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How to kill the marijuana black market

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Sen. Cory Booker, D-N.J., has recently introduced legislation to legalize marijuana at the federal level. His bill will no doubt inspire the standard criticisms, one of which is that legalization does not eliminate the black market. Kevin Sabet, director of the Drug Policy Institute, claims that “[e]ven under legalization, there’s a black market.” This view contains a kernel of truth, but it misses the bigger picture.

Most consumers prefer, other things equal, to purchase from legal suppliers. This allows them to resolve disagreements about quality, service, and payment with lawsuits or by reporting to private and public watchdogs; it facilitates repeat shopping from a high-quality seller, and it avoids the risks of adulterated or excessively potent goods. Thus despite the costs created by regulation and taxation for most legal goods, black markets do not often arise.

Instead, black markets arise only when government policy forces markets underground by outlawing them or by imposing excessive regulation or taxation. After the United States repealed Alcohol Prohibition in 1933, most of the market returned to the legal sphere, except in states that continued prohibition or imposed excessive taxes.

One obstacle to moving the marijuana market fully above ground is that all state legalizations to date — and the regulatory frameworks imposed at the state or city level — impose substantial restrictions on the marijuana market. Details vary, but regulations generally limit the number of retail outlets, the specific products they can sell, the amount customers can purchase per visit, and the location of stores. Much regulation also restricts or bans home delivery, bars some individuals from obtaining retail licenses, and imposes a minimum purchase age of 21. Apart from this over-regulation, some states impose a tax burden that prices legal marijuana well above illegal marijuana.

A different obstacle to eliminating the black market is ongoing federal marijuana prohibition. Federal authorities can, and do, conduct busts and buys, prosecute violations of federal prohibition, and imprison those convicted. Moreover, federal banking regulation keeps marijuana businesses from operating legally, even in legalized states. The federal tax code also bars standard expense deductions for businesses that are illegal under federal law; this means that marijuana businesses face highly punitive tax rates. According to Fortune Magazine, a legal marijuana business owner can pay an effective tax rate as high as 90 percent.

Additionally, regulation currently protects those lucky enough to already have licenses. In Oregon owners of legitimate marijuana businesses are losing customers to the black market. They blame “delays in the state’s permitting process for new entries into the recreational

marijuana market, which acts as an artificial control on supply, which... in turn pushes customers to explore cheaper options.”

All these factors encourage continued black markets even under legalization.

The critics are therefore right that partial legalization will not eliminate the black market, but the solution is trivial: full legalization. Most importantly, federal law must legalize marijuana so that marijuana businesses can access the legal banking sector and comply with federal tax codes without putting themselves at a competitive disadvantage.

More broadly, the desire to control the marijuana market via regulation is misguided.

If regulation is mild, it has no meaningful effect. Consider a rule that limits purchases to one ounce per customer per month. For most users an ounce lasts at least a month anyway. And consumers who want more can purchase at multiple stores or have friends or family purchase for them

If regulation is instead strict, it promotes continuation of the black market. Consider a requirement for registration of every purchase and enforcement of the rule of only one ounce per month across all stores in a state. This would be expensive and would place real barriers to using retail stores, ultimately resulting in less tax revenue, more need for enforcement, and perpetuation of the illegal market.

Thus legalization without excessive regulation or taxation is the only way to eliminate the black market. And this approach has the added virtue of maximizing tax revenue from legalized sales, minimizing enforcement costs, and respecting the freedom of those who wish to consume marijuana.

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