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ADAM SMITH'S "TOLERABLE ADMINISTRATION OF JUSTICE" AND THE WEALTH
OF NATIONS

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ABSTRACT

In the Wealth of Nations, Adam Smith argues that a country's national 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's answer, in an important but neglected theme of his work, is the security of property rights that enable individuals to "secure the fruits of their own labor" and allow the division of labor to occur. Countries that can establish a "tolerable administration of justice" to secure property rights and allow investment and exchange to take place will see economic progress take place. Smith's emphasis on a country's "institutions" in determining its relative income has been supported by recent empirical work on economic development.

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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 others not? Book III, "Of the different Progress of Opulence in different Nations," promises an answer, but fails to deliver. By far the shortest of the five books in Smith's treatise, Book III examines the symbiotic relationship between town and country, but does not give a clear answer to the question implicit in its title.

Yet, ultimately, Smith does provide an answer to this second question: the security of property rights. Without the protection of property, the division of labor will be severely retarded. Secure property rights provide 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, consequently, in Smith's view, it 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.”² 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. The administration of justice – a term Smith used frequently – was more than just a means of enabling individuals to “secure the fruits of their own labor” and provide an incentive for productive effort, it was also a matter of peacefully adjudicating disputes and ensuring just relations between individuals. And such justice was absolutely essential for society to subsist at all; without the “administration of justice,” society itself would disintegrate and dissolve. The administration of justice did not have to be perfect, just tolerable, and an independent judiciary was critical, in Smith’s view, to ensuring that this would happen.

Smith provides a compelling explanation as to why secure property is important to a country’s development and, in turn, why the judicial system is important in ensuring such security. He also provides several illustrations of the impact of secure versus insecure property rights on economic development, much in the way that economists 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.³

² Smith 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 the piece 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.

³ Previous 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.

Smith's analysis of these matters is worthy of study because only recently have economists 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 drew 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 and Ghatak 2011), political institutions (Acemoglu and 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 attempts to provide a coherent 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 views on the importance of having a system of justice 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, but 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 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.

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.⁴ To create such a system, the government had to eliminate existing policies that prevented individuals from pursuing any economic activity 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 687).⁵

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

⁴ “The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society” (WN 687).

⁵ Of course, Smith was not an advocate of “laissez faire” and acknowledged many exceptions to simple system of natural liberty; see Hollander (2013).

“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. Smith believed that government had three main 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 687).

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 inroaching on one anothers property, or seizing what is not their own.” Indeed, the very purpose of government was “to give each one the secure and peacable 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.⁶ 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.⁷ The sight of injustice or injury gives rise to resentment, which naturally leads to the desire for punishment or retaliation. This resentment, Smith believed, is “the safeguard of justice,” while the desire for retribution “seems to be the great law which is dictated to us by Nature” (TMS 79, 82).⁸

⁶ Smith wrote that “few men have reflected upon the necessity of justice to the existence of society,” but it was a key concern to those writing in the Scottish enlightenment (TMS 89). Other major thinkers also considered the societal and economic importance of justice and the security of property, but in a somewhat less systematic way (Pascal 1938, Stein 1970, Bowles 1985).

⁷ “Nature has implanted in the human breast that consciousness of ill-desert, those terrors of merited punishment which attend upon its violation, as the great safe-guards of the association of mankind, to protect the weak, to curb the violent, and to chastise the guilty.” (TMS 86).

⁸ “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 79).

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 119). 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 is 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 86).⁹

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 87).

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.¹⁰ In the *Theory of Moral Sentiments*, he argued that

⁹ Late, 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 340).

¹⁰ 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 26-7).

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 86). Here Smith memorably compared society to a building, writing that beneficence is an “ornament which embellishes, not the foundation which supports the building,” but 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 86).¹¹

What do individuals need to do to behave in a just manner? By Smith’s definition, it is not doing good deeds for others (beneficence), but simply refraining from directly harming them: “Mere justice is, upon most occasions, but a negative virtue, and only hinders us from hurting our neighbor” (TMS 82). Indeed, the “foundation of justice and humanity” is having a “sacred regard” for the life and property of others (TMS 153).¹² For example, the poor cannot simply take from the rich, even if that redistribution would pass a utilitarian cost-benefit test, because such an act would inflict harm on others.¹³

¹¹ 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” (EPM3:2:159) and that “without justice society must immediately dissolve” (EPM 199).¹¹ Similarly, rules about property that gave stability of possession are “not only useful, but even absolutely necessary to human society” (EPM 501).

¹² 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, those 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 84).

¹³ “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” Why? “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 138).

