

THE WAR ON DRUGS AS ANTITRUST REGULATION

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Some Neglected Economic Consequences of the War on Drugs

Many economists have employed their analytical tools to examine the effects of the current War on Drugs, but these past efforts have concentrated on issues like the social cost of productivity lost to the economy as a result of drug use compared to the costs of drug prohibition, the effect of illegal drug use on poverty rates, and the costs versus the benefits of drug illegality.¹ While these are important issues, economists have tended to neglect the “industrial organization” of the illegal drug “industry,” and the effects the War on Drugs has had on the structure of that market. We offer some suggestions for how such a study might proceed.

Drug Laws as Antitrust Regulation

The ostensible purpose of anti-drug legislation is to reduce the supply of drugs available to drug abusers. However, as often happens in other markets subjected to government regulation, the complex economic consequences of anti-drug laws include some surprising outcomes.

In a completely free market for intoxicating substances, drugs like cocaine, heroin, marijuana, and so on that are currently illegal would be sold at lower prices, be available in larger quantities, and be of higher quality than we currently observe. (Some advocates of

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¹See Boaz (1990), Ostrowski (1989), and Trebach (1987) for some recent surveys.

continuing illegalization argue that this increase in price and decrease in availability is, in fact, an appropriate goal of such policy.)

However, legal prohibition will only imply actual elimination of a good or activity if the enforcement of that prohibition is costless. In the real world, perfect enforcement of laws—including laws against the sale and use of intoxicating drugs—is normally impossible, because a completely effective prohibition would be prohibitively costly. Therefore, we normally expect that any real law will be only imperfectly enforced.

Consequently, despite the severe legal penalties for the possession and sale of certain drugs, drug producers—*industries*—exist to provide goods to drug consumers. The War on Drugs, which undoubtedly has increased the average price of such drugs and possibly reduced the aggregate quantity supplied, has not—and probably could not—eliminate the drug “industry.”

Given that the continued existence of an illegal drug “industry” is practically inevitable, a secondary problem becomes of interest: How does the War on Drugs, as actually implemented, influence the structure of that illegal “industry,” and how do those black market “service providers” behave toward their customers?

Drug enforcement activities have some surprising unintended effects on the structure of the illegal drug “industry.” In reality, the War on Drugs keeps this black market “industry” highly competitive. As a result of drug laws, new entrants into the industry do not have to overcome investments by existing suppliers in brand-name capital. Drug law enforcement as conducted in practice actually promotes greater competition in the market for illegal intoxicants.

Consider what kind of strategy the War on Drugs would follow to minimize the actual use of illicit substances. An illegal drug “industry” (of some size) will continue to exist under any drug law regime, even the most draconian. The government could maximize the magnitude of losses to consumers of illegal drugs by forcing them to buy their merchandise from black market “monopolies”—single sellers in the drug market protected from competing potential entrants by the drug enforcement authorities. Grant a monopoly to one seller—say, to one heroin “firm,” perhaps “Mafia, Inc.”—and allocate massive law enforcement resources to protecting that firm from all competition. This crime-minimizing solution to law enforcement was first suggested by James Buchanan (1973).² That monopoly firm would behave in a predictable manner, increase price and decrease quantity sold to consumers. By encouraging monopoly of the market for drugs,

²See Buchanan (1973).

which would exploit its consumers by overcharging and underproviding, the government would maximize the losses those consumers faced. This, in the peculiar universe of the War on Drugs, would be a "victory."

Oddly, the War on Drugs seems to pursue precisely the opposite policy in practice. Current drug enforcement strategy seems designed to increase, rather than decrease, competition in the drug "industry." Naturally, price is considerably higher than it otherwise would be in the absence of drug prohibition; but given the existing regime of prohibition, it is probable that price is lower and availability higher than it might be under a different regulatory strategy. Consider the effects of the War on Drugs on a commonly used metric of market competitiveness, industrial concentration.

