INTRODUCTION

Perhaps the most fundamental question in all of economics is explaining why some countries are rich and others are poor. That was the central question posed by Adam Smith in the Wealth of Nations, justly regarded as the discipline’s foundational text. Smith's answer is found in the first three chapters of Book I: a country’s income depends upon the productivity of its labor force, which in turn depends on specialization and the division of labor driven by exchange (trade) and limited by the extent of the market.

But that explanation leads to another question: why are some countries able to take advantage of the division of labor and become rich, while others fail to do so and remain poor? Smith describes how the security of property rights, through a “tolerable administration of justice,” allows investment and exchange to take place, bringing about economic progress. Recent empirical work on economic development has supported Smith's emphasis on a country’s political “institutions,” particularly the judiciary, in determining its national income.

Abstract

Adam Smith argues that a country’s income depends on its labor productivity, which in turn hinges on the division of labor. But why are some countries able to take advantage of the division of labor and become rich, while others fail to do so and remain poor? Smith describes how the security of property rights, through a “tolerable administration of justice,” allows investment and exchange to take place, bringing about economic progress. Recent empirical work on economic development has supported Smith's emphasis on a country’s political “institutions,” particularly the judiciary, in determining its national income.

KEYWORDS

economic growth, institutions, judiciary, property rights, security, wealth of nations
Yet, ultimately, Smith does provide an answer to this question: the security of property. Without the protection of property, the division of labor will be severely constrained. Secure property provides the necessary incentive to align effort and reward, to enable people to reap what they sow, and to allow individuals and firms to plan for the future and invest in economic improvements. The protection of private property makes economic progress possible and therefore, in Smith’s view, is the most important duty of government.

In 1755, more than a decade before the publication of the Wealth of Nations, Smith wrote a single sentence that encapsulates much of his thinking about economic development: “Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things.” Smith believed that a “tolerable administration of justice” required the establishment of a legal system to protect private property from encroachment and enforce contracts and the repayment of debts. Of course, the administration of justice, a term Smith used frequently, was more than just a means of incentivizing productive effort by enabling individuals to “secure the fruits of their own labor.” It was also a matter of peacefully adjudicating disputes and ensuring just relations between individuals. And justice was absolutely essential for society to subsist at all; without any “administration of justice,” society would disintegrate and dissolve. Furthermore, the administration of justice did not have to be perfect, but it had to be tolerable. An independent judiciary was critical to ensuring that this was the case.

Thus, Smith provides a compelling explanation as to why the security of property is important to a country’s economic development and, in turn, why an independent judicial system is important in providing that security. He also provides several illustrations of the impact of secure versus insecure property on economic development, much in the way that those working on comparative economic systems do today. Unfortunately, Smith’s discussion of these issues was scattered throughout the Wealth of Nations, the Theory of Moral Sentiments, and his Lectures on Jurisprudence. Perhaps because of this fragmentary treatment, Smith’s emphasis on the link between the administration of justice and the wealth of nations has never been fully appreciated.

Smith’s analysis of these matters is worthy of study because only recently have economists and political scientists returned to focus on the role of a country’s institutions, including the legal system and the security of property rights, in fostering economic development. These factors were neglected both by the classical economists (such as David Ricardo and Thomas Malthus) and by later neoclassical economists (such as Alfred Marshall), although Jeremy Bentham and John Stuart Mill appreciated their importance. Not until the work of Douglass North and others gave renewed attention to the importance of institutions in economic development, and really only in the past decade, has there been much research on the role of property rights (Besley & Ghatak, 2010), political institutions (Acemoglu & Robinson, 2012), and the legal system (La Porta, Lopez-de-Salinas, and Shleifer, 2008) in fostering economic growth and development. In doing so, recent research has provided empirical support for many of the propositions that Smith advanced, including the importance of an independent judiciary for ensuring the protection of property and the sanctity of contracts.

This paper provides an account of Smith’s important but neglected views on the relationship between the administration of justice, the security of property, and the wealth of nations. After examining Smith’s belief that a system of justice is needed so that property rights can be protected, the paper sets out his case for why security of property provides an essential incentive for economic activity to take place. Smith describes the attributes of a system for the impartial administration of justice and proposes a positive theory for its emergence in Great Britain, although he has less to say about how it can be established elsewhere. The paper then briefly examines why the classical economists neglected Smith’s views on this matter and how Bentham and Mill extended Smith’s

1Smith continued: “All governments which thwart this natural course, which force things into another channel, or which endeavour to arrest the progress of society at a particular point, are unnatural, and to support themselves are obliged to be oppressive and tyrannical” (EPS IV 25). This is taken from a short paper that Smith wrote to establish his priority in these ideas. Smith wrote it out of fear that his ideas, which were presented in lectures at the University of Glasgow, might be plagiarized. Dugald Stewart quotes from the manuscript in his memoir of Smith, but unfortunately the document was later destroyed.

2Previous studies of Smith’s views on the importance of the legal system (Lieberman 2006) and on the role of government in economic development (Robertson 1983) touch on these matters, but only tangentially. Billet (1975) comes closest to making the same point as this paper.
discussion. Finally, the paper concludes by showing how recent empirical studies on institutions and the wealth of nations have provided support for the factors that Smith highlighted in his writings more than two centuries ago.

2 | JUSTICE AND THE SYSTEM OF NATURAL LIBERTY

In the *Wealth of Nations*, Adam Smith advocated a "system of natural liberty," a system of free enterprise, as his preferred framework for organizing economic activity. In his view, such a system did not require the government to allocate resources, manage the economy, or direct business enterprises; instead, decentralized, competitive markets could be left to determine what goods and services would be produced. To create such a system, the government had to eliminate existing policies that prevented individuals from pursuing economic activities that they saw fit. Government preferences for selected industries or classes of citizens, or regulations and monopoly privileges that prohibited entry into certain markets or occupations, were unjust, unwise, and should be abolished. As Smith put it:

"All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men" (WN IV.ix.51).

