

ARTICLE

# The Economic Analysis of Law as a Reference for the Grounds of Judicial Decisions

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## ABSTRACT

The present article aimed to analyze the application of the economic analysis of Law as a reference for the reasoning of judicial decisions. To that end, an analysis was carried out on the definitions of what is hermeneutics and economic analysis of law, based on the construction of the matrix rule of conduct for public administration. The method of the approach followed was empirical-dialectical, using bibliographic, legislative and jurisprudential research, having a reference to the Law and Economics.

**Keywords:** Economic analysis of law; Hermeneutics; Matrix rule

## 1. Introduction

In the scope of civil law, the legal system is formed based on written texts, in order to allow different interpretations, considering that, through the use of the most varied hermeneutic techniques, the student of Law can proceed in different ways when applying the same law to the specific case.

However, despite the diversity of ways of interpreting the law, the Judge State, when judging a concrete case, must observe the principles of legality, impersonality, morality, publicity and efficiency. In this context, it is up to the Judiciary, when applying the law, to obey the aforementioned principles, so that the analysis of the legal text must use the tech-

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nique that is closest to their observance.

Faced with this reality, the following question arises: Observing the principles of legality, impersonality, morality, publicity and efficiency, can the economic analysis of Law be used as a reference for the interpretation of the Brazilian legal system, guiding the decisions of the Judiciary Power applicable to specific cases?

In this context, the validity and consequences of using the economic analysis of law <sup>[1]</sup>, as a reference before the legal system, gains special importance, since it provides new directions for legal thinking, seeking to achieve ethical consequences that result in social well-being, a reflection of the direction of judicial decisions to pursue their social functions, orienting them to a context that provides the best conditions for the community, offering legal certainty, which is why it becomes the objective of this study.

To carry out this analysis, Law and Economics were used as a theoretical framework, in order to verify the validity of applying the economic analysis of law in judicial decisions.

In this way, legal hermeneutics was first approached, clarifying what it consists of and its applicability, then weaving brief considerations in relation to the economic analysis of Law, the concepts of externality, rationality and transaction costs, in order to provide an adequate cut methodology for further study.

## **2. Methodology**

To carry out this research, the deductive approach method was adopted, based on bibliographic research.

In the Brazilian legal system, more specifically in the Brazilian Civil Code, there is a provision that the State Judge, when judging a concrete case, must apply the law through an interpretation of the positive norm based on the principles of legality, impersonality, morality, publicity and efficiency.

In this context, it is up to the Judiciary, when applying the law in the concrete case, to obey the aforementioned principles, so the analysis of the legal text must use the interpretation technique that is

closest to the observance of these principles.

In this way, the following research problem arises: The economic analysis of the Law can reveal itself as an interpretation technique capable of guiding the Judge in the application of the Law to a concrete case, observing the principles of legality, impersonality, morality, publicity and efficiency?

In this sense, from the deductive method, the following research premises can be arrived at: a) in the application of the positive law, the Brazilian State Judge must observe the principles of legality, impersonality, morality, publicity and efficiency; b) for the application of the positive law, the State Judge must use one of the several existing techniques of interpretation of the Law; c) the economic analysis of the Law can reveal itself as a technique of interpretation of the Law that allows the Judiciary to apply the Law to the concrete case with observance of the principles of legality, impersonality, morality, publicity and efficiency.

Thus, major works were analyzed in order to, from knowledge already studied, seek to answer the problem that is the focus of the present research, in order to provide new knowledge about the researched subject.

Through the use of the theoretical framework studied from the literature related to this research, it is intended to verify the possibility of using the economic analysis of Law, as a reference for the interpretation of the Brazilian legal system, guiding the decisions of the Judiciary Power applicable to cases concrete.

In this methodological context, the concepts covered, of a founding nature, are presented in the investigation, linked to legal hermeneutics and the economic analysis of law.

The punctual analysis of such concepts only gave way when they were united to the present interpretative proposal, the vital nucleus of this study.

The teleological reasoning, therefore, progresses towards the mixture of these institutes of paramount importance to verify the validity of the application of the economic analysis of Law in judicial decisions, before the Brazilian legal system.