If injustice – harm to 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 answer is to satisfy the demand for justice by punishing the unjust act by establishing a system for the administration of justice and the resolution of disputes. This would resolve the injustice peaceably and pacify those potentially destructive passions.¹⁴

Smith saw this as the original purpose of government, believing that “the object of Justice is the security from injury, and it is the foundation of civil government” (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).¹⁵

In Smith’s view, once individuals and groups began to accumulate property, 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.” Thus, “property and civil government very much depend on one another” (LJ 401).

¹⁴ 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.

¹⁵ 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 708-9).

Of course, this means that government protects those who have property from those who do not.¹⁶ 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 715).¹⁷ 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.¹⁸

Smith was unapologetic for the resulting inequality that came with the protection of property. The protection of property served the important purpose of preventing people from getting rich simply by taking from others. An economy simply 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

¹⁶ “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 709-10).

¹⁷ 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).

¹⁸ “By law and government all the different arts flourish, and that inequality of fortune to which they give occasion is sufficiently preserved” (LJ 213).

¹⁹ Smith 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

Consequently, the poor would enjoy 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 669).

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

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,

fruits of their labor strengthens “our motives to industry.” Without that assurance, “the depriving of persons of the fruits of his own innocent labour, 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 *labours*; without which *right*, we could scarce hope for any *industry*, or anything beyond the product of uncultivated nature.” In his *Short Introduction to Moral Philosophy* (1747), Hutcheson returned to this theme. “Our sense of right and wrong also shows, that it must be inhuman and ill-natured for one who can otherways subsist by his own industry, to take by violence from another what he has acquired or improved by his innocent labors.” Property was needed to provide a motive for industry because “no man would employ his labours unless he were assured of having the fruits of them at his own disposal: otherways, all the more active and diligent would be a perpetual prey, and a set of slaves, to the slothful and worthless.” Therefore, the need for security of possession to the formation of government for the purpose of establishing justice; “that justice is necessary cannot be a question.” Without the enforcement of justice, “if laws and justice don’t prevail,” he held, “all industry must languish.”

²⁰ In addition, protecting property gave the right incentive to those without property: rather than acquire goods from taking them from others, such individuals could either stay poor or could acquire possessions by participating in the economy and the division of labor. “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).

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 910).

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 today call “property rights,” which he viewed as the security of possession (and presumably freedom of disposal) and the enforcement of promises (contracts and debts).

Smith illustrated his statement by comparing 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 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 284-85). As examples of the latter he pointed to Turkey, India, and most governments in Asia.

Differences in the security of property rights could even be found within countries. He 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 405).

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 50). This motive was powerful enough to overcome 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 343).

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:

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

“He 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 œconomy, in some degree, both partial and oppressive. Such a political œconomy, 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 674).

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:

“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 540).

Elsewhere he pointed out that

“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 345).

Smith was famous for his critique of the monopolies and exclusive privileges that existed under the mercantile system, but at least, he observed, 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 610).

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 541).

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).²² In explaining the relative poverty of Spain and Portugal, Smith pointed to the inability to collect on sovereign debts.

²² 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 112).

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 610).

Smith also pointed to China, where economic development was held back because the protection of property was unequal and uneven. He speculated that the country could be doing much better with a different set of laws and institutions.

“China seems to have been long stationary, and had probably long ago acquired that full complement of riches which is consistent with the nature of its laws and institutions. But this complement may be much inferior to what, with other laws and institutions, the nature of its soil, climate, and situation might admit of. A country which neglects or despises foreign commerce, and which admits the vessels of foreign nations into one or two of its ports only, cannot transact the same quantity of business which it might do with different laws and institutions. In a country too, where, though the rich or the owners of large capitals enjoy a good deal of security, the poor or the owners of small capitals enjoy scarce any, but are liable, under the pretence of justice, to be pillaged and plundered at any time by the inferior mandarines, the quantity of stock employed in all the different branches of business transacted within it, can never be equal to what the nature and extent of that business might admit” (WN 112).

Smith also believed that the administration of justice trumped 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” and that its absence would hold Ireland back “as long as it continues to be divided between two hostile nations, the oppressors and the oppressed, the protestants and the Papists” (Corr 243-44).²³

Of course, the administration of justice was a valuable service that had to be paid for. For this reason, although he sympathized with the Americans in their brewing conflict with Britain, he also believed that they owed their economic success to British institutions and therefore they should pay taxes to defray the cost of protection provided by the crown.

