The Medieval Expansion of Long-Distance Trade: Adam Smith on the Town’s Escape from the Violent and Low-Growth Feudal Equilibrium

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Abstract

Most people in medieval Europe lived at subsistence in a violent feudal world. Adam Smith explained both the long-term stability of the feudal system and how the towns escaped this violence trap through political exchange that fostered their ability to enter long-distance trade, significant division of labor, and economic growth and development. Violence is central to Smith's approach to development, which Smith scholars have systematically under-appreciated. In the face of episodic violence, individuals had little incentives to be industrious, to save, or to invest. Smith argued that the medieval towns escaped the violence trap through trade expansion. In Smith's view, development required three mutually reinforcing elements – law and liberty; commerce, including long-distance trade; and security from all forms of violence.

1. Introduction

Most people in medieval Europe lived at subsistence in a violent feudal world. Why did this world remain so stable and yet so poor? And how did Europe escape this violence trap?

Although Adam Smith’s work on jurisprudence – his label for the study of politics, law, and government – is far less known then his economics, it is nonetheless equally foundational. In particular, Smith answers both questions and, in so doing, contributes to our political-economic understanding of development. The purpose of this paper is to explore Smith's answers to these questions and, secondarily, to argue that in answering them he develops political-economic theories that rival his economics.

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In his *Lectures on Jurisprudence (LJ)*, Adam Smith asked, given the immediate effects of the division of labor in producing economic growth, why does “every nation … continue so long in a poor and indigent state”? [LJ(B) 521] Smith explained both the long-term stability of the feudal system and how the towns escaped this violence trap through political exchange that fostered their ability to enter long-distance trade, foster significant increases division of labor, and hence provide for economic growth and development.

Smith did not confine his understanding of development to economic issues. Smith's discussion of the transformation of feudalism into the commercial society hinges on politics, political exchange, and, also, on violence. Smith embeds his analysis of the politics and economics of development of Western Europe in a narrative, so the underlying theory is easy to miss (Weingast 2015). Violence is a principal impediment to economic growth. Moreover, violence arises in the medieval Europe in multiple ways; within a society as different lords, factions, religions, or regions fight one another; or when the government plunders its citizenry. Smith’s answer to the puzzle of the “slow progress of opulence” or the lack of economic development involves violence, especially in the form of government plunder: “The causes of this may be considered under these two heads, first, natural impediments [such as geography], and secondly, the oppression of civil government.” [LJ(B) 521]

Smith explains the unfortunate effects of incentives fostered by violence and “oppression of the civil government”: “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

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2 Abbreviations for Smith's works are given at the end of the text, just before the references.
3 See, for example, Aspromourgos (2009); Hollander (1973); O’Brien (1975[2004]); and Rothschild and Sen (2006).
their being threatened with any of those disasters to which they consider themselves as at all
times exposed.” [WN II.i.30-31:284-85]

In this paper, I develop Smith's explanation of the long-term stability of the violent, low-
growth feudal equilibrium and how the towns escaped that equilibrium through a combination of
political exchange, institutional change, market-supporting infrastructure (such as property
rights, contract enforcement), security, and long-distance trade.

Following the invasions leading to the collapse of the Roman Empire, “The rapine and
violence which the barbarians exercised against the antient inhabitants, interrupted the commerce
between the towns and the country. The towns were deserted, and the country was left
uncultivated, and the western provinces of Europe, which had enjoyed a considerable degree of
opulence under the Roman empire, sunk into the lowest state of poverty and barbarism.” [WN
III.II.1:381-2]

Eventually, the feudal form of governance arose. In this system, land represented the
means to power, wealth, and security. Violence, as Smith emphasizes, was a constant presence
under feudalism. The most powerful lords typically obtained the largest and best land, allowing
them to support many retainers and large armies. The lords constantly fought each other and the
king.

The feudal society can be characterized by the “violence trap” (Cox, North, and Weingast
2015 – CNW), which works as follows. Economic growth requires both capital accumulation
and economic integration that accompany an increasing division of labor; moreover, economic
integration raises the costs of fighting. But violence threatens the value of the investments
necessary for economic integration, especially integration across regions or factions that might
fight each other. Smith again and again explains that, given the risk of violence, rational
investors will not invest in economic integration:

   In the infancy of society, as has been often observed, government must be weak and
feeble, and it is long before it’s authority can protect the industry of individuals from the
rapacity of their neighbours. When people find themselves every moment in danger of
being robbed of all they possess, they have no motive to be industrious. There could be
little accumulation of stock, because the indolent, which would be the greatest number,
would live upon the industrious, and spend whatever they produced. Nothing can be more
an obstacle to the progress of opulence. [LJ(B) 522]

Given these incentives, the violence trap is self-sustaining and difficult to escape; most
incremental changes – a modest increase in investment or economic integration – are insufficient
to escape the trap.\(^4\) Smith's logic reflects the violence trap. Hence the feudal equilibrium of
violence and low-growth was stable.

