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The increased interest in the study of Law & Economics in Brazil only very recently has opened an important opportunity to discuss with scientific methodology rather than solely using the philosophical traditional legal dialect the effects of abstract concepts which are endlessly debated and have been the cause of legal uncertainty detrimental to development. In this scenario, this paper discusses the effects of the concept "social function" of property rights born in the Brazilian Constitution of 1988. The variation of interpretations of "Social Function of property rights" that has created effects detrimental to the performance of the country's national economy is explored in the text. The paper also discusses the relationship between the social movements (guided by MST) and land owners marked by confrontation as a result of the uncertainty, lack of association of decisions to its effects and the ambiguity of law. Overall, the main objective of the paper is to analyze the different channels through which the three powers view the concept and how this has effected the behavior of economic agents and, indirectly, economic development. The paper also provides a greater analysis of the problems resulting from the current understanding of "productivity". It concludes offering recommendations towards the importance of a more efficient system of property rights in Brazil able to provide order, peace and certainty in the social and economic realms resulting in efficient incentives for the best use of the property.



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## **THE SOCIAL FUNCTION OF PROPERTY RIGHTS IN BRAZIL**

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## **ABSTRACT**

The increased interest in the study of Law & Economics in Brazil only very recently has opened an important opportunity to discuss with scientific methodology rather than solely using the philosophical traditional legal dialect the effects of abstract concepts which are endlessly debated and have been the cause of legal uncertainty detrimental to development. In this scenario, this paper discusses the effects of the concept “social function” of property rights born in the Brazilian Constitution of 1988. The variation of interpretations of “Social Function of property rights” that has created effects detrimental to the performance of the country’s national economy is explored in the text. The paper also discusses the relationship between the social movements (guided by MST) and land owners marked by confrontation as a result of the uncertainty, lack of association of decisions to its effects and the ambiguity of law. Overall, the main objective of the paper is to analyze the different channels through which the three powers view the concept and how this has effected the behavior of economic agents and, indirectly, economic development. The paper also provides a greater analysis of the problems resulting from the current understanding of “productivity”. It concludes offering recommendations towards the importance of a more efficient system of property rights in Brazil able to provide order, peace and certainty in the social and economic realms resulting in efficient incentives for the best use of the property.

## INTRODUCTION

Restrictions on what a person may do with his or her property are common in all legal systems although variations of these restrictions result in different effects to country's institutional and economic development.

Common law tends to allow owners to do anything with their property that does not interfere with other people's property or other rights, and therefore, is the legal system that is closer to maximum liberty.<sup>1</sup> This guarantees the assurance needed for owners to use their property efficiently, with low costs for its protection and efficient incentives for production.

Although Roman law is greatly involved by the notion of property rights, present in all of its civil law institutes, it tends to create more restrictions on how people use their property as compared to common law. Beyond some appreciable restrictions that exist to accommodate the interaction of individual and collective rights in society, many legal limitations to property rights have a philosophical justification supported by questionable ideologies that agree to interfere with people's property rights in name of distributive justice. Apart from any reasoning on what legal traditions have resulted in greater development, Brazil is beginning to awaken and realizes the real effects on society and economic development of its legal regulations and judicial decisions regarding property rights.

There is extensive literature written by international scholars of Law & Economics that argues the importance of property and contract rights to a country's institutional and economic development. This is possible because, dissociated from any ideology, although the results may appear to have a liberal bias, the economic analysis of law provides tools and methodology for an in-depth scientific analysis with the use of quantitative methods and behavioral theories of microeconomics that can unravel causes and effects of the implementation of a property rights system. Beyond the legal jargons and philosophic reasoning of the traditional operator of law in Brazil, by using more pragmatic methods

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<sup>1</sup> Robert Cooter and Thomas Ulen, Law and Economics, 4th edition, Pearson Addison Wesley, 2004; (chapter 4, pg. 110)

Law & Economics objectively focuses on how alternative bundle of rights create incentives to use resources efficiently which affects economic growth.

Fortunately, the recent growth of debates in Law & Economics in Brazil has opened a venue for a possible reconsideration of some regulations and interpretation by the courts of crucial concepts as “the social function” of property rights and “productivity”, especially regarding rural properties. Apart from a common defensive reaction of some leftist scholars and legal professionals towards the neoliberal appearance of the recently arrived field, the ongoing opening of the interdisciplinary study in Brazil provides an analytical perception of the importance of property rights to social order, peace and security, as well as to the efficient incentives for production or the best use of the property.