“It is not contrary to justice that both Ireland and America should contribute towards the discharge of the public debt of Great Britain. That debt has been contracted in support of the government established by the Revolution, a government to which the Protestants of Ireland owe, not only the whole authority which they at present enjoy in their own country, but every security which they possess for their liberty, their property, and their religion; a government to which several of the colonies of America owe their present charters, and consequently their present constitution, and to which all the colonies of America owe the liberty, security, and property which they have ever since enjoyed. (WN 944).

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

²³ 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.

importance of the administration of justice in securing property rights 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?

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 was to be provided (TMS 3). But he does provide 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.²⁴ As he put it:

"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

²⁴ "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 717).

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 723).

What could be done to ensure judicial independence so that it was not compromised by politics? Here Smith describes some of the characteristics of such a system without saying how it could be brought about. Specifically, judges “should not be liable to be removed from his office according to the caprice of that [executive] power.” And a judge’s salary should not be paid at the discretion of the executive or by those involved in the legal process.²⁵ Instead, it should be paid out of ordinary revenue because a system of justice benefits everyone in society.²⁶ 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. “The law of England, always the friend of liberty, deserves praise in no instance more than in the careful provision of impartial juries” (LJ 425).

Although Smith did not give advice as to how to establish an independent judiciary, he provided an historical account of how they had arisen in England. As Smith 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

²⁵ “This scheme of making the administration of justice subservient to the purposes of revenue could scarce fail to be productive of several very gross abuses. 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” (WN 716).

²⁶ “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 814).

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 it led to corruption (WN 716).²⁷ 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” (WN 717). “During the continuance of this state of things, therefore, the corruption of justice . . . scarce admitted of any effectual remedy” (WN 718).

Smith offered two historical explanations for how judiciaries became independent from executives. One story is that the increasing threat of foreign invasion or conflict required the sovereign to shift attention to ensuring national defense against foreign attack. 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 718).

Elsewhere, Smith argues the separation was simply due to the growing number of tasks facing the executive and the need to take advantage of the division of labor. This division of labor also helped regularize the administration of justice (since lower authorities could not collect fees for themselves) making it less corrupt and insulating it from politics. As he put it:

²⁷ “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 716-17).

“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 722).

In either case, whether it was an external threat that led to more revenue demands or the eventual division of labor within government, 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 have much to say on how it can be established. He did praise the British system, with the House of Commons and an independent judiciary, for having “government properly restrained” and ensuring something close to “a perfect security to liberty and property” (LJ 422).²⁸ But he does not elaborate on how other societies could develop those institutional checks on executive power.

²⁸ Smith pointed to the North American colonies as having institutions that limited the power of the executive. “In everything, except their foreign trade, the liberty of the English colonists to manage their own affairs their own way is complete. It is in every respect equal to that of their fellow-citizens at home, and is secured in the same manner, by an assembly of the representatives of the people, who claim the sole right of imposing taxes for the support of the colony government. The authority of this assembly over-awes the executive power, and neither the meanest nor the

Lost Lessons: From Political Economy and Economics

Most of the English classical economists writing in the early nineteenth century did not elaborate on the importance of property rights for 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 underlying prerequisites for economic development, which were largely satisfied in Britain.²⁹ Most of the classical economists did not completely ignore the importance of property rights, but only mentioned it in a paragraph or two without much analysis.³⁰ They also followed Senior in dismissing such questions as being in the realm of politics rather than political economy.³¹ They did not feel the

most obnoxious colonist, as long as he obeys the law, has anything to fear from the resentment, either of the governor or of any other civil or military officer in the province” (WN 584-85).

²⁹ Ricardo (1951, 204) does dissent from Adam Smith’s view on land taxes by saying “Rent often belongs to those who, after many years of toil, have realized their gains, and expended their fortunes in the purchase of land or houses; and it certainly would be an infringement of that principle which should ever be held sacred, the security of property, to subject it to unequal taxation.”

³⁰ 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 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: “Let a Nation, though still in a rude state, possess the knowledge of some of the simplest and most essential arts—a certain degree of division of labour—and above all a recognition, and tolerable security, of *property*; and it will not fail, unless very grievously harassed by wars, inundations, or some such calamities, to increase its wealth, and to advance, more or less, in civilization. I have spoken of *security of property* as the most essential point, because, though no progress can be made without a division of labour, this could neither exist without security of property, nor could fail to arise with it. No man, it is plain, could subsist by devoting himself either wholly or partially to the production of one kind of commodity, trusting to the supply of his other wants by exchanging part of that commodity with his neighbours, unless he were allowed to keep it, and to dispose of it, as his own. On the other hand, let property be but established and secured, and the division of labour would be the infallible result; because the advantages of it to each individual, in each particular instance, would catch the attention of every one who possessed but a moderate degree of forethought.”