   How did Western Europe escape the violence trap? According to Smith, the rise of towns
represented the essential step in the political economic development of Europe. In the midst of
the feudal equilibrium, the king and town (small groups of traders) engaged in a political
exchange, forming a coalition against their common enemy, the local lords. The king granted the
towns rights of self-governance, trading, and defense in exchange for taxes and military service.
The new system represented a non-incremental change that simultaneously produced liberty and
justice, commerce, and security, allowing the town to escape the violence trap and a positive
feedback system with increasing returns.

   As the towns grew, they extended their reach into the countryside, transforming those
engaged in self-sufficient agriculture into specialists producing food and raw materials for the
towns and, often, long-distance trade. A necessary component of the towns’ escape from the

\(^4\) Smith understood the logic of poverty traps. For example, he argued that: “This is one great cause of the
slow progress of opulence in every country; till some stock be produced there can be no division of labour, and
before a division of labour take place there can be very little accumulation of stock” [LJ(B) 287:522].
violence trap was that the towns gained local military superiority relative to the local lords. This superiority allowed them to protect property rights, trade, amass wealth, and grow opulent while defending themselves against the arbitrary exactions and rapacious violence of the local lords – and also the king.

This paper proceeds as follows. In the second section, I discuss the NWW and CNW approach to violence and economic development. Section 3 presents several abstract propositions summarizing Smith's arguments. Section 4 analyzes Smith's approach to the feudal equilibrium, while sections 5 and 6 explain his theory of the towns’ escape from that equilibrium and interpret it, respectively. My conclusions follow.

2. Elements of the NWW/ CNW Political-Economic Approach to Development

Violence is a tool by which some groups survive by plundering the efforts of others (Hirschleifer 1994, Dixit 2004). As CNW show, intra-state violence is remarkably high in the developing world. Violent takeover of leadership, for example, occurs once every seven years for the median developing country in the poorest half of the distribution of countries by income. Violence is likely to have been more frequent in the medieval era.

All developing states, past and present, must devise a means of limiting manifest violence, even if they cannot rid themselves of multiple and independent sources of violence. How they do so affects their ability to develop. NWW/ CNW argue developing countries limit violence by inducing individuals and groups with violence potential to cooperate rather than fight. They induce cooperation through rent-creation. Developing countries create and limit access to privileges, rights, state services, organizations, and competition; they distribute the
implied rents to powerful constituencies with violence potential. Because violence typically lowers rents, rents targeted to those with violence potential makes the latter better off than fighting. NWW calls these societies *natural states* because this has been the dominant way of organizing states throughout history and remains so today.

CNW provide a bargaining approach to model the natural state; the model produces several results relevant for this paper. Suppose two groups compete for a total surplus normalized to 1 to make the logic more transparent. The two groups may either fight or bargain to an agreement. Let \( p \) be probability that the first wins if a fight occurs; \( c_1 \) is the first’s groups cost of fighting, while \( c_2 \) is the second’s. As is standard in this approach, the group which wins the fight captures the entire surplus of 1. The expected value of fighting to group 1 is \( p*1 - c_1 = p - c_1 \); while 2's expected value from fighting is \((1-p) - c_2\).

To prevent violence, natural states distribute rents and privileges according to the *proportionality principle*, the idea that benefits from cooperation among those with violence potential must be distributed in proportion to power. To maintain peace and cooperation among the powerful, the following inequalities – the “no fight conditions” – must hold: \( R_1 \geq p - c_1 \) and \( R_2 \geq 1 - p - c_2 \), where \( R_i \) is the value of the rents and privileges going to group \( i \). These inequalities simply state that a bargain to support peace between groups 1 and 2 requires that the rents and privileges to each group be higher than the expected value of fighting.\(^5\) If either of these inequalities fails, then one of the bargaining parties is better off resorting to violence, so peace is not an equilibrium. The inequalities also imply that more powerful groups – those with larger expected values of fighting – must receive more privileges and rents to cooperate than do less powerful groups.

\(^5\)Because war wastes value – i.e., \( c_1 + c_2 \) – allocations of rents exist that make both players better off if they cooperate rather than fight.
CNW introduce a dynamic element to the bargaining framework, the idea that the world is constantly changing. All states experience episodic shocks, such as changes in relative prices, uneven economic growth, and innovation in military technology. In natural states, these shocks often alter the relative power of groups with violence potential.