## **PROPERTY RIGHTS IN BRAZIL**

At the time of the drafting of the 1988 Constitution, Brazil was living in an era of democratic excitement and a spirit of conciliation. The result was a Constitution that brought together interests and ideologies of all sorts as if it were a quilt with different patterns. Historically, property rights have been clearly guaranteed by previous Constitutions and in 1988 this could not have been different. In 1988, the spirit of the writ leaves no doubt that the constituencies had the concern of maintaining private property since it was mentioned in several articles. However, like many other clauses with combination of ideas and interests, the idea of property rights has to live in harmony with limitations that have imprecise interpretations.

Article 5 of the Constitution states:

All persons are equal before the law, without any distinction whatsoever, Brazilians and foreigners residing in the country being ensured of inviolability of the right to life, to liberty, to equality, to security and to property, on the following terms:

XXII - the right of property is guaranteed;  
XXIII - property shall observe its social function;  
XXIV - the law shall establish the procedure for expropriation for public necessity or use, or for social interest, with fair and previous pecuniary compensation, except for the cases provided in this Constitution;  
XXV - in case of imminent public danger, the competent authority may make use of private property, provided that, in case of damage, subsequent compensation is ensured to the owner;

Coherently, Article 170, indent II and III, respectively, establishes, among others, the principles of “private property” and “the social function of property”, when providing that the economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice. Furthermore, article 219 states concern for development.<sup>2</sup>

Therefore, restrictions and regulations of property rights must be congruous with the interests of the owner of properties and society. Some examples of these restrictions to propriety rights present in the Constitution are: the possibility of use of the property by the competent authority in case of imminent public danger (Article 5, intent XXV); the obligation to reconcile the use of property with the environment (Article 170, intent VI, among others); and the requirement to provide accessibility for disabled in public buildings and transportation (Article 227, paragraph 2).

The restrictions cited above fall into a category of reasonable limitations that benefit society as a whole. However, the concept of “social function” (stated in Article 5, intent XXIII, and, Article 170, intent III, and Article 184) generates controversies and emotional debates because of its philosophical and abstract characteristic.

Chapter III – on Agricultural and Land Policy and Agrarian Reform - establishes the main premises that define the social function of propriety. Article 184 of the Constitution provides that the Union can expropriate on the grounds of social interest, for purposes of

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<sup>2</sup> Article 219 states: “The domestic market is part of the national patrimony and shall be supported with a view to permitting cultural and socio-economic development, the well-being of the population and the technological autonomy of the country, as set forth in a federal law”.

agrarian reform, the rural property which is not performing its social function.<sup>3</sup> Article 185 complements the idea clarifying that the expropriation of “productive property” or “small and medium-size rural property” are not permitted.

Furthermore, the main premises of the concept of social function provided by the 1988 Constituciones states:

“The social function is met when the rural property complies simultaneously with, according to the criteria and standards prescribed by law, the following requirements:

- I - rational and adequate use;
- II - adequate use of available natural resources and preservation of the environment;
- III - compliance with the provisions that regulate labor relations;
- IV - exploitation that favors the well-being of the owners and employees.”

According to article 186, the social function of rural propriety has three main elements: ① Economic (rational and adequate use); ② Environmental (adequate use of available resources and preservation of the environment); and ③ social (compliance with the provisions that regulate labor relations and the guarantee of well-being of the owners and employees). The social function of rural property is fulfilled when all elements have been complied with.

The concern of the Constituciones is compassionate at first sight, but too abstract if one thinks of its implementation. Also, the lack of private information is a limiting factor when one attempts to allocate resources or assess the *rational and adequate use* of a property.

Law 8629, of 25th February 1993, known as the Agrarian Reform Law provides more details. It establishes among others that “productive property” can be defined as having a predetermined level of productivity. Moreover, according to the legal text, productivity is reached by the owner when exploring the property to a minimum economic and rational

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<sup>3</sup> About the takings, article 184 provides parameter for compensation: ..... “*against prior and fair compensation in agrarian debt bonds with a clause providing for maintenance of the real value, redeemable within a period of up to twenty years computed as from the second year of issue, and the use of which shall be defined in the law*”.

level of utilization of the land (index GUT) and a minimum degree of efficiency of exploration (index GEE), in light of the indexes defined by the competent authority (Article 6). The Constituencies probably did not realize that they were interfering with unknown grounds.

