smaller in a prohibited market than a free market, because evading apprehension for one set of illegal activities—drug dealing—is complimentary with evading apprehension for another set—initiating violence (pg. 177).

This violence, along with the street presence of users, creates fear and unrest in a community, and, thus, can result in other adverse effects. For example, the fear created as a result of the presence of this market may lead average law-abiding citizens to purchase guns in self-defense. These guns, when in the hands of unskilled users, can then be, as Miron and Zweibel put it, “discharged accidentally or used in domestic and other non-drug related disputes” (pg. 178). The violence associated with being a dealer in the illicit-drug market is so great that dealers experience “a 1-in-4 chance of being killed,” a figure that cannot be even remotely compared to what the Bureau of Labor Statistics refers to as the “most dangerous job in America,” a timber cutter: who experiences over a four-year tract, a 1-in-200 chance of being killed. Shockingly, an even more extreme comparison has been drawn by noting that, “[In 2003] Texas, which executes more prisoners than any other state...put to death twenty-four inmates—or just 5 percent...Which means that you stand a greater change of dying while dealing crack in a Chicago housing project than you do while sitting on death row in Texas,” (*Freakonomics*, Pg. 104).

In accordance with trying to gain an increased sense of safety, property and business owners may, thus, invest in more security to protect themselves and/or their property. As a consequence of this, however, business owners must raise prices to compensate for the increased investment in security and the increased risk of operating in a high-crime area. People living in the area are, resultantly, now subjected to higher relative prices of goods, and will either buy goods elsewhere or be forced to pay a premium on goods to finance the high-risk involved in having those goods provided to them. Again, this may also lead to a series of other adverse affects. Individuals financially capable of leaving the area, and businesses without the desire or resources to

stay afloat in a high-crime area, will then exit, leaving behind empty, derelict buildings to facilitate future crime. These empty buildings and lack of businesses or investment in the area will, thus, cause property values in the area to fall, and the high crime in the area may cause taxes to rise to subsidize the, now necessary, increased policing in the area.

Another negative externality often associated with illegal drug use is increased incidences of property crime. Because many drug offenders have no legitimate means of income, and as was noted earlier, there are no positive profits to be made in the long-run at the street level, offenders often resort to property crime as a means of subsidizing their habits. More specifically, it is estimated that anywhere from 1/3 to 2/3 of all property crime is committed or can be closely tied to drug offenders (Malone).

Perhaps more emotionally appealing, however, is the negative externality dealing with the increasing numbers of substance-dependent children, “coke babies”, being born. These children are not only capable of drawing our emotions, but quite frankly, draw much of our resources, as well. In fact, in 1997, the cost of pre-natal care for “coke babies” alone was estimated to be approximately \$26.7 Billion (Malone).

Also important to note, are the negative effects the illegal drug market have on legitimate markets. For example, a farmer in a third world country like Peru or Colombia can easily make more money by farming an illegal crop than any other legitimate form of farming available to him. Worsening this situation is the fact that drug lords in these countries, especially Colombia, also invest heavily in real-estate, cattle ranching, and small local businesses, thereby, creating a form of impossible competition for small legitimate business owners, ranchers, and farmers. The overwhelming presence of black market power in these areas also destabilizes the government, which can, consequently,

lead to the pushing out of legitimate investment in the area as bad investment crowds out good, and result in an economy left in shambles (Malone).

With all these costs, including direct, social, and those associated with negative externalities, it must be obvious, now, that an incredible amount of resources are being spent to deal with the illicit-drug market. However, the list compiled so far cannot be complete without considering other attempts targeting both sides of the market: supply and demand, to decrease the drug problem. On the supply-side alone, it has been estimated that over \$20 Billion per year is being spent to lessen the negative effects of the drug trade. These costs include efforts to stop supply through source-country control, interdiction through seizure by the INS, as well as domestic enforcement. However, profits are so high at the smuggling and host level that very little impact is made even when they are attacked, leading us to the harsh realization that, despite immense efforts and the incredible amount of resources going into supply-side attacks, our efforts are only met with minimal success. On the demand-side, numerous harm-reduction programs have been implemented and greeted with some degree of success. One analysis conducted by C. Peter Rydell, Susan Everingham, and Rand revealed a higher per-dollar return on investment for treatment of heavy users than did any supply-side effort (Malone).

These harm reduction programs may include programs such as methadone programs, replacement of heroin by a medically licensed professional as a substitute, or needle exchange programs where exchangers are given new, clean needles for their old ones. However, these programs have found little welcome here in the U.S., and have only been implemented in certain European countries and, more recently, Canada. Perhaps the prohibitive nature of our laws has stemmed from our puritan roots, regardless though,

these programs have stimulated much controversy in the U.S. because of the belief that they encourage drug use. In an article from FoxNews.com entitled, “Clinic to Prescribe Heroin to Addicts,” one such harm-reduction plan is implemented to legally administer heroin in British Columbia in order to eliminate some of the negative externalities stemming from drug abuse. It is also noted in the same article that, “The U.S. government would not back a similar program,” and that, according to one White House official, “addiction should be treated as a disease and cured.” Douglas Husak described our situation as Americans accurately when he said, “An unwillingness to criminalize an activity is misconstrued as a denial that it is a problem at all. As a result our state suffers from a crisis of overcriminalization,” (Chpt.1, Husak).