However, the caveat in the last sentence—the requirement that individuals "not violate the laws of justice"—suggests that Smith did not really mean that the system would simply "establish itself of its own accord" by having the government step out of the way. Instead, the government had a very important role to play in fostering the conditions under which the system of natural liberty could flourish. Indeed, Smith believed that government had three principal duties: providing for the national defense, "protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice," and establishing and maintaining certain public works (WN IV.ix.51).

This second duty, the administration of justice, was a critical one. In his *Lectures on Jurisprudence*, Smith held that "the first and chief design of every system of government is to maintain justice; to prevent the members of a society from incroaching on one another's property, or seizing what is not their own." Indeed, the very purpose of government was "to give each one the secure and peaceable possession of his own property" (LJ 5).

Smith viewed the establishment of justice, meaning the protection of each individual's person and property, as absolutely essential to the very existence of society. Smith made these points in the *Theory of Moral Sentiments*, where he argued that humans have an innate and instinctive reaction against injustice and injury to others. Smith believed that "as mankind go along with, and approve of the violence employed to avenge the hurt which is done by injustice, so they much more go along with, and approve of, that which is employed to prevent and beat off the injury, and to restrain the offender from hurting his neighbors" (TMS II.i.1.5).
But if there was no established means for punishing injustice, then resentment could not be kept in check because "there is no greater tormentor of the human breast than violent resentment which cannot be gratified" (TMS III.2.11). If resentment at an unpunished injustice was not pacified in some way, individuals might take matters into their own hands and retaliate, possibly threatening the peace and order of society. This could lead to a breakdown in society because no society could function if everyone was injuring one another. As he put it:

"Society ... cannot subsist among those who are at all times ready to hurt and injure one another. The moment that injury begins, the moment that mutual resentment and animosity take place, all the bands of it are broken asunder, and the different members of which it consisted are, as it were, dissipated and scattered abroad by the violence and opposition of their discordant affections. If there is any society among robbers and murderers, they must at least, according to the trite observation, abstain from robbing and murdering one another" (TMS II.ii.3.2).8

In short, the absence of justice can lead to a breakdown of society. As he concluded, "society cannot subsist unless the laws of justice are tolerably observed, as no social intercourse can take place among men who do not generally abstain from injuring one another" (TMS II.ii.3.6).

In this respect, justice plays a much more important role in holding society together than other virtues such as beneficence. Indeed, Smith seemed fond of drawing attention to the limited role that benevolence plays in society.9 In the Theory of Moral Sentiments, he argued that beneficence "is less essential to the existence of society than justice. Society may subsist, though not in the most comfortable state, without beneficence; but the prevalence of injustice must utterly destroy it" (TMS II.ii.3.3). In a memorable passage, Smith compared society to a building, writing that beneficence is an "ornament which embellishes, not the foundation which supports the building," whereas justice "is the main pillar that upholds the whole edifice. If it is removed, the great, the immense fabric of human society... must in a moment crumble into atoms" (TMS II.ii.3.4).10

What do individuals need to do to behave in a just manner? To Smith, behaving justly does not require doing good deeds for others (beneficence) but simply refraining from directly harming them: "Mere justice is, upon most occasions, but a negation, and only hinders us from hurting our neighbor" (TMS II.ii.1.9). Indeed, the "foundation of justice and humanity" is having a "sacred regard" for the life and property of others (TMS III.3.37).11 For example, the poor cannot simply take from the rich, even if such takings would pass a utilitarian cost-benefit test, because such an act would inflict harm on others.12

If injustice—violating someone's person or property or rights—naturally gives rise to the demand for retribution, what was needed to tame this potentially dangerous passion and prevent it from destroying society? The

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8 Later, Smith also writes: "As the violation of justice is what men will never submit to from one another, the public magistrate is under a necessity of employing the power of the commonwealth to enforce the practice of this virtue. Without this precaution, civil society would become a scene of bloodshed and disorder, every man revenging himself at his own hand whenever he fancied he was injured. To prevent the confusion which would attend upon every man's doing justice to himself, the magistrate, in all governments that have acquired any considerable authority, undertakes to do justice to all, and promises to hear and to redress every complaint of injury" (TMS VII.iv.35).

9 In the Wealth of Nations, he observed that self-interest, not beneficence, is the driving force in a commercial society. As he famously wrote, "it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but with regard to their own interest" (WN I.ii.2).

10 David Hume also pointed to justice as the foundation of society, arguing before Smith that it was "absolutely requisite to the well-being of mankind and existence of society" (EPM 159) and that "without justice society must immediately dissolve" (EPM 199). Similarly, rules about property that gave stability of possession are "not only useful, but even absolutely necessary to human society" (EPM 501).

11 Indeed, Smith ranked the severity of the infringement in descending order: a person's life, their property, and their personal rights. "The most sacred laws of justice, therefore, whose violation seems to call loudest for vengeance and punishment, are the laws which guard the life and person of our neighbor; the next are those which guard his property and possessions; and last of all come those which guard what are called his personal rights, or what is due to him from the promises of others" (TMS II.ii.2.2).

12 One individual must never prefer himself so much even to any other individual, as to hurt or injure that other, in order to benefit himself, though the benefit to the one should be much greater than the hurt or injury to the other. The poor man must neither defraud nor steal from the rich, though the acquisition might be much more beneficial to the one than the loss could be hurtful to the other. Not only would that injury be "contrary to nature," but any such infringement would deserve punishment. "for having thus violated one of those sacred rules, upon the tolerable observation of which depend the whole security and peace of human society." This is because "for one man to deprive another unjustly of anything, or unjustly to promote his own advantage by the loss or disadvantage of another, is more contrary to nature, than death, than poverty, than pain, than all the misfortunes which can affect him, either in his body, or in his external circumstances" (TMS III.3.6).
answer is to satisfy the demand for justice by punishing the unjust act. This can be done by establishing a system for the administration of justice and the peaceful resolution of disputes.\textsuperscript{13}

Smith saw this as the original purpose of government, believing that “the foundation of civil government” was “the object of Justice is the security from injury” (LJ 398). The institution of government arose for the protection of life and property:

“The first and chief design of every system of government is to maintain justice; to prevent the members of a society from encroaching on one another’s property, or seizing what is not their own. The design here is to give each one the secure and peaceable possession of his own property … Law and government, too, seem to propose no other object but this, they secure the individual who has enlarged his property, that he may peaceably enjoy the fruits of it” (LJ 5).\textsuperscript{14}

Once individuals and groups began to accumulate property, he explained, they created an institution—government—for their protection against domestic and foreign encroachment. “The acquisition of valuable and extensive property, therefore, necessarily requires the establishment of civil government,” he wrote. “Where there is no property, or at least none that exceeds the value of two or three days labour, civil government is not so necessary.” For this reason, “property and civil government very much depend on one another” (LJ 401).