It must be said that the concept of productivity, originally imported from engineering to the other fields of knowledge, is a useful concept in the economic analysis and can be extremely complex demanding in-depth analytical study by specialized professionals, free from ideological bias or risk of politicization.

Therefore, an economic analysis of the legal concept can be helpful to explain “productivity”, the value of output (goods and services) produced per unit of input (productive resources) used. Thus an increase in productivity means producing more goods and services with the same amount of resources, or producing the same goods and services with fewer resources, or some combination of these two possibilities. In general, the legislation applies the concept of productivity based solely on the factor of production (hectare of land). In this sense, Law 8629/93 seeks to reinforce indexes to be used in the assessment of productivity fallaciously since a more precise and complete view of the sources of productivity incorporates the effects of *all* inputs to production, including capital, labor (man-hour), machinery, seeds, fertilizers, ...etc. Furthermore, to increase overall productivity one should consider the specialization and division of labor, investments in increasing the stock of capital goods and investments in human capital (e.g. teaching workers new or more efficient production skills) and technological innovation that creates new ways of combining somewhat different inputs of the factors of production to produce the same goods at lower costs.<sup>4</sup> Innovation therefore is a variable that influences the productivity of a rural property.

Unions should have a lot to say about a farm X being declared “unproductive” for reaching the required indexes of production per hectare, while it has more labor (man-hour) than Farm Y, with the same index of production. This is because unions usually measure productivity only in terms of the productivity of labor (output per man-hour).

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4 A glossary of political terms by Paul M. Johnson – Site: <http://www.auburn.edu/~johnspm/gloss/productivity>



Although a further reasoning of the concept of productivity shows its complexity, many rural landowners intuitively suffer the result of the fallacy. One producer said in an interview that *“the social function of a property can not be seen solely from the perspective of its production. If all of the rural properties produced according to the rates required by INCRA, all rural producers will go bankrupt, and in the following year, there will not be sufficient production to supply to the national market. As a consequence, although productive in his standards, the property will not have fulfilled the distorted social function”*.

Moreover, the ownership of land is not the only and necessary condition for a farmer to produce. There are other ways of gaining access to land as provided by the rental and land banks programs.<sup>5</sup> Over and above that, the experience of agrarian reform throughout the world shows that the producer has to have primordially “tradition” in the rural area.<sup>6</sup> As a result, most squatters, mainly people excluded from the urban areas that have been settled legally as a result of the agrarian reform policy transfer their land in a short time. The census are not clear and do not target the results. Productivity of the settled farmers should also be measured, even if they fall in the category of small land owners. Evasion and the transfer of the properties should be assessed because this is indeed a very expensive program that involves public revenues.

Another perspective of the concept of productivity is that its application should be extended to other sectors, rather than solely to the agrarian sector. As an example, an entrepreneur may have many farms and industries and might find that it is more “productive” to allocate resources from one segment to the other, where there is more

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5 A land bank is a public authority created to efficiently hold, manage and develop tax-foreclosed property.(1) Land banks act as a legal and financial mechanism to transform vacant, abandoned and tax-foreclosed property back to productive use. Generally, land banks are funded by local governments' budgets or the management and disposition of tax-foreclosed property.(2) In addition, a land bank is a powerful locational incentive, which encourages redevelopment in older communities that generally have little available land and neighborhoods that have been blighted by an out-migration of residents and businesses.(3) While a land bank provides short-term fiscal benefits, it can also act as a tool for planning long-term community development. Successful land bank programs revitalize blighted neighborhoods and direct reinvestment back into these neighborhoods to support their long-term community vision.

<sup>6</sup> This is well seen when learning the percentage of students of agronomy that graduate from college. The ones that do not have tradition will prefer a job in any institution with air conditioning. Moreover, knowledge about rural production is learned with experience, with time. This is why the population in the rural area around the world has dropped drastically.

profitable, and the country will certainly benefit from this change. Following this rationale, zooming out to a greater perspective, the GNP per capita can be a relatively good parameter to assess productivity since it can measure the allocation of resources efficiently among different sectors of production.

