



Research paper

“Should I Buy or Should I Grow?” How drug policy institutions and drug market transaction costs shape the decision to self-supply with cannabis in the Netherlands and the Czech Republic

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ARTICLE INFO

Article history:

Received 2 May 2014

Received in revised form 5 December 2014

Accepted 7 December 2014

Keywords:

Cannabis cultivation

Self-supply

Drug policy practice

Institutional economics

Transaction costs

Comparative analysis

ABSTRACT

Background: This paper uses the framework of institutional economics to assess the impact of formal and informal institutions that influence the transaction costs on the cannabis market, and users' decisions to self-supply in the Czech Republic and the Netherlands, two countries with seemingly identical policies towards cannabis cultivation.

Methods: A comparative analysis was conducted using secondary qualitative and quantitative data in four areas that were identified as relevant to the decision to cultivate cannabis: (i) the rules of the game – cannabis cultivation policy; (ii) “playing the game” – implementation of cannabis cultivation policy, (iii) informal institutions – cannabis cultivation culture, and (iv) the transaction costs of the cannabis market – availability, quality, and relative cannabis prices adjusted by purchasing power parity.

Results: Although the two policies are similar, their implementation differs substantially. In the Czech Republic, law enforcement has focused almost exclusively on large-scale cultivation. This has resulted in a competitive small-scale cultivation market, built upon a history of cannabis self-supply, which is pushing cannabis prices down. In the Netherlands, the costs of establishing one's own self-supply have historically outweighed the costs associated with buying in coffee shops. Additionally, law enforcement has recently pushed small-scale growers away from the market, and a large-scale cannabis supply, partly controlled by organised criminal groups, has been established that is driving prices up. The Czech cannabis prices have become relatively lower than the Dutch prices only recently, and the decision to buy on the market or to self-supply will be further shaped by the transactions costs on both markets, by policy implementation and by the local culture.

Conclusions: The ability to learn from the impacts of cannabis cultivation policies conducted within the framework of UN drug treaties is particularly important at a time when increasing numbers of countries are seeking more radical reforms of their cannabis policy.

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Introduction

Several studies suggest that drug policies have little effect on any type of prevalence (lifetime, current, etc.) of drug use, but influence the behaviour of people who use drugs (PUD) in ways that militate or mitigate the potential for harm of drug use (Grund,

Stern, Kaplan, Adriaans, & Drucker, 1992; Huigen, 2013a, 2013b; MacCoun & Reuter, 2001; Reinerman, Cohen, & Kaal, 2004). However, it remains unexplored how particular drug policies shape the decision to purchase or self-supply illicit drugs in cases where it is possible – typically, with cannabis, and, to a somewhat lesser extent, with other psychoactive substances.

This paper aims to analyse the relevant factors in the decision to cultivate cannabis under two cannabis cultivation policies that at first sight seem very similar and that “allow” the cultivation of up to five cannabis plants. In the Czech Republic, ‘home-grown’ is a rather common source of cannabis, whereas in the Netherlands, cannabis cultivation for personal use is much less widespread. This paper

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compares cannabis policies and their everyday implementation, the cultures of cannabis cultivation, the market prices of cannabis, and other factors that may shape the decision “to buy or to grow” of cannabis users in the two countries. In this paper, we apply the theoretical framework of institutional economics, which explains the choices of individuals who participate in markets as an outcome of legal constraints, cultural boundaries, and, most importantly, the so-called “transaction costs”.

Our paper contributes to the recent debate on the impact of emerging regulated markets (Uruguay and two states of the USA, with more countries and US states debating similar measures) by scrutinising whether cannabis cultivation for personal use is a deliberate choice or, and to what extent, it is shaped by policy, culture, or other market factors.

Transaction costs and institutions on the illegal market

Institutional economics is an area of economics that centres around so-called “transaction costs”, a concept that is considered of primary influence in modern economic theory (Coase, 1937; Williamson, 2000). Transaction costs are the costs of finding an agreeable and reliable market counterpart, of the negotiations between these parties, and of reducing the uncertainty as to whether the parties to a contract will comply with their commitments. This is the case especially in the formally unregulated market transactions that are typical of illicit markets. For instance, an entrepreneur going into business has to contract suppliers, staff, and facilities. Each time, the price and contractual conditions have to be settled so that both contractual parties are *maximising utility* from the transaction, as the basic principles of the market have been defined since Adam Smith (Mankiw, 2007; Smith, 1776a, 1776b). The magnitude of the transaction costs is understood to predict the organisation of a particular market.