Of course, this means that government protects those who have property from those who do not.\textsuperscript{15} Smith admitted that “civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all” (WN V.i.b.12).\textsuperscript{16} Smith accepted that such a system led to and perpetuated inequality—“wherever there is great property there is great inequality”—and suggested that inequality was a natural condition that would always exist.\textsuperscript{17}

At the same time, Smith was deeply critical of rules that protected property-owners from competition, such as the practice of entail which prevented enterprising free men from acquiring property. He was equally opposed to rent seeking (or extraction) by the monarchy, the aristocracy, merchants and manufacturers, the church, and especially land owners who “love to reap where they never sowed” (WN I.vi.8). These groups could capture

\textsuperscript{13}This is another example of Rosenberg’s (1960) classic interpretation of Smith as exploring the role of institutions in diverting destructive passions into serving constructive goals.

\textsuperscript{14}In the Wealth of Nations, Smith repeated that “the duty of establishing an exact administration of justice” meant “protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it” (WN I.i.b.1).

\textsuperscript{15}“Men may live together in society with some tolerable degree of security, though there is no civil magistrate to protect them from the injustice of those passions. But avarice and ambition in the rich, in the poor the hatred of labour and the love of present ease and enjoyment, are the passions which prompt [them] to invade property, passions much more steady in their operation, and much more universal in their influence…. The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease, and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it” (WN I.i.b.2).

\textsuperscript{16}Therefore, “laws and government may be considered in this and indeed in every case as a combination of the rich to oppress the poor, and preserve to themselves the inequality of the goods which would otherwise be soon destroyed by the attacks of the poor, who if not hindered by the government would soon reduce the others to an equality with themselves by open violence” (LJ 208).

\textsuperscript{17}“By law and government all the different arts flourish, and that inequality of fortune to which they give occasion is sufficiently preserved” (LJ 213).
government and possibly distort the rules of society to their own benefit. In such cases, government policies or specific legal rules were the problem, not the system for the administration of justice itself.¹⁸

Despite the risk that rules could be rigged in favor of some groups, the protection of property prevented people from getting rich simply by taking from others because an economy could not function if some groups were constantly taking from others. “[I]t is next to impossible that any accumulation of stock can be made” where there is plundering, pillaging, and perpetual wars. “When people find themselves every moment in danger of being robbed of all they possess, they have no motive to be industrious,” he argued. “Nothing can be more an obstacle to the progress of opulence” (LJ 522).¹⁹

Consequently, the poor would enjoy a much higher standard of living under a system in which property was kept secure than one in which property was left insecure. Security of possession was a precondition for economic progress from which all groups could prosper.²⁰ “The establishment of perfect justice, perfect liberty, and of perfect equality, is the very simple secret which most effectually secures the highest degree of prosperity” to all classes of citizen, he argued (WN IV.i.x.17).

In this context, Smith examined the role of secure property in promoting the wealth of nations.

3 | SECURITY AND THE INCENTIVES FOR ECONOMIC ACTIVITY

In the Wealth of Nations, Smith made this sweeping summary statement:

“Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government” (WN V.i.iii.7).

Note that Smith identifies three factors associated with the administration of justice: the security of possessions, the fulfillment of contracts, and the payment of debts. This is the closest that Smith actually comes to defining what we call “property rights,” which essentially comes down to the security of possession (and presumably freedom of disposal) and the enforcement of promises (contracts and debts).

To illustrate this statement, Smith compared countries where property was secure to countries where property was insecure. In places where property was secure, people would be willing to accumulate capital and put it

¹⁸Smith believed that market competition, undistorted by privilege and restrictions, would mitigate some forms of inequality; see Boucoyannis (2013). Smith was worried about inequality, as Rasmussen (2016) notes, but more for how it distorts our sympathy rather than for its economic effects. More to the point, Smith did not seriously grapple with the issue of how property is originally acquired. As Salt (1994, 311–12) points out: “in Smith’s theory, the right of property does not derive from the way in which the object was acquired but from the fact of possession” which can be defined as “expectation of continued use.... For Smith there was no problem of legitimizing first taking. He was therefore free to define justice narrowly as the respect for the property rights which people have acquired historically without also having to justify how those rights were distributed.”

¹⁹Smith was exposed to these ideas from his teacher, Francis Hutcheson. In his 1726 book An Inquiry into the Original of Our Ideas of Beauty and Virtue, Hutcheson (2004, 284–85) discusses the incentive effects of property. “It is well known, that general Benevolence alone, is not a Motive strong enough to industry, to bear labour and toil, and many other difficulties which we are averse to from self-love.” Therefore assuring that people can enjoy the fruits of their labor strengthens “our motives to industry.” Without that assurance, “the depriving of persons of the fruits of his own innocent labor, takes away all motives to industry from self-love, and the nearer ties; and leaves us no other motive than general benevolence: nay, it exposes the industrious as a constant prey to the slothful, and sets self-love against industry. This is the ground of our right of dominion and property in the fruits of our labors; without which right, we could scarce hope for any industry, or anything beyond the product of uncultivated nature.”

