Adam Smith’s Industrial Organization of Religion: Explaining the Medieval Church’s Monopoly
And its Breakdown in the Reformation

Barry R. Weingast¹
Stanford University

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In … the greater part of Europe during the tenth, eleventh, twelfth, and thirteenth centuries, … the constitution of the church of Rome may be considered as the most formidable combination that ever was formed against the authority and security of civil government, as well as against the liberty, reason, and happiness of mankind, which can flourish only where civil government is able to protect them. In that constitution the grossest delusions of superstition were supported in such a manner by the private interests of so great a number of people as put them out of all danger from any assault of human reason… Had this constitution been attacked by no other enemies but the feeble efforts of human reason, it must have endured forever. Adam Smith, Wealth of Nations (V.i.g.24:803-04).

It may be laid down as a certain maxim, that, all other things being supposed equal, the richer the church, the poorer must necessarily be, either the sovereign on the one hand, or the people on the other; and, in all cases, the less able must the state be to defend itself. Adam Smith, Wealth of Nations (V.i.g.41:812).

Abstract

Adam Smith argued that, as the monopoly provider of religious services, the medieval Church represented a formidable impediment to economic development. How did the Church maintain its monopoly; and how did that monopoly break down in the Reformation? Further, given that the secular lords had a substantial comparative advantage in violence relative to the Church, how did the Church maintain its power?

In addressing these questions, Smith developed a rich and systematic approach to the incentives, institutions, and competition surrounding the medieval Church. In answer to his question about the relationship between the secular and ecclesiastic lords, Smith discusses a third group, the masses. According to Smith, the secular lords could not pacify the masses on their own, although the Church could. The ability to influence the masses granted the Church a credible threat over

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¹ Senior Fellow, Hoover Institution, and Ward C. Krebs Family Professor, Department of Political Science, Stanford University. The author gratefully acknowledges Gary Cox, Robert Ekelund, Charles Griswold, Robert Hébert, Lisa Herzog, Glory Liu, Jerry Muller, Josiah Ober, Jennifer Sage, Kenneth Shepsle, and Robert Tollison for helpful comments.
the secular lords: were the latter to attempt to appropriate the Church’s revenue, assets and control, the Church and the masses would turn against them. The secular and ecclesiastic elites therefore had incentives to cooperate to exploit the masses. To maintain this equilibrium, the Church had to prevent economic growth. Growth would have granted the masses wealth, power, and independence, undermining the Church’s ability to mobilize the masses in times of threat from the secular lords.

As to the Reformation, Smith argues that the masses gradually became less dependent on the Church. Independence meant that the masses were less responsive to the Church’s influence. This change, in turn, removed the Church’s credible threat over the secular lords, allowing them to force considerable concessions from the Church or to remove the Church altogether in favor of newly established sects.

1. Introduction

In his discussion of institutionalized religion in the *Wealth of Nations* (*WN*), Adam Smith developed a systematic theoretical approach to understanding the incentives, institutions, violence, aspects of morality and theology, and competition surrounding organized religion in the Middle Ages. Curiously titling his discussion, “Of the Expence of the institutions for the Instruction of People of All Ages” (*WN* V.i.g, pp 788-814), Smith characterized the Roman Catholic Church as a force impeding Europe’s economic and political development. An enduring institution, the Church was, in Smith words of the above head-note, “the most formidable combination that ever was formed against the authority and security of civil government, as well as against the liberty, reason, and happiness of mankind” (*WN* V.i.g.24: 803-804). In many ways, the Church’s survival seems—as it probably did to Smith—“miraculous” (Minowitz 1993:176). How did the Church maintain its power as both the monopoly provider of religious services but also as one of the principal impediments to European political and economic development?
Smith does not ask this question explicitly, although his approach to institutionalized religion directly relates to his theory of European development, a topic of great conversation among Smith scholars. Despite plentiful literature on the incentives of the clergy (Anderson 1988; Griswold 1999, Lindgren 1973, Minowitz 1993, West 1990, ch10) and the organization of the medieval Roman Catholic Church (Anderson 1988; Minowitz 1993, Ekelund, Hébert and Tollison 2006, and Iannoccone 1991), Smith scholars have largely overlooked two aspects of his views on the medieval Church: how it fits in the larger secular medieval environment including kings and lords; and the role of religious institutions in Smith’s theory of development (but see Anderson 1988:1074 and Kennedy 2005:41).  