### 3. Related literature

#### 3.1 Essay on legal hermeneutics

Since the emergence of the word, hermeneutics has been understood as the science and, respectively, the art of interpretation, taking the form of a doctrine that presents the rules of competent interpretation.

Its intention was predominantly technical and normative, providing the openly interpretive sciences with some methodological indications, in order to prevent, in the best possible way, arbitrariness in the field of interpretation of texts or signs <sup>[2]</sup>. Hans-Georg Gadamer <sup>[3]</sup> states that, through hermeneutics, when interpreting a text, understanding has a productive and not merely reproductive character, because: “The meaning of a text goes beyond its author not only occasionally, but also but ever”. Thus: “One understands differently, when one understands effectively” (our own translation).

The hermeneutics consists of the understanding of re-experiencing the text construction process from the author’s perspective. The author is the protagonist of a linguistic attitude according to a time, a perception that is alien, so that it can be given meaning, but never reconstituted. “The task of hermeneutics is essentially to understand the text, not the author” <sup>[4]</sup>. It is a true art, and because of that, it only builds a set of guidelines for interpreting a text that is neither fixed nor rigid.

Because it is an art, it requires a creative spirit, which is characterized by a free process, whose source is the interaction of faculties unique to each artist. Thus, his product is a unique and inimitable achievement, like all art and interpretation. The interpreter follows his own inspiration, leaving mechanical rules out of the question, so that the encounter between reader and text is an event that cannot be predicted or defined, two worlds that merge in a way that creates another world, which overcomes even the author’s expectation, so that the text takes on a life of its own <sup>[5]</sup>.

With regard to legal studies, it can be said that hermeneutics is an auxiliary science of law that aims to establish principles and rules aimed at making

possible the interpretation and explanation not only of laws, but also of law as a system <sup>[6]</sup>.

The hermeneutics “is the scientific theory of the art of interpreting”, that is, “of determining the meaning and scope of the expressions of Law”. It is thus a legal science that “has as its object the study and systematization of the application processes to determine the meaning and scope of the expressions of Law Direito” <sup>[7]</sup>. That is, it is the science that studies the methods and techniques of interpretation of law, seeking to systematize them in order to make the exegete’s work easier and more efficient.

Thus, because the laws are formulated in general terms, which do not present specificities, hermeneutics is used to establish the relationship between the abstract text and the concrete case, in order to interpret and apply the law correctly.

Hermeneutics cannot be confused with interpretation, since the concept of hermeneutics is more comprehensive, as it concerns the systematization of applicable processes to determine the meaning and scope of legal expressions.

The identification and application of Law involve numerous argumentative and interpretative aspects of the normative context and the reality of a given society, and the interpretative aspect is essential to demonstrate how legal discourse cannot be reduced to the mere subsumption of a fact to the norm <sup>[8]</sup>.

In this context, the importance of the interpretive dimension is certain, and it is pertinent to identify which of the possible interpretations allows for a better justification of decisions from the point of view of morality, which pursues an ideal acceptable to society <sup>[9]</sup>.

Thus, legal interpretation must be understood within an argumentative framework <sup>[10]</sup>. It is in this context that the present study proposes the economic analysis of Law as an argumentative framework to promote the subsumption of facts to the norms, in the way that best meets the principles to which it is subject, providing the most adequate justification of decisions, with the objective of to reach the ideal solution for society.

### 3.2 Economic analysis of the law: An understanding

The economic analysis of law (AED) consists of applying theoretical contributions from the economic sciences to the law, enabling the understanding of the legal system as a structure of incentives for human behavior and the clarification of the consequences of legal and judicial commands, assuming relevance in the process itself of elaboration of these. According to Ivo Gico Júnior<sup>[11]</sup>, the economic analysis of Law consists of:

*The application of analytical and empirical instruments of economics, especially microeconomics and social welfare economics, to try to understand, explain and predict the factual implications of the legal system, as well as the logic (rationality) of the own legal system. In other words, AED is the use of the economic approach to try to understand the law in the world and the world in law (our own translation).*

In its approach, the economic analysis of Law assumes methodological individualism, consistent with the assumption that collective behaviors are a product of the set of actions of all members of the collectivity. Individual choices are therefore the “fundamental unit of analysis”<sup>[12]</sup>.