²⁰In addition, protecting property gave those without property the incentive to work rather than to take. “The government and laws hinder the poor from ever acquiring the wealth by violence which they would otherwise exert on the rich; they tell them they must either continue poor or acquire wealth in the same manner as they [the rich] have done” (LJ 208).
to work; in places where property was insecure, people would lack the incentive to accumulate capital and would seek to move or hide what capital they possessed. By slowing capital accumulation, a key factor in the wealth of nations, the insecurity of property held back economic development. "In all countries where there is tolerable security, every man of common understanding will endeavour to employ whatever stock he can command in procuring either present enjoyment or future profit," he wrote. "In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their stock, in order to have it always at hand to carry with them to some place of safety, in case of their being threatened with any of those disasters to which they consider themselves as at all times exposed" (WN II.i.30). As examples of the latter he pointed to Turkey, India, and most countries in Asia.

Differences in the security of property rights could even be found within nations. Smith contrasted the prosperity of cities, where the administration of justice and the enforcement of property rights was effective, with the country, where such enforcement was more tenuous:

> "Order and good government, and along with them the liberty and security of individuals, were ... established in cities at a time when the occupiers of land in the country were exposed to every sort of violence. But men in this defenceless state naturally content themselves with their necessary subsistence, because to acquire more might only tempt the injustice of their oppressors. On the contrary, when they are secure of enjoying the fruits of their industry, they naturally exert it to better their condition, and to acquire not only the necessaries, but the conveniences and elegancies of life" (WN III.iii.12).

Smith did not believe that the administration of justice had to be perfect, just as other government policies did not have to be perfect, to allow economic growth to occur. Instead, the administration of justice only had to be "tolerable."21 The underlying, driving force that generated economic progress is the desire of individuals to improve their condition. As he put it, "the great purpose of human life" is to "better our condition" (TMS I.iii.21). This motive was powerful enough to overcome the many obstacles put in its way, even an imperfect administration of justice. As Smith famously said, "The uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which publick and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration" (WN II.iii.31). Indeed, Smith criticized Francois Quesnay, the French physiocrat, for his belief that "the exact regimen of perfect liberty and perfect justice" was a prerequisite for economic progress.22

The basis for Smith's belief that the effort of every individual to better their condition could overcome the extravagance of government and the errors of administration was the historical experience of Great Britain. Though government policies had been far from perfect, Britain's economic condition had steadily improved over time because individuals had been allowed to pursue their own interests within an institutional framework that protected property. The security of property through the administration of justice encouraged capital accumulation and allowed economic progress to take place more than bad government policies retarded that progress:

21Indeed, Smith believed that "[n]othing is more difficult than to perfectly secure liberty" (LJ 480).

22Quesnay "seems not to have considered that, in the political body, the natural effort which every man is continually making to better his own condition is a principle of preservation capable of preventing and correcting, in many respects, the bad effects of a political economy, in some degree, both partial and oppressive. Such a political economy, though it no doubt retards more or less, is not always capable of stopping altogether the natural progress of a nation towards wealth and prosperity, and still less of making it go backwards. If a nation could not prosper without the enjoyment of perfect liberty and perfect justice, there is not in the world a nation which could ever have prospered. In the political body, however, the wisdom of nature has fortunately made ample provision for remedying many of the bad effects of the folly and injustice of man, in the same manner as it has done in the natural body for remedying those of his sloth and intemperance" (WN IV.ix.28).
“That security which the laws in Great Britain give to every man that he shall enjoy the fruits of his own labour is alone sufficient to make any country flourish, notwithstanding these and twenty other absurd regulations of commerce ... The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations; though the effect of these obstructions is always more or less either to encroach upon its freedom, or to diminish its security” (WN IV.v.b.43).  

Smith was famous for his critique of the monopolies and exclusive privileges that existed under the mercantile system, but, he observed, at least England allowed freedom of trade without government direction. That freedom to trade, along with the impartial administration of justice, made all the difference:

“In England, ... the natural good effects of the colony trade, assisted by other causes, have in a great measure conquered the bad effects of the monopoly. These causes seem to be: the general liberty of trade, which, notwithstanding some restraints, is at least equal, perhaps superior, to what it is in any other country; the liberty of exporting, duty free, almost all sorts of goods which are the produce of domestic industry to almost any foreign country; and what perhaps is of still greater importance, the unbounded liberty of transporting them from any one part of our own country to any other without being obliged to give any account to any public office, without being liable to question or examination of any kind; but above all, that equal and impartial administration of justice which renders the rights of the meanest British subject respectable to the greatest, and which, by securing to every man the fruits of his own industry, gives the greatest and most effectual encouragement to every sort of industry” (WN IV.vii.c.54).

In this regard, England stood apart from other European countries, such as Spain and Portugal, which had equally bad policies but which lacked both free internal trade and secure property rights. Consequently, "this bad policy is not in those countries counter-balanced by the general liberty and security of the people. Industry is there neither free nor secure, and the civil and ecclesiastical governments of both Spain and Portugal are such as would alone be sufficient to perpetuate their present state of poverty, even though their regulations of commerce were as wise as the greater part of them are absurd and foolish" (WN IV.v.b.45).

As noted earlier, Smith did not limit the administration of justice to simply the security of possession, but also the enforcement of contracts and the ability to collect on debts, although he did not seem to emphasize these factors as much. With regard to contracts, Smith thought that “imperfections in the law with regard to contracts” was “another thing which greatly retarded commerce” in Europe after the fall of the Roman Empire (LJ 528). In explaining the relative poverty of Spain and Portugal, Smith pointed to the inability to collect on sovereign debts.  

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23 Elsewhere he pointed out: “In the midst of all exactions of government, this capital has been silently and gradually accumulated by the private frugality and good conduct of individuals, by their universal, continual, and uninterrupted effort to better their own condition. It is this effort, protected by law and allowed by liberty to exert itself in the manner that is most advantageous, which has maintained the progress of England towards opulence and improvements in almost all former times, and which, it is to be hoped, will do so in all future times” (WN II.iii.6).