Scholars provide no clear answer to the questions about Smith’s views about how the medieval Church managed to accomplish many goals simultaneously; namely, sustain its remarkable long-term monopoly over the provision of religious services and protect itself and its prerogatives against the violence of the secular lords. Further, why was the Church so hostile to commerce? These questions seem particularly pressing questions given Smith’s preoccupation with the simultaneity of political and economic freedom in order to spur economic growth, as evidenced in Book III of the *Wealth of Nations*. 

This paper demonstrates not only Smith's unique answers to these questions, but the power of his approach that has been overlooked in general Smith scholarship,

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2 While scholars in the literature on the new social science of religion provide excellent models of the Church, they have not studied the questions addresses here, notably the interaction of the secular and ecclesiastic lords (see, e.g., Ekelund et al. 1996). Smith's work on the medieval Church can therefore be viewed as on the frontiers of this literature.

3 Various scholars have explored Smith’s ideas about the relationship between the Church and the masses (Minowitz 1993: 169), the nature of religious services sought by the people, and, in economic terms, the demand for religious services (Anderson 1988, Griswold 1999:281); as well the role that religion plays in morality more generally (Anderson 1988; Griswold 1999; Haakonsen 1981; Lindgren 1973, Muller 1993).
namely, a small number of pioneering scholars have termed the “industrial organization” of the Church (Anderson 1988, Ekelund, Hébert, and Tollison 2006, and Ekelund, Hébert, Tollison, Anderson, and Davidson 1996). In his approach to both feudalism and the medieval Church – and put in modern terms – Smith demonstrates three major results. First, he explains how these institutions created a stable equilibrium lasting for several centuries; second, why the Church opposed commerce and suppressed liberty and markets; and third, Smith explains how these institutions fell apart during the Reformation as the forces supporting that equilibrium diminished or disappeared.4

In addressing these questions, Smith explained how an implicit political accommodation emerged between the secular and ecclesiastic lords whereby each respected the other’s powers within their respective domain. He shows how this accommodation hinged on a third group, the masses. The masses were a potential source of disorder; for example, by rebelling against their lords. According to Smith, the secular lords were unable to pacify the masses on their own5; the masses presented a powerful threat to the secular lords, especially when the Church encouraged them to confront the lords. The Church gained leverage over the masses because it subsidized them; notably, providing food in years of poor harvests while offering comfort in the face of death in this life and the promise of salvation in the next (Griswold 1999:284-85; Minowitz 1993:169ff; Rasmussen 2017:**) The Church’s credible threat to withhold these goods and services afforded it power over the masses.

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4 In two companion papers, I develop Smith’s theory of the persistence of feudalism and of slavery, despite their inefficiencies; these papers complement the approach of this paper (see Weingast 2017a,b).

5 “In those great landed estates, the clergy, or their bailiffs, could easily keep the peace without the support or assistance either of the king or of any other person; and neither the king nor any other person could keep the peace there without the support and assistance of the clergy” (WN V.i.g.22:801).
Generally during this period, the secular and ecclesiastic lords cooperated to exploit the masses. But if a secular lord thought to challenge the Church, the Church encouraged the masses to resist and rebel. Hence, both sets of elites had incentives to cooperate with each another so as to keep the masses in a state of dependence, allowing the Church and the lords to exploit them.

