

The supply side in the Portuguese Cannabis market

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Executive Summary

1. The present report intends to characterize the supply side in the Portuguese Cannabis market.
2. We contribute to a better knowledge of how the supply side works in markets of illegal consumption goods.
3. The market analysis follows the Structure – Conduct – Performance paradigm.
4. The analysis is, naturally, conditioned by the availability of information, as it deals with an illegal activity. In many points, it was based on indirect inference and “soft” information.
5. The product market definition includes all the products derived from Cannabis Sativa.
6. The quantities supplied to market have mainly origin outside Portugal.
7. There is a non-zero price elasticity of demand, both in aggregate and individual levels, being smaller in absolute value in the latter.
8. There is some degree of product differentiation. The degree of product differentiation results from the quality of production associated with the import origin.
9. Alcohol and ecstasy are complementary products, in the economic sense of the term, to the hashish consumption. A decrease in the price of the latter is normally associated with an increase in the consumption of all three products.
10. There are legal barriers to the supply of the product, as the sale of Cannabis products is not allowed.

11. The storing requirements to imports do not create significant barriers to entry of new entities in the distribution of the product.
12. Distribution networks are not a significant barrier to entry in the supply side. The distribution networks have several hierarchical levels, although with the available information we are not able to provide a detailed and precise characterization.
13. Existing distribution networks show enough flexibility to adapt it to the needs of each place so as to minimize the distribution costs. Distribution networks have, in general, a light and decentralized structure.
14. There is, in many cases, a proximity relationship between the “retailer” and the final consumer. A stable and specific relationship between “retailer” and final consumer may develop, as a way to overcome the uncertainty over product quality.
15. The existence of exclusive distribution territories has important implications for the working of markets. Currently, there is no information about the existence, size and effectiveness of exclusive territories.
16. We conjecture that an existing supplier does not face significant barriers to entry in different geographical regions.
17. We consider Continental Portugal to be a single geographical market, although some geographical differences persist. Integration at the national level is ensured by the potential geographic mobility of supply side players. The degree of integration in a single national market is assessed by analysis of price differentials across distinct geographical areas.
18. Within the integrated market in Continental Portugal, some geographic segmentation can be identified, with the region of Great Oporto on one side and the region of Great Lisbon, on the other side.
19. The Autonomous Regions of Azores and Madeira constitute separate geographical markets.

20. Profits' laundry is an important component of supply side activities. Laundry of profits is done both in small and large scale, according to the size of the group operating on the supply side.
21. Market power exercise by supplier has ambiguous effects on social welfare in the case of a social positive value of a smaller consumption level.
22. From the available information, we conclude in favour of a market structure for Cannabis supply in Portugal characterized by the existence of several players, of different sizes, and operating close to the notion of competition. This results from easy entry conditions (aside legal restrictions, of course) and survival of small groups.
23. Since 2001 we observe a price decrease. The price decrease is explained by two sets of factors. First, there was an increase in supply. Second, the prices are now measured in different points of the distribution chain. At present, we do not have information that allows for separation of the two effects.
24. In the context of this market, and taking into consideration the probability of law enforcement interventions, with the associated penalties, the expected profit margin seems relatively small, and allows only for what we coin, in economics, by "normal return".