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Intereconomics

Suggested Citation: Shams, Rasul (1992) : The drugs economy and anti-drug policy in developing countries, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 27, Iss. 3, pp. 139-144,
<https://doi.org/10.1007/BF02926324>

This Version is available at:

<https://hdl.handle.net/10419/140351>

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Rasul Shams*

The Drugs Economy and Anti-Drug Policy in Developing Countries

The drugs economy has now developed into a major factor in many developing countries. What effects on the economies of the countries concerned do drugs production and the drugs trade have? How should the prospects of success for substitution policies be judged? What strategy to curb the demand for drugs in the industrial countries might carry the promise of success?

During the last few decades, drugs have grown to become one of the most dynamic branches in many developing countries' economies, and now constitute the basis of a rapidly growing informal trade between industrial and developing countries. The worldwide revenues of the drugs industry are now estimated to be more than US\$ 500 billion. The greater part of that figure, despite the strong growth currently occurring in synthetic drugs markets, is still taken up by the traditional narcotics heroin and cocaine together with the products from which they are obtained and with their derivatives. Heroin is chiefly produced in Asia, while the main cocaine-supplying areas are in Latin America.

The situation is such that development policy can afford less and less to neglect the deep-seated structural and economic effects generated by the drugs business on the countries concerned, if it wishes to avoid making grave errors of judgment and issuing irrelevant policy recommendations. However, any systematic enquiry into this sector and its significance for development policy inevitably falls victim to the lack of reliable data. Only estimates are available, and these cover a wide range, depending on their source. They do nevertheless allow researchers the opportunity – as will be attempted in this article – to elaborate on the essential problems associated with drugs production and trade, and to develop a rough idea of the scale of these operations.

The developing countries which are linked with the drugs business are not all involved with this growing

market in the same way. In Latin America, for example, Bolivia and Peru are the major producers of coca leaves, whereas the processing and refining centres were, until recently, concentrated in Colombia. Mexico and other Central American or Caribbean nations are used as transit countries. A number of the latter, together with Uruguay, also function as major money-laundering centres. As cocaine consumption in Europe has increased, and also as a consequence of the so-called cocaine war in Colombia, the structure of this division of labour has been undergoing rapid changes in the recent past. Brazil is gradually developing into a major growing country, and the processing stages are now increasingly being carried out in Peru and Bolivia. Venezuela and Chile, along with a number of African countries, have begun to play an important transit role.

The picture is a similar one among the Asian countries. The traditional growing areas for the opium poppies needed to obtain heroin are those of the "Golden Triangle", namely Myanmar (Burma), Laos and Thailand, with the latter increasingly playing the part of a transit country. At the same time, the Golden Triangle has now been overtaken in its prominence as a growing area by the "Golden Crescent" of Afghanistan, Iran and Pakistan. Pakistan has also increasingly been developing as a processing centre, while the important transit countries, apart from India and China, include a number of African countries (Nigeria, Ivory Coast, Cameroon, Kenya, Somalia).

The traditional consumer outlets are in the USA and Europe. The emphasis in Europe is still largely on heroin consumption. Since greater efforts started to be made to

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combat the drugs problem in the USA and because of certain signs of saturation there, the drugs mafia has been endeavouring to open up new markets. As a result, cocaine consumption is now on the increase in Europe and Japan. However, rapid consumption increases are also occurring in the producing and transit countries. For example, drug abuse has become a serious problem in Thailand and Pakistan. The African transit countries, too, are increasingly being drawn into the vicious circle of drug consumption and drug-based crime. The same also applies to producing and transit countries alike in Latin America.

Growth and Employment Effects

The narcotics business presents the growing and other processing countries with serious problems in the sense that it can generate considerable economic benefits to the countries concerned at least in the short term, whereas they face disadvantages in the long term. The main benefits consist of higher growth rates arising from the cultivation of the source crops and the multiplier and accelerator effects triggered by it (increased demand for food and drink, and consumer durables, reinvestment, increased capacity to import). In addition, both direct and indirect employment effects occur.