Drawing on ideas from the new social science of religion (e.g., Anderson 1988, Barro and McCleary 2003, Ekelund, et. al., 1996, Iannaccone 1990, 1991, Stark and Bainbridge 1989), I show how Smith explains the Church’s dominance and the subsequent European social, political, and economic order in a coherent narrative of rational cooperation and organization in a context characterized by violence and low growth.

Smith’s theory of institutionalized religion forms part of his larger, tri-partite project of an integrated and comprehensive approach to developing a “science of man” encompassing politics, economics, and moral development (see, e.g., Fitzgibbons 1994:11-22; Griswold 1999:**; Phillipson 2010:2-3; Rasmussen 2017:**). Smith’s theoretical approach focuses on two sets of forces that kept this low-growth arrangement in place for several centuries, the constant violence of the feudal equilibrium (discussed in WN Book III and in LJ(A) i.116-46:49-2;iv.124-41:248-55; LJ(B) 49-63:415-22) and the Church’s monopoly position as provider of religious services (discussed in WN V.i.g).

The Church suppressed liberty and economic growth among the masses because, over time, growth would have afforded the people power and independence, undermining the Church’s authority over them; or, in Minowitz’s (1993:169) terms,
growth would have loosened the Church’s “grip” over the masses. The weakening of the Church’s authority over the people, in turn, would have weakened the Church’s threat over the secular lords. The Church’s long-term survival therefore required that it maintain its credible threat over the lords by suppressing growth among the masses (Acemoglu and Robinson 2006 demonstrate circumstances under which incumbents choose to solidify their hold on power at the expense of growth). Keeping the people in a state of dependence rather than of liberty, freedom, and economic growth, served the private goals of the ecclesiastic lords. I develop two simple games to demonstrate the logic of Smith’s claims. I also discuss Smith’s views on the breakdown of the Church’s grip on the masses and the rise of strong competitors in what we now call the Protestant Reformation.

This paper proceeds as follows. Section 2 describes Smith’s views on the industrial organization of the medieval Church and its relationship to the secular powers. Section 3 provides a game theoretic account of Smith’s logic of the political accommodation between the secular lords and the Church. Section 4 discusses the changing industrial organization of religion; that is how organized religion adapted to changing circumstances. Section 5 models the changes discussed in section 4 as a comparative static result derived from the game in section 3. My conclusions follow.

2. Smith’s Industrial Organization of Religion

To explain the political and economic position of the medieval Church, Smith uses logic that anticipates the modern industrial organization of religion (as Anderson

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6 This paper examines Smith’s ideas, including his narrative of events. It does not claim that Smith’s account represents an accurate historical account of the events, ideas, and arrangements, especially given the more than two centuries of historical research since his work.
1988 demonstrated nearly three decades ago). Muller’s (1993:154) analysis reflects this assessment: “Smith’s analysis of religion in the *Wealth of Nations* is one of the clearest and perhaps least expected applications of his characteristic approach to the role of institutions in channeling the passions and to the unintended consequences of social action.”

Drawing on this modern approach, especially the collective work of Anderson (1988), Ekelund, Hébert, and Tollison (2006), and Ekelund, Hébert, Tollison, Anderson, and Davidson (1996) – hereinafter, AEHT – this section studies a range of features associated with the medieval Church⁷; namely, the structure of competition and the effects of monopolization; the implications of various religious organizations and institutions; the relationship between ecclesiastical and secular authority; and the major strategic choices made by the organization, such as the activities, services, and products it provides, and the nature of the rents that it extracts.⁸

**Secular Lords and the Church**

The secular and ecclesiastic lords constituted the lion’s share of the medieval elite, especially early on before the rise of the commercial elite. The elite owned most of the land, by far the most important asset in this society. They also depended on the peasants, who were tied to the land, for production.