Sufficiently large shocks in a natural state’s environment alter the distribution of relative power so that the proportionality principle no longer holds. In the face of such shocks, the old bargaining agreement breaks down so that the parties must bargain to reallocate benefits or risk violence. Absent any change in the allocation of benefits, at least one group now prefers to fight. If the effects of the shock on power are common knowledge, then it is possible for the two parties to reach a new bargaining agreement to prevent violence by transferring some rents and privileges from player 2 to player 1, so that the no-fight inequality holds again.

Peaceful adjustment is not inevitable, however. A problem arises when the common knowledge assumption about the effects of the shock fails. In this case, three major problems make renegotiation difficult, low economic costs of violence, commitment problems, and asymmetric information. For example, given uncertainty about the implications of a shock, asymmetric information hinders renegotiation: one party might believe itself far more powerful after a shock than the other party so that the minimum bargain the first is willing to accept is higher than the maximum the other is willing to grant. As is well-known, these problems impede the success of bargaining so that the parties often fail to arrive at a peaceful a solution (Fearon 1995 and Powell 1999).
Implications of the Framework for Political-Economic Development

What prevents most natural states from developing? The NWW framework, as refined by CNW, suggests that the problem of development involves two equilibria with very different characteristics. In the first equilibrium, a violence trap prevents natural states from developing; the need to solve the problem of distributed violence leads natural states to rent-creation policies that hinder markets and prevent development.

An important route to non-violence and development is greater economic integration, which raises the costs of intra-state violence. But in the face of distributive violence potential, investments in greater economic integration do not occur. Violence makes them too risky. Herein lies the violence trap. Economic integration raises the costs of violence; but people will not make these investments in integration because the threat of violence makes the investments too risky. These states are therefore caught in a low growth, non-development equilibrium.

In the second equilibrium, the costs of violence are sufficiently high so that violence is not a credible threat. Due to high economic investments and economic integration, even powerful groups face a negative expected value of fighting.

The great difficulty for development is moving from the violence trap equilibrium to the development equilibrium. How is this achieved? The absence of deep theories of development involving violence means we have too little theory to help us answer this question.

NWW trace many of the steps necessary for this development, suggesting the critical importance of the doorstep conditions; namely, establishing rule of law for the elite; perpetual lives for organizations and the state; and neutral control of the violence potential by the state. To this insight, CNW adds that the natural state equilibrium means that incremental steps toward the
doorstep conditions do not work. Because the natural state is an equilibrium, incremental changes do not lead to development.

A central feature of the doorstep conditions involves the concept of perpetuity. A perpetual organization is one that lives beyond the individuals who create it. A traditional business partnership, for example, is not perpetual because it ceases upon the death of one of the partners. In contrast, a corporation is perpetual because its life is independent of the lives of its shareholders. Perpetual organizations have substantial advantages over ones with limited life: for example, they can more easily raise capital, pool risks, and sustain a wider range of long-term contracts.

The concept of perpetuity applies not only to all organizations but to states. In particular, some states are perpetual, although most are not. Perpetuity in a state means that the institutions of the state are self-enforcing in the sense that no actor with the power to disrupt the state has an incentive to do so. In a perpetual state, citizen rights and political and economic institutions are independent of the identity of those in power. In these states, new leaders have no incentive to alter the political rules of the game. Perpetuity also requires that turnover in political leadership is peaceful.

In contrast, natural states that rely on rent-creation to produce cooperation regularly experience violent leadership turnover frequently leads to sudden and major reallocations in political institutions, organizations, rights, privileges, and policies. As we have seen, states are subject to regular, if episodic, environmental shocks. Sufficiently large shocks require redistributions of rents and privileges, forcing the existing regime to redefine privileges and revise institutions regardless of what the constitution might say. Perpetuity in this environment restricts the regime’s ability to adjust to shocks, making violence more likely. The absence of a
perpetual state, in turn, means an absence of perpetual organizations. Significant political risk therefore attends long-term planning and investments in natural states.

More broadly, the rule of law requires perpetuity so that economic agents, for example, can depend that the rules today will also be in force tomorrow. A state lacking perpetuity cannot provide the legal and political infrastructure of a market economy: secure property rights, the enforcement of contracts, and justice. The main implication is that natural states are not characterized by the rule of law (see Weingast 2010).

3. Smith's Theory of the Political Economics of Development

In Book III of the Wealth of Nations, and parallel sections of his Lectures on Jurisprudence, Adam Smith provides a theory of the political economics of development of Western Europe. In reporting on Smith's understanding of development in Western Europe, I take the history as Smith conceived it to study how Smith devises a theoretical explanation for the events of this era as he understood them.

