The International Narcotics Trade: The Case of Three Less Developed Countries

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In recent years the war which the US Drug Enforcement Agency has waged on the international drugs trade has received considerable international attention. Much of this, however has been focused on the social and political side of the problem, especially in the US. A much neglected area is the profound effects the narcotics trade has on the producing economies. The purpose of this essay is to examine the economic effects of the drugs trade on the three principal producing economies; namely, Colombia, Bolivia and Peru.

In section one, the three economies and the structure of their cocaine industries are briefly examined. Section two then proceeds to outline the main macroeconomic effects on the three economies of the drugs trade. It is concluded that a durable solution to the drugs problem must be located in the demand side of the industry, but that such a solution cannot but have a debilitating effect on drug economies.

The economic backdrop

The Columbian, Peruvian and Bolivian economies all exhibit the characteristics of Less Developed Countries. All rely on one or two major sources of export income and all are heavily agriculture or primary industry based. Foreign debt and balance of payments problems impinge severely, and unemployment is a fact of life. The Peruvian economy has been a victim of world economic trends, natural disasters and economic mismanagement. Bolivia relies mainly on agriculture and tin, and has experienced several inflation spirals. Colombia is the country which is most prosperous, but despite this, it's foreign debt has become unmanageable.

Having said this, the economies of these nations have one dimension that those of other LDCs do not - narcodollars. This additional income does not appear in official statistics, but it can be argued with some conviction that the repatriated earnings of South American drug barons represent a significant portion of GNP.

Bolivia and Peru are the main growers of the coca, while Columbia processes it into cocaine. Columbia therefore receives most of the value added, while Bolivia and Peru are paid by the Colombians for the raw material. However, Columbia is a much larger economy than the other two, and therefore the proportional effect of the narcotics earnings is approximately the same.

Structure of the cocaine industry

The economics of coca are impressive. Business Week (1986) estimates that a hectare crop of coca (the plant from which cocaine is derived) is worth about $5,000 to the farmer compared to only $500 for an equivalent harvest of coffee. A hectare of coca yields about 9kgs of cocaine which sells wholesale for about $800,000 (several times the price of gold). Because of the large value-added at each stage of production and distribution, the industry has witnessed much horizontal integration. The scale of the cartels which resulted prompted Mr. Alan Garcia, President of Peru, to comment that the drugs industry was "Latin America's only successful multinational" (*Economist*,1988,25). The cartels compete not through price or strategic mechanisms, but rather through violence.

The revenues generated are estimated to be huge - between $76-$181 billion[1]. Exactly how much of this is repatriated to Columbia, Bolivia and Peru is not known, but one estimate puts the figure at approximately $11 billion. It is widely but incorrectly held that these repatriated earnings stay in the hands of a relatively small number of traffickers and middlemen. In fact, as the next section reveals, the impact is far more dissipated than this.

Consequences and implications

The drugs industry impacts on the economies of these countries in a number of ways. The effects are both positive and negative. Five of the most significant are discussed below.

Inflation

One of the initial effects of such an influx of money is a growth in the money supply. This spawns an increase in the demand for goods and services, especially luxury goods and construction services, causing prices to tend upwards. Many lower and middle income families have been driven out of the property market as a result. Once inflation spirals begin, they prove very difficult to collapse. In August 1990 the Peruvian government quadrupled staple food prices and drove up petrol prices by 3000% causing demand to collapse. Such were the shock measures needed to control the narcotics-induced inflation.

Balance of Payments and Foreign Debt

Huge foreign debt is a major burden for the three economies in question, and narcodollars are an unofficially welcome source of foreign exchange. Wisotsky (1986) estimated that in 1984, coca brought in approximately $2 billion in foreign exchange for Bolivia, at least three times the value of it's leading official export, tin. The repatriated drug money is absorbed directly into the financial system by the banks, who provide high interest-yielding, confidential accounts. Indeed, the US Drug Enforcement Agency has accused the South American banking industry of being an integrated money laundering organization. These dollars are then used to service the huge foreign debts of the economies. For government leaders who see vast amounts of trafficking dollars infused into their faltering economies, it appears that the drug trade has its benefits.

Uncompetitiveness

Drug dollars have implications for the exchange rates of the economies. As well as causing an excess of dollars in the economy, drug dollars have caused what Mr. Francisco Thoumi, a Colombian economist, has termed "Dutch Disease" (Economist,1988:25). This phenomenon occurred in Holland in the 1970s when a sudden surge of income from natural gas exports distorted the Dutch economy. Just as the energy boom pushed up the value of the guilder and made many other Dutch exports uncompetitive, the coca boom has pushed up the currencies of the three economies, which has undermined the competitiveness of their other exports.

Employment

One of the clearest effects of drug money is that it creates jobs. Mr. Rennssalaer Lee, a foreign policy consultant in Washington, estimates that between 750,000 and 1.1 million people are employed directly in the drugs trade, which is 5% of total official employment in the three economies. As well as the large numbers of farmers

1 The nature of the industry is such that no official figures appear and therefore revenue measurement can only be approximated.

involved in the actual growing of the, coca traffickers support large numbers of drivers, runners, "security" men, builders, chemists and so on. Since unemployment is rife, wage levels are extremely low and because the jobs are not official workers are easily exploited. Many of the jobs also involve violence and crime, which has a high social cost. The narcotics industry also indirectly supports countless secondary jobs in banking, accountancy, real estate, and law. However, the nature of employment in these sectors is generally illegal. Many lawyers and bankers are threatened if they do not provide their services. Thus, when set in context, it is arguable that the employment provided by the cocaine industry is not socially desirable.

Agriculture

Farming is the most labour intensive aspect of the business and in 1987 it was estimated that approximately 300,000 Bolivian farmers were engaged in coca production, 17% of total Bolivian employment (Inciardi,1986:179). The economics of coca production have made it extremely difficult for farmers not to produce. Although the US funded long term projects to develop alternative crops, their unsuitability to the South American environment and the comparative price of coca ensured that these efforts foundered. Coca also provides three harvests a year compared to only one for most of the other commercial produce.

For many peasants, the cultivation of coca offers a way out of poverty. Attempts by the governments of the three economies to eradicate coca production have met strong resistance from both traffickers and peasants alike. Yet if no action is taken, the agricultural sectors of these economies will become ever more dependent on coco, concomitantly increasing exposure to the whims of cocaine prices. The answer to the problems cocaine causes is not, however, in supply eradication. The relative price inelasticity of cocaine means that restrictions on supply cause prices to soar, further enhancing the incentives for traffickers[2]. The governments of the three economies have been slow to recognize this. Attention should instead be focussed on the demand side of the narcotics market, wherein the kernel of a durable solution lies.

Conclusion

It is clear from the above discussion that the narcotics trade has important latent effects on the economies of Colombia, Peru and Bolivia. The effects would appear to be positive with regard to balance of payments, foreign exchange and employment but negative with regard to competitiveness and inflation. Socially and politically, however the cocaine industry has been disastrous for these nations. Violence, corruption, bribery and blackmail have led to instability, most notably in Columbia, where there has been many political assassinations. The hidden social costs to these economies negate any benefits which the revenues may provide.

However, historically the demand for any one drug has been cyclical, and if world demand for cocaine drops (as it has shown signs of doing in 1990) this will have significant effects for these three economies. Although there are social costs, Colombia, Bolivia and Peru need narcodollars to survive. As a senior Colombian Central Bank official commented: "We need that money to keep the economy going. That's a sad but unequivocal reality."

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2 It is precisely illegality that makes cocaine trafficking one of the worlds most lucrative business. It is a high risk, high return business.

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