The two components of the medieval elite differed in important ways. Perhaps the most important difference was the structure of competition and violence. Smith

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⁷ The larger literature on the new social science of religion is rapidly expanding. See, for example, Ekelund, Hébert, and Tollison (2006), Barro and McLeary (2003), Gorski (2003), Iannaccone (1990, 1997), and Stark and Bainbridge (1989).

⁸ Ekelund, Hébert, and Tollison (2006:13) explain that, Smith “took a broad, industrial organization approach to religion, in which market *structure* has an important impact on individual and collective outcomes.”
addresses violence among the secular lords in Book III of the *Wealth of Nations* and in his *Lectures on Jurisprudence* where he asks, why are so few countries developed?\(^9\)

Although Smith lists two causes, he focuses almost exclusively on the second, “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). In his political-economic approach to development, Smith held that violence in the feudal era prevented development (see Weingast 2017a). Smith highlights again and again the negative incentives fostered by violence and “oppression of the civil government.” Kings could not keep the peace and were forced of necessity to “grant the power of jurisdiction to these lords; for as he had no standing army there could be no other way of bringing the subjects to obey rules” (*LJ*(A) iv.119:246).

This political accommodation of decentralized power, itself based on the reality of decentralized sources of violence, had two implications: first, no uniform law could be established and enforced in the entire kingdom; second no one had the ability to enforce political arrangements that would secure peace and cooperation among the lords. This world was violent; the lords “were always at war with each other and often with the king” (*LJ*(A) iv.6,249). Secular lords faced considerable violent competition, both vertical (as when a vassal challenged his lord) and horizontal (as when one baron challenged another). The feudal hierarchy evolved to allow the lords the ability to defend their property and to project force against other lords; but in this setting, local lords faced great difficulties establishing long-term cooperation, and instead fought each other regularly.

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\(^9\) This paragraph draws on Weingast (2017a).
Regular violence had unfortunate but predictable economic effects. "In the
infancy of society, as has been often observed, government must be weak and feeble,
and it is long before [sic] 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).10

Violence consumed and dissipated almost all sources of rents in the secular
world, including rents realized and those foregone that could be realized in the absence
of violence. As Smith argues in WN book III, this violent world was poor (see Skinner
1975 and Weingast 2017a). Violence and predation precluded investment and the
prospect for economic growth. This environment therefore afforded few gains from
specialization and exchange. The main agricultural products could not be carried far
over land. Attempts to save and invest risked confiscation. "[M]en in this defenceless
state naturally content themselves with their necessary subsistence; because to acquire
more might only tempt the injustice of their oppressors" (WN III.i.12:405). The relative
absence of specialization and exchange – the division of labor in Smith's famous phrase
– doomed most people to live at subsistence.

In contrast to the secular lords, the Church elite were far more cooperative (WN
V.i.g.17:797; see also Anderson 1988:1080; Minowitz 1993:170). “There was always

10 Again: “In those unfortunate countries, indeed, where men are continually afraid of the violence of their
superiors, they frequently bury and conceal a great part of their stock, in order to have it always at hand to carry with
them to some place of safety, in case of their being threatened with any of those disasters to which they consider
themselves as at all times exposed” (WN II.i.30-31:284-85). Or yet again: a “person who can acquire no property,
can have no other interest but to eat as much, and to labour as little as possible” (WN III.i.9:387-88ea).
much more union among the clergy than among the lay-lords. The former were under a
regular discipline and subordination to the papal authority. The latter were under no
regular discipline or subordination, but almost always equally jealous of one another,
and of the king” (WN V.i.g.22:801). Intra-Church violence, although not absent, was
far less common than violence among the secular lords.