Thus, through the economic analysis of Law and the need for its observance, a realistic view of legal phenomena (legal realism) will be demonstrated, moving away from a merely formal analysis<sup>[13]</sup>, taking into account that, for this purpose, the relationships between individuals in society are examined from an economic perspective. The dialogue between law and economics is essential to offer the best solutions for society at any time, especially in the current one, in which these sciences are increasingly related<sup>[14]</sup>. The usefulness of the economic analysis of Law lies in finding the rationality of each and every decision, regardless of whether it is inside or outside the market, considering that all non-instinctive human activity is included in this concept and can, therefore, be economically analyzed<sup>[15]</sup>.

Thus, the method that takes economics into ac-

count for the analysis and application of Law, considering the interaction between economic thought and Law, began to gain strength and was consolidated through the studies carried out by Richard Allen Posner<sup>[16]</sup> for whom Law must be interpreted and thought from the principles of Economics. Starting with pragmatic logic, the author defends a consequentialist method of interpretation of Law, transforming it into an instrument guided by the effects of legal decisions. In this context, it clarifies that judicial decisions must be guided by the standard of cost-benefit analysis, which is called wealth maximization, which represents a true behavioral ethical principle. Following his reasoning, Posner argues that the Judiciary must be predictable and stable to provide the market with security for the free flow of resources. Judicial decisions must, therefore, be free from evaluative subjectivities arising from the legal logic of principles and be guided by the guideline of efficiency in the allocation of resources.

The loss of resources/efforts represents a social cost, which is undesirable from any perspective, so the use of law in the production and application of norms must aim at achieving the best economic result with the minimum of errors or losses, which will result in obtaining better performance and achieving goals in a more productive way, making clear the need to consider the existing relationship between Law and Economics.

In this way, it can be said that the Law is an open system that influences and is influenced by the existing social institutions in the community in which it is applied. For this reason, defenders of the evolutionary theory of societies admit that the set of socially predisposed rules serves to organize intersubjective relations and, at a given moment, is consecrated as established Law. Thus, economic factors will be involved in the process of creation and application of norms<sup>[17]</sup>.

Furthermore, when it comes to the application of norms by an institution, an essential point to be highlighted is the teaching of Douglas North<sup>[18]</sup>, who clarifies that institutions have the vocation of inducing or restraining conduct from an evaluative

judgment. In this sense, when economics is taken as a science that is directly related to the study of human behavior, its instruments prove to be powerful for prospecting the behavior of agents in the face of the various prescriptions of the legal system <sup>[19]</sup>. It should also be noted that economic analysis is applicable to all branches of law <sup>[20]</sup>.

It is from this perspective, considering externalities, rational choice and transaction costs, that it will be demonstrated how the economic analysis of Law composes the material criterion of the matrix rule of public administration conduct in the Brazilian legal system.

### ***Externalities in the economic analysis of law***

The notion of externality proposed by the economic analysis of law has its origins in the work of Ronald Coase, for whom, despite having based his discussions on externalities on Arthur Cecil Pigou's discussions on divergences <sup>[21]</sup>, externalities could be resolved if the people affected by them and the people who created them could easily come together and bargain, that is, externalities, positive or negative, could be resolved within a strictly private relationship, without the need for any state intervention. On the other hand, Arthur Cecil Pigou, when dealing with divergences[s] asserted that they are reflected in "imposed costs or benefits conferred on others that are not taken into account by the person taking the action" and that their existence would be "sufficient justification for government intervention", imposing taxes on those that generate a negative externality and subsidies on those that generate positive externalities <sup>[22]</sup>.

