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## Making an economic case for legalizing drugs

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State and federal governments face a daunting fiscal outlook. The national debt stands at 60 percent of GDP, its highest level since World War II. Under current projections this ratio will rise to more than 75 percent of GDP by 2020 and continue increasing thereafter. States are also facing severe budget shortfalls.

Politicians and the public express concern about the debt, but standard proposals for expenditure cuts or tax increases garner little support. Understandably, therefore, some politicians, commentators, interest groups, and citizens have embraced unconventional approaches to closing fiscal gaps, such as legalizing drugs.

Legalization would reduce state and federal deficits by eliminating expenditure on prohibition enforcement - arrests, prosecutions, and incarceration - and by allowing governments to collect tax revenue on legalized sales.

This potential fiscal windfall is of particular interest because California, which is facing a budget shortfall of \$19.9 billion for fiscal 2011, will vote Nov. 2 on a ballot initiative that would legalize marijuana under California law. Advocates of the measure have suggested the state could raise billions in annual tax revenue, in addition to saving criminal-justice expenditure or reallocating this expenditure to more important priorities. Should the California measure pass and generate the forecasted budgetary savings, other states would likely follow suit.

In our recent study, just released by the Cato Institute, we estimate the impact of legalization on federal, state, and local budgets. The report concludes that drug legalization would reduce government expenditure about \$41.3 billion annually. Roughly \$25.7 billion of this savings would accrue to state and local governments, and roughly \$15.6 billion to the federal government. About \$8.7 billion of the savings would result from legalization of marijuana, \$20 billion from legalization of cocaine and heroin, and \$12.6 billion from legalization of all other drugs.

Legalization would also generate tax revenue of roughly \$46.7 billion annually if drugs were taxed at rates comparable to those on alcohol and tobacco. About \$8.7 billion of this revenue would result from legalization of marijuana, \$32.6 billion from legalization of cocaine and heroin, and \$5.5 billion from legalization of all other drugs.

These estimates should be taken with several large grains of salt. The markets for illegal drugs are opaque, and different approaches to estimating either the size of this market or the effect of legalization can therefore vary substantially. Further complicating matters, different approaches make different implicit or explicit assumptions about exactly what policy change is under consideration, such as whether legalization applies nationwide, under both federal and state law (the scenario we consider), or in just one state, just for marijuana, and just under state law (the California experiment). Our estimates are in the middle of available numbers.

The fact that legalization would generate a fiscal dividend does not, by itself, make it a better policy than prohibition. Legalization would have many effects, and opinions differ on whether these are desirable on net. Both sides in this debate, however, should want to know the order of magnitude of the fiscal benefit that might arise from legalization.

Our results imply that the budgetary implications of legalization are neither trivial nor overwhelming. Legalization will not solve America's fiscal woes; the budget effects are small in comparison with current deficits. Yet the budgetary benefits are more than mere rounding error; for those with mixed feelings about prohibition vs. legalization, these benefits might be a deciding factor.

Several specific aspects of our estimates bear comment.

Roughly half the budgetary savings comes from reduced criminal-justice expenditure on drug prohibition. For this component of the effect to show up in government budgets, policymakers would have to lay off police, prosecutors, prison guards, and the like. Such a move would be politically painful, so it might not occur. Reduced expenditure on enforcing prohibition can still be beneficial if those criminal-justice resources are redeployed to better uses, but that outcome is not easy to achieve.

Only about \$17.4 billion in budgetary improvement can be expected to come from legalizing marijuana in isolation. Yet the current political climate gives no indication that legalization of other drugs is likely in the short term. So the budgetary impact from the politically possible component of legalization - marijuana - seems modest.

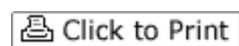
None of these considerations weakens the broader case against drug prohibition, which has always rested on the crime, corruption, and curtailment of freedom and civil liberties that are the side effects of attempting to fight drug use with police officers and prisons. What our estimates do provide are two additional reasons to end drug prohibition: reduced expenditure on law enforcement, and an increase in tax revenue from legalized sales.

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