Two factors help us understand the Church’s behavior: first, the means by which
it pursued its goals of organizational maintenance, securing sufficient power and wealth
to survive in a hostile world; and second, the Church’s monopoly position. With respect
to the first, Smith argues that religion is only one component of motivation; whereas the
clergy was always concerned for its own private interests (Haakonsen 1981:175; see
also Lindgren 1973:ch7). “The [Church’s] great interest is to maintain their authority with
the people; and this authority depends upon the supposed certainty and importance of
the whole doctrine which they inculcate, and upon the supposed necessity of adopting
every part of it with the most implicit faith, in order to avoid eternal misery” (WN
V.i.g.17:797). As Minowitz (1993:169) observes, “Smith could hardly be more emphatic
about religion’s grip on the masses.”

With respect to the issue of monopolization, Smith explains that the Church’s
position arose out of times of violent political and religious conflict. The secular parties
to this conflict allied with religious organizations, and the success of one side left the
favored religious organization in a sufficiently strong position as to “over-awe the chiefs
and leaders of their own party” (WN V.i.g.7:791-92). With respect to the “civil
magistrate,” the first demand of the clergy:

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11 Ekelund, *et al.* (1996) provide the best analysis of the manifold dimensions of this problem.
was generally, that he should silence and subdue all their adversaries; and their second [demand], that he should bestow an independent provision on themselves... In making this demand therefore they consulted their own ease and comfort, without troubling themselves about the effect which it might have in future times upon the influence and authority of their order (WN V.i.g.7:792).

The Church’s monopoly in Europe fostered very different behavior than that of the secular lords. For one, its “multinational monopoly” position allowed the Church to form a hierarchy that was, in comparison with the organization of the secular lords, relatively cooperative and powerful (Minowitz 1993:170; see also Anderson 1988:1080). The Church coordinated the activity of a great many people who pursued common goals. The Church also commanded substantial resources in the form of tithes from parishioners; benefices, indulgences, and bequests from the wealthy; and from its vast landholdings. Although it sometimes engaged in violence with the secular lords, the Church was far less violent, and different segments of the Church much less frequently fought one another. Manifest violence in the form of combat among armies was not the principal means by which the Church defended itself from the secular lords.

The secular lords and the Church at once competed and cooperated. Although the lords held obvious military advantages over the Church, the Church possessed a very different stock of weapons with which to defend itself, including resources used to gain and maintain allies among the common people and doctrinal weapons to impose costs on uncooperative secular leaders. The secular lords and the Church also had mutual goals, such as maintaining order, exploiting the masses, salvation, and preserving their property, wealth, and sources of income. Over time, a stable, political accommodation evolved between the two sources of power, secular and ecclesiastic,
which economists call an implicit bargain or contract (Ekelund, Hébert, and Tollison 2006:15).

A major implication is that, in contrast to the secular lords, the Church accumulated real rents and power. Members of the organization consumed some of these rents; but much of the rents went to the poor in the form of food. The Church systematically exploited its monopoly, being less responsive to the population than otherwise. Interpreting the passages in the head notes, Anderson (1988:1080) opines:

Smith was, in effect, accusing the monopoly church of reducing the quality of religion supplied to consumers, whose welfare was reduced as a result. In the same passage he clearly attributes this quality reduction to the self-interested behavior of the clergy, who extracted monopoly rent from their flock both directly and indirectly by promulgating irrational doctrines that served their own interests. The consumers of religion were badly served by the monopoly purveyor of spiritual guidance, just as in the case of monopolies in the provision of more mundane goods.

Although monopoly religious organizations, such as the medieval Roman Catholic Church, do not literally compete with other organizations, the Church had to worry about the rise of rival organizations. To use language from modern industrial organization, their monopoly was "contestable" by potential entrants (Baumol, Panzar and Willig 1982; see also West 1990,**). To survive, monopolists must have the tools to prevent or eliminate such rivals. In the medieval environment, the Church activity sought to protect its position, for example, by wiping out competing sects, such as the Cathars in Italy and Southern France in the 13th century. “Competing entrants in the supply of religion were defined as "heretics" and systematically persecuted" (Anderson 1988:1079).