Adam Smith understood violence to be a first order problem for development; development, therefore, had to involve limiting violence. Smith studies several types of violence, including predation by the government, plunder by neighbors, and invasions by distant foes. These and other sources of violence reduce the incentives for industry, saving, investment, and specialization. To develop, a society must therefore mitigate these sources of violence.

Smith shows why the violence of the feudal era created a stable political-economic equilibrium of very low growth. Because of the risk of violence and plunder, men rationally

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6 I draw on the work of a range of scholars who study Book III, for example, Skinner (1975), Winch (1978:ch 4), Aspromourgos (2009,ch 5), and Kennedy (2010,chs 5,8,&9).
avoided hard work, initiative, and investment. “[T]he occupiers of land in the country were exposed to every sort of violence. But men in this defenceless state naturally contented themselves with their necessary subsistence; because to acquire more might only tempt the injustice of their oppressors.” [WN III.iii.12:405].

Smith’s argument reveals that the escape from the violence trap was non-incremental. King and town made an alliance against their common enemies, the local lords. This political exchange encompassed an explicit revision of the constitution governing the towns, redefining rights and political authority. The alliance made both the king and the towns more powerful – the king through revenue and military service from the town; and the towns, a non-incremental increase in control over their own destiny.

Smith suggests three necessary conditions for the growth of towns following the political exchange with the King. The first required that the town to provide for its security. Given the plunder of the great landholders, the towns’ survival required that they gain a local comparative advantage in violence relative to the local lords. Without this advantage, the towns could not have been sufficiently secure to grow. Commerce was also necessary, for it provided the gains from specialization and exchange and hence the engine of town growth. With growth came the means for financing the towns’ public goods, such as order, security, and justice, including strong property rights. Liberty – in the form of strong property rights, a system of justice, and the absence of predation – was also necessary; liberty provided economic actors with the incentives to save, invest, and take initiative.

The new arrangements did not simply reconfigure existing actors. They also represented changes in the nature of organizations and of the tools available to organizations. Towns created working governments, including court system, guilds, governing bodies, military organizations,
and various business organizations. All of these changes rested on the three necessary conditions of security, commerce, and liberty/justice.

4. The Feudal Equilibrium, or the “Lowest State Of Poverty and Barbarism”

In this section, I develop Smith’s argument that violence is a principal impediment to both economic growth and the escape from poverty. I begin with Smith's observations about the consequences of the fall of Rome. For several centuries prior to the invasions that would destroy it, the Roman Empire sustained sufficient security to foster substantial division of labor, specialization and exchange, and hence opulence. The various invasions destroyed this peaceful stability, with disastrous economic effects.

Having displaced the Romans, the invaders settled down. In the post-Roman world, property represented more than an economic asset. As the principal means of supporting warriors, property also represented political and military power. Those who held higher quality and larger tracts of land commanded larger armies.

Reflecting the natural state logic described in section 2, no one could keep the peace. The king was insufficiently powerful to enforce their authority, law, and order throughout his domain. The result was violence and disorder. The great lords “were always at war with each other and often with the king, their whole power depended on the service of their retainers and tenants.” [L](A) iv.126-27:249]

This setting had implications for local political organization. In these violent times, the king was insufficiently strong to impose his rule across the land. Of necessity, the great landlords
ruled their territory, serving as executive, legislature and judge. The great landlords also led their tenants in war.

Smith characterized the feudal world as violent and predatory, with little overall growth. Most people lived at subsistence, with minimal degrees of trade or the division of labor. Centered on the manor, the local agrarian economy was largely self-sufficient and based on custom with little monetary exchange. The local lord captured most of the local surplus, converting it into security through local military organization (North and Thomas 1973,** ) and by dividing the surplus among retainers in exchange for various service obligations, especially military obligations.

Investment, in Smith's view, was generally fruitless because of violence and predation. Indeed, to invest, improve, and better one’s condition was to become a target of plunder. Violence and plunder meant that people focused on subsistence “because to acquire more might only tempt the injustice of their oppressors.” [WN III.iii.12:405].

The Feudal Equilibrium as a Violence Trap

The bargaining model introduced in section 2 applies to the feudal setting. Regular shocks, changing circumstances, asymmetric information, and the absence of credible commitments all plagued the possibility of agreements to maintain peace. In modern terms, the feudal society represented an equilibrium in the sense that, though the fortunes of individual lords changed over time, the basic structure of the political and economic arrangements remained stable.

Military competition drove the political and organizational structure. Because of the constant threat to security, lords who failed to capture most of the surplus and use it to maintain
their violence potential became vulnerable. The absence of a state that could provide order and security (WN III.iv.9:418) meant great risks to specialization and exchange as transporting items risked being stolen in the attempt.