Another perspective of the fallacy is the temporary use of land for stock or leisure. The famous Brazilian soccer player Pelé has been seen as a model of citizen surely bringing revenues and recognition to the country. He may decide to buy land to raise horses and he may use the land to entertain others in the sports world. There he can recharge his energy and have enough time to develop a new project. He also will use the farm to bring his other sport entrepreneur and network. When analyzing the use of his land, since we are fond of him, it will not be hard to agree that it is beneficial to the country although the legal indexes may accuse an unproductive land and expropriate it. In other words, the utility of a land can be a small part of a global context of productivity of its owner. On the contrary, in theory, the owner tends not to maintain it since he will be paying taxes and other maintenance expenses and not be benefiting from the land. Sooner or later, he will have all incentives to transfer the land to someone who will value it the most, creating a cooperate surplus for society. Therefore, the study and implementation of the concept of productivity is dangerous since it involves many variables and can be easily manipulated, creating loses for society. In this sense, land that is essentially productive may be declared unproductive and be expropriated and given, at high cost, to people that apparently are hungry and excluded, but that will not be able to solve their own problems nor create any benefit to the country.

The problematic that confines property rights is more complex. There is a cultural understanding among many groups in the Brazilian society that supports extremely organized and strong social movements of squatters. The most famous one is called “*Movimento Sem Terra*” (Landless labor movement). In this sense, the Provisional Measure 2183/2001 was one of the most important instruments to hinder invasions at the very end of the government of the former president Fernando Henrique Cardoso, since it expressly revoked any act of expropriation of land that had been invaded by squatters. The

content of this Provisional Measure has continued to be in effect once it was incorporated to the text of the agrarian reform Law 8629/93.

In light of the invasions and the actions taken by the MST, the Joint Congressional Ad hoc Committee on land was created by the Request 13/2003-CN, approved the Separate Vote in November 2005, having in its 400 page report among others, the following affidavit called my attention:

“In terms of the management of the private resources of MST, I must reinforce that the frauds in this case must be investigated by this Committee. The reason is that MST has become the principal actor in the agrarian reform, being responsible for most of the squatter camps existent and therefore, the management of the resources of the movement, public or private, at this point is of national relevance. The issue related to patrimonial responsibility is also of great importance while MST is the only person (or institution) that has total immunity for its actions in Brazil. If a regular citizen causes an accident, he or she will have to compensate for the lost; if a state vehicle causes an accident, the State will be responsible; but, if MST destroys fences, houses, and plantations, nobody pays for that.”

The result of the investigations of the Joint Congressional Committee shows the concern with Public Security and intolerance to the marginality that hinders property rights in detriment of a social “well being”. Many arguments were critical of an elastic jurisprudence as a result of abstract laws and lack of uniformity. As a result, disincentives are created to land users to work and produce. The Final Report of the Committee was concluded with the introduction of two bills that typify invasions as a criminal act with political intent, establishing penalty of reclusion from 3 to 10 years and the extinction of any institution used for the practice of such crimes.

In the legislative branch some additional information regarding the backstage politics should be pointed. There are some Congressmen that support the movement. It is a wealthy organization that owns at least four universities and has some political support. In

light of Gary Becker, they have all the incentives to invade land since the opportunity cost of crime is high. On one hand the expected benefits of crime are high (receive land for free) and on the other, the expected cost of crime (invasions) are low, which includes the extremely low probability of being caught and the severity of the punishment (added to the cost of committing the crime). This scenario is explained by the cultural and political condescendence in relation to invasions, while many sectors of the government and the population in general patronize the criminal attitude with appealing excuses as of protecting the victims of the unjust inequality, poverty and hunger. Consequently, the great majority of invasions are a terrorism to land owners endangering the huge benefits of a sound property rights system.

Members of the Judiciary have confronting positions. Considering the size of Brazil, there are also state and regional differences in the position of the judiciary and government officials. As an example, in the State of Goiás, there is a gentlemen agreement (almost a social norm) in which squatters do not invade land until it has been previously declared “unproductive” by the competent authority (INCRA). Conversely, in the southernmost state of Rio Grande do Sul, there is a huge conflict between landowners and squatters since there is no agreement and the judiciary decisions vary. Some judges agree to most injunction of repossession, but others, in name of “social justice”, decide in favor of the squatters. When will they realize that their decisions cause a greater impact other than on the parties directly involved, but causing disincentives for production or incentives for disorder or invasions?

However, as in the Legislative Branch, there seems to be a movement of consciousness in favor of the benefits of the institution of property rights. The vote of the Justice of the Supreme Court, Minister Marco Aurelio, relative to the Federal Intervention 2793-6, ordered the state government of Paraná to use public force and have the judicial decision of repossession of a land enforced. With extreme eloquence, the vote argues the underlying uncertainty as results of the non enforcement of the judicial decision by the state government (and police) and the necessity to guarantee social peace and order. Although the state alleged to have difficulties with the poor squatters and to resettle the “invaders”, they had to enforce the decision and give back the land to the productive owner.

