

# ADAM SMITH, JUSTICE, AND THE SYSTEM OF NATURAL LIBERTY

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**M**urray Rothbard dismisses Adam Smith's contribution to economics as "dubious," and he lists many specific Smithian lapses. For instance, Smith abandons the subjective theory of value, and maintains that only material commodities constitute production or value; he has "no conception of the entrepreneur or of the function of entrepreneurship"; he excuses collective bargaining, implicitly justifying union cartels; and he even provides part of the foundation for Karl Marx's confused labor theory of value.<sup>1</sup>

Rothbard also rebukes Smith for failing to consistently uphold free-market principles. Smith defended usury restrictions, supported standing government armies, advocated the "strategic" use of protectionism, called for tax-financed education, and much more. In short, there is ample evidence that Smith was an inconsistent defender of liberty, at best.<sup>2</sup>

But in defense of Smith, the author of the *Wealth of Nations*<sup>3</sup> did show, on occasion, that he was willing and able to follow his laissez-faire principles to their logical conclusion. For example, take his vigorous attack on medical licensure, in which he boldly

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<sup>1</sup>Murray N. Rothbard, *An Austrian Perspective on the History of Economic Thought*, 2 vols. (Brookfield, Vermont: Edward Elgar, 1995), vol. 1, p. 435; vol. 1, p. 448; vol. 2, pp. 430, 284, and 409. Jeffrey Herbener and Mark Thornton, "Adam Smith, Monetary Crank and Inflationist: A Rothbardian Perspective on the Founder of Economics" (paper presented at the Durrell Monetary Conference, Shendoah University, Winchester, Virg., October 1995), p. 6, add that among these other flaws, Smith was a monetary crank and a pragmatic inflationist.

<sup>2</sup>According to Rothbard, *An Austrian Perspective*, vol. 2, p. 3, the earlier writers Cantillon and Turgot had been far superior to Smith "both as technical economic analysts and as champions of laissez-faire." The classic account of Smith's many inconsistencies is Jacob Viner, "Adam Smith and Laissez-faire," *Journal of Political Economy* 35 (April 1927): 198-232, who apparently intended to defend Smith against the charge of having been an "extremist in the defense of liberty."

<sup>3</sup>Adam Smith, *An Inquiry in the Nature and Causes of the Wealth of Nations*, R.H. Campbell, A.S. Skinner, and W.B. Todd, eds. (Indianapolis, Ind.: Liberty Press [1776] 1981).

advocates a completely free market in higher education.<sup>4</sup> Similarly, he advocates the elimination of state interference in the market for religious services.<sup>5</sup> Thus, Smith was capable of rigorous consistency in the application of his free market principles, at least on certain issues, regardless of his frequent bouts of inconsistency.

Unfortunately, Smith's consistent application of *laissez faire* broke down in relation to one especially critical topic, at least if the orthodox interpretation of Smithian doctrine is to be believed. This concerns the provision of law and order. Modern historians of economic thought generally agree that Smith believed that the state must establish a system of justice before commerce can proceed. According to Jacob Viner, Adam Smith "recognized that the economic order . . . was marked by serious conflicts between private interests and the interests of the general public," and that the monopoly provision of justice was a prime example of "government interference with private interests" that promoted the general welfare.<sup>6</sup> More recent writers generally agree.<sup>7</sup> Thus, the conventional wisdom adds one more example to Rothbard's case against Smith, although these mainstream historians of thought applaud this particular Smithian inconsistency.

However, Viner and company have misread Smith on this score. A close reading of Smith reveals a different, and radical, thesis: the law emerges independently of government. While governments normally monopolize the provision of law enforcement and courts in the course of economic development, judicial services evolved historically through voluntary commercial transactions. Furthermore, the monopolization of judicial services by government leads to serious problems, which market

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<sup>4</sup>Unfortunately, this particular neat piece of analysis is contained in a letter (dated 20 September 1774), not in the *Wealth of Nations* or any other published tome. At least the letter is conveniently accessible; see *The Correspondence of Adam Smith*, Ernest C. Mossner and Ian S. Ross, eds., (Oxford: Clarendon Press, 1977), pp. 173–79.

<sup>5</sup>See David Levy, "Adam Smith's 'Natural Law' and Contractual Society," *Journal of the History of Ideas* 39 (October–December 1978): 665–74.

<sup>6</sup>Viner, "Adam Smith and Laissez-faire," p. 217.

<sup>7</sup>Cf. Edward S. Cohen, "Justice and Political Economy in Commercial Society: Adam Smith's 'Science of a Legislator'," *Journal of Politics* 51 (February 1989); Donald J. Devine, "Adam Smith and the Problem of Justice in Capitalist Society," *Journal of Legal Studies* 6 (June 1977); J. Ralph Lindgren, *The Social Philosophy of Adam Smith* (The Hague: Martinus Nijhoff, 1973); Edwin G. West, "Adam Smith's Economics of Politics," *History of Political Economy* 8 (Winter 1976); and Donald Winch, *Adam Smith's Politics: An Essay in Historiographic Revision* (Cambridge: Cambridge University Press, 1978).

competition would tend to mitigate.

This is not meant to suggest that Smith was an anarcho-capitalist. He did not advocate a completely free market in the provision of justice, but he did argue that the market provision of justice services was feasible without prior government intervention, contrary to the statist conventional wisdom concerning this important problem. Smith was, indeed, a pragmatist, as Rothbard charges, and was mostly interested in improving the efficiency of government monopoly provision of justice, rather than challenging that monopoly *per se*. Smith carefully outlines the relationship between institutional incentives and judicial behavior, and argues how superior mechanisms of residual claimancy would improve judicial performance and increase output.