As described by Smith, the feudal equilibrium reflects the logic of the natural state. Organizations existed largely to the extent they strengthened the violence capacity of the local lords. The feudal hierarchy illustrates this, involving organization of the projection of military force, the system of vassalage, the nature of rights in land and the form of labor organization, which Smith considers a form of slavery. All these organizational elements reflected the feudal logic of violence.

The model in section 2 suggests that the rents and privileges were distributed according to the proportionality principle and adjusted as shocks and changing circumstances required. When bargaining failed to make adjustments according to the proportionality principle, violence occurred. Agreements between lords and the king, among lords, or between lords and their retainers were constantly broken or adjusted unilaterally. A lord or king who sought incremental reform to increase rule of law, credible commitments to rules, or limits on their own use of violence made themselves worse off in this environment of violence and the frequent need, in the face of changing circumstances, to adjust the distribution of privileges and rents.

In NWW’s term, regular violence meant the absence of perpetuity and impersonality. Perpetual institutions stand in the way of natural state adjustments to changing circumstances, and impersonality implied violations to the proportionality principle. Given the natural state bargaining setting, the need to adjust rules and privileges to changing circumstances so as to maintain the proportionality principle, the failure of perpetuity and impersonality meant the
absence of the rule of law in natural states (Weingast 2010). Needless to say, this world was poor, violent, and undeveloped.

**Economic Effects of the Feudal Equilibrium**

Violence and predation had clear economic effects. The violence prevented extensive overland trade, precluding the basis for the division of labor and of hence of opulence. Trade and communication were limited. Speaking of the great lords, Smith says: “Their lawless and freebooting manner of life [of the great lords] also destroyed all … commerce and industry.”


**Property Rights in Land**

Because land represented power in the feudal society, the form of property rights in the feudal system was central to its survival. The form of rights reflected the needs of security over efficiency. In Smith’s argument, the rights in land were endogenous to the feudal environment.

Modern, developed open access orders have a complex system of legal infrastructure that facilitates exchange and efficient allocation of land based on a strong system of property rights, land titling, and contract enforcement. These characteristics facilitate the exchange of land from lower to higher valued users.

The problem of feudal violence forced significant deviations of property rights from modern ones. Lords regularly fought one another, and the winners often forced the losers into non-voluntary transfer of land. The absence of a government and a judicial system implied an absence of titling and contracts.
As Smith explains, the logic of feudal property rights involved violence: “when land was considered as the means, not of subsistence merely, but of power and protection, it was thought better that it should descend undivided to one… The security of a landed estate, therefore, the protection which its owner could afford to those who dwelt on it, depended upon its greatness. To divide it was to ruin it, and to expose every part of it to be oppressed and swallowed up by the incursions of its neighbours.” [WN III.i.3:382-83] Individuals did not own the lands in the modern sense of clear title with an absence of the ability of the government or other individuals to force the property holder to give up the land.

A wide range of restrictions affected the right of property-holders to devise property by will, particularly *primogeniture*, which prevented division of the land among several sons; and *entails*, which prevented a landowner from dividing his property and alienating some of the pieces. The feudal system of land rights dramatically restricted the transfer of land from low valued users to higher valued users; and, also, of markets to engineer movement toward more efficient production.

Adam Smith argued that the emergence, role, and stability of primogeniture, entails, and wardship all improved the lord’s ability to project force and maintain local security. For example, primogeniture prevented lords from dividing their property among many heirs, requiring instead that all of a lord’s property go to his first born son. In the violent feudal society, primogeniture enhanced security. One larger parcel had clear advantages, in Smith’s account, small properties were insecure. They “could not defend [themselves] and must be entirely dependent on the assistance of some of the neighbouring great men… [A]s the only security in the other case was from the strength of the possessor, small property could be in no security. [LJ i.130-31,55] Smith then draws the main implication: “If therefore an estate which when united
could easily defend itself against all its neighbours should be divided in the same manner as moveables were, that is, equally betwixt all the brothers, it would be in no state of equality with those to whom it was before far superior.” [LJ i.131,55]

To summarize: the feudal world was violent, stable, and poor. In terms of section 2, this world was an equilibrium characterized as a violence trap. Endemic violence put a premium on security; while the means for providing security limited the possibilities for economic growth.