In order to minimise the transaction costs on the market, societies create *formal and informal institutions*, such as contractual laws or the enforcement of property rights. In this context, an “institution” is understood as any common principle that regulates how market participants behave (Commons, 1931). According to Williamson, there are four types of institutions that influence the decision making of individuals in a market: (i) informal institutions, customs, and culture; (ii) formal “rules of the game,” such as laws and legislation, which commonly evolve out of the former type; (iii) “playing the game,” especially contract enforcement, and (iv) resource allocation on the level of a firm.

On the illicit drug market, no formal institutions in the form of laws, legislation, or enforceable bi-partisan contracts exist that could regulate market behaviour, since the transactions themselves are prohibited. The transaction costs on these markets are remarkably high. In fact, all formal prohibitive laws that target the drug market aim to increase the transaction costs and discourage interested parties from participation in the market. Among those costs we can count the risk of arrest and of seizure of the product, or the risk of low product quality and lack of choice, as well as the risks of violence, which, in illegal markets, substitutes for the legal enforcement of property rights (Andrade, Sifaneck, & Neaigus, 1999; Decorte, 2008; Reuter & Kleiman, 1986; Sifaneck, 2005). Although the term “transaction costs” has not been commonly used in analyses of these illicit market risks, it has been acknowledged that they increase substantially with each transaction or encounter between vendor and customer, in particular in rushed transactions between parties in the market who are unknown to one another.

As a result, illicit market players create *informal norms* aimed at reducing the transaction costs imposed on the market participants by the formal embargos. Wilkins and Casswell (2003) and Wilkins (2001) have shown that transaction costs in an illicit market can be reduced by establishing trusted relations among market

players. These can involve rules encouraging “*friends supplying friends*” (Belackova & Vaccaro, 2013; Coomber & Turnbull, 2007; Grund, Kaplan, Adriaans, & Blanken, 1991) or encouraging market participants to act in a “friendly” manner (Belackova & Vaccaro, 2013). These behavioural patterns can be referred to as “cannabis culture” (we define the term later) and act as institutions that reduce the transaction costs in the illegal market.

In the economic theory, another option for reducing transaction costs is leaving the market by establishing “*the firm*” instead (Coase, 1937; Crook, Combs, Ketchen, & Aguinis, 2013; Williamson, 1989). Within the firm, the transaction costs of bi-partial market contracts are obviated or diminished by long-term arrangements. For instance, instead of contracting with different supply chains, the entrepreneur uses management, administration, and governance instruments in order to produce marketable goods. If the transaction costs in a particular market are high, it pays off to bear the full costs of production – even when the associated costs would be lower had the product been outsourced as a result of *economies of scale* achieved by a specialised market counterpart.

This paper focuses on the role of formal and informal institutions in shaping users’ decision to “leave the market” and establish a firm – (small-scale) cannabis cultivation for personal use. It demonstrates how institutions outlined in economic theory (in particular, the *rules of the game* in the form of cannabis policies, *playing the game* in terms of law enforcement, and cannabis (cultivation) *culture* and *transaction costs*, such as availability, quality, and relative market price) influence the choice to cultivate cannabis.

Cannabis cultivation in the Czech Republic and the Netherlands

Domestic (indoor) cannabis cultivation has largely replaced imported cannabis products in developed countries in recent decades. In most Western European markets, much of the imported hashish has been overtaken by a wide variety of cannabis hybrids, referred to by Potter (2008) as the “green avalanche”. In other countries, domestically produced high-grade indoor cannabis has taken the place of the established outdoor cannabis production and imported indoor cannabis (Belackova & Zabransky, 2014b; Duffy, Schaefer, Coomber, O’Connell, & Turnbull, 2008; Hough et al., 2003). Domestic cannabis production is widely (but not exclusively) practised by small-scale cannabis cultivators, who mostly produce the herb for personal consumption (Decorte, 2008, 2010a, 2010b; Hakkarainen & Perala, 2011).

The two countries subjected to our analysis, the Czech Republic and the Netherlands, have notably different levels of small-scale cultivation for personal use. In the Czech Republic, about 9% of the last-year cannabis users recruited within a representative population sample claimed to have cultivated the cannabis they used the last time (Belackova, Nechanska, Chomynova, & Horakova, 2012), and so did 14% of the Czech cannabis users that participated in an EU online survey focusing on drug markets (Trautmann, Kilmer, & Turnbull, 2013).¹ The role of these small-scale growers in the Czech cannabis market is complemented by the relatively large proportion of the Czech cannabis users in this survey (44%) who declared they had received cannabis for free. This is much higher than in any of the other EU countries that participated in the survey – and more than twice the Dutch figure of 21%. Indeed, the Dutch respondents buy their cannabis at twice the rate of their Czech counterparts, 75% as opposed to 37%. Only 2% of the Dutch respondents using cannabis claimed to have grown their own – which was the lowest figure for all the survey participating countries. In the 2014 Global

¹ Non-probability sample of self-nominated respondents, recruited from a large cannabis cultivation discussion board.

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