



# BATTLE TACTICS

**Why has the war on drugs proven so difficult to win?** Recent research suggests the answer lies in the basic economics of the market for illegal drugs. **By Jessamine Chan | Research by Gary Becker and Kevin Murphy**

Every American president since Richard Nixon has fought a war on drugs. In spite of the efforts of the police, military, FBI, CIA, Drug Enforcement Agency (DEA), and military and police forces of other nations, no president or DEA chief has been able to claim victory.

Why do international drug traffickers command the resources required to corrupt foreign governments and thwart the efforts of the most powerful nation in the world? Why do efforts to reduce the supply of drugs on city streets seem to lead to more violence and greater influence for street gangs and other criminal organizations?

Professors **Gary Becker** and **Kevin Murphy**, along with Michael Grossman of the National Bureau of Economic Research, address these questions in their recent study, “The Economic Theory of Illegal Goods: The Case of Drugs.”

The war on drugs has so far been targeted at drug suppliers in an effort to raise the street price of drugs and thereby reduce consumption.

As the authors argue, the current approach to the war on drugs is not only unsuccessful, but also is a very costly method of cutting consumption. Becker, Murphy, and Grossman instead suggest that legalizing drug use and



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taxing consumption would be a more efficient method of reducing consumption than continuing to prohibit the use of drugs. Such a tax would be similar to existing “sin” taxes on alcohol or cigarettes, though the tax penalties might be greater.

“Our goals in this study were to first understand how the market for illegal drugs works and then understand the implications for public policy, including how an explicit tax system would operate,” said Murphy.

“An individual can be very committed to reducing drug consumption and still accept our argument,” Becker said. “We are not taking a civil libertarian approach and are not advocating unrestricted drug consumption. Reducing consumption may still be an ultimate goal.”

According to the authors, the fundamental problem plaguing the current war on drugs is that the demand for drugs is “inelastic.” “Elasticity of demand” is a term economists use to describe how sensitive consumers are to price. If consumers are more price sensitive, this indicates that demand is elastic; if consumers are less price sensitive, that suggests demand is inelastic. The authors argue that resources devoted to supplying drugs will rise with the imposition of the drug war if demand is inelastic, and fall if demand is elastic. If the demand for drugs were highly elastic, efforts to reduce consumption would be relatively effective—a more vigorous drug war would lead to higher prices and a larger percentage reduction in consumption.

The relatively ineffective nature of the U.S. drug war and the growth of the international drug industry suggest that inelastic demand may well fit the U.S. experience.

Inelastic demand makes it difficult to stamp out drugs because the more the government tries to reduce consumption, the more steeply consumers’ willingness to pay rises. As a result, the total amount consumers on the whole are willing to spend increases. This pattern creates greater incentives for suppliers to find ways to bring drugs to the market. With inelastic demand, the total amount people spend on drugs will rise, and the government will fight the war harder.

An efficient and socially optimal drug war would be one that accomplishes the given objective at the lowest overall cost to society, when factoring in all the costs borne by consumers, by imprisonment, government corruption, and all the elements of the illegal drug trade.

The authors compare the costs of reducing consumption significantly below what it would be in a competitive market through a drug war versus taxation on the legalized

sale of goods. While their analysis shows that the equilibrium in a competitive market with taxation may look similar to the equilibrium under a drug war, the difference is the revenues going to the government as opposed to real costs imposed on suppliers and users.

Legalization with taxation would reduce enforcement costs, since the government would need to deter only underground activity rather than all suppliers. Since a tax is less costly to implement and may achieve the same or possibly greater reduction in consumption, this method will save resources rather than draw further resources into drug activity. This approach would also reduce many external costs imposed on society, such as violence, crime, and corruption.

### The Market for Illegal Drugs

“We were interested in studying market approaches to solving policy issues and found that you can take the same tools used to understand regular markets and apply those tools to understanding how a prohibition works,” Murphy said. “Our model provides a framework for directly comparing the option of legalization with taxation with the current method of prohibition.”

In the authors’ model of the market for illegal drugs, the demand for drugs is assumed to depend on the market price. This market price is affected by the costs imposed on traffickers through enforcement and punishment and costs imposed by the government on users.

Becker, Murphy, and Grossman argue that it is necessary to study the elasticity of demand for an illegal good in order to understand the effects of prohibition on the overall cost of supplying and consuming that good. The authors compared outputs and prices if drugs were legal and taxed with outputs and prices under the current system.

With inelastic demand, stricter enforcement will further raise prices and reduce consumption, but the resources devoted to trafficking will increase even further because consumption falls by relatively little. The higher drug prices will provide funding for the counterwar waged by the drug suppliers and producers.

The additional resources devoted by traffickers will then further increase the external costs imposed on the government and its citizens. These external costs can be seen in the vast empires controlled by international drug smugglers, the crime and violence imposed on residents of affected communities, and the large number of drug smugglers

## Legalizing drug use and taxing consumption would be a more efficient method of reducing consumption than continuing to prohibit the use of drugs.

imprisoned in the United States and around the world. These costs are as large as, or larger than, the costs imposed on drug traffickers themselves.

“It is important to distinguish between the cost of the war on drugs and the cost of drugs themselves,” Murphy said. “The violence associated with the drug trade tends to be a natural consequence of drugs being illegal. These issues may be avoidable under alternative methods.”

### Benefits of Taxation

By current estimates, the size of the U.S. market for illegal drugs totals \$60 billion annually. If \$45 billion of the \$60 billion in private costs borne by drug traffickers is the added cost imposed by enforcement, and if that is matched by an equal level of external costs, the total cost to society of drug production under the current drug war would be roughly \$105 billion.

With a monetary tax that leads to the same market price of drugs, the authors estimate that the private costs of drug production would fall to about \$15 billion, while \$45 billion would be collected annually in taxes.

“Even if the government wastes the money collected, this would represent an improvement of \$45 billion,” note the authors.

In order to prevent suppliers from trying to sell in an illegal market, the government may still need to engage in enforcement efforts against illegal suppliers and impose penalties on those caught consuming drugs from underground suppliers. Therefore, enforcement costs would not be eliminated with a tax solution but would almost certainly be lowered due to the reduced number of violators.

Evidence on the taxation of goods such as cigarettes and alcohol suggests that even relatively large taxes can be collect-

ed without driving the bulk of production and distribution underground.

### A Shift in Consumption

One key assumption in Becker, Murphy, and Grossman’s analysis is that the effective price of drugs is the same for all users in both the illegal and legal markets. In reality, the total cost of drugs is likely to vary substantially across users from different income levels. The cost of imprisonment, for example, is likely to be greater for high-

income people and others for whom criminal prosecution has the greatest personal and social costs.

The poor will also generally be more affected by price increases because drugs are generally not luxuries. Because most crimes are concentrated in poorer neighborhoods, illegal drug production and distribution tends to be concentrated there as well. This makes illegal goods cheaper to the poor because they have easier access and are more likely to be involved in trafficking.

The shift to legalization would potentially shift some drug consumption toward more affluent individuals, while reducing the major external costs for minority and inner-city communities and citizens of countries where drugs are produced.

“We argue that drug consumption among the poor would be reduced if drugs were legal simply because those individuals would not be able to afford the high price,” Becker said. “Moreover, there is no reason why a legalized market should be so heavily concentrated in poor neighborhoods.”

“The poor would likely be the biggest winners from the legalization of drugs,” Murphy said. ■



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