5. From Feudalism to the Commercial Economy

The transformation of Western Europe out of feudalism began with the chartering of towns, creating a significant, non-marginal constitutional and organizational change affecting a small but important subset of the feudal society. These changes had unintended consequences, helping the towns and the territory surrounding them to escape the violence trap. Small time traders during the feudal era typically suffered in “servile, or very nearly servile” relations to local lords (WN III.iii.2:397-98). Traders operated under remarkably unfavorable conditions of violence and predation. Potentially significant gains existed from specialization and exchange in long-distance trade. But the threat of violence and plunder prevented these gains from being realized. The “wealth which [the traders] did manage to accumulate under such unfavorable conditions was subject to the arbitrary exactions of both the king and those lords on whose territories they might happen to be based on through which they might pass” (Skinner 1975:162, citing WN III.iii.2:397-98).

To take advantage of profitable opportunities in long-distance trade, the towns and traders needed various forms of market infrastructure. These included investments in physical capital (port facilities, ships), a range of new organizations (judicial, firms, markets, military),
and non-marginal increases in security from local violence and predation. Increased security allowed the towns to govern themselves, affording protection from plunder. Security also allowed the emergence of islands of perpetuity, impersonality, and order for elites. The more secure political environment fostered investment, specialization and exchange, and economic expansion. Rothschild and Sen capture this logic: “The progress of opulence can be seen as a virtuous circle, in which legal and political improvement leads to economic improvement, and economic improvement, in turn leads to further improvement in political and legal institutions” (Rothschild and Sen 2006:336)

I explore Smith’s logic of the towns’ escape from the violence trap in four stages; I evaluate Smith’s logic in the following section.

**Political Exchange between King and Town**

Smith’s explanation for the escape from feudalism involves three relatively independent groups: the king, the lords, and the towns. Under feudalism, as we have seen, the king and lords were constantly fighting. The constant threat of predation from the lords hindered the town’s ability to capture the gains from long-distance trade.

The political exchange between town and king created a coalition against a common set of enemies. Importantly, this political exchange allowed the towns to initiate the transformation out of the old feudal equilibrium and to capture the benefits of specialization, exchange, and long-distance trade.

The feudal environment afforded the possibility for generating substantial gains for the town through commercial trade, greater division of labor, and exchange. These opportunities provided the King and the towns with strong incentives to engineer a political exchange: The
king granted the town political freedom, self-governance, and independence in exchange for financial and military support against the barons (WN III.iii.3:399). This freedom allowed the town to provide its own rules, property rights, governance, justice, and the rule of law. All of these activities required organizations and, the town itself can be thought of as an organization of the organizations, as I discuss in the next section. The right to build walls and military organizations allow towns to protect themselves against the local lords, but also the king.

In exchange, the towns lent the king military support and paid the king taxes, which were to be fixed for all time, lowering the king’s ability to expropriate the gains of investment through ex post rises in taxes. According to Smith, the tax agreement became perpetual and impersonal. [WN III.iii.4:400]

**Towns Escape the Violence Trap**

The advantage of the political exchange to members of the town is obvious: they obtained greater security, protection for their investments, and growth of their economy. The king gained a security alliance with the towns and larger resources up-front with which to deal with the local lords.

These agreements led to the first real emergence of liberty in late medieval Europe. “Order and good government, and along with them the liberty and security of individuals, were, in this manner, established in cities at a time when the occupiers of land in the country were exposed to every sort of violence.” [WN III.iii.12:405] Smith explains insights now central to modern political economics of development. When men capture the fruits of their efforts, they exert themselves to “better their condition” and to “acquire not only the necessaries, but the conveniencies and elegancies of life.” In contrast, in the feudal environment, people had little
incentive to work hard. Those living near towns who managed to accumulate a small amount sought protection of the towns as sanctuaries. [WN III.iii.12:405]

**The Towns Incrementally Extend their Reach into the Countryside**

As the towns grew, Smith explains, they had incentives to expand their reach into the surrounding countryside, bringing military security, the security of property rights, and markets. Smith argued that the towns’ military advantage over the local lords fostered the towns’ reach: “The militia of the cities seems, in those times, not to have been inferior to that of the country, and as they could be more readily assembled upon any sudden occasion, they frequently had the advantage in their disputes with the neighbouring lords.” [WN III.iii.10:403ea] The towns more easily coordinated men, weapons, and supplies; and they could assemble their forces more rapidly than the local lords. And over time, the towns became far richer than the local lords. All this granted the towns a military advantage, allowing them to extend their reach into the local countryside, provide a growing area secure from the predation of local lords.