The War on Drugs means that, in the case of the "illegal drug industry," most forms of advertising by drug "firms" are legally prohibited. (Obviously, some forms of "advertising" by drug firms, e.g. word of mouth, continue to exist.) Thus, one potential "barrier to entry" is eliminated. Product differentiation is kept minimal, so that the goods sold by various firms (i.e., illegal drugs) are essentially homogeneous commodities—one of the basic assumptions of the economic model of "perfect competition." There are no "brand names" in the market for cocaine, marijuana, etc. Consumer loyalty to particular "brands" does not develop, so new firms do not face an uphill battle attracting the old firm's customers.

Another factor in the War on Drugs that reduces industrial concentration in the "drug industry" involves the legal risks associated with large size. As the industry becomes more highly concentrated, average firm size becomes greater. Larger firms in the drug industry are more visible, harder to hide, and therefore more likely to come to the attention of drug enforcers. Small, informal firms that invest in little or no fixed capital can rapidly disappear in the event of unusual attention from the police. Therefore, even if there might tend to be other reasons (e.g., economies of scale in distribution) that might otherwise lead to an industry with only a few big firms, the legal risks associated with large size keep firms little and numerous. In a black market, small is beautiful.

Frequent references to various "cartels" in the illegal drug trade might seem to suggest that the War on Drugs tends to cartelize the "drug industry" by restricting competition. However, the "cartels" that receive so much media attention are not cartels at all in the economic sense, but merely large, vertically integrated drug manufacturing enterprises. There are a number of competing "drug cartels," which is another way of saying that the production of illegal

drugs is highly competitive although individual firms are price-searchers. Drug retailing—i.e., the “gas stations” in the world of drugs, which actually deal with consumers—is an intensely competitive market composed of numerous tiny “firms.”

True industrial cartels are even less likely in the illegal drug market than they would be if drug laws were eliminated. The government drug enforcement effort systematically attacks larger firms, both because smaller firms enjoy lower costs of hiding from the War on Drugs and also because the bureaucratic incentives within the government drug enforcement agencies reward bigger busts. Hugh seizures of illegal drugs are rewarded with intense media attention and are most likely to result in bigger budgets for drug enforcement agencies as well as promotions for individual agents. In contrast, an equivalent number of minor seizures receive comparatively little attention. Small firms are most likely to be left alone, albeit forced to provide information to (say) the Drug Enforcement Administration (DEA) on their larger competitors. The DEA is the trust-buster of the illegal drug market.

This may help to explain a curious fact: over the last few years, while the resources devoted to the War on Drugs grew rapidly, the street price of most forms of illegal drugs (e.g., cocaine) consistently fell. It has been often noted that large seizures of drugs seldom result in any measurable increase in the street prices afterwards. Large seizures selectively target larger illegal drug “firms” and tend to reduce industrial concentration in this “industry” as a result. By contrast, while the drug “merchandise” of relatively small dealers is equally illegal, a greatly disproportionate share of drug enforcement resources is in practice allocated to the effort to capture and prosecute “major” dealers, i.e., large drug firms. Therefore, over time this activity leads to price reductions (and increases in the quantity of drugs available to consumers!) as a predictable consequence of reduced industrial concentration. (Incidentally, the drugs “seized” in massive busts do not necessarily represent a supply that was imminently destined for market at all by the “oligopoly” firm. Such supplies might have been held off the market for a long period, as the firm attempted to exploit market power by restricting the quantity of drugs it sold to consumers.)

If the War on Drugs abandoned its current “antitrust” aspects, the “licensing” of monopoly (regulated) drug suppliers would be only one option. Another might be identifying, and selectively targeting, drug firms that have relatively efficient operations, experience rapid growth, offer consumers high quality at a relatively low price, or otherwise stand out for their efficiency. Current Drug War policy

sanctions drug sales in such a manner as to implicitly promote competition, and therefore drug use (because “products” are available at a lower price than would otherwise be the case).