### A DISTINCTION WITH A DIFFERENCE

Smith writes:

The second duty of the sovereign, that of 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, requires two very different degrees of expence in the different periods of society.<sup>8</sup>

Similarly, when Smith discusses the “system of natural liberty,” he lists the “duty of establishing an exact administration of justice” as one of the three duties to which the sovereign’s responsibility is limited.<sup>9</sup>

This passage might seem to suggest that the provision (and production) of justice must necessarily be undertaken by the state. In fact, this is the standard interpretation in the secondary literature.<sup>10</sup> But when we compare Smith’s account of the “duty of the

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<sup>8</sup>Smith, *Wealth of Nations*, “Of the Expence of Justice,” pp. 708–9. A similar statement is recorded in Adam Smith, “Report of 1762–3,” in *Lectures on Jurisprudence*, R.L. Meek, D.D. Raphael, and P.G. Stein, eds. (Indianapolis, Ind.: Liberty Press, 1982), p. 6.

<sup>9</sup>Smith, *Wealth of Nations*, p. 687.

<sup>10</sup>Cohen, “Justice and Political Economy in Commercial Society,” p. 50, summarizes Smith’s view by claiming that “When properly guided by the legislator, [commerce yields] both justice and opulence.” Edwin G. West, in “Adam Smith’s Public Economics,” *Canadian Journal of Economics* 10 (February 1977): 3, refers to the “Expence of Justice” discussion as concerning Smith’s “division of the functions of the state.” Devine, in “Adam Smith and the Problem of Justice in Capitalist Society,” p. 405, refers to “the first great institution of capitalism” being “the three-functioned national state.”

sovereign” to provide justice with the related discussion<sup>11</sup> of what we would today term “infrastructure,” it is clear that he does not rule out the private provision of justice or of anything else. The “third and last duty of the sovereign,” is to provide institutions and public works which, although they are beneficial to society as a whole,

are . . . of such a nature, that the profit could never repay the expence to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should erect or maintain.<sup>12</sup>

In other words, according to Smith, the question of whether or not government should provide particular public goods is an empirical issue. Rothbard would probably dismiss this position as yet another example of Smith’s failure to take a principled moral stand in defense of liberty, but of course the same charge could be leveled at many other prominent libertarian thinkers, such as Milton Friedman.

He explains that transportation routes, including highways, bridges, and navigable canals might possibly be provided by the free market. He notes that in “several different parts of Europe” canals are, in fact, privately provided, and explains that profit-maximizing owners tend to operate those canals more effectively than public commissioners (“who had themselves no interest in them”) would.<sup>13</sup> Tolls for the maintenance of high roads “cannot with any safety be made the property of private persons,” because under-maintained roads (unlike canals) continue to generate toll revenues for their owners. Smith then proceeds to outline the predictable inefficiencies associated with public management.<sup>14</sup>

The factual context of Smith’s analysis is important. Both the national road network (the “turnpikes”) and the canal system in eighteenth-century England were authorized by Acts of Parliament, but entirely financed and operated by private enterprise.<sup>15</sup> Turnpikes were operated by private trusts, and canals were usually organized as joint-stock companies. Both limited

<sup>11</sup>Smith, *Wealth of Nations*, pp. 723–31.

<sup>12</sup>Smith, *Wealth of Nations*, p. 723.

<sup>13</sup>Smith, *Wealth of Nations*, pp. 724–26.

<sup>14</sup>Smith, *Wealth of Nations*, pp. 729–30.

<sup>15</sup>In the context of the 1720 “Bubble Act” that imposed restrictions on joint-stock enterprise, express Parliamentary authorization substantially lowered the cost of capital to investors in such undertakings. See Paul Langford, *A Polite and Commercial People: England 1727–1783* (Oxford: Clarendon Press, 1989).

access to toll-paying customers; in neither case were the tolls the property of private persons, but instead the property of the undertaking organizations.<sup>16</sup> Smith was surely aware that one of the parts of Europe with privatized infrastructure was England herself.

Smith's repeated reference to "the sovereign" may sound statist, but does not really betray such a sympathy. Elsewhere in *Wealth of Nations*, the King is consistently portrayed as a simple wealth maximizer who constantly seeks to expand the domain of his power (and his revenue) while defending his position and rents from external and internal threats. Kings and their ministers are the greatest spendthrifts in the country,<sup>17</sup> and devote themselves to accumulating treasure and spending on luxuries for their personal enjoyment.<sup>18</sup> Monarchs often adulterate the coinage when their profligacy places them in arrears, despite the serious harm such coin-clipping (or revaluation) does to the country.<sup>19</sup> The sovereign is not portrayed as an idealized ruler engaged in the noble pursuit of improved social welfare, but rather as *Homo economicus* on the royal throne.

Smith's statement about the sovereign's "duty to establish an exact administration of justice" does not imply that a government monopoly of lawmaking and courts is necessary. In fact, government monopoly itself leads to a host of problems. Elsewhere, he engages in an analysis of these practical difficulties and suggests reforms designed to increase the efficiency of government courts, taking the government monopoly as a given.<sup>20</sup> But Smith also argues that private markets can provide judicial services, at least under certain circumstances. We now turn to this important, but widely neglected, aspect of Smith.

<sup>16</sup>See Langford, *A Polite and Commercial People*, pp. 391–417.

<sup>17</sup>Smith, *Wealth of Nations*, p. 346. In the preceding sentence, Smith writes:

It is the highest impertinence and presumption, therefore, in kings and ministers, to pretend to watch over the oeconomy of private people, and to restrain their expence either by sumptuary laws, or by prohibiting the importation of foreign luxuries.