The extension of local security from external violence and predation transformed the agricultural areas surrounding the towns. In combination with the town’s system property rights, security fostered growing specialization and exchange whereby the agricultural products went to the town (for consumption and for long distance trade), and the products of the town moved to the countryside. Allen (2009:106) explains the reciprocal and positive-feedback relationship; the growth of cities fostered the growth of local agriculture production; and, at the same time, a more productive agriculture led to greater urbanization. This cycle reflects a virtuous circle, a positive feedback loop, the opposite of a violence trap.
The non-incremental changes in local security, Smith argues, had further unintended consequences in the countryside surrounding the towns: “commerce and manufactures gradually introduced order and good government, and with them, the liberty and security of individuals, among the inhabitants of the country, who had before lived almost in a continual state of war with their neighbours, and of servile dependency upon their superiors. This, though it has been the least observed, is by far the most important of all their effects.” [WN III.iv.4:412]

As the towns expanded their security and legal umbrella, a “regular government was established in the country as well as in the city, nobody having sufficient power to disturb its operations in the one, any more than in the other” (WN III.iv.14:421). The umbrella fostered a revolution in the organization of the country-side surrounding the towns.

6. Political Exchange and the Constitution

The constitutional level involves the forces that foster the movement from the feudal equilibrium to that of the towns on the doorstep. I interpret Smith’s account of the feudal equilibrium and initiation of the transformation to the commercial economy; in NWW terms, the feudal equilibrium was a natural state, not very differentiated, and hence quite poor. Many localities experiencing considerable violence were fragile natural states, while the more stable ones were basic natural states. In comparison with a mature natural state, the feudal state had relatively few organizations, with military organizations being among the most well-developed.

Executive moral hazard was a major problem during feudalism, and at many levels; for example, the local lord was at once the local executive, law-maker, and judge with all the usual
problems of governance that such an arrangement implies.\textsuperscript{7} Predation was an omnipresent problem. Fighting and violence characterized this world. In Adam Smith’s view, the feudal world provided minimal incentives for investment, specialization, and exchange. Most people lived at subsistence. As explained in section, this pattern is consistent with our bargaining approach.

Liberty, commerce, and security brought the towns from fragile and basic natural states to a state on the doorstep. They engineered perpetuity, both of the state and of organizations. The result was rule of law, the growth of the commercial economy, and control of the military.

**The Emergence of Towns**

The towns engineered political development, creating new governance structures that differed radically from those of the feudal system. I define political development as the institutions that provide the market infrastructure necessary for the economic development of markets. Perpetuity, impersonality, and inclusion in governance all appeared to varying degrees; and all necessary for the protecting property rights, enforcing contracts, and providing justice. As we have seen, the growth of towns involved all these features. Economic and political development proceeded in tandem, fostering investments, specialization and exchange, and the growing reach of markets and the price mechanism (WN III.iv).

The towns’ economic and political development arose simultaneously as part of a single process; neither antedated nor caused the other. Smith appreciated the “reciprocal relationship between commerce and liberty,” and much of the *Wealth of Nations* examines how economic

\textsuperscript{7} Besley (2007) provides a thorough investigation of executive moral hazard.
liberty fostered “the growth and diffusion of commercial prosperity” (Winch 1978,70), especially Books I, II, and IV.

The political exchange between king and town granted the towns the ability to make non-incremental changes that, in turn, allowed the towns to enter the positive feedback loop leading to a new and better equilibrium than feudalism. The political exchange altered the condition of the towns sufficiently that they became more powerful than the local lords. A central feature of the town’s economy was economic integration. The specialists in long-distance trade depended on the town’s military organization for security and the town economy for many raw materials and food. Local specialists in food and raw products depended on both the towns’ demand for their products and the towns’ security system. Put in Smith’s terms, economic integration at once expanded the scope of the market, created greater division of labor, and fostered investment, all features of economic growth.8

In terms of the violence trap, economic integration raised the economic costs of intra-town violence, as did competition among merchants from different towns. The high costs of violence encouraged disputing parties to solve their problems non-violently. Moreover, the towns had strong incentives to expand markets. As they extended their reach into the countryside, the towns sought to expand local markets, transforming highly inefficient, self-sufficient agriculture into market economies. The towns typically did not use their military might to become another type local lord who extracted from the local economy. Instead, the towns used their economic and military power to create markets and political freedom (for the elite, at least).

8 Smith clearly understood the nature of economic integration. For example, he explains the surprising level of economic integration in the modern commercial economy through his analysis of all the inputs necessary to produce a woolen coat (WN I.i.11:22-24). See Kennedy (2010,ch 6, especially table 6.1) for an extensive discussion.
In our terms, the opportunities for expanding commerce made possible a new form of political exchange, producing new political institutions governing the towns. These political institutions, in turn, fostered the townsmen’s ability to exploit new economic opportunities provided by trade. Here too political and economic development is inextricably intertwined, reflecting Winch’s “reciprocal relationship.”