Other Perverse Effects of Current Drug War Strategy

In an ordinary legal market, disputes about the terms of a contract can be resolved in court. But drug firms have no legal recourse in the event of a contractual dispute. Therefore, transactions are kept simple and “cash-on-the-barrelhead.” More complex, intertemporal contracts are relatively unenforceable. This factor also serves to keep operations small and simple.

The threat of private violence is the only contractual enforcement mechanism available in inner-city drug markets. After all, if someone accepts delivery of a shipment of cocaine and then refuses to pay for it, the dealer cannot haul him into court and sue. At least some drug-related murders represent private sanctions imposed on violators of contractual agreements.

If dealing drugs is already punishable by long prison sentences, then dealing drugs and committing murder, or assault, in addition is not much more “expensive” in terms of expected legal penalties. Therefore, the relative price of using violence is low to drug dealers. The criminal justice system does not reward drug dealers for resolving disputes peacefully. Thus, we expect drug-murder rates to be higher simply because of the War on Drugs, although other factors might influence the drug-murder rates as well. If stamp collecting was punishable by long prison terms, stamp dealers would probably resolve disputes with firearms, too.

For example, take the “gang problem.” Gangs in the inner city are essentially mercenary organizations that provide military services to their “clients.” Anti-gang laws limit the ability of gangs and other potential mercenary firms to engage in the kind of training and other activities (e.g., wearing uniforms) that tend to improve their military efficiency. Such laws effectively eliminate the access of larger, established firms to more expensive, and efficient, forms of paramilitary organization for accomplishing their violent ends. All firms—established and well funded, and potential, with little capital—are restricted to the use of poorly organized, individual assassins. In the absence of military-type organizations, individual assassins are approximately homogeneous.

In consequence, the professional murderers who are available for the established firms to hire will be about as efficient as the

murderers available to the potential entrants. Thus, larger firms are unable to exploit the potentially available economies of scale in murder. The law prevents big firms from hiring more expensive, but more efficient, well-trained private armies. Anti-gang laws, gun restrictions, and other regulations ensure that all drug dealers, big and small, old and new, compete on a level playing (or rather, killing) field.

Even if the net advantage of the availability of relatively low-cost use of murder is zero, a city with a higher drug-murder rate may be an area in which there is a relatively high level of competitive entry. If no potential entrants were trying to compete with established firms, the murder rate would be low. Thus, in a city where the murder rate is very high, we would expect prices in the illegal drug market to be lower than they would be under a drug monopoly.

If instead of a blanket prohibition on the sale and use of illegal drugs, the government decriminalized use and licensed a monopoly supplier (that was then tightly regulated), a significant portion of the extraordinary violence associated with the drug trade would cease. Legal drug "contracts" would be enforceable in court and would not require enforcement at gunpoint. Consumers of regulated intoxicants would have an incentive to avoid the violence and lawlessness of street deals, and consequently street thugs would lose much of their clientele. Such a regulated monopoly would benefit public order and might reduce the total quantity of drugs available at the same time.

Government-Subsidized Drug Advertising

The illegality of narcotics prevents the emergence of brand names in the drug market and severely restricts the ability of drug sellers to differentiate their products. We argued above that this legally enforced product homogeneity makes the drug market closely resemble the (unrealistic) model of "perfect competition." The absence of "brand names" in the illegal drug market also tends to lower average quality of the goods, and the resulting impurities result in thousands of deaths each year among users.

On the other hand, the War on Drugs itself provides a kind of advertising campaign for illegal drugs in general. Whether intended or accidental, a byproduct of government activity ostensibly designed to reduce drug use may be to increase demand for illegal drugs.