24 Smith’s view that a central duty of the sovereign was the preservation of property via a proper legal framework is also emphasized in the following: “When the law does not enforce the performance of contracts, it puts all borrowers nearly upon the same footing with bankrupts or people of doubtful credit in better regulated countries. The uncertainty of recovering his money makes the lender exact the same usurious interest which is usually required from bankrupts. Among the barbarous nations who over-ran the western provinces of the Roman Empire, the performance of contracts was left for many ages to the faith of the contracting parties. The courts of justice of their kings seldom intermeddled in it. The high rate of interest, which took place in those ancient times, may perhaps be partly accounted for from this cause” (WN I.i.x.15).

25 Those countries remained poor for various reasons, “but above all, that irregular and partial administration of justice, which often protects the rich and powerful debtor from the pursuit of his injured creditor, and which makes the industrious part of the nation afraid to prepare goods for the consumption of those haughty and great men to whom they dare not refuse to sell upon credit, and from they are altogether uncertain of repayment” (WN IV.vii.c.54).
Smith also pointed to China, where economic development was held back because the protection of property was unequal and uneven (WN I.ix.15).

Smith believed that the administration of justice was more important than the availability of natural resources as a factor in economic development. In 1779, when asked why Ireland remained poor and whether manufactures from the country might ever pose a threat to those in England, Smith replied that he doubted Ireland would develop extensive manufacturing because it lacked coal and wood. But he added that the lack of “order, police, and a regular administration of justice both to protect and to restrain the inferior ranks of people, (are) articles more essential to the progress of industry than both coal and wood put together.” This absence would hold Ireland back “as long as it continues to be divided between two hostile nations, the oppressors and the oppressed, the protesters and the Papists” (Corr 243–44).

In sum, Smith believed that security of possession—protecting property from encroachment by others—and the enforcement of promises (contracts and debt) were key factors in providing an incentive for investment and economic growth. While Smith did not discuss the importance of the administration of justice in securing property in any single part of the Wealth of Nations, as he did with the division of labor, he referred to it repeatedly throughout his work. But did he offer any guidance as to how the tolerable administration of justice could be established?

4 | ESTABLISHING A TOLERABLE ADMINISTRATION OF JUSTICE

Smith’s plan for a third book on “the general principles of law and government” never came to fruition, so he never went into detail on how the administration of justice could be established (TMS 3). But elsewhere he gives extensive hints about his views.

In all his works, Smith argued that the “impartial” administration of justice required a judicial system that was independent of executive power. An independent judiciary was “the foundation of that greater Security which we now enjoy both with regard to Liberty, property, and Life” (LRBL 176). By contrast, if the judiciary was controlled by the executive, the administration of justice would be liable to corruption and abuse.

“When the judicial is united to the executive power, it is scarce possible that justice should not frequently be sacrificed to what is vulgarly called politics. The persons entrusted with the great interests of the state may, even without any corrupt views, sometimes imagine it necessary to sacrifice to those interests the rights of a private man. But upon the impartial administration of justice depends the liberty of every individual, the sense which he has of his own security. In order to make every individual feel himself perfectly secure in the possession of every right which belongs to him, it is not only necessary that the judicial should be separated from the executive power, but that it should be rendered as much as possible independent of that power” (WN V.i.c.25).

What could be done to ensure that judicial independence was not compromised by politics? Here Smith describes some of the characteristics of such a system. A judge “should not be liable to be removed from his office according to the caprice of that (executive) power.” A judge’s salary should not be paid at the discretion of the executive or by those involved in the legal process.

Of course, he hastened to add that, should Ireland, “in consequence of freedom and Good Government,” develop industry equal to that of England, “so much the better would it be” for both countries.

“When the sovereign or chief exercised his judicial authority in his own person, how much soever he might abuse it, it must have been scarce possible to get any redress, because there could seldom be anybody powerful enough to call him to account” (WN V.i.b.14).

Instead, it should be paid out of ordinary revenue because a system of justice benefits
everyone in society. Smith also praised juries as a valuable institution for ensuring the impartial administration of justice: “Nothing can be a greater security for life, liberty, and property than this institution,” he argued.

Smith did not give advice as to how to establish an independent judiciary, but he provided an historical account of how they had arisen in England. As he had already explained, with the accumulation of property there came a demand for protective services. Property owners were willing to create an institution—government—to do so, or to pay the sovereign to protect their land and possessions and to levy fines on those found guilty of violating someone’s property. This tied revenue to the administration of justice. Speaking about the period after the fall of the Roman empire with regard to the Germans in Europe and the Tartars of Asia, Smith held that “the administration of justice not only afforded a certain revenue to the sovereign, but to procure this revenue seems to have been one of the principal advantages which he proposed to obtain by the administration of justice.” However, Smith noted, “[t]his scheme of making the administration of justice subservient to the purposes of revenue could scarce fail to be productive of several very gross abuses” and led to corruption (WN V.i.b.14). Indeed, in Europe during this period “the administration of justice appears for a long time to have been extremely corrupt; far from being quite equal and impartial even under the best monarchs, and altogether profligate under the worst.” “During the continuance of this state of things, therefore, the corruption of justice... scarce admitted of any effectual remedy” (WN V.i.b.15).

Smith offered two historical explanations for how judiciaries became independent from executives. One story is that the threat of foreign invasion or conflict required the sovereign to raise more money than could be had by collecting fees for the administration of justice. A related story was that the separation was simply due to the executive facing a growing number of tasks and therefore needing to delegate the matter to a separate authority. This separation helped regularize the administration of justice (since lower authorities, unlike the executive, could not collect fees for themselves) and made it less corrupt by insulating it from politics.

In either case, Smith believed that judicial independence was introduced "by chance":

“This Separation of the province of distributing Justice between man and man from that of conducting publick affairs and leading Armies is the great advantage which modern times have over antient, and the foundation of that greater Security which we now enjoy both with regard to Liberty, property and Life. It was introduced only by chance and to ease the Supreme Magistrate of this the most Laborious and least Glorious part of his Power, and has never taken place untill the increase of Refinement and the Growth of Society have multiplied business immensely” (LRBL 176).