However, the scale of these beneficial effects varies considerably from one country to another. For example, the production of coca leaves is estimated to be equivalent to 9% of the official gross national product in Peru, and 24% in Bolivia. The employment effects are placed at 800,000 jobs in Peru and 500,000 in Bolivia. The foreign exchange income repatriated to Peru is believed to be in the order of \$ 800 million annually, and \$ 600 million in Bolivia (representing approx. 45% and 75% respectively of official export earnings).¹ The employment effects in Colombia are relatively slight. On the other hand, foreign exchange earnings from the drugs trade are believed to have played a major part in the country's high growth rates during the 1980s.² However, the picture there is believed to have changed considerably since the fight against drugs in Colombia was intensified and the price of coca leaves declined from 1989 onwards.³

No comparable estimates are available for the opium and heroin producing countries. However, it can be said with certainty in their case too that the effects vary from

one country to another. Simply by virtue of its large share of overall production, the growth effects in Burma can be expected to be much higher than those in Thailand.⁴

Though the multiplier and accelerator effects emanating from the drugs business are usually considerable, they should nevertheless not be overestimated. The greater part of drug export earnings – often over two-thirds – usually remains abroad. Only a small portion of those earnings which are repatriated are actually invested. The preferred areas of investment are the construction and service sectors, large-scale agricultural enterprises, and partly also unofficial small businesses. For example, the construction booms in cities such as Cochabamba or Santa Cruz in Bolivia or Chiang Mai and Chiang Rai in Thailand are attributed to the influx of drug money. The demand for capital goods together with the additional consumption funded by drugs money leads – given the low elasticity of supply, in the short term at least, in agriculture and domestic industries such as is the case in Bolivia – either to a high level of imports or, where import barriers are high, to a burgeoning business in smuggling. All of these factors diminish the indirect contribution made to growth by drugs exports.

Negative Development Effects

However, drugs exports can also have a negative influence on the economy of the growing and producing countries. As the "Dutch disease" model has shown, a boom in the production and export of natural resources leads to economic resources being drawn away from other sectors and to an overvaluation of the currency, thus dampening exports from other sectors. This can have a particularly detrimental effect on the agricultural and industrial sectors.

There have been no empirical investigations into these negative effects because of a lack of data. The effects can once again be expected to vary from country to country depending on the relative importance of the coca industry and the economic policies which are applied. In Bolivia's case, for example, the negative effects are probably not very significant at the present time.⁵ The reason for this is that those who found their way into the coca sector had generally been unemployed beforehand, and the areas

¹ Cf. R. Shams: *Das Koka- und Kokaingeschäft in Bolivien, ökonomische Relevanz und Drogenbekämpfungspolitik*, HWWA Report No. 95, Hamburg 1992; and P. Lindlein: *Kokawirtschaft in Peru: Banale Fakten und Fromme Mythen*, in: *Vierteljahresberichte*, No. 122, December 1990, pp. 421-432.

² Cf. IRELA (Instituto De Relaciones Europeo-Latinoamericanas): *Latin America, Europe and the Drug Problem: New Forms of Cooperation*, Madrid 1991, p.17.

³ As a result of the fall in price, the proportion of Bolivia's GNP accounted for by the coca sector fell back to 12%, and export earnings to \$ 210 million. Cf. R. Shams, *op. cit.*, p.8.

⁴ For more on these countries, cf. P. Eschenbacher: *Drogenproduktion und Drogenhandel, Beispiele aus Lateinamerika und Südostasien*, ifo-Forschungsberichte No. 72, Munich, Cologne, London 1990.

⁵ Cf. R. Shams, *op. cit.*

cultivated have primarily been newly developed. In addition, devaluations of the Bolívano in real terms coupled with a strict stabilization policy which has been pursued since 1985 have restrained the currency's overvaluation. However, the consequence has been a very high level of real interest rates, which have inhibited investment.

The drugs economy also results in serious environmental damage. Both cocaine and heroin are obtained by way of a refining process which runs through several stages in which chemicals are applied in primitive laboratories, often situated in inaccessible terrain. Residues of these chemicals are absorbed into the ground and enter watercourses, destroying the habitats of flora and fauna by contamination. Both in Peru and in Bolivia, the environmental pollution caused has already attained alarming proportions. Moreover, tree felling is leading to the destruction of ecologically important forest areas in both countries.⁶

Production Prohibitions

In the face of economic stagnation and widespread unemployment, governments in the developing countries concerned tend to lay more emphasis on the positive effects of the drugs economy than on its negative consequences. That weakens their commitment to the pursuit of an effective anti-drugs policy. At the same time, though, they are under heavy pressure from the industrial countries, especially from the USA, to put a stop to the cultivation and production of drugs. The result has been that the producer countries have declared a prohibition, but that not all of them have exercised the necessary determination to enforce it.⁷

Yet that is not the only reason why the prohibition policy has not brought any appreciable success. It is practically impossible to prevent cultivation and production altogether since they are normally carried out in inaccessible areas. It is virtually impossible to fully patrol these countries' long borders. Insurmountable barriers to effective policing are also posed by the ease with which new growing areas can be developed, production laboratories moved and transport organized. All this is further aggravated by widespread corruption and by the personnel infrastructure which has been built up by the drugs mafia, reaching into the highest circles of politics and government, the army, banking and industry. Yet another obstacle is presented by strong, militant peasant organizations, as in Bolivia, or armed rebels and

liberation movements which use drugs earnings as their main source of income, as in Peru, northern Thailand or Afghanistan.