<sup>18</sup>Smith, *Wealth of Nations*, p. 908.

<sup>19</sup>Smith, *Wealth of Nations*, p. 932.

<sup>20</sup>An example of the latter is the famous statement in Smith, *Wealth of Nations*, p. 910, beginning

Commerce and manufactures seldom flourish long in any state which does not enjoy a regular administration of justice . . . 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.

In other words, assuming a state monopoly in the market for justice, economic efficiency requires that private contracts be effectively enforced.

### SMITH'S THEORY OF THE ORIGIN OF JUSTICE

Smith offers an evolutionary model of justice that explains how economic development leads to increasingly complex legal institutions. Justice is explained as the unintended outcome of purely voluntary transactions.

After private ownership begins to emerge, the need for justice and the orderly resolution of disputes arises. As property emerges, “the hatred of labour and the love of present ease and enjoyment” among the poor prompt them to invade property belonging to others. Avarice and ambition among the rich also motivate violation of ownership rights. But the greatest threat to private property comes from the poor who desire to appropriate wealth rather than laboring to produce their own. Smith asserts that “great property” is always associated with great inequality of wealth. For every rich man, there must be five hundred poor; “the affluence of the few supposes the indigence of the many.”<sup>21</sup> Under such conditions, the rich man’s property is in grave jeopardy.<sup>22</sup>

Throughout this discussion, “civil government” refers to the functional role of maintaining law and order, and does not strictly imply “the state.” Provision of such services by way of a monopoly of coercion is only one possibility.

“Subordination,” the voluntarily accepted sense of social rank, is antecedent to any civil order. There are four causes to subordination: superiority of personal qualifications, superiority of age, superiority of fortune, and superiority of birth. Birth and fortune are the two great sources of personal distinction, principally setting one man against another. These two sources of subordination both reflect wealth available to the individual (with “birth” standing for the wealth available to the person’s family). Wealth generates influence, because in time of trouble, the weak naturally look to the strong for protection. As the economy

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<sup>21</sup>The “500-to-1” ratio is hyperbole, not a literal numerical relationship. Smith seems to mean “relative poverty” rather than “impoverishment” in the modern sense. Elsewhere in *Wealth of Nations*, he notes that “the very meanest person in a civilized country” enjoys an “accommodation” exceeding that of “many an African king,” and further that the modern European peasant is closer in well-being to a European prince than the African king compares to his subjects, toward whom he is the “absolute master” (p. 24). Thus, development increases the wealth of the poorest citizens faster than it increases the wealth of the richest citizens, reducing the degree of inequality.

<sup>22</sup>Smith, *Wealth of Nations*, pp. 709–10.

evolves beyond the most primitive stages, the strong are those who command the most valuable resources, and not necessarily individuals possessing the greatest size or physical strength. In other words, overt respect for the powerful and wealthy is a kind of insurance policy for the weak and poor.

The emergence of tangible wealth, unequally distributed, generates the demand for the enforcement of property rights:

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.<sup>23</sup>

Civil government emerges spontaneously from a social setting after tangible physical wealth has first accumulated. When property exists, individuals will from time to time come into conflict over the boundaries of their respective property rights. Such conflicts result in the demand for mediation.

It is at this stage that a “degree of authority and subordination”—and consequently, a system of justice—arises.

Men of inferior wealth combine to defend those of superior wealth in the possession of their property, in order that men of superior wealth may combine to defend them in the possession of theirs.<sup>24</sup>

He refers to the “most powerful local man” as a “little sovereign.”

This little sovereign is an authority in a strictly adjudicative sense. He resolves disputes among his inferiors. He does this because doing so is a source of revenue to him. Persons who apply to him for justice are always willing to pay for it, “and a present never failed to accompany a petition.” Eventually, this arbitrator charges the individual found guilty an “amercement,” or fine, over and above any “satisfaction . . . he was obliged to make.”<sup>25</sup> The adjudicator supplies a legal resolution to a dispute, awards damages to the party found injured, and charges a fee for the service.

Justice originates in the market provision of dispute resolution, and “deterrence” of future crime plays no role in determining penalties; the system is oriented toward awarding compensation to the individual victim from the party found guilty. This market system of justice even accommodates the peaceful resolution

<sup>23</sup>Smith, *Wealth of Nations*, p. 715.

<sup>24</sup>Smith, *Wealth of Nations*, p. 715.

<sup>25</sup>Smith, *Wealth of Nations*, pp. 715–16.

of cases involving murder. Heirs are compensated by means of fines imposed on the guilty in these cases as well. Smith offers a historical example. He explains that the barbarian German tribes seldom employed capital punishment, but relied on a system of fines.<sup>26</sup>

Smith does not advocate replacing capital punishment for murder with a system of graduated fines; in fact, he argues that in “every civilized nation death has been the punishment of the murderer [sic],” with pecuniary compensation being accepted only in “barbarous countries.”<sup>27</sup> But the system of market-determined judicial compensation arose prior to the existence of the state-imposed uniform punishments for equivalent crimes.<sup>28</sup>

The little sovereign, then, is merely the most respected, and influential, person in the community. This influence derives from his social accomplishments, e.g., his wealth, and fills a market niche. Therefore, the interaction between this person and those seeking his advice and judgment is a simple market trade. At this stage, the voluntary purchase of these services constitutes this individual’s only source of revenue.<sup>29</sup>

<sup>26</sup>Smith, “Report dated 1766,” *Lectures on Jurisprudence*, pp. 476–77, goes into some detail about the “price of murder”:

A price was sett on every person according to his station. There was one price paid for killing the king, and another for killing a slave. The compensation was proportioned to the dignity of the person and of his relations. What was paid to the prince for interposition was increased and diminished in the same proportion. It was a higher fine to kill a man belonging to a lord than one belonging to a little baron. To disturb the king’s peace subjected to a greater fine than to disturb the peace of a baron or lord.