Thus, Smith describes a well-functioning, independent judicial system, but does not say much on how it can be established. He praised the British system for having "government properly restrained" and ensuring something close to "a perfect security to liberty and property" (LJ 422). But he does not elaborate on how other societies could develop those institutional checks on executive power.

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29 *The expence of the administration of justice, too, may, no doubt, be considered as laid out for the benefit of the whole society. There is no impropriety, therefore, in its being defrayed by the general contribution of the whole society* (WN V.i.i.2).

30 *The law of England, always the friend of liberty, deserves praise in no instance more than in the carefull provision of impartial juries* (LJ 425).

31 *The person who applied for justice with a large present in his hand was likely to get something more than justice; while he who applied for it with a small one was likely to get something less. Justice, too, might frequently be delayed in order that this present might be repeated. The amercement, besides, of the person complained of, might frequently suggest a very strong reason for finding him in the wrong, even when he had not really been so. That such abuses were far from being uncommon the ancient history of every country in Europe bears witness* (WN V.i.b.14).

32 The higher expenses of maintaining national defense required a new set of taxes, rather than just collecting fees for the administration of justice. This separated revenue from the administration of justice and led to the delegation of the administration of justice to others rather than the person of the sovereign (WN V.i.b.16).

33 As he put it: “The separation of the judicial from the executive power seems originally to have arisen from the increased business of the society, in consequence of its increasing improvement. The administration of justice became so laborious and so complicated a duty as to require the undivided attention of the persons to whom it was entrusted,” and so the task was delegated. (WN V.i.b.25).
Smith's message on the importance of judicial independence in securing property and promoting the wealth of nations was largely unappreciated by subsequent generations. Most of the English classical economists writing in the early nineteenth century did not examine the importance of secure property in promoting economic development. David Ricardo, Thomas Malthus, Nassau Senior, Robert Torrens, and others, were more interested in questions of rent, value, and population than in identifying the institutional features that would promote economic development, which were largely satisfied in Britain. While the classical economists did not completely neglect the importance of secure property, they often mentioned it only in passing without much analysis. They also followed Senior in dismissing such questions as being in the realm of politics rather than political economy. They did not feel the need to consider the political system that would best provide for the security of possession, but rather began shifting the debate from political economy to more technical questions of economics.

Because the security of property was a significant theme in Adam Smith's work, and that of the Scottish enlightenment more broadly, it may not come as a surprise that the classical economist who stressed its importance most was from Scotland, John Ramsay McCulloch. In the first edition of his *Principles of Political Economy*, McCulloch (1825, 73–4) argued that security of property, trade and exchange, and capital accumulation were the three "circumstances, without whose conjoint existence and co-operation" countries would never move from poverty to affluence. Of these, "security of property is the first and most indispensable requisite to the production of wealth." Like his Scottish predecessors, he held that secure property is "the foundation on which almost all the other institutions of society rest," but he avoided speculation about the origins of property.

By the fourth and final edition of his book, McCulloch (1849, 84) expanded his discussion of "the utility, or rather necessity, of making some general regulations, that should secure to every individual the peaceable enjoyment of the produce he had raised, and of the ground he had cultivated and improved." McCulloch argued that economic development was nearly impossible when governments did not respect property rights:

"The finest soil, the finest climate, and the finest intellectual powers, can prevent no people from becoming barbarous, poor, and miserable, if they have the misfortune to be subjected to a government which does not respect and maintain the right of property. This is the greatest of calamities. The ravages of civil war, pestilence, and famine, may be repaired; but nothing can enable a nation to contend against the deadly influence of an established system of violence and rapine."

Because of their broader intellectual interests, Jeremy Bentham and John Stuart Mill explored the role of property rights in different ways. Bentham, of course, put enormous stress on the important of laws, legislation, and the legal system as a foundation of government and the economy. In *Principles of the Civil Code*, Bentham (1961, [1843] 307, 311) argued that the objective of law is security, which is "the foundation of life, of subsistence, of abundance, of happiness; everything depends on it." Law helps establish security and all the benefits that follow; "Without law there is no security; and consequently no abundance, nor even certain subsistence."

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34 For example, Malthus (1820, 346, 251) noted that "No people can be much accustomed to form plans for the future, who do not feel assured that their industrious exertions, while fair and honourable, will be allowed to have free scope; that the property which they either possess, or may acquire, will be secured to them by a known code of just laws impartially administered." But this was a matter of politics: "Security of property, without a certain degree of which, there can be no encouragement to individual industry, depends mainly upon the political constitution, the excellence of its laws, and the manner in which they are administered." Other less notable authors, such as Richard Whately (1831, 144), also called brief attention to the importance of such security for ensuring that the division of labor would take place.

35 To explain what are the causes of the relative increase of subsistence and population is rather the business of a writer on politics than of a Political Economist. At present we will only say that knowledge, security of property, freedom of internal and external exchange, and equal admissibility to rank and power, are the principal causes which at the same time promote the increase of subsistence, and, by elevating the character of the people, lead them to keep at a slower rate the increase of their numbers" (Senior 1850, 49).
Bentham (1961, [1843], 308) argued that law is essential because “property is entirely the creature of law.” By protecting property, law provides security, aligns effort and reward, and provides the incentive for work and investment:

“The Law does not say to a man, ‘Work and I will reward you;’ but it says to him, ‘Work, and by stopping the hand that would take them from you, I will ensure to you the fruits of your labor, its natural and sufficient reward, which, without me, you could not preserve.’ If industry creates, it is the law which preserves: if, at the first moment, we owe everything to labour, at the second, and every succeeding moment, we owe everything to the law.”

The assurance that investment today will be protected against confiscation tomorrow gives everyone an expectation about one’s property in the future. “If I despair of enjoying the fruits of my labour, I shall only think of living from day to day; I shall not undertake labours which will only benefit my enemies” (310).