For the rural population, growing coca shrubs or opium poppies is often the only secure basis available to them for earning a living. The plants are easy to grow, and the methods have been handed down over the centuries or millenia. They do not require particularly high soil quality, and hardly any special equipment, fertilizers or herbicides are needed. They can be easily transported and processed into coca paste or opium, the sales outlets are guaranteed, and the income they provide is relatively high. Moreover, because coca leaves can be harvested several times a year and opium can easily be stored, these are products which provide a steady income throughout the year.

Substitution Policy

For the reasons already mentioned, pursuit of growers and producers by the police can quickly give rise to social problems, which in turn can easily trigger off general unrest. A potential way out of this difficulty is to couple the prohibition policy with a substitution policy which secures a living for farmers from growing alternative crops or from working on agricultural development projects. Such substitution policies have been in operation since the 1970s in the Golden Triangle and in Pakistan's north-west frontier province, and since the 1980s in the Chapare region of Bolivia.

However, experience to date with substitution policy has by no means been encouraging. Apart from certain successes in specific regions such as the northern provinces of Thailand, the production of drugs has continued to increase rapidly despite these alternative projects. The projects achieved mainly area substitution, since the acreages given over to the new alternative products have been more than compensated for by the opening up of new areas for the cultivation of drug plants. As an added problem, in areas such as Chapare the substitution policy was hardly able to keep pace with the growing land areas being put to use for the cultivation of drug plants as more and more people migrated into the area.

The main difficulty facing any successful substitution policy is that drug cultivation and production are highly profitable. Farmers would only be willing to change voluntarily to alternative crops or activities if the prices of coca leaves and opium were to fall. Yet that is highly unlikely given the special demand circumstances

⁶ Cf. *ibid.*, pp. 20 f., and M. J. Dourojeanni: *El impacto ambiental del cultivo de coca y producción de cocaína en la cuenca amazónica peruana*, La Paz 1990.

⁷ In some countries such as Peru and Bolivia, the illegal market is supplemented by a legal one to cater for traditional consumption.

prevailing in the drugs markets. Drastic price reductions for a period of time are a rare occurrence, though one example was the effect of the large-scale military pursuit of drugs growers and processors in Colombia in 1989. Moreover, the necessary transport and marketing infrastructure for alternative products is often lacking, and that reduces their competitiveness still further.

Strengthening the Formal Sector

Until such time as the worldwide demand for drugs is noticeably reduced, the chances of success for any substitution policy will remain limited. Moreover, as long as development projects remain focused on the growing areas, there is the added danger that more people will migrate into these areas, giving rise to large-scale regional imbalances. Thus the only possibility open to the countries where drugs are grown is to boost the strength of the formal economy relative to the drugs economy, by way of a comprehensive programme of economic development including all major sectors and all regions with development potential. Although this would not be especially detrimental to the drugs economy as such, it would nevertheless offer a relatively secure, legal means of earning a living to those people whose poverty or lack of

any other alternatives motivate them to run the risks associated with illegal activities within the drugs sector.

A comprehensive concept of this type has recently come into operation in Bolivia. However, implementing such a programme not only depends on bureaucracy working efficiently, but also on considerable additional funding which can normally only be made available via development cooperation schemes.⁸ However, a moral hazard problem can then arise in the sense that there will be an incentive for other developing countries to stake their own claims for financial support from development programmes by tacitly tolerating or even supporting drug-growers within their borders.

Curbing the Demand for Drugs

As already mentioned, drug cultivation in developing countries can be most effectively reduced by a fall in the price of coca leaves or opium. Before that can happen, there needs to be a drastic reduction in the demand for drugs in the industrial countries. The instruments which

⁸ The funding requirement for a six-year programme in Bolivia to run until 1995 is estimated at \$ 1.2-1.8 billion. Cf. R. Shams, op. cit., pp. 54 f.