Refusal to pay the allotted fine resulted in the perpetrator being turned over to the victim’s relatives, a harsh sanction: “If the injurer refused to pay the compensation he was left to the resentment of the injured, and if he was not able to pay it, he was obliged to implore the assistance of his friends.”

<sup>27</sup>Smith, “Report dated 1766,” p. 476. In the immediately following sentence, he says that the fines imposed were “not adequate to the offence,” but does not explain what he means by “adequate.”

<sup>28</sup>Smith’s account of justice among the ancient Germans, including the status-related scale of compensation, seems to be generally accurate. On this, see A.S. Diamond, *The Evolution of Law and Order* (Westport, Conn: Greenwood Press, 1975), pp. 150–53. Smith’s primary source for his information appears to have been Tacitus, whose *Germania* (a study of the customs of the Germanic tribes in the third century A.D.) receives seven separate cites in Smith, “Report of 1762–3.” Other works by Tacitus receive an additional seven cites in the lecture course.

<sup>29</sup>Smith, *Wealth of Nations*, p. 718. Smith does not suggest that the little sovereign erects coercive entry barriers designed to provide himself with protection against competition, although that personage is described in a manner suggesting a local monopolist. The possibility that members of the community might “vote with their feet” for a different, nearby little sovereign is not addressed by Smith.

Like the butcher, the brewer, and the baker in Smith's famous example from the *Wealth of Nations*,<sup>30</sup> the little sovereign is motivated by the desire to earn a profit by supplying judicial services. But like other private traders, the little sovereign (judge) can only earn that profit through voluntary transactions with consumers. Only by providing effective service to consumers can the judge expect to retain his market share.

As anthropology, Smith's account is basically accurate. Posner explain that in primitive cultures, the enforcement of law is almost entirely a privately provided activity (as was the case in many ancient societies), and that law enforcement in England followed the Becker-Stigler pattern (i.e., being a service marketed to consumers) "for centuries."<sup>31</sup> Smith uses this historical account to frame his economic model of the emergence of justice as the outcome of private market exchanges. The emergence of a system of justice does not require the pre-existence of government. In fact, Smith argued the other way around: a system of justice tended to lead to the emergence of government.

### THE TRANSITION TO COERCIVE MONOPOLY

Smith explains that the most powerful local sovereign eventually acts coercively to exclude competitors in order to extract monopoly rent:

[A]s long as the emoluments of justice, or what may be called the fees of court, constituted in this manner the whole ordinary revenue which the sovereign derived from his sovereignty, it could not well be expected . . . that he should give them up altogether. It might, and it frequently was proposed, that he should regulate and ascertain them. But after they had been so regulated and ascertained, how to hinder a person who was all-powerful from extending them beyond those regulations, was still very difficult, not to say impossible. During the continuance of this state of things, therefore, the corruption of justice, naturally resulting from the arbitrary and uncertain nature of those presents, scarce admitted of any effectual remedy.<sup>32</sup>

To paraphrase Smith, the strongest man in the community first becomes accepted as the arbiter of disputes, and the sole source of accepted law. But this places that person in a strategic

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<sup>30</sup>Smith, *Wealth of Nations*, p. 27.

<sup>31</sup>Richard Posner, *Economic Analysis of Law* (Boston: Little, Brown, 1986), pp. 559–60; Gary S. Becker and George Stigler, "Law Enforcement, Malfeasance, and Compensation of Enforcers," *Journal of Legal Studies* 3 (January 1974): 1–18.

<sup>32</sup>Smith, *Wealth of Nations*, p. 718.

position which allows him to gradually extend his authority beyond the resolution of disputes brought before him, and to pass judgments designed to reinforce his own power and wealth. The respected arbitrator becomes the feared governor, and eventually the state emerges from what modern economists would term a “rent-seeking” process. Smith also claims that the eventual usurpation of justice by monopoly government leads to the “corruption of justice.”<sup>33</sup>

The little sovereign eventually tends to delegate the actual judicial decision-making to employees, allowing him to allocate his own time and energies to other matters. The coercive monopoly over justice eventually comes to be managed by multiple judges who act as the agents of the monarch. Appropriating the resulting revenue “seems to have been one of the principal advantages” obtained by the sovereign from the administration of justice.<sup>34</sup>

Thus, the “natural” local monopoly of judicial services leads to a broader monopoly of coercion in society—the state. But this monopoly of coercion is not a necessary condition for the provision of judicial services. Rather than the provision of judicial services first requiring a state to emerge, in fact, the state develops out of the judicial services firm that itself arises through purely voluntary transactions with consumers.

What is particularly interesting is the absence of Pigouvian reasoning in explaining this situation. The transition from a profit-maximizing local monopoly firm to a monopoly of coercion is not portrayed as a solution to the failure of the private market to provide justice. Instead, the monopolization by the state leads to a corruption of justice. [We will return to this theme below].

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<sup>33</sup>Smith’s account of how the state emerges from anarchy bears some resemblance to Robert Nozick’s model of the origin of the minimal state. Nozick maintains that a process of free competition between providers of defense services will naturally tend to result in the emergence of a “monopoly of coercion,” that could nevertheless be kept limited to only essential duties associated with protecting the natural rights of private parties. See Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974). Here is where Smith differs from Nozick: Smith argues that once the state emerges, it tends to grow beyond what the simple definition and enforcement of private property rights would require. In other words, Smith offers a closer approximation to the anarchist critique of the state as a fundamentally oppressive entity than does Nozick. For a detailed refutation of the basic “natural monopoly” argument held by both Smith and Nozick (i.e., that the free competition between private defense agencies inevitably leads to the emergence of the state), see Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, N.J.: Humanities Press, 1982), pp. 229–48.