Bentham also believed that an oppressive government could prove to be a major obstacle in this regard. A passing calamity that destroys one’s possessions or productive capital, he argued, would only have a temporary adverse effect because it would not destroy the spirit of industry. By contrast, “nothing less is requisite for freezing up industry, than the operation of a permanent domestic cause, such as a tyrannical government,” which can cause lasting damage. Yet, unlike Smith, Bentham opposed having an independent judiciary that was not accountable to the legislature or the public. He was also skeptical of lawyers and the jury system. Instead, Bentham placed his faith in a legislature that was accountable to the people to ensure secure property.

For John Stuart Mill as well, the administration of justice was the basis of civilization. In his Principles of Political Economy, Mill described the primary reasons why productivity differences existed across countries (including natural advantages such as the fertility of land and the skill and knowledge of the workforce) and the secondary reasons. Of the secondary reasons, Mill ranked “security” against predation as the most important. Such security was necessary to align reward with effort. As Mill (1909 [1848], 115) put it, “the efficiency of industry may be expected to be great, in proportion as the fruits of industry are insured to the person exerting it: and that all social arrangements are conducive to useful exertion, according as they provide that the reward of every one for his labour shall be proportioned as much as possible to the benefit which it produces.” When such security is not provided,

“it means uncertainty whether they who sow shall reap, whether they who produce shall consume, and they who spare today shall enjoy tomorrow. It means not only that labour and frugality are not the road to acquisition, but that violence is. When person and property are to a certain degree insecure, all the possessions of the weak are at the mercy of the strong” (Mill, 1909 [1848], 881).

Mill believed that providing security was an important function of government and that “person and property cannot be considered secure where the administration of justice is imperfect.” However, like Smith, Mill did not believe that the administration of justice had to be absolutely perfect. Mill (1909 [1848], 882) argued that “in attaching to this great requisite, security of person and property, the importance which is justly due to it, we must not forget that even for economical purposes there are other things quite as indispensable, the presence of which will often make up for the very considerable degree of imperfection in the protective arrangements of government.”

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36 In savage life there is little or no law, or administration of justice; not systematic employment of the collective strength of society, to protect individuals against injury from one another.... We accordingly call a people civilized, where the arrangements of society, for protecting the persons and property of its members, are sufficiently perfect to maintain peace among them” (Mill 1963, 28: 120).

37 In his Considerations upon Representative Government, Mill argued that “The greater security of property is one of the main conditions and causes of greater production, which is progress in its more familiar and vulgarpest aspect.” (386, Considerations.) Mill also believed that “the security of person and property are the first social interests not only of the rich but of the poor, is obvious to common sense” (CW-JSM, 18: 80).
Mill also pointed out that government itself was often a problem, not just because of the inadequate provision of security but because it could be a source of insecurity. Mill distinguished between security as protection against others by the government and security from the government itself, judging the latter as more important. “Where a person known to possess anything worth taking away, can expect nothing but to have it torn from him, with every circumstance of tyrannical violence, by the agents of a rapacious government, it is not likely that many will exert themselves to produce much more than necessaries” (Mill, 1909 [1848], 113). Like McCulloch and Bentham, Mill (1909[1848], 113–14) believed that government predation was much more harmful than private predation: “The only insecurity which is altogether paralyzing to the active energies of producers is that arising from the government or from persons invested with authority. Against all other depredators there is a hope of defending oneself. As Mill (1909[1848], 882–3) explained:

“Insecurity paralyzes only when it is such in nature and in degree that no energy of which mankind in general are capable affords any tolerable means of self-protection. And this is a main reason why oppression by the government, whose power is generally irresistible by any efforts that can be made by individuals, has so much more baneful an effect on the springs of national prosperity, than almost any degree of lawlessness and turbulence under free institutions. Nations have acquired some wealth, and made some progress in improvement, in states of social union so imperfect as to border on anarchy: but no countries in which the people were exposed without limit to arbitrary exactions from the officers of government every yet continued to have industry or wealth. A few generations of such a government never fail to extinguish both.”

He concluded that “difficulties and hardships are often but an incentive to exertion: what is fatal to it, is the belief that it will not be suffered to produce its fruits.” And that was the problem with government acting as a taker of property.

Unlike Bentham, Mill did not place great emphasis on law as securing property rights. "Much of the security of person and property in modern nations is the effect of manners and opinion rather than law," Mill (1909[1848], 115) argued. For example, much of “the security of property in England is owing (except as regards open violence) to opinion, and the fear of exposure, much more than to the direct operation of the law and the courts of justice.” In particular, Mill pointed to two problems with the law. First, the legal system was costly and slow and could even “make it preferable to submit to any endurable amount of the evils which they are designed to remedy.” Second, the laws themselves could be either defective in protecting “idleness and prodigality against their natural consequences” or unjust in protecting inequitable institutions such as slavery.

Mill did not elaborate on these matters as much as he could have. The economic effects of security, property, law and customs were all important, but Mill (1909[1848], 888) wrote that “these considerations introduce considerations so much larger and deeper than those of political economy, that I only advert to them in order not to pass wholly unnoticed things superior in importance to those of which I treat.”

Unfortunately, Mill was the last prominent political economist to raise these matters. By the late nineteenth century, with the marginal revolution of W. Stanley Jevons and Philip Wicksteed, and the emergence of neoclassical economics and Alfred Marshall, interest in the security of property and the wealth of nations had largely faded away.

6 | EMPIRICAL EVIDENCE ON SMITH’S INTERPRETATION

Although Adam Smith and John Stuart Mill pointed to the importance of secure property rights for economic growth and development, most economists subsequently chose to focus on other matters. Not until Douglass North and others began writing about the importance of institutions, and the incentives that they create, as
shaping economic growth did the economics profession return to this set of issues. Since then, however, there have been innumerable empirical and historical studies on the role of property rights in shaping economic outcomes, including the wealth of nations. Two questions—one economic and the other political—are raised by Smith’s analysis: (a) will a country providing greater security to property enjoy a higher per capita income, other things being equal? and (b) is an independent judiciary the key political institution necessary to ensure the greater security of property?