Thus, Ronald Harry Coase <sup>[23]</sup> proposes to analyze the externality from the notion of opportunity cost, a comparative analysis between the revenue obtained from a given combination of factors and the possibilities of revenue that would be obtained with alternative arrangements. Thus, instead of treating factors of production as things, he proposes to consider them as rights. In this sense, the right to do something that harms others can also be seen as a factor of production, that is, the cost of exercising. This right (to use a factor of production) is always a loss for those who

suffer the effects. In this way, Coase inverted the terms in which the issue was traditionally considered, giving it a dual approach. According to him:

*The traditional approach has tended to obscure the nature of the choice that has to be made. The question is commonly thought of as one in which A inflicts harm on B and what has to be decided is: how should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid harm to B would inflict harm on A. The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm.*

There is then a problem of a reciprocal nature, whose solution is not as obvious as the traditional analyzes pointed out, given that, from this perspective, in order to achieve the lowest social cost, the ideal is to search for the outcome that provides the least harm, regardless of who the reason in the conflict is. Coase follows in his reasoning, exemplifying as follows:

*The problem of straying cattle which destroys crops on neighbouring land. If it is inevitable that some cattle will stray, an increase in the supply of meat can only be obtained at the expense of a decrease in the supply of crops. The nature of the choice is clear: meat or crops. What answer should be given is, of course, not clear unless we know the value of what is obtained as well as the value of what is sacrificed to obtain it.*

The problem is not simply avoiding damage, but avoiding the greater damage. What must be evaluated is whether it is feasible, from the point of view of society, to allow or inhibit the action of "A", and the answer is not obvious, unless the values of gains and losses involved in the question are known.

This situation arises from the fact that decision-making at the time of law enforcement must take into account all the values involved in the issue under analysis, directly and indirectly, and all externalities must be considered.

## **Rational choice**

Once the concepts of externalities are addressed, to complement the understanding of the economic analysis of law and its application to the national legal system, it is necessary to understand the assumption of rationality of human conduct.

Based on the teachings of Coase<sup>[24]</sup>, rationality consists of the possibility of the individual, whenever faced with a diversity of choices, to evaluate which option offers him the greatest benefit, analyzing the losses and choosing the situation that is best for him. That is, the individual, faced with various possibilities of choice in everyday life, does so according to what is best for him, always aiming at his own interests, opting for what brings him greater satisfaction<sup>[25]</sup>.

Thus, through economic analysis, individual makes decisions based on their individual interests, without considering whether that decision is the best thing to be done for society. This is the thesis of natural selfishness, which:

*Finds support in Western thought in two distinct traditions: The tradition of Leviathan (Hobbes) and that of the invisible hand (Adam Smith). The first leads to an emphasis on state and bureaucratic control of social antagonisms; the second trusts that, unchecked, private vices result in public benefits. These distinct conceptions are expressed in the analysis of public policies in the pendular oscillation between state intervention and privatization. Both disregard the collaborative vocation of human beings as the basis of collective action<sup>[26]</sup>.*

Paula Forgioni<sup>[27]</sup> highlights that “the individual decisions of economic agents are marked by the selfish desire to satisfy their needs” (our own translation), which is why, in pursuit of their own interests, they choose the conduct that best meets their objectives. Adam Smith<sup>[28]</sup> exemplifies stating that “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest”.

## **Behavior induction**

Taking into account the economic analysis, the

human being’s choice will depend on the advantages and disadvantages related to compliance with and non-compliance with the norm, always prevailing that which presents the best benefit from the point of view of the individual who practices it. As demonstrated through rational choice, it is clear that the legal system can influence the conduct of individuals in society, since legal norms are about incentives or not incentives for human beings to act or not act in a certain way. The sanction or reward is simply a price that will be valued by the economic agent according to the cost/benefit logic of their possible behaviors.

Thus, institutions, including legal ones, form the rules of the game, which will serve as a parameter for the choices made on a day-to-day basis by economic agents. Therefore, the law exerts influence on the conduct of individuals, using instruments of sanction and reward.

Thus, through rationality, taking into account the current legal system, the individual will analyze the individual costs and benefits to make the best decision for himself. In this scenario, the relationship between Law and Economics is not merely financial, but has implications of rational choice, resulting in the effects of legislation on the behavior of individuals, so that it will take into account all externalities arising from their conduct<sup>[29]</sup>.