<sup>34</sup>Smith, *Wealth of Nations*, p. 716.

In the early stages of economic development, justice is provided by a kind of voluntary association, or club.<sup>35</sup> However, such an “arbitration club” is inadequate to protect liberty and property as the economy grows, since the decisions of the arbiter are non-binding. Eventually, the community agrees to appoint judges who have the power to render binding decisions about disputes.<sup>36</sup>

Smith sees the original purpose of laws as instituted to protect society from the depredations of judges, that is, as a kind of constraint. The “thing which has given occasion to the establishment of laws has always been the general or partial institution of judges.”<sup>37</sup> He continues:

At the first establishment of judges there are no laws; every one trusts to the naturall feeling of justice he has in his own breast and expects to find in others. Were laws to be established in the beginnings of society prior to the judges, they would then be a restraint upon liberty, but when established after them they extent and secure [it], as they do not ascertain or restrain the actions of private persons so much as the power and conduct of the judge over the people.<sup>38</sup>

Thus, government and laws emerge in part as a form of constraint on judicial malfeasance. In consequence, judges become agents of the state, and are no longer servants of their consumers in a private market.

This institutional change alters the qualitative characteristics of justice services. The punishment of criminals replaces the compensation of victims as the chief goal of the judicial process. Judges now prosecute criminals as threats to state revenues and power. At the same time, the judiciary allocates an increasing proportion of its resources to prosecuting acts which do not actually involve violations of individual property rights, offenses such as treason, “all conspiracies against the state,” and desertion from the military.<sup>39</sup> In other words, the individual consumer in the market for justice is provided with inferior service by the

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<sup>35</sup>As Smith explains in his “Report of 1762–3,” p. 313:

Tho one was ready to stand by the sentence of an arbiter chosen perhaps out of the whole body of the people, as the heads of families, yet they would be altogether unwilling they should lay down laws for their conduct. He has no notion of any one having this power over him. No more than a member of a club will submit himself to the rules they may lay down, no more would a savage when he agrees to be a member of a society [would] think that he was bound to obey all their regulations.

<sup>36</sup>Smith, “Report of 1762–3,” pp. 312–13.

<sup>37</sup>Smith, “Report of 1762–3,” p. 313.

<sup>38</sup>Smith, “Report of 1762–3,” p. 314.

<sup>39</sup>Smith, “Report of 1762–3,” p. 130.

state monopoly, because state justice looks after state interests in addition to adjudicating private disputes.

A curious omission is the absence of any discussion of policing.<sup>40</sup> Given the modern interest in the economics of crime and law enforcement, this absence is striking. However, modern-type municipal police forces were not formed in Britain until the mid-nineteenth century, and then existed only in London until late in the century. In the countryside, local magistrates "were responsible for appointing local officers, such as constables," who constituted the law enforcement community of the time, such as it was.<sup>41</sup> But most criminal cases were actually brought before judges by private parties, typically the alleged victims of the crime. In other words, in Smith's day, police work was basically private.<sup>42</sup>

### THE BEST JUDGES MONEY CAN BUY

Employing the administration of justice as a revenue-raising device produced "several very gross abuses." The higher bidder in a dispute could expect "more justice."

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.<sup>43</sup>

For example, justice might be delayed in order that "this present [i.e., bribe] might be repeated." The amercement from the individual found guilty may even provide an incentive to convict the accused in order to generate the amercement. Such abuses are alleged to have been common in the past, and the ancient history of every country in Europe demonstrates that such abuses "were far from being uncommon."<sup>44</sup>

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<sup>40</sup>Actually, while Smith occasionally uses the term "police" (e.g., throughout the *Theory of Moral Sentiments*, and at various places in the *Wealth of Nations*), he usually means "regulation."

<sup>41</sup>Clive Emsley, *Policing and its Context, 1750-1870* (New York: Schocken Books, 1984), p. 23.

<sup>42</sup>Cynthia B. Herrup, *The Common Peace: Participation and the Criminal Law in Seventeenth-Century England* (Cambridge: Cambridge University Press, 1987), p. 72, explains that in the seventeenth century,

Either the victim, or the victim's relatives or neighbors, organized the detective work to identify the proper suspect. Relatives and neighbors rather than legal officers assisted with the investigation; they also served later as witnesses. . . . As long as private individuals were willing to participate in the process of detection, the arrangement was both reasonable and, within limits, reasonably effective.

<sup>43</sup>Smith, *Wealth of Nations*, p. 716.

<sup>44</sup>Smith, *Wealth of Nations*, p. 717.

Smith argues that the administration of justice is always extremely corrupt in countries where justice is a government monopoly, and where justice is a source of revenue. With the growth of taxation, most countries “abolished bribery” in the administration of justice. Judges were paid “fixed salaries,” and justice was said to be administered “gratis.” In reality, the “bribes” formerly paid to judges now go to lawyers, and the expenses have actually increased. But judicial corruption was the problem which fixed salaries were designed to reduce. Nowadays, the total expense of justice is a “very inconsiderable part of the whole expense of government.”<sup>45</sup>

However, this institutional change has created another problem. Judges now have an incentive to behave opportunistically by shirking on their duties, because their pay is not a direct function of the number of cases they hear.

