The Methododology of Law and Economics in International Law

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Law and economics (L&E) is the application of economic methods to legal analysis. However, economics itself is not so much a methodology as an epistemology. Economics encompasses a broad range of methods. In this regard, economics is simply another word for rationalism – properly applied, it rejects no method that is rational. In fact, economics is learning to accept the irrational as well, but seeking to apply rational analysis to irrational actions. Economics is a strong social science because it is an open system. The only requirements are rational analysis (but not necessarily the assumption that man is rational) and methodological individualism.

Therefore, contrary to naïve criticisms, economics requires no assumptions of avarice or even selfishness. Nor does it prescribe any limitations of individuals’ preferences to those regarding material goods. Rather, its assumptions are simply (a) methodologically, that individuals seek to maximize the achievement of their preferences, and (b) normatively, that the only valid source of preferences – of values – is individuals. These are known as methodological individualism and normative individualism. Normative individualism is closely aligned with liberalism.

It is therefore important to note that economic methods, properly applied, contain no prejudices in favor of property or against the state. It is simply bad economics to assume that the market mode of allocation is always superior to bureaucratic allocation by government. Properly applied, economic methodologies are simply descriptive of relationships. Good economics helps to reveal relationships between legal rules, institutions or policies on the one hand, and outcomes on the other hand: they are consequentialist.

It is also important to note that there is an essential unity to the social sciences, of which economics is only one. Others include political science, sociology, social psychology, and anthropology. They all seek descriptively, or positively, to understand how humanly-created institutions (including laws) affect behavior, and, normatively, to understand how changes in these institutions would affect behavior. Therefore, the positive and normative are intertwined.

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Economic methodologies, or social science methodologies, are therefore inclusive: they accept all rational ways of knowing.

Economic analysis holds great promise for international law. This promise lies in the ability of economic analysis to suggest useful methods for analyzing the actual or potential consequences of particular legal rules. This approach is consequentialist, and it has everything to do with *lex ferenda*. In determining what the law should be, what else is required than to know what the desired consequences are, and the extent to which the available legal rules achieve these consequences? Of course, we have complex desires. We want both to preserve sovereignty and to prevent genocide. We want both to promote environmental protection and to increase free trade. We want both predictability and flexibility. Economic analysis cannot tell us how to value these different preferences, but it can tell us how to maximize the things we value.

On the other hand, economic analysis generally holds little utility for the *lex lata*, strictly understood. It tells us little about how to read or interpret law. In particular fields, of course, such as competition law or trade law, economic analysis may be part of the *lex lata*. Economic analysis does counsel fidelity to process, to the extent that we can rely on legislative processes to be the best structure for identifying the preferences of constituents. Similarly with respect to contract: economic analysis counsels fidelity to the transactions that persons make for themselves, as the best way to articulate their preferences. Those who argue that laws should be interpreted with economic efficiency in mind misunderstand the nature of efficiency: it is efficiency to maximize preferences, not efficiency to maximize wealth, and we cannot easily know the preferences of others. In fact, economists reject the possibility of interpersonal comparison of utility.

There are two main activities in social science, as in science: modeling and empirical testing. A model is based on theory, and sometimes also on empirical testing. It is a source of predictions, and hypotheses. Once a model has been validated by empirical testing, it might be appropriate to engage in normative public policy on the basis of the model itself. This type of use would depend on the degree of validation, and the extent to which the factual parameters that have been tested accord with the factual parameters in the setting sought to be evaluated without its own empirical testing.

Economic models begin with price theory, which assumes that, all things being equal, people prefer cheaper goods and services, and more efficient means of achieving their non-consumption goals. An additional level of complexity is added by transaction costs analysis, which simply recognizes, within price theory, that there are costs to engaging in transactions, and that these costs may prevent otherwise efficient transactions or may account for institutional structures. A third level of