

## **If our neighbors legalize**

### **Some clarifications about the IMCO findings**

On October 31st, IMCO released a report on the potential impact of state-level marijuana legalization in the United States on Mexican marijuana exports. That report has created a significant amount of buzz not only in Mexico, but also in the United States. We are thankful for the attention, but we think some of the conclusions of the report have been misconstrued in some media accounts. We would like to clarify what the report actually says:

1. Our main claim is that legalization could translate into significantly lower marijuana prices in the states that pursued that policy. That would open up a price differential between legalization states and states that continued to ban marijuana production and sales. A significant price differential would in turn create incentives for smuggling from legal marijuana states to the rest of the country.
2. Under certain conditions, domestic smuggling could displace international smuggling. That could lead to a reduction in the volume of Mexican marijuana exports and consequently, a decline in the gross drug export revenues of Mexican criminal organizations. In our base scenario, we estimated that decline at around USD 1.4 bn for the cases of Colorado and Washington, equivalent to slightly less than a quarter of gross drug export revenues. Note that we were talking about revenues, not profits, and only those generated by illegal drug exports, not the total income of criminal organizations.
3. As we stated explicitly in the report, the results are contingent on the actual existence of a state-level legal marijuana market in the US. The US federal government could prevent that from happening: if it moves forcefully and effectively against Colorado and Washington, be it through court challenges, increased federal enforcement, or selective harassment of producers, wholesalers and retailers, there will be no legal marijuana market in either state and, therefore, little or no diversion to other states. The effect on Mexican illegal drug revenues would then be close to zero.
4. There is no contradiction between our findings and the 2010 *RAND Corporation's* report on the potential effects of marijuana legalization in California. For a rather simple reason: we explicitly replicated their model, with just of couple of minor methodological tweaks. That makes the results very similar. The *RAND* report found that, in the absence of effective intervention to prevent exports to third states, Mexican illegal drug export revenues could potentially decline by 20% (their best estimate). Our best estimate for the cases of Washington and Colorado are -22.7% and -23.5%, respectively.

5. Our best estimate of gross drug export revenues is USD 6.1bn (with an estimate range of 4.7 to 7.8 bn). That is the estimate for the four major export drugs (cocaine, heroin, methamphetamine, and marijuana). It is not radically different from the best estimate included in the *RAND* report (USD 6.6 bn). Our corresponding number for marijuana is USD 2bn (estimate range: 1.4 to 2.6 bn), as opposed to USD 1.5bn for *RAND*. As a result, our best estimate for the share of marijuana in total drug export revenues is 33% (vs 23% for *RAND*).
6. Our numbers are slightly different from those of the *RAND* report as a result of recent evidence on changes in US illegal drug demand. According to the 2011 National Survey on Drug Use and Health (NSDUH), the number of past month users of cocaine in the US went down 28% (from 1.9 to 1.4 million) between 2008 and 2011, whereas the number of past-month marijuana users jumped 19% over the same period (from 15.2 to 18.1 million). Consequently, we believe the share of cocaine in Mexican drug export revenues has probably declined in recent years, while the share of marijuana has likely increased.
7. Demand-side estimates about the declining role of cocaine in Mexican drug export revenues are buttressed by recent seizure data. According to official sources, cocaine seizures in Mexico declined from an average of 25 metric tons in the 2000-2009 period to 9.9 metric tons in 2010, 11.3 in 2011, and 1.2 over the first seven months of 2012. Mexican seizures of other drugs (including marijuana) have remained stable or increased over the same period.
8. We made no claim as to the effects of reduced marijuana export revenues on the behavior of Mexican drug trafficking organizations. We currently have no opinion on the potential impact of state-level marijuana legalization on the overall levels of criminal violence in Mexico.
9. We do think that losing marijuana revenues could have a transformative impact on the Mexican drug trafficking industry, over and beyond the direct potential reduction of marijuana export income. There are a number of possible effects that, although of indeterminate magnitude, should be considered when analyzing the impact on Mexico of the recently approved measures in Colorado and Washington, including:
  - a. Potentially larger-than-proportional effects on employment (given the relatively high labor intensity of marijuana compared to other illegal drugs)
  - b. Potential changes on the cost structure and overall profitability of Mexican drug smuggling operations (as a result of a loss of the marijuana contribution to the fixed costs of Mexican drug trafficking organizations)
  - c. Differential impact at both the regional and organizational levels (given the geography of the marijuana trade in Mexico)

10. In brief, contrary to some media reports, our findings are not fundamentally different from those of the 2010 *RAND* report. We do think state-level marijuana legalization could have a somewhat larger effect on Mexican drug export revenues than hypothesized two years ago, as a result of declining cocaine demand and growing marijuana consumption in the US. But, in essence, we are making the same argument:
- a. Even at the state level, full-blown legalization for recreational purposes is a major marijuana policy change in the United States.
  - b. Over the medium-term, state-level legalization (even in only two states) could potentially create significant downward pressure on marijuana prices throughout the United States.
  - c. Large-scale domestic marijuana smuggling, driven by price differentials between legalization and non-legalization states, could also potentially lead to a substantial reduction of Mexican marijuana exports to the US.
  - d. That development could have a non-trivial impact on the revenues of Mexican drug trafficking organizations. The effect, however, would not be devastating.
  - e. Large-scale domestic smuggling (and its impact on Mexican marijuana exports) is contingent on a number of factors, most particularly the reaction of the US federal government. The forcefulness and specific characteristics of that reaction are still unknown.
  - f. The biggest effect of state-level legalization will likely be political. It changes the nature of the debate on marijuana policy and may convince other states and countries to follow suit.