Smith maintains that reforms in the reward structure confronting judges might solve this problem, without reintroducing perverse incentives to judicial malfeasance. The whole expense of court might easily be defrayed by the fees of court. Assuming that the fees were collected by officers of the court independent of judges, there was no real hazard of corruption.

Smith assumes that it would be possible to arrange the fee-collection system so that government judges have no role in setting their own fees. The major component in this reform is establishing a standard structure of fees for different kinds of cases, irrespective of the actual decision the judge hands down. Also, the fees would not actually be payable until the case had been decided, so there “might be some incitement to the diligence of the court in examining and deciding it.” In courts consisting of several judges, the share of fees for each might be proportioned to the actual number of hours or days that judge had “employed in examining the process, either in court or in a committee by order of the court,” and this arrangement would also tend to reward judicial diligence.<sup>46</sup>

Thus, judicial pay can be linked to output:

Publick services are never better performed than when their reward comes only in consequence of their being performed and is proportioned to the diligence employed in performing them.<sup>47</sup>

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<sup>45</sup>Smith, *Wealth of Nations*, p. 717.

<sup>46</sup>Smith, *Wealth of Nations*, p. 719.

<sup>47</sup>Smith, *Wealth of Nations*, p. 719. On pp. 758–64, he offers a similar argument about linking pay and performance in the case of university professors.

A carefully designed system of residual claimancy can reward diligence, while at the same time eliminating incentives for perverse judicial behavior.<sup>48</sup>

He proposes a stamp-duty upon the law proceedings of each court, to be levied by that court. This would involve charging fees based on the length of court deliberations, or some other metric for determining the cost of service in a particular case. However, he notes that one difficulty with such a scheme is that courts will then have an incentive to multiply unnecessarily the proceedings in order to obtain increased stamp-duties.<sup>49</sup>

Regardless of exactly how the administration of justice is paid for, it should be possible to set that payment up so as to remove the executive power from any involvement in paying judges.

He suggests that the fund might come from the rent of landed estates, the management of each estate being entrusted to the particular court that was to be maintained by it. Alternatively, the court might be maintained out of an endowment which was left to the court to administer. Smith claims that a system designed along these lines already existed in eighteenth-century Scotland.<sup>50</sup>

## COMPETITION AND COURTS

Smith noted that although government usually monopolizes the provision of justice, and prohibits private courts, at times the various separate governmental courts have continued to compete with each other. Hence, the state monopoly over the judiciary has sometimes operated in practice as a kind of imperfectly enforced cartel. This competition had important implications for the quality of services provided by those courts.

Smith pays close attention to an example of this intercourt competition drawn from English history. Fees of court were originally the principal support of the different courts of justice. Revenue-maximizing courts competed with each other to attract

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<sup>48</sup>Smith notes that France employs a version of such a system to supplement the pay of judges. Called "Epices and vacations," this amounts to merit pay for diligent judges. For more on this, see Smith, *Wealth of Nations*, p. 720.

<sup>49</sup>Smith, in *Wealth of Nations*, p. 721, writes:

In Europe, the payment of attorneys and clerks of court are based on the number of pages they write. The attorneys have contrived to multiply words beyond all necessity, in order to increase their payment.

<sup>50</sup>Smith, *Wealth of Nations*, p. 722.

litigants, and were

willing to take cognizance of many suits which were not originally intended to fall under [their] jurisdiction . . . each court endeavored, by superior dispatch and impartiality, to draw to itself as many cases as it could. The present admirable constitution of the courts of justice of England was, perhaps, originally in a great measure, formed by this emulation, which antiently took place between their respective judges; each judge endeavoring to give, in his own court, the speediest and most effectual remedy, which the law would admit, for every sort of injustice.<sup>51</sup>

Surprisingly, given Smith's intense interest in the process of competition and its effects, this argument is only briefly expounded in the *Wealth of Nations*. However, Smith considered this competition in more detail in his *Lectures on Jurisprudence*. For example, in the "Report of 1762–3" he offers several specific illustrations of improvements in judicial service which resulted from such "rivalship." Competition between the Court of Kings Bench and the Court of Common Pleas led the former to begin hearing civil as well as criminal cases. The Court of the Exchequer at first only heard cases involving debts owed to the King, but gradually entered the market for civil debt cases by use of a writ of *quominus et precipimus* (that allowed the court to define the civil debt as indirectly related to the King's interests). This competition was motivated by the pursuit of profit on the part of the separate courts:

The profits of these courts depended chiefly on dues from the severall causes they tried, what we call in this country sentence money; from them also the clerks and notaries derived their fees. As the whole profits of the courts thus depended on the numbers of civill causes which came before them, they would all naturally endeavour to invite every one to lay his cause before their court, by the precision, accuracy, and expedition (where agreeable) of their proceedings, which emulation made a still greater care and exactness of the judges.<sup>52</sup>

He continues, explaining how the Court of Chancery gradually emerged from the office of Chancellor (who originally was just the keeper of the King's Great Seal, and the secretary of state for all royal departments) through a process of seeking greater revenues from hearing cases.<sup>53</sup>

<sup>51</sup>Smith, *Wealth of Nations*, p. 720.

<sup>52</sup>Smith, "Report of 1762–3," p. 281.

<sup>53</sup>Smith, "Report of 1762–3," p. 282. Smith fails to mention the Law Merchant, a body of non-governmental law and judges that emerged in the middle ages and resolved commercial disputes into the early 1600s. These courts freely competed

During the middle ages in Europe, there was a huge and complex system of courts and law entirely independent of governments and feudal lords: the ecclesiastical courts, which enforced the Catholic Church Canon Law.