A final aspect of the costs that must be presented regarding the illicit-drug market are the opportunity costs to society and the negative impacts the illicit-drug market has on the environment and tourism. Particularly, when thinking about the opportunity costs of spending our resources in places like the war on drugs, prisons, and treatment programs, we must consider what other programs could have likely received the funds. Accordingly, the opportunity cost of not spending the money on education, on homeland security, or some other important, but costly, aspect of public policy is tremendous. The illicit-drug market also has a potentially large negative impact on the environment, (Malone). Common environmental issues associated with the illicit-drug market are deforestation, soil erosion or degradation, and increased water pollution. Lastly, the drug trade can have very inhibiting effects on tourism. Not surprisingly, people do not want to travel to places that are unsafe or unstable: two features that are very positively correlated with countries dominated by the illicit-drug market.

Why, then, has so much controversy surrounded legalization of drugs? Possible answers to this question might include the facts that, despite its reduction in the negative externalities associated with prohibiting drug use, legalization would not eliminate all the costs or externalities associated with the problem. You would still, for one, have to deal with loss of productivity, inhibitions, addiction, etc. It is also argued that legalization, although leading to fewer incarcerations of the lower class, would distribute harm more evenly across society and cause an increase in the incarceration of middle and upper-class citizens. There are other obvious economic implications as well. For instance, legalizing the market would thus lead to decreased prices because of increased competition and not having to pay to hide the activity, therefore leading to an increase in supply, a corresponding decrease in price, and possibly an increase in demand due to the increase of people now willing to “dabble.” People argue, then, that complete legalization would allow for an increase in users of drugs.

However, there are other possibilities in-between our current method of prohibition and the relatively unlikely event of complete legalization. One method, as already discussed is the Harm-Reduction Model—Dutch Model—in which addicts are treated. Tied hand-in-hand with that Harm-Reduction Model is the Medicalization Model, in which medical officials may administer particular drugs under certain given circumstances. Lastly, the Alcohol/Cigarette Model, as proposed by Miron and Zweibel, would implement a reform to use taxation, age limits, quantity restrictions, and other requirements before the purchase of an illegal drug can be made. These models all adhere to the possibility that they may help to eliminate black markets after implementation,

however, a combination of these programs is likely to be the most realistic chance for additional reform.

The disheartening list of direct costs, social costs and negative externalities associated with the market for illicit-drugs, perhaps, can now better illustrate the motivation behind the desire to fight against the illicit-drug market, and perhaps, seem to justify it; However, the list of costs compiled so far, conversely, may raise the question of whether or not current forms of drug prohibition are an effective and efficient means of dealing with these problems. The answer to this question, and my conclusion, is quite simply: they aren't. The current system of drug prohibition leads to an insurmountable list of costs-- direct, social, or through negative externalities—the attacks on the supply-side of the market have proven to be, at best, minimally effective due to the huge profits to be made by offenders at this level, demand-side efforts are notably more effective, but also present very controversial arguments and mixed messages about the importance of the problem. Complete legalization, however, is not a realistic option, whether stemming from out puritan roots or otherwise, it is not likely to be given serious consideration, despite arguments in its favor. However, adopting a position on prohibition in-between our current position and legalization, (possibly a combination of those alternatives already mentioned), would likely be a more optimal way of dealing with the problem.

Despite the economic incentives for policy decisions regarding this issue, it must also be recognized that there are some serious philosophical questions that are called to mind here. Accordingly, from a philosophical point of view, we might then be obligated to consider the question: “Even if victory were possible in the war on drugs, should victory be sought?” Other typical philosophical questions that are called to mind here

involve the fairness or appropriateness of prohibiting your “right” to consume these substances. As the moral philosopher Douglas N. Husak notes in his book Drugs and Rights, “most philosophers begin with a ‘presumption of freedom,’ or liberty, which places the onus of justification on those who would interfere with what a person wanted to do,” (Chpt. 1). Husak, an advocate for a form of decriminalization of drugs that would exhibit some degree of compassion and leniency for who he considers to be “recreational users”—those using drugs with the intention only to “promote the pleasure, happiness, or euphoria of the user”—also adheres to the fact that people usually take either one of two sides in this argument: The first, that “Drugs are a scourge that no responsible state would tolerate,” and the second that, “Prohibition of Drugs is not the business of the government,” (Husak, Chpt. 1). Husak, however, believes himself to be somewhere in-between these two extremes.

Other philosophers, though, exhibit a more clear distinction between the two sides of the argument, and are not as reluctant to choose one side or another. Robert Nozick, for example, as established in his *Entitlement Theory of Justice*, would have likely attested to the fact that government, being a minimalist state, does NOT have the right to make drugs illegal. John Rawls, on the other hand, might likely conclude that one has no right to drugs. It is also arguable that Rawls wouldn’t even touch crime, as it seems likely that he would leave it for the legislative stage, not the original position. Husak also calls to attention the common view of the *legal moralist*. One adopting this position would likely adhere to the statement presented by Husak as an example in, “The simple fact is that drug use is wrong. And the moral argument, in the end, is the most compelling

argument." These *legal moralists*, accordingly, also present drug use as sinful and wicked, and attest to its degrading nature.

In any event, as a newly christened student of philosophy, I cannot ignore the moral questions that have been called to attention by the problem of the illicit-drug market. However, as an economist, I cannot ignore the grandeur of the problems, costs, and effects associated with this problem, either. Further, it is my argument that, despite the moral questions that may arise when calling this problem to attention, the drastic economic effects *do* justify some degree of limitation or control of this market. Achieving the *optimal* level of limitation or control, however, should prove to be one of our greatest and most argumentative feats.

Sources

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