In view of these considerations, it can be said that the Law is a powerful inducer of conduct, capable of leading individuals to reflect on their acts and their respective consequences, which, based on economic analysis, directly or indirectly, can inhibit or encourage behavior in society.

## **Transaction costs**

The analysis of transaction costs is also essential to verify the applicability of the economic analysis of Law to the legal system. Transaction costs are those related to the establishment of a commercial relationship, which does not involve the manufacture of the transacted object.

These costs can be defined, for example, as the costs of negotiating, drafting and enforcing a contract. Transaction costs are those related to the movement of the economic system, differing from produc-

tion costs, which are related to other factors such as raw material and labor<sup>[30]</sup>.

Transaction costs are those related to (i) the search for interested parties in the business; (ii) expenses for negotiation and formalization of transactions; and (iii) the costs to inspect and take the appropriate measures, in the event of a breach of contract<sup>[31]</sup>.

Thus, faced with the impossibility of eliminating transaction costs, individuals will always pursue their reduction, taking into account the legal system to which they are subject and the form of action of legal institutions.

In this sense, the reduction of transaction costs is related to the search for greater efficiency in the economic sphere, as previously discussed with regard to externalities. Thus, in the present study, the scenario in which there is a reduction in transaction costs will be considered efficient.

## 4. Results

Through the use of the theoretical framework studied from the literature related to this research, it is intended to verify the possibility of using the economic analysis of Law, as a reference for the interpretation of the Brazilian legal system, guiding the decisions of the Judiciary Power applicable to cases concrete.

As verified, the economic analysis of Law, both prescriptive and descriptive, allows the students of Law to evaluate the best solutions to be adopted, in view of the rationality that is inherent to the human being, who pursues his well-being within society.

In the present study, the validity of the use of the economic analysis of Law as a theoretical reference for the reasoning of judicial decisions is approached. Therefore, it uses the economic analysis of Law as a way of adequately fulfilling the material criterion of the Judiciary's conduct, which is done based on its principles.

As already discussed, the material criterion of the Judiciary's conduct is obedience to the principles of legality, impersonality, morality, publicity and efficiency. Therefore, as a verb of the material criterion,

we have to obey; and as a complement, the principles of legality, impersonality, morality, publicity and efficiency. In this way, the Judiciary, when applying the laws, must obey the aforementioned principles. Obedience to the principles is what gives validity to the conduct of the Judiciary before the legal system.

However, as demonstrated, through hermeneutic techniques, there are several ways of thinking about the consequences of applying a certain law to concrete cases, so, when judicial decisions are made, the way that best provides obedience to the principles of legality, impersonality, morality, publicity and efficiency.

When faced with specific cases, magistrates can use the most varied hermeneutic techniques to apply the law, which will lead to countless possibilities. Once the possibilities have been raised in the face of the various possible interpretations, the magistrate will carry out prognostic exercises in order to consider, among the possibilities, which one will provide the best result for society, taking into account the material aspect of obedience to the principles of legality, impersonality, morality, publicity and efficiency.

The economic analysis of Law allows the magistrate, when applying the rule, to do so in the most pertinent way, taking into account all these principles. This is because, (i) it will always seek the best interpretation observing the set of the current legal system, thus obeying the principle of legality; (ii) through the study of rationality, which is inherent to the human being, as well as the externalities and transaction costs potentially caused, it will identify the best interpretation to promote the well-being of society, and not of certain classes or individuals, thus enforcing the principle of impersonality; (iii) the economic analysis of Law pursues ethical consequences within society, so that, among the various possibilities of interpretation for the application of laws, it will recommend the one that is morally more beneficial for the achievement of social well-being; (iv) its recommendations are aimed at promoting greater efficiency for society, so that, when applying the law, it will take into account which of the pos-

sible options will lead to greater efficiency, in view of the social cost/benefit to be produced, for means of analyzing potential externalities and transaction costs, also taking into account the rationality of individuals; and (v) it is always publicity, which is essential to provide an efficient dialogue between Law and Economics.