Consider the problem facing a seller of illegal drugs when competing for consumer favor in the marketplace. He is (individually) prevented from advertising openly, and therefore cannot directly

approach potential customers of his "product." All drug dealers face the same disadvantage, which means both that product differentiation among those competitors is restricted, and also that their collective market share of consumer entertainment/intoxication expenditures is smaller than it would otherwise be. Legal intoxicants (e.g., alcoholic beverages) and other potential substitute forms of entertainment (e.g., movies) are free to advertise their price and availability to consumers, and thereby attract a relatively larger share of consumer dollars.

The War on Drugs redresses this imbalance. While individual drug sellers are unable to engage in legal advertising, government drug law enforcement publicizes to consumers the availability of drugs as a form of intoxication. Potential "recreational users" are reminded of the option of taking illegal drugs instead of getting drunk or going to a concert. Drug users are also provided substantial amounts of information about illegal drugs, including the quality, characteristics, price, and availability for purchase of the "product."

In short, the War on Drugs functions like an illegal drug industry "trade association" that provides collective advertising for member firms. Major drug busts function as huge drug-industry promotional campaigns. Large drug seizures communicate to potential drug consumers the availability of the type of drug involved, and most important, the location of the "market outlets." For example, a widely publicized bust in a particular section of South-central Los Angeles communicates to drug users in Los Angeles County what kind of drugs are currently available on the street, and approximately where they can go and expect to make a purchase. We should even consider the possibility that from time to time drug dealers intentionally allow fairly large quantities of cocaine to be "discovered" and seized for the purpose of securing free advertising.

Unlike more ordinary cases of industries where firms band together in trade associations to pool advertising resources, in this instance the government pays the cost of the advertising campaign. (Drug dealers bear some significant costs, such as increased risk of arrest and conviction in drug sweeps, merchandise lost to seizures, etc., but these losses tend to be relatively small compared to the total costs of the War on Drugs.) By contrast, the pharmaceutical industry, the almond industry, and the raisin industry (to mention only three that pool advertising resources) all have to pay for their own advertising campaigns. This enormous, heavily subsidized drug advertising campaign, managed entirely by the government, increases the demand for illegal drugs. A truly "serious" effort to reduce the demand for illicit intoxicants would refrain from extensive efforts to

educate the non-using public about the detailed aspects—and to some potential consumers, advantages of—drug use.

An Educated Consumer Is a Smart Shopper

Government-subsidized advertising for illegal drugs also includes activities described as “drug education.” Such government efforts claimed to “discourage” drug use among young people through persuasion may actually tend to increase the demand for drugs, holding other things equal.

Naturally, providing young people with accurate information concerning the negative consequences of drug use could conceivably reduce drug consumption on net; youngsters who might mistakenly take drugs (which they wrongly believed were not detrimental to their health) might be deterred. But how likely is it that any person, no matter how naive, might “mistakenly” spend a large sum of money on a product like cocaine without the expectation of intoxication?

On the other hand, the mere “fact” communicated by “drug education” programs that drug use involves health risks (assuming, for the sake of argument, that an accurate account of the real risks is really presented by police officers and narcotics control agents in the classroom) will not necessarily deter consumer demand. Degrees of risk aversion in the general population vary. Some people regard the risk of injury from skiing as too great and stay off the slopes, but many other people react differently to that same degree of risk. Similarly, in the case of drug use people may react differently to the same information pertaining to health risks. In the case of cigarette smoking, the health risks are universally understood, but many people continue to smoke anyway. Even if we assume that drug education conveys only completely accurate and reliable information about the health risks associated with drug use—a very optimistic assumption—it is unrealistic to expect that all individuals will react identically to this information.

Consider the average teenager. Challenging authority is her favorite pastime. Rebellion is her middle name. Furthermore, to the average teenager, risk is exciting. Normal adolescents are at least less risk averse than normal adults, on average; in many cases, they are more properly described as risk lovers. Observers of adolescent behavior since the dawn of time have noted this characteristic of the post-pubescent set.