Smith explains that the ecclesiastical courts were the first to recognize the legally binding nature of contracts, and that this protection of individual rights led to veneration of—and increased litigation business in—those courts. This competition with the Royal courts forced the latter to provide better quality services to consumers:

The civill law of the country was at that time very imperfect, and the cannon or ecclesiasticall law, tho far from perfect, was much preferable to the other; and it was by this the clergy were directed. Their judgments would therefore be most equitable. The whole right of testamentary succession proceeded from them, as well as the obligation of contracts. They were [the] only obstacle that stood in the way of the nobles; the only thing which made them keep some tollerable decency and moderation to their inferiors.<sup>54</sup>

In other words, the government courts were forced to begin recognizing, and protecting, contractual rights due to competition for legal customers from the Church courts. Particularly interesting is Smith's argument to the effect that consumer loyalty to the Church courts had little to do with religiosity, but was basically the result of perceived superior quality of service they provided.

The favorable reference to the Canon Law is surprising when compared to the harsh criticism Smith offers of the Catholic Church in the *Wealth of Nations*.<sup>55</sup> Smith's account of the role of the ecclesiastical courts during the middle ages is consistent with studies by modern legal historians.<sup>56</sup>

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with the common-law courts, until the latter courts began to refuse to accept merchant-law judgments as binding in 1606. See Bruce L. Benson, *The Enterprise of Law: Justice without the State* (San Francisco: Pacific Research Institute for Public Policy, 1990), p. 61.

<sup>54</sup>Smith, "Report of 1762-3," p. 90. However, Smith qualifies this favorable account of the Canon Law. In the following passage, he writes:

Thus an ecclesiasticall court, which in a country where the regulations of the civil government are arrivd to a considerable perfection is one of the greatest nuisances imaginable, may be of very great benefit in a state where the civil government is baddly regulated.

<sup>55</sup>See Gary M. Anderson, "Mr. Smith and the Preachers: The Economics of Religion on the *Wealth of Nations*," *Journal of Political Economy* 96 (October 1988): 1066-88.

<sup>56</sup>See Harold J. Berman, *Law and Revolution: The Formation of the Western Legal Tradition* (Cambridge, Mass.: Harvard University Press, 1983); William Holdsworth, *A History of English Law* (London: Methuen, 1956), vol. 1; and Robert E. Rodes, Jr., *Ecclesiastical Administration in Medieval England* (Notre Dame, Ind.: University of

However, Smith noted that unrestricted competition between courts implied what modern economists would term a problem of the commons. He declares that “new courts and new laws are . . . great evils.”<sup>57</sup> The reason is that new courts may fail to follow established precedents, and make “loose and inaccurate” decisions. These loose decisions enter the body of legal precedent, and reduce its reliability.

But the new courts which caused Smith concern were the new courts established by the King to evade existing laws. These new courts were not voluntary market phenomena, but creatures of the state. The power of the King made their legal rulings binding precedent, regardless of the evaluation by consumers of the quality of those decisions. After all, new courts could not “pollute” existing precedent unless they enjoyed legal monopoly status, at least within a certain geographic or subject-matter jurisdiction.

As an example of this kind of political pollution, Smith mentions Henry VIII’s establishment of the Court of the Star Chamber, which ignored legal precedent in the common law, and allowed the King to evade established courts.<sup>58</sup>

The Viner thesis fails to reconcile Smith’s supposed presumption of the necessity for government monopoly of justice with his carefully stated concern about the likely domination of such a the judiciary by the politicians currently in power.

Separation of judicial from executive authority arises following the increasing extent of the division of labor as the economy developed. While at first the monarch monopolizes the judicial services personally, eventually he delegates this authority to someone else. Where the judicial and executive are not separated, “it is scarce possible that justice should not frequently be sacrificed to, what is vulgarly called, politics.”<sup>59</sup>

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Notre Dame Press, 1977). Smith also argues that the clergy assisted in the recognition of contractual rights (breaking a contract was a sin), influenced the secular courts to eventually distinguish between murder and manslaughter, and played an important role in the abolition of slavery in Europe. See Knud Haakonssen, *The Science of a Legislator: The Natural Jurisprudence of David Hume and Adam Smith* (Cambridge: Cambridge University Press, 1989), pp. 74–77.

<sup>57</sup>Smith, “Report of 1762–3,” pp. 286–87.

<sup>58</sup>Smith, “Report of 1762–3,” p. 95. Smith probably oversimplifies the legal history in this case. Holdsworth, *A History of English Law*, vol. 1, pp. 498–508, argues to the contrary that the Court of the Star Chamber was originally a provider of improved legal services which respected existing precedent, and permitted private litigants to avoid the relatively corrupt existing Royal courts. On pp. 514–15, he argues that the Star Chamber only began to behave as the extralegal agent of the King during the reign of the Stuart James I.

<sup>59</sup>Smith, *Wealth of Nation*, p. 722.

Politicians will sometimes find it expedient to sacrifice the rights of the common man. In consequence, the judge should not be removable at the “caprice” of politicians, nor should his salary be subject to political discretion.<sup>60</sup>

Paying judges out of public revenue leads to shirking problems when the link between judicial pay and judicial output is weak, in addition to granting politicians undue power over judicial decisions. Smith argues that justice would be better provided by replacing these subsidies from tax revenues with a system of user fees. Such a system of financing the judiciary would not have required the monopolization of judicial services under the control of government.

Still, Smith might have argued that government monopoly of justice is necessary for various other reasons unrelated to the problem of judicial remuneration. He did not do so. His account of the negative externalities generated by new courts was about new government courts which enjoyed the support of state coercion. In short, governmental provision and production of justice provides no advantages over private provision, and moreover leads to severe problems which reduce the quality of justice provided. His repeated assumption that the state was, in fact, the monopoly supplier of justice services was not a normative prescription, but just a positive assessment: such governmental monopoly is predictable given a revenue-maximizing leviathan.