PUBLICATIONS OF THE HWWA-INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

Stefan Brand

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42 ressourcenreichen Entwicklungsländern –

Large octavo,
347 pages, 1989,
price paperbound DM 49,–
ISBN 3-87895-364-X

At first glance the availability of resources seems to have nothing but advantages for the development of a country; the scarcity of capital is ameliorated and the financing of essential imports is taken care of. Nevertheless, there are numerous countries which, in spite of the existence of significant resources, have not succeeded in translating these into economic development. This study first ascertains the theoretical grounds determining the success of development policy in countries rich in resources and then confronts them with empirical findings. Finally, recommendations for development policy measures are derived from the analysis.

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are being applied in the industrial countries range from law-enforcement campaigns against drug-dealing, the prosecution of those consuming drugs and the prevention of money-laundering right through to demand substitution (methadone programmes), preventive and therapeutic measures. With certain exceptions in particular regions, however, such measures have yet to achieve any appreciable success.⁹

Law-enforcement campaigns are frequently frustrated by the ease with which replacement organizations can be established and new channels opened up. In addition, if the drugs mafia which is so well organized internationally, and maintains such good contacts to the political and business worlds even in the industrialized countries, is to be effectively fought this will necessitate a permanent increase in the budget allocated to the law enforcement agencies. Attempts to confiscate illegal drugs earnings normally fail due to highly sophisticated money-laundering procedures. In view of the sheer scale of the problem, prosecuting the consumers is also an impracticable solution.

Drives to detain and prosecute drug dealers are not only ineffective and expensive, but turn out to be counter-productive even when they are successful, since the resulting higher prices serve only to make drug-dealing still more enticing.

Experience to date with preventive and therapeutic measures is also not very encouraging. Prevention campaigns are often confined to disseminating information and deterring potential users. However, in the face of the tremendous pressure exerted on potential consumers by the vast number of young "street pushers", many of whom are themselves addicts, such measures often generate little effect. A further problem is that far less funds are generally made available for prevention and therapy than for law enforcement.

Legalizing Drugs

In view of the limited success of prohibition policies in the growing and in the consuming countries, the legalization of drugs has now increasingly come under discussion. Advocates of legalization assume that this would remove the incentives which have ultimately been responsible for the burgeoning growth of the illegal market. Prohibition creates a high price for drugs, making

both production and trading in them especially profitable because it is possible to establish monopolies. The price for drugs not only includes the monopolist's surplus charge, but also a risk premium to compensate for the stiff penalties which await anyone brought to justice, and a compensation for the bribes and other measures used to undermine law enforcement efforts. Having been pushed upwards by all of these factors, these prices can still be commanded because of the very low price elasticity of demand.

These effects are readily apparent in the massive price mark-ups which are usual in the drugs trade. In 1987, for example, one metric tonne of coca leaves would fetch a price of US \$ 1,567.¹⁰ The normal weight of leaves required to make one kilo of coca paste, then valued at \$ 262, is 96 kg. Two kilos of this paste are then used to obtain one kilo of cocaine base (value: \$ 1,500). Finally, 1.25 kg of the base is used to produce one kilo of pure cocaine the price of which in the producing country was \$ 3,917 in 1987. In the consuming countries, on the other hand, that same kilo of cocaine would, depending on the market situation, fetch a wholesale price of between \$ 20,000 and \$ 40,000.¹¹ A similar price escalation is typical of the heroin trade: an opium farmer will receive between \$ 850 and \$ 1,360 for 10 kg of opium, and the price of the kilo of heroin obtained from that will rise from stage to stage to reach something in the order of \$ 100,000 wholesale in the consuming country.¹²

Reduced Incentives

The profit margins it is possible to earn from drugs are thus enormous. The immediate result of legalization would be a substantial drop in the price of drugs since alternative sources of supply would enter the market. This would reduce profit margins and hence remove some of the incentive to develop an above-average involvement in the sector. However, that effect would only apply if any additional demand from existing addicts and potential new drug users called forth by the fall in price were to be appreciably less than the increase in the quantity supplied. There are a number of reasons why one could expect that to be the case:¹³

- ☐ The crucial factor in fuelling demand is not the price but the enormous pressure exerted by street pushers who in

⁹ Official reports from the USA state that there has been a decline in drugs demand in recent times. However, other enquiries suggest that drugs consumption is shifting to poor groups in the inner cities rather than declining overall. Cf. H. Gramekow: Die Drogenpolitik der Bush-Administration und die Entwicklung des Drogenproblems in den USA, in: *Aus Politik und Zeitgeschichte*, supplement to the weekly *Das Parlament*, issue 42/90, pp. 28-39.

¹⁰ The structure of prices and quantities at various stages of production tends to vary on account of differences in quality between growing areas and the market situation in the various centres of consumption.