But this common adolescent characteristic has an implication that has been ignored in the excitement over the War on Drugs: education about the risks of drug use may have little or no effect on the demand

for drugs from adolescents. Drug education may actually make the problem worse, by eliciting greater interest in taking drugs. Adult preoccupation with the evils of drug abuse makes drug abuse marginally more attractive to rebellious teens. Highly advertised risk is made to seem more exciting, and drugs are made an adolescent badge of honor in the War Between Adults and Teens. Ironically, if (as critics sometimes charge) there is a tendency for drug education to exaggerate the true extent of the risks associated with drug use, this perverse effect on teenage behavior might be even stronger. Therefore, it is not surprising that drug education has been found to increase drug use, if only slightly.³ In 1982, in the Netherlands (where possession and use of small amounts of marijuana is legal) only 0.5 percent of high school seniors used the drug daily, compared to the United States, where 6.3 percent of high school seniors reported daily use.⁴

Inner city youth do not need “drug education” programs to inform them about the effects and consequences of illegal drug use—such activity is likely to be all around them. But middle-class kids, in “safe” neighborhoods, may really not know much about drugs prior to becoming “educated” about such consumption, thanks to government. Hence, the principal effect of Drug War “education” may be to increase awareness of—and interest in pursuing—drug use among that portion of the population that would otherwise be unaware and uninterested.

Drug education provides information to potential consumers that would otherwise be unavailable to them, or available only at high cost. Students exposed to drug education are likely to learn about the effects of various substances, the appearance of drugs, some general price information, and perhaps even something about where and how to shop. Regardless of the anti-drug context in which this information is packaged, the information is valuable to potential drug consumers nonetheless. Thus, the real costs of purchasing and using drugs are reduced by drug education. This is independent of the possibly perverse effect of the emphasis on the riskiness of drugs mentioned above.

For these reasons, massive public spending on “drug education” may have the opposite effect from that claimed by proponents. The effects of such efforts are at minimum ambiguous, and at worst are self-defeating. It is as if IRS employees were sent into schools to teach students that they should not cheat on their taxes—and then

³See Martz (1990, p. 74), Miller (1989, p. 77), and Berke (1990, p.1).

⁴See Trebach (1987, pp. 103–5). These figures are also cited in Ostrowski (1989, p. 3).

explained the very cheating techniques that the students “must never use.”

Conclusion

The War on Drugs generates a variety of perverse consequences that are at odds with the War’s ostensible purpose. Drug illegality increases the rate of violent crime, leads to corruption among law enforcers, lowers the average quality of street drugs and hence leads to the deaths of many users from impurities, and draws scarce law enforcement resources away from providing citizens with protection from robbers, thugs, and murderers. These are only some of the more tangible, potentially quantifiable losses.⁵

Assume a large government bureaucracy, providing paychecks to tens of thousands of civil servants, whose tax-based funding is gigantic and rapidly growing. This bureaucracy is assigned the task of eradicating some activity. Once that activity is actually eradicated, the demand for the services of the bureaucrats will cease. How would we expect this bureaucracy to respond?

An inconsistent “eradication” strategy might be a consistent solution to this rational bureaucracy’s problem. Busily and noisily “eradicate” with the one hand, and busily (but more quietly) promote and encourage the prohibited activity with the other. The War on Drugs bureaucracy seems to have stumbled on to just such a “solution” to its peculiar problem—ensuring that the War on Drugs continues into perpetuity.

Our purpose here has been to outline some neglected “perverse consequences” of the manner in which the War on Drugs has been “fought.” The government imposes severe penalties on the sale and use of certain illegal intoxicants; but that same government engages in a kind of informal “antitrust” program in the market for illegal drugs, which has the effect of increasing competition in that market and (indirectly) making more drugs available to consumers more cheaply than would otherwise be the case.

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⁵See Boaz (1990) for a recent accounting of these effects. Other losses, such as the higher level of general disrespect for the law, the increasingly arbitrary disregard for individual liberties, and the huge costs borne by individuals found guilty of a victimless “crime,” are equally important, but inherently difficult to quantify.

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