The executive branch has also shown moments of intolerance and unconformity with the invasions and criminal actions of MST while publishing the Directive 101, 22<sup>th</sup> February 2001, of the Institution of Agrarian Reform (INCRA), and Directive 62, 27<sup>th</sup> March 2001, that excludes and eliminates all identified “squatters” from the Program of Agrarian Reform, including any benefits as urban land.

In general, the State has to guarantee the security of property rights so that owners have the incentive to invest and lower transaction cost, generating wealth, jobs and a sequence of benefits to society. There is data that confirms that in the state of the Amazon, landowners that had a formal title of the land and therefore had more certainty of the expected return of investment, therefore, being able to invest, create more wealth and be more productive (Alston, Libecap and Mueller). Legal uncertainty is extremely hazardous to the economy and to society.

In addition, the ability to access financial assistance is crucial to development. The risk of accessing financial assistance is well managed through obtaining certainty as to who holds the land and who must take responsibility for the risk. The non legal recognition of property rights creates not only conflicts over who owns the land, but also restricts the ability to raise the capital needed to make these economic investments.

Although the discipline Law and Economics is beginning to be grow in Brazil, many judges do not realize the extension into which their decisions creates effects beyond the parties involved. Touched by the huge inequalities existent in the country, they seek to do “social justice” by distributing wealth. They do not realize that their attitude and decisions have negative externalities. These effects not only create uncertainty, reduce the incentives for an efficient use of property, but restrict the ability to raise the capital needed to make economic advancement in innovation.

Unfortunately, these judges have not studied economics to assimilate that private law, including property rights, is NOT an inefficient tool to reach redistributive goals because of peculiarities as imprecise targeting, unpredictable consequences, high transaction costs and

large distortions in incentives.<sup>7</sup> On the other hand, progressive tax policies can better reach redistributive goals. Hence, the spread of training in Law & Economics can build the necessary theoretical foundation needed to develop a judicial system that can decide based on coherency and an analysis of the effects of the decision.<sup>8</sup>

In addition to expanding the education of Law & Economics in general, the decision makers of all three branches of power in Brazil should develop a comprehension of the connection between a system that guarantees property rights and economic growth. The existence of the constitutional concept of “**social function**” is better interpreted in harmony with the assurance of property rights. Apparently this is not an easy task. First, the indexes of productivity are limited and fragile. Second, the fallacy that government, legislators and judges have the necessary private information to be able to allocate resources efficiently among individuals is extremely tricky and frequently overlooked. Nevertheless, if these decision makers realize that the invisible hand of the market is the best vehicle to allocate resources efficiently, they will dedicate more time to analyze actions that concur with a stronger system of property rights. By providing the necessary incentives, each person is the very best agent to allocate their individual resources (including property), which will build up to a strong market and the maximization of the nation’s economic growth and social welfare. By this means, the social function of property rights will certainly have been fulfilled.

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<sup>7</sup> Cooter, Robert and Ulen Thomas, Law & Economics, chapter 1, pg. 10

<sup>8</sup> The study of Law & Economics in Brazil will be of great relevance. But where should academics target the study of law & economics? Being a Civil coded country, common sense suggests that the legislative branch should be a primary target, parallel to the development of the field in the academia. However, a further thought might point priorities in a different direction. The reason is the existence of a gap between written and applied law in Brazil. It is comprehensive that judges and lawyers from common law countries seldom have any deeper sense of the civil-law tradition. There is a common understanding that since the common law follows an “adversarial” model while civil law is more “inquisitorial,” civil law is “code-based,” civil-law judges do not interpret the law but instead follow predetermined legal rules. However, the unspecific, abstract and imprecise characteristic of most written laws gives rise to different interpretations and therefore different judicial decisions. This gap formed by the lack of binding of jurisprudence gives judges a wider spectrum of freedom to decide upon since they do not have to be bound to precedents.

Although restricted to laws and principles, judges have quite a large margin for interpretation in each specific case. In this paper’s topic of restrictions to property rights and the general concept of social function, this enormous power given to the judges is a risk to the certainty needed to guarantee the legal institution of property rights. In this sense, hopefully, the growth of Law & Economics in Brazil will provide a more analytical methodology for the “operators of law” to understand fully the impact of their decisions on society, rather than only for academics to contemplate.

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