Establishing a statistically causal relationship between the security of property—to the extent that it can be measured—and a country’s per capita income has not been easy. Early research showed that countries with open political institutions that respected private property, enjoyed the rule of law, and allowed markets to allocate resources enjoyed higher productivity and more rapid growth than other countries. However, by taking those factors as exogenous, this approach was unable to determine if good institutions were responsible for higher incomes or if higher incomes led to good institutions. Subsequent research sought to find institutional variation across countries that is random, exogenous, or independent of income and has generally found a positive relationship between institutions that secure property and higher incomes.

More recent research has sought to determine which institutions were most important for a country’s income. For example, Acemoglu and Johnson (2005) considered two aspects of property rights: protection against expropriation and security of contracts. They found that countries with greater constraints on politicians and more protection against expropriation had substantially higher income, investment rates, and use of credit than others. However, after controlling for these property rights institutions, contracting institutions have little economic effect. They conclude that an economy can function reasonably well with weak contracting institutions, but not with the presence of a significant expropriation risk.

A related literature has focused more directly on financial development under different legal regimes (common law versus civil law), finding that common law countries perform better. The question then becomes: what aspect of common law countries gives rise to the greater security of property rights? La Porta, Lopez-de-Silanes, Pop-Eleches, and Shleifer (2004) argue that judicial independence accounts for some, though not all, of the beneficial effects of common law on economic freedom. Voigt and Gutmann (2013) also find that judicial independence is required to establish a credible commitment that the political system will respect property.

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38 See, for example, North and Thomas (1973) and North (1991). Weingast (1993, 1997) has also focused on the critical question of the structure of politics that is required to ensure that government does not become predatory and infringe on property rights. Adam Smith seems to have agreed with the contention by North and Weingast (1989), but disputed by Murrell (2017), that the Glorious Revolution of 1688 gave the country better political institutions for economic activity, marking a break-point in Britain’s economic development. Smith mentioned that the revolution “perfected” the legal security for individuals to enjoy the fruits of their labor. “That security which the laws in Great Britain give to every man that shall enjoy the fruits of his own labour is alone sufficient to make any country flourish, notwithstanding these and twenty other absurd regulations of commerce; and this security was perfected by the revolution” (WN IV.v.b.43).

39 Besley and Ghatak (2010) and Haggard, MacIntyre, and Tiede (2008) provide surveys of recent research on the economics and politics of property rights in economic development, respectively; see also Acemoglu, Johnson, and Robinson (2005), in addition to Auerbach and Azariadis (2015) and Besley and Persson (2009).

40 See Scully (1988). Similarly, De Long and Shleifer (1993) showed that, in medieval times, absolutist governments were associated with low economic growth, as measured by city growth, compared to other regimes.

41 Acemoglu, Johnson, and Robinson (2001) argue that the mortality rates of colonial settlers can be used to identify the causal relationship between institutional quality and income levels. They find that institutional quality has a persistent and positive effect on a country’s income. Similarly, after also accounting for the endogeneity of institutions (using settler mortality and the fraction of people speaking English as instruments), Rodrik, Subramanian, and Trebbi (2004) examined whether institutions, geography, or openness was the most important determinant of a country’s income. They found that measures of property rights and the rule of law always trumped geography and economic integration in determining income and concluded that the presence of property security for investors is a key, if not the key, element of the institutional environment that shapes economic performance.

42 La Porta, López-de-Silanes, and Shleifer (2008) argue that common law countries provide greater legal protection of property rights and prevent expropriation of possessions and financial rights than in civil law countries; see also Glaeser and Shleifer (2002), Mahoney (2001) also finds that common-law countries experienced faster economic growth than civil-law countries and suggested that this was due to the greater security of property and contract rights.
There also appears to be strong support for Smith's view that the security of property gives individuals an incentive to undertake investments. Other work has focused on the difference between Bentham and Mill on formal law versus informal rules regarding the security of property. A regular finding is that informal norms are more important than formal rules in protecting property, implying that Mill was right in that non-state governance arrangements are of key importance (Dixit, 2009; Williamson, 2009; Williamson and Kerekes, 2011; Bubb, 2013).

At the same time, Hadfield and Weingast (2014) have pointed out the difficulty of providing any precise definition of "property rights" and the "rule of law" and Haggard, MacIntyre and Tiede (2008) have argued that the many empirical indicators of these concepts may deliver different empirical results. Helmke and Rosenbluth (2009) note that judicial independence is not synonymous with the rule of law. Furthermore, Rios-Figueroa and Staton (2014) find important differences between \textit{de facto} and \textit{de jure} measures of judicial independence.

Despite the difficulties in determining the precise meaning of these terms, recent research provides broad support for the ideas that Adam Smith was proposing nearly 250 years ago, that "institutions" to ensure the security of property—including the administration of justice and judicial independence—are critical for economic development. In a belated recognition of the importance of these factors, the World Bank's \textit{World Development Report 2017} was devoted entirely to governance and the law. Just like Smith, the World Bank (2017, 5) maintained that economic "growth requires an environment in which firms and individuals feel secure in investing their resources in productive activities."

7 | CONCLUSION

In his writings, Adam Smith emphasized the importance of secure property both for reasons of justice and for its effect on economic development. Smith did not believe that government had to be proactive in generating economic progress. Rather, he heralded "the establishment of a government which afforded to industry, the only encouragement which it requires, some tolerable security that it shall enjoy the fruits of its own labour" (WN I.xi.n.1). Smith explored this theme at length throughout his work, but in no single place, which might account for its relative neglect in subsequent accounts of his theory of economic development.

While the importance of providing security to property was accepted by participants in the Scottish Enlightenment, this tradition was lost when the classical economists shifted the focus of inquiry to the determinants of the distribution of income (wages, rent, and profits) within a system that took such security for granted. Only in the past decade or so have researchers finally turned their attention back to the institutional framework of economic activity (property rights, legal system, non-legal norms, etc.). In doing so, they have found ample support for many of the propositions that Smith advanced long ago.

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43In the case of land ownership, see the survey of Galiani and Schargrodsky 2011. More generally, see recent work by Besley and Mueller (2018) and Besley, Fetzer, and Mueller (2015).


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