¹¹ Cf. R. Shams, *op. cit.*, pp. 25 f.

¹² Cf. UN Economic and Social Council: Recommendations of the Intergovernmental Export Group to Study the Economic and Social Consequences of Illicit Traffic in Drugs (E/CN.7/1991/25), 21st Dec. 1990, p. 8.

turn have every incentive to increase their "customer base" both because of their need to finance their own habits and because of the huge profits which beckon.

□ Even in the event of a fall in prices, the price elasticity of demand remains very low, as studies undertaken in the USA have shown. It is calculated that a 10% fall in the street price would call forth a 2% increase in demand for heroin and a 0.6% increase for cocaine.

□ The main effect of falling prices would be to reduce procurement crime rather than to increase consumption.

However, it cannot readily be disputed that, in the longer term, the legalization of hard drug consumption and the permanent reduction in prices that would bring could indeed lead to a pronounced increase in demand for them, at least from addicts. Investigations into smoking, alcohol consumption and gambling have shown that price elasticities are much higher in the long term than the short term. These findings are also in agreement with theoretical models which ascribe rational behaviour to addicts.¹⁴

Lower Social Costs

Nevertheless, provided that it did not unduly increase overall demand and that a sufficient fall in prices could be achieved, the market solution would also be vastly superior to dirigistic approaches on the grounds that the social costs associated with it would also be substantially lower than those of dirigistic solutions. Because it is impossible to enforce prohibition, the dirigistic solution not only entails costs in providing for and rehabilitating those already dependent on drugs, but also the costs of combating crime of the most serious kind (committed by the drugs mafia) together with the need to keep down procurement crime. Further social costs are generated by a growing milieu of professional criminals and the increasing trend to social disintegration.

However, hard drugs are not normal economic goods. Apart from the negative externalities they create, they also cause radical changes in the structure of preferences among addicts, with all other goods declining in importance relative to the drug to which they are addicted.

In this sense, it is indeed appropriate for governments to intervene in the market structure. It is doubtful, however, whether prohibition is the most appropriate type of intervention, as it is in any case unenforceable. A much more appropriate approach, if the prohibition were lifted, would appear to be the imposition of a tax on hard drugs which would keep down consumption without encouraging greater supply.

Need for a Differentiated Policy

Beyond these basic considerations, what is really needed is a much more subtly differentiated policy in order to minimize the risk of a strong expansion in consumption. The empirical surveys already cited show, for example, that addicts with low incomes respond more strongly to price changes than those with higher incomes. The latter will be more concerned with the negative effects drug consumption will have for them than with the price they have to pay. Young people also respond more strongly to price changes than adults. Anti-drugs policy ought therefore to include elements such as an advertising ban and a variety of broadly-based, class-specific preventive measures which would take much more account than is generally the case today of the deeper social and psychological root-causes of drug dependence.¹⁵

Factors militating against the liberalization of the market for hard drugs are not, though, confined to the fears of a large portion of the general public, which need to be considered by the politicians. Resistance can also be expected from law-enforcement agencies, some of whose members would face the prospect of losing their jobs in the event of liberalization.¹⁶

As the various drug problems in industrial countries grow more and more menacing, as expenditure on combating drugs increases while dirigistic anti-drugs policies continue to show little success, it is quite probable that the liberal solution may suggest itself more and more as the only workable alternative. Another possibility already under discussion is a partial liberalization in which the sale of drugs would be prohibited whereas purchase, possession and consumption would be legally permissible and, in an associated measure, those already addicted would be able to obtain their supplies publicly and free of charge. Such a partial liberalization is likely to meet with less political opposition than the complete liberalization which might be more justifiable on economic grounds. One thing that is certain, whichever solution is given preference in the end, is that unless the world-wide demand for drugs can be curbed there can be no prospect of success for anti-drugs policy in the developing countries.

¹³ On the following, cf. E. J. Mishan: *Narcotics: The Problem and the Solution*, in: *The Political Quarterly*, Vol. 61, 1990, pp. 411-462.

¹⁴ Cf. G. S. Becker, M. Grossmann, K. M. Murphy: *Rational Addiction and the Effect of Price on Consumption*, in: *The American Economic Review*, Vol. 81, No. 2, May 1991, pp. 237-241.

¹⁵ Cf. *ibid.*, pp. 240 f.

¹⁶ The anti-drugs bureaucracies affected would not only include national authorities, but also the United Nations International Drug Control Program (UNIDCP), which is strictly opposed to any liberalization.