³¹ “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

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 rights 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) 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 strongly rejected the idea that securing property rights helped the rich at the expense of the poor, holding that all classes benefit from the system that allowed a country to grow in wealth. Property, he insisted, was not the cause of poverty but the source of wealth.³² McCulloch mentioned the incentive effects of aligning effort and reward and

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).

³² McCulloch (1849, 82) stated that "where property is not publicly guaranteed, men must look on each other as enemies rather than as friends. The idle and improvident are always desirous of seizing on the wealth of the laborious and frugal; and, were they not restrained by the strong arm of the law from prosecuting their attacks, they would, by generating a feeling of insecurity, effectually check both industry and accumulation, and sink all classes to the same level of hopeless misery as themselves."

allowing individuals to enjoy the fruits of their labor.³³ But he also recognized that it may sometimes be in the interest of society to appropriate private property for a public purpose, although he warned that property “should never be wantonly taken for such purposes” until it had been reviewed by a competent tribunal and “full compensation” paid to the property owners (89).

Finally, 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.”³⁴

“Let us not, therefore, deceive ourselves,” he concluded, “by supposing that it is possible for any people to emerge from barbarism, or to become wealthy, prosperous, and civilized, without the security of property.”

Because of their broader interest in law and government, in addition to economics, Jeremy Bentham and John Stuart Mill showed a much greater interest in exploring the role of property rights, although 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

³³ “If A climb a tree and bring down fruit, which, as soon as he comes to the ground, is taken from him by others, he will not again engage in any similar undertakings, till he be well assures that he shall be permitted exclusively to the profit by what has been obtained through his sole exertions; nor will others engage in any such undertaking without a similar assurance” (McCulloch 1849, 80).

³⁴ McCulloch (1849, 84) pointed to contemporary examples of this, saying that “the want of security, or of any lively and well-founded expectation among the inhabitants of their being permitted freely to dispose of the fruits of their industry, is the principal cause of the present wretched state of the Ottoman dominions.”

economy. In *Principles of the Civil Code*, Bentham (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.”

Bentham (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 temporary or passing calamity that destroys one’s possessions or productive capital, he argued, does not destroy the spirit of industry and the adverse effects would only be temporary. 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 rights.

John Stuart Mill agreed with many but dissented from several of Bentham's conclusions. For Mill as well, the administration of justice was the basis of civilization.³⁵ 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. Once again, 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."³⁶ 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).

³⁵ "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).

³⁶ 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 vulgarest 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 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 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” (882). For example, he pointed out that the domestic unrest afflicting Flanders and the Hanseatic League had not been an insurmountable obstacle to economic progress. Even though government failed to provide adequate protection for property in these cases, individuals could still get a “tolerable means of self-protection.”

More than Adam Smith had, Mill stressed that government itself was often the problem, not just because its provision of security was inadequate but because it was 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 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” (113-14).

He elaborated on this point this way:

“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” (882).

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” (883). 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 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” (115). In particular, Mill also 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 unfortunately Mill (1909, 888) said 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.”³⁷

However, Mill was the last major political economist to discuss these issues. 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 property rights and the wealth of nations largely faded away.

Empirical Evidence on Smith’s Interpretation

For decades after Adam Smith and John Stuart Mill pointed to the importance of secure property rights for economic growth and development, most economists 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

³⁷ Mill stood apart from his predecessors (with the exception of Malthus) on one critical issue that was overlooked by most of his predecessors: he was willing to ask hard questions about the origin of the existing distribution of property ownership. Whereas many of his predecessors seemed to take that distribution as given, Mill (1909, 208) questioned the fairness of that distribution. “The social arrangements of modern Europe commenced from a distribution of property which was the result, not of just partition, or acquisition by industry, but of conquest and violence: and notwithstanding what industry has been doing for many centuries to modify the work of force, the system still retains many and large traces of its origin. The laws of property have never yet conformed to the principles on which the justification of private property rests They have not held the balance fairly between human beings, but have heaped impediments upon some, to give advantage to others; they have purposely fostered inequalities, and prevented all from starting fair in the race.” For that reason, Mill was will to consider policies to offset those inequalities, such as land reform and limits on inheritances. For the enormous contemporary debate in Britain on the relationship between property and poverty, see Horne 1990.

return to this set of issues.³⁸ 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.³⁹ This section will focus on two aspects of this large literature as it relates to Adam Smith's views. The first is an economic question: will a country providing greater security to property rights enjoy a higher per capita income, other things being equal? The second is a political question: is an independent judiciary the key political institution necessary to ensure greater security to property rights?