In order to better elucidate, a real case that occurred in Brazil and addressed by Luciano Benetti Timm<sup>[32]</sup> is presented:

*In 1994, the advent of the Real Plan provided parity of the national currency in relation to the dollar. As a result, many consumers, in search of lower interest rates offered by the North American market, assumed the exchange rate risk and contracted vehicle leasing operations with readjustments linked to the price of the North American currency. In 1999, due to the government policy of the Brazilian State, the national currency (the Real) suffered a great devaluation, resulting in increases of more than 150% in the installments of these operations. This situation reached the Judiciary, before which, the Superior Court of Justice (STJ), when interpreting the law, divided the damage caused by the exchange variation between consumers and financial institutions (our own translation).*

Is this interpretation given to the law by the Brazilian court the one that best meets social aspirations in terms of applying the economic analysis of law to judicial decisions?

The economic analysis of law shows that it is not. This is because the decision was efficient only for the few consumers involved, to the detriment of society as a whole. After that decision, even though it was legally permitted, this type of leasing contract disappeared from the market, which currently prevents all other consumers, who are willing to assume the risks of exchange variation, to contract leasing operations with very low-interest rates.

In this context, the decision of the Brazilian court in the present case did not seek the greatest efficiency for society nor was it impersonal, as it was con-

ferred in the privilege of a minority. Likewise, it was not coated with morality, completely at odds with the material criterion of the matrix rule of public administration conduct.

It is in this scenario that, through the analysis of the externalities involved, as well as the inherent rationality of individuals and the cost/benefit in relation to society, the economic analysis of Law is valid in relation to the reference system adopted in this research.

## 5. Conclusions

Legal hermeneutics is the scientific theory of the art of interpreting, in a way that determines the meaning and scope of the expressions of Law.

It is a legal science whose object is the study and systematization of applicable processes to determine the meaning and scope of legal norms.

Thus, it is a science that provides scholars with methods and techniques for interpreting Law, seeking to systematize them in order to make the exegete's work easier and more efficient.

Economic analysis, one of the methods of interpreting the law, provides theoretical contributions from the economic sciences, enabling the understanding of the legal system as a structure of incentives for human behavior and the clarification of the consequences of judicial commands, assuming, therefore, relevance in the process of enforcement of laws.

The economic analysis is applicable to all branches of law, given that, even if it falls under rules with extra-economic reasons and regulates activities with extra-economic purposes, such rules will have economic effects that can be described and analyzed.

Through the analysis of the externalities involved, as well as the rationality and cost/benefit in relation to society, the economic analysis of Law provides new directions for legal thinking, in order to identify the ethical consequences that may result in social well-being, thus directing judicial decisions to pursue their social functions, orienting them to a context that provides the best conditions for the community, offering legal certainty, through compliance with the



principles of legality, impersonality, morality, publicity and efficiency.

Thus, regarding the initial premises of this research, it is possible to conclude that, within the scope of the Brazilian State, for the application of the positive law to the concrete case placed for trial, the State Judge must observe the general principles of Law, pursuant to art. 4 of Decree-Law No. 4,657, of September 4, 1942, amended by Law No. 12,376, of December 30, 2010, including the principles of legality, impersonality, morality, publicity and efficiency.

In order to interpret the positive law and apply the Law to concrete cases placed for judgment, the State Judge must make use of one of the various interpretation techniques existing within the scope of legal hermeneutics.

The economic analysis of the Law allows, as a technique for interpreting the Law, the Judiciary to apply the Law to the concrete case in compliance with the principles of legality, impersonality, morality, publicity and efficiency, since, based on the analysis of the externalities involved, then a judge can identify the legal and ethical consequences of a particular judicial decision for society and, thus, can decide more efficiently, providing legal certainty for society and generating a consequent increase in social well-being.

The present research was limited to analyzing the economic analysis of the Law as a technique of interpretation of the Law to be used as a reference for the application of the law approved by the Judiciary Power when judging concrete cases.

This study demonstrates that the use of economic analysis of law, as a technique for interpreting the law, can contribute to the legal certainty of judicial decisions in Brazil, in order to increase social well-being based on the security generated by the efficiency and effectiveness of what decided by the Judiciary in concrete cases placed for trial.

## Conflict of Interest

There is no conflict of interest.

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