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12 Smith the term, “tacit contract in LJ,” for this concept: see, e.g., LJA v.118:317; LJA v.128-29:321; and LJA v.134:323.
To maintain their position, leaders of religion organizations need to tailor the various attributes of their services to their members (Ekelund, Hébert and Tollison 2006; Iannaconne and Bainbridge 2009). Put another way, sect and religious leaders to a certain extent tailor their doctrine, morals, and theology to the needs of their members. Failing to do so means that they are less likely to attract or retain members; and hence they are more vulnerable to entry by potential competitors. Similarly, Church leaders also structured their organization and institutions in ways that suited their environment so that they could deliver their services effectively.

As a final issue, Smith did not view the Church as just another feudal fiefdom, but an independent player whose interests and opportunities differed considerably from those of the king and lords in feudal Europe. Smith makes several arguments about the differences. First, as discussed earlier in this section, the secular lords were only loosely hierarchical in the sense that they challenged and fought one another all the time. This violence meant that cooperation was difficult, and no one could enforce peace across all the land. In contrast, the Church was more hierarchical, coordinating 10s of 1000s of Church officials. In Smith's words, “The clergy of every established church constitute a great incorporation. They can act in concert, and pursue their interest upon one plan and with one spirit, as much as if they were under the direction of one man; and they are frequently too under such direction” (WN V.i.g.17:797).13

Second, the Church had influence and even command over the masses in ways feudal lords did not. The Church sought to be a very different kind of agent than the

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13 Smith restates this point in another way: “There was always much more union among the clergy than among the lay-lords. The former were under a regular discipline and subordination to the papal authority. The latter were under no regular discipline or subordination, but almost always equally jealous of one another, and of the king” (WN V.i.g.22:801).
secular hierarchy by providing religious services and salvation; and charity for the poor (Lindgren 1973:ch7).

Third, although Smith did not put it this way, in his scheme, the Church held the pivotal political position in the feudal political system, able to side either with the lords against the peasants or with the peasants against the lords. Under most circumstances, the Church preferred a coalition with the lords to exploit the peasants. If some lord sought to challenge the Church, however, the Church would react strongly by withholding essential services (such as salvation) and mobilizing the peasants against the lord.

**Political Exchange and Equilibrium between the Church and the Lords**

The medieval setting fostered a mutually beneficial political exchange between the Church and the Lords. I call the exchange political because it involves the distribution of authority and social control between these two entities, including the means of establishing and maintaining political order.¹⁴

On the demand side of the market for religious services, the vast majority of people wanted comfort and salvation in times of sickness and death, charity in times of economic difficulty, a community to belong to, and a morality that supports social order (Griswold 1999:284-85). On the supply side, consider the Church and the poor. The Church helped comfort and feed the poor. The Church provided valuable services for the poor, namely comfort and salvation in the face of death; a community; and a set of moral standards that rose above the emotions of the moment, helping to control the

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¹⁴ Laswell (1966, title) offered a famous mid-twentieth century definition of politics as “who gets what, when, and how.”
passions and focus activity on ensuring that their world was as best as possible given the constraints of the necessities of life. Second, the Church’s revenue was typically “paid in kind, in corn, wine, cattle, poultry, &c.” (WN V.i.g.22:801). As this amounted to far more than the clergy could consume themselves, the Church employed it in “extensive charity. Both the hospitality and the charity of the antient clergy, accordingly, are said to have been very great. They ... maintained almost the whole poor of every kingdom” (WN V.i.g.22:801). In return, the poor attended Church and paid the tithes. They also followed the Church’s rules, including the moral rules. The moral and religious teachings emphasized acceptance of the earthly order in exchange for the rewards in the afterlife.\(^{15}\) Moreover, the Church held an ultimate sanction over the poor. The Church provided eternal salvation, a value that could be withheld (Minowitz 1993:169). The exchange between the Church and masses helped pacify the poor:

In the antient state of Europe, before the establishment of arts and manufactures, the wealth of the clergy gave them the same sort of influence over the common people, which that of the great barons gave them over their respective vassals, tenants, and retainers. In the great landed estates, which the mistaken piety both of princes and private persons had bestowed upon the church, jurisdictions were established of the same kind with those of the great barons; and for the same reason. In those great landed estates, the clergy, or their bailiffs, could easily keep the peace without the support or assistance either of the king or of any other person (WN V.i.g.21:800-01, emphasis added).