The demonstration of statistical causality between property rights – to the extent that such rights can be measured – and a country's per capita income has been elusive. An early paper by Scully (1988) 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 “institutions” as exogenous, this approach was unable to determine if good institutions were responsible for higher incomes or if higher incomes led to good institutions.⁴⁰

Subsequent research sought to find institutional variation across countries that is random, exogenous, or independent of income. Acemoglu, Johnson, and Robinson (2001) argue that the mortality rates of colonial settlers can be used to identify the causal relationship between

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) 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 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; and this security was perfected by the revolution” (WN 540).

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.

⁴⁰ 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.

institutional quality and income levels. They find that institutional quality has a persistent and positive effect on a country's income.⁴¹ 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 clear property rights for investors is a key, if not the key, element of the institutional environment that shapes economic performance.⁴²

Acemoglu and Robinson (2005) also sought to determine which institutions were most important for a country's income. They 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. Private non-legal, non-governmental institutions can emerge to help enforce contracts (Dixit 2009), but this is not something that Smith examined in detail.

A related literature has focused more directly on financial development under different legal regimes. La Porta, López-de-Silanes, and Shleifer (2008) argue that common law countries

⁴¹ In their view, settler mortality affected the type of institutions that were built in areas colonized by European powers. Where the colonizers encountered relatively few health hazards, European settlers established institutions to protect property rights and enforce the rule of law. In areas unsuitable for settlement, the colonists mainly sought to extract resources and showed little interest in establishing high-quality institutions.

⁴² Glaeser, La Porta, López-de-Silanes, and Shleifer (2004) note that property rights can be secured in authoritarian regimes (poor political institutions in the sense of the rule of law), but that the economic development that occurs as a result of those property rights can lead to demands for changes in political institutions.

provide greater legal protection of property rights and prevent expropriate of possessions and financial rights than in civil law countries.⁴³ Mahoney (2001) also finds that common-law countries experienced faster economic growth than civil-law countries during the period 1960–92 and then presented instrumental variables results suggesting that the common law produces faster growth through greater security of property and contract rights. 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 rights.

There also appears to be strong support for Smith’s view that the protection of property rights gives individuals an incentive to undertake investments (in the case of land ownership, see the survey of Galiani and Schargrotsky 2011).⁴⁴ Many recent papers have focused on the difference between Bentham and Mill on formal law versus informal rules regarding the security of property rights. 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).

⁴³ Djankov, La Porta, Lopez-de-Silanes and Shleifer (2003) find that procedural formalism of dispute resolution is systematically greater in civil than in common law countries. Furthermore, procedural formalism is associated with higher expected duration of judicial proceedings, more corruption, less consistency, less honesty, less fairness in judicial decisions, and inferior access to justice. Observing that a country’s legal system, whether it be common law developed in England or civil law developed in France, is often determined exogenously by history (Glaeser and Shleifer 2003), they find contracting rights are better established in common law than in civil law countries and hence experience deeper financial development.

⁴⁴ This does not mean that property rights are immutable, or that any change in those rights will always undermine economic incentives. As Naomi Lamoreaux (2011) points out, property rights have changed, sometimes in significant ways, throughout the history of the United States without much adverse impact on economic incentives for investment and exchange.

At the same time, political scientists have pointed out the difficulty of providing any precise definition of “property rights” and the “rule of law” (Hadfield and Weingast 2014) and have argued that the many empirical indicators of these concepts may deliver different empirical results (Haggard and Tiede 2010). Others have pointed out that democracy is a necessary but insufficient condition for judicial independence and that judicial independence is not synonymous with the rule of law (Helmke and Rosenbluth 2009). Furthermore, Rios-Figueroa and Staton (2014) find important differences between *de facto* and *de jure* measures of judicial independence.

Despite the vagaries of determining the precise meaning of these terms, recent research provides broad supports for the ideas that Adam Smith was proposing nearly 250 years ago, that “institutions” to protect property rights are critical for economic development, and that they include the administration of justice and judicial independence.

Conclusion

In his writings, Adam Smith emphasized the importance of secure property rights 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 256). Smith explored this theme at length throughout his work, but in no single place, which might account for its relative neglect.

While the importance of property and security was accepted by participants of 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 over the past decade or so have many economists finally turned their attention back to the institutional framework of economic activity (property rights, legal system, non-legal norms, etc.) and its role in fostering or retarding economic development. In doing so, they have found ample support for many of the propositions that Smith advanced long ago.

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