The non-incremental change – reflecting simultaneous changes in perpetuity, impersonality, inclusion, and in investment, specialization and exchange, and military organization – allowed the towns to escape the violence trap and enter the positive feedback loop. Once the towns were organized and generated sufficient security, they extended their reach into the countryside, increasing the size of the market and the division of labor. Expanding long distance trade increased the town’s wealth. All these changes led the town to extend yet again the reach of larger security umbrella, with greater expansion of its reach into the countryside, further deepening the division of labor, and so on through the positive feedback loop.

7. Conclusions

Adam Smith’s Wealth of Nations is well-known for its understanding of economic development, including the division of labor and the importance of savings and capital accumulation.

In this paper, I add an additional aspect to Smith’s explanation for why so many countries fail to become opulent – Smith's approach to political development. In Book III of the Wealth of Nations, Smith discusses the necessary political foundations of markets. Smith explains that, absent these foundations, countries cannot grow. He presents this argument, not in the abstract as he does with, say, the division of labor; but in an historical narrative. Smith embeds in the
narrative a theory that drives the logic of the development of a commercial society out of the natural state of feudalism.

Feudalism was an equilibrium based on the violence trap. The prevalence of violence meant that property rights were insecure, as, therefore, were savings, investment, innovation, and economic integration. In this world, most people lived at subsistence. No one, neither king nor great lord, was capable of providing peace, order, and the basis of prosperity.

The towns arose through political exchange between king and town that granted them the right to a corporate form of self-governance. This exchange allowed the towns to create a non-incremental change and escape the violence trap through a three-fold revolution that simultaneously created liberty (including justice and the security of property rights), commerce and hence economic growth, and security from menacing outsiders. The towns grew through long-distance trade, specialization and exchange, capital accumulation, and expansion into the local countryside where they helped transform the local economy from poor, self-sufficient agriculture into specialists in food and inputs into manufacturing shipped to the town and often entering long-distance trade.

The central elements of Smith's argument of the escape from the violence trap as follows. The incorporation of towns in the context of political exchange with the king allowed them to enter the positive feedback loop of economic growth. The political exchange granted the town the ability to enhance state-capacity through non-incremental changes in security and investment in economic activities. They subdued the local lords, expanding both long-distance trade and trade with the local countryside. As the towns extended their security umbrella, the local countryside experienced a non-incremental increase in the security of property rights, with incentives for investment, hard work, and exchange. The towns also transformed what Smith
called “unproductive labor” (for example, labor facing predation which had no incentive to work hard or invest) into productive labor. At the same time, the local lords coming under the town’s jurisdiction no longer needed their expensive retainers for defense. As they de-militarized, the lords became consumers, expanding the demand for the traders’ service.9

Smith’s analysis involves the political exchange and constitutional changes necessary to make the escape work; and an analysis showing why the new arrangements were an equilibrium, so that the towns were not a temporary aberration that would fall back into the old, feudal equilibrium. Instead, the towns proved to be durable institutions that lasted centuries.

Adam Smith’s approach to the transformation of feudalism into the commercial society fits well with aspects of the emerging literature on the political economics of development; and it adds ideas relatively lacking. Economic development and political development are not separate tasks in Smith's view, but inextricably intertwined as a single process, an idea echoed in the modern literature (e.g., Bates 2001, Besley and Persson 2011, Acemoglu and Robinson 2006, 2012, NWW 2009, Persson and Tabellini 2003, Tilly 1993). Attempts to reform markets without political reform generally fail. Smith's view of the rise of towns and the commercial society out of feudalism demonstrates that the escape from the poverty and violence of the feudal society required simultaneous changes in economics, politics, and security. When the three elements coexist, growing opulence is the result. Similarly, when any of the three elements is missing, growing opulence fails.

Finally, the central importance of violence in Smith's approach is relatively lacking in the literature (but see CNW and NWW). Reflecting the tradeoff between security and efficiency,

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9 Towns also represented an explosion of new organizations – the corporate form, as mentioned, the overall government, specific units within the government, such as the executive, the judiciary, and a town council (Weingast 2015). Merchants organized their guilds and their firms; and the town’s military organization provided defense. The Church also had its organizational reach into the town.
societies facing existential threats take actions to defend themselves, and these actions – as Smith argues – force substantial deviations from political institutions and policies that generate opulence or long-term economic growth. Smith illustrated this point with his discussion of feudal property rights, such as primogeniture, designed to increase security at the expense of efficiency. Most of feudal Europe failed to develop due to violence and oppression.

**Abbreviations**

**The works of Adam Smith.**

All references are to the Glasgow edition, as reprinted by the LibertyFund.


\[LJ(A)\] The first set of lecture notes, corresponding to the 1762-63 term;

\[LJ(B)\] The second set of lecture notes, dated 1767 though thought to correspond to the 1763-64 term.


**Other Abbreviations**


**References**