### JUSTICE AS A PRIVATE GOOD

The mainstream public economics literature tends to view justice as a pure public good, and the secondary literature on Smith bases much of its interpretation of his views on justice on this assumption. Smith was more interested in specific judicial decisions resulting from the efforts of particular rational individuals to resolve disputes at low cost.<sup>61</sup> Smith thought that justice was simply a kind of ordinary, private good. In *Wealth of Nations*, book 5, after acknowledging that the administration of justice provides some benefits to society as a whole, he continues:

The persons . . . who give occasion to this expence are those who, by their injustice in one way or another, make it necessary to seek redress or protection from the courts of justice. The persons again most immediately benefitted by this expence, are those whom the courts of justice either restore to

<sup>60</sup>Smith, *Wealth of Nations*, p. 723.

<sup>61</sup>This point has been noted previously by Andrew S. Skinner, *A System of Social Science: Papers Relating to Adam Smith* (Oxford: Clarendon Press, 1979), p. 212.

their rights, or maintain in their rights. The expence of the administration of justice . . . may very properly be defrayed by the particular contribution of one or other, or both of those two different sets of persons . . . by the fees of court. It cannot be necessary to have recourse to the general contribution of the whole society, except for the conviction of those criminals who have not themselves any estate or fund sufficient for paying those fees.<sup>62</sup>

Therefore, governmental subsidies can and should be restricted to those specific aspects of the provision of justice which can be shown to involve problems of nonoptimal provision in a private market. He assumes that the existing court system is, in fact, a governmental monopoly, but does not claim that such a monopoly is a necessary solution to any problem of market failure. Smith did not actually advocate ending governmental provision of justice, but his position seems to have been consistent with his general presumption in favor of free-market competition.<sup>63</sup>

## CONCLUSION

Murray Rothbard trenchantly critiques the many failures of Adam Smith both as an economist and as a defender of *laissez faire*. But Adam Smith nevertheless deserves credit for his fascinating analysis of the provision of justice that challenged the now-conventional assumption of the prior necessity of a state to provide law before the private marketplace can function. According to Smith, justice itself evolves as a market phenomenon, an unintended byproduct of the competitive process.<sup>64</sup>

<sup>62</sup>Smith, *Wealth of Nations*, p. 815.

<sup>63</sup>He is more explicit about arguing in favor of a true free market in the case of the provision of another kind of service with obvious “public good” characteristics: religion. In a famous passage later on in *The Wealth of Nations*, p. 793, Smith argues that free competition among religious sects was feasible, and would lead to optimal provision as well:

[free competition] might in time probably reduce the doctrine of the greater part of them to that pure and rational religion, free from every mixture of absurdity, imposture, or fanaticism, such as wise men have in all ages of the world wished to see established.

He goes on to explain that his plan of ecclesiastical government (i.e., legal entry barriers) is more properly described as “no ecclesiastical government.” On this, see Levy, “Adam Smith’s ‘Natural Law’ and Contractual Society,” p. 674. However, in his discussion of state-sponsored religion in the *Wealth of Nations*, p. 796, Smith seems to advocate the end of state subsidies to particular religions in a generally free, but regulated, market. The object of the regulations would be to “correct whatever was unsocial or disagreeably rigorous in the morals of all the little sects into which the country was divided.”

<sup>64</sup>For defenses of a free-market system of justice by modern economists, see David Friedman, “Efficient Institutions and the Private Enforcement of Law,” *Journal of*

Further, throughout his writings on the provision of justice, Smith consistently models judges as rational, self-interested economic actors who respond in predictable ways to the incentives they face. Along the way, he develops the rudiments of a theory of economic agency in which self-monitoring by means of residual claimancy is presented as a low-cost method of controlling judicial malfeasance.

Many of the problems with the existing judiciary—shirking by judges, corruption, and political interference with courts—are explained by Smith as resulting from the monopolization of court services by government. Competitive private markets tend to eliminate these problems. Even in historical instances where private courts were eliminated, competition among different government courts still tends to improve the quality of judicial services.

Finally, most scholars have overlooked one of the most intriguing aspects of Smith's model of the market for justice—that such a market is feasible because justice is a kind of private good. To Smith, justice was a prerequisite, but not necessarily a governmentally-provided prerequisite, for commercial exchange.

While Smith deserves recognition for his insight into the economics of justice, he did not advocate a completely free market in the provision of justice services. This was, after all, the same Adam Smith who later became a Commissioner of Scottish Customs, and bragged about his ability to squeeze revenue from peaceful international trade.<sup>65</sup> Nevertheless, Smith implicitly admitted the possibility of free-market justice, and this itself was a radical insight.<sup>66</sup>

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*Legal Studies* 13 (June 1984): 379–98; and by the same author, *The Machinery of Freedom* (La Salle, Ill.: Open Court, 1989); also see Murray N. Rothbard, *For a New Liberty: The Libertarian Manifesto* (New York: Collier Books, 1978).

<sup>65</sup>See Rothbard, *An Austrian Perspective*, vol.1, p. 469.

<sup>66</sup>As we have seen, much of Smith's discussion of the market provision of justice appears in his *Lectures on Jurisprudence*, delivered between 1762 and 1766, a decade before the *Wealth of Nations* appeared, and did not find its way into that *magnum opus*. This is consistent with Rothbard's observation that the quality of Smith's contribution to economic thought actually *deteriorated* over time. On this, see Rothbard, *An Austrian Perspective*, vol. 1, p. 436.