Second, consider the exchange between the Church and the secular lords. Each generally respected the other’s authority in its respective domain. The Church’s efforts to pacify the population benefitted the secular lords, providing security and protecting the lords’ property and wealth. The Church also provided salvation for the lords. Salvation and protection, in turn, gave the Church leverage over the lords. In the

\(^{15}\) Smith says, the object of “religious instruction is not so much to render the people good citizens in this world, as to prepare them for another and a better world in a life to come” (WN V.i.g.1,788). See also Kennedy (2005:44) and Minowitz (1993:169).
exchange for the services provided by the clergy, the secular elite respected the Church and its authority in its domain rather than using violence to undermine or remove it. Further, the lords paid tithes and various benefices, supporting the Church organization and its efforts with the poor. This financial support of the Church became a permanent obligation.

Using modern language, Smith's logic constitutes a stable pattern of interaction; that is, an equilibrium (as I demonstrate in the next section). Both parties had incentives to honor and maintain this exchange. The Church had the obvious revenue incentives to serve the Lords' interests, especially in providing salvation and in aiding the secular lords through maintaining order rather serving more exclusively the poor. The lords, in turn, had incentives to participate in this exchange because it helped maintain political order, lowering the probability of an existential threat from violence by the poor. This political exchange thus provided salvation while protecting both the lords' and the Church’s property and sources of power and wealth.

Consider the threat of violence from the poor. Violence was a constant possibility, both among the poor and between the poor and the rich. Smith explains the threat from the poor to the rich:

Wherever there is great property, there is great inequality. For one very rich man, there must be at least five hundred poor… The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease, and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it. The acquisition of valuable and extensive property, therefore, necessarily requires the establishment of civil government (WN V.i.b.2:709-10).
The logic, just stated in general form, applies to the Church’s efforts in pacifying the poor during the Middle Ages. The Church helped sustain this political order, again, pacifying the local population, despite so many living at bare subsistence. Muller (1993,154) makes this point as follows, “For Smith, religion expressed in metaphorical terms the reality that acting justly and beneficently is the source of greatest reward and happiness while acting ignobly brings its own punishment... The core truth of religion is that by acting justly and beneficently we fulfill the purposes of our creation. And so, Smith concludes, ‘religion [helps enforce] the natural sense of duty’” (Muller 1993;154, quoting TMS III.5.12:170).\(^{16}\)

A final aspect of the political accommodation between secular and ecclesiastic lords is that the Church held various weapons over the secular lords that could be used were the lords to challenge the Church’s authority in its domain. If the sovereign sought to challenge the Church’s authority, the Church fought back, employing “all the terrors of religion to oblige the people to transfer their alliance to some more orthodox and obedient prince” (WN V.i.g.17:797). Princes who failed to heed this reaction fared poorly: “during the course of several centuries, the turbulence of the Roman clergy was continually occasioning in every part of Europe, sufficiently demonstrate how precarious and insecure must always be the situation of the sovereign who has no proper means of

\(^{16}\) Smith also notes that various passions led to problems, such as “Fraud, falsehood, brutality, and violence.” These passions raised a dilemma, “The industrious knave cultivatesthe soil; the indolent good man leaves it uncultivated. Who ought to reap the harvest? who starve, and who live in plenty?” Maintaining political order, including the incentives for people to produce subsistence, required channeling the passions into productive activity so that people work and reap the rewards of their work and refrain from exercising passions and violence to take from a neighbor after failing to work (TMS III.5.9:167-68).
influencing the clergy of the established and governing religion of his country (*WN* V.i.g.17:798).\(^{17}\)

Because the Church held both the keys to salvation and the allegiance of the people, its ability to provide the former while pacifying the latter proved a two-edged sword. When the secular lords accommodated and respected the Church’s interests, pacification benefitted the lords. But the same power over the people allowed the Church to rally the people against uncooperative or threatening lords. For example, Smith reports that, “when Robert, the second prince of the Capetian race [in France], was most unjustly excommunicated by the court of Rome, his own servants, it is said, threw the victuals which came from his table to the dogs, and refused to taste any thing themselves which had been polluted by the contact of a person in his situation. They were taught to do so, it may very safely be presumed, by the clergy of his own dominions” (*WN* V.i.g.27:805).

Moreover, a serious threat from a particular lord or king might lead the Church authorities to support an alternative, “more orthodox and obedient prince.” Secular lords who challenged the Church’s authority therefore risked losing their support, position, honor, wealth, and soul. Smith concluded that the clergy of an “established church” were dangerous, indeed, potentially “ruinous” for secular authorities who attempted to use violence against them. Secular lords therefore had strong incentives to work with

\(^{17}\) Smith elaborates: “Should the sovereign have the imprudence to appear either to deride or doubt himself of the most trifling part of their doctrine, or from humanity attempt to protect those who did either the one or the other, the punctilious honour of a clergy who have no sort of dependency upon him, is immediately provoked to proscribe him as a profane person, and to employ all the terrors of religion in order to oblige the people to transfer their allegiance to some more orthodox and obedient prince. Should he oppose any of their pretensions or usurpations, the danger is equally great. The princes who have dared in this manner to rebel against the church, over and above this crime of rebellion, have generally been charged too with the additional crime of heresy, notwithstanding their solemn protestations of their faith and humble submission to every tenet which she thought proper to prescribe to them. But the authority of religion is superior to every other authority. The fears which it suggests conquer all other fears” (*WN* V.i.g.17:797-98).
and manage the clergy, and the “means seem to consist altogether in the preferment which he has to bestow upon them” (*WN* V.i.g.19:799).

**Long-Term Economic Consequences**

The coalition of secular and ecclesiastic authorities directly affected the medieval society’s long-term economic growth and development. As Smith makes clear about feudalism, the violence of the secular lords prevented agrarian economic development; indeed, Smith claimed that this violence forced European political-economic development into an “unnatural and retrograde order” (*WN* III.i.9:380; see also Hont 1988). In particular, these arrangements combined with constant violence to suppress many economic activities that might have made many much better off and more independent. Yet these economic activities threatened the elite by fostering the growth of independent sources of authority which might displace existing elite. The secular and religious authorities therefore cooperated to suppress competing ideas, organizations, and economic activities. As Smith concludes in the first head note to this paper, the Church represented a formidable barrier to development.

Smith argued that the clergy’s singular interest was “to maintain their authority with the people” (*WN* V.i.g.17:797; see also Minowitz 1993,**). Pursuing these interests, the Church kept the masses in a position of dependency. Its principal tools, as noted, involved salvation and charity during hard times. Moreover, peasants on the Church’s vast landholdings – the Church was by far the biggest landholder in Western Europe – could be thrown off their land at a moment’s notice and their source of livelihood withdrawn. Because all of these means – salvation, charity, and (for peasants on the
Church land’s) the rights to work the land – could be withheld, the Church created a system of dependency. Dissent risked ruin.\textsuperscript{18}

The Church thus opposed economic growth and development, even within narrow confines. In discussing Smith’s view of the Church as “the most formidable combination against civil government, liberty, reason, and happiness of mankind,” Anderson (1988:1074) reports that “Roman church impeded the development of capitalism by promoting anti-commercial attitudes and barriers to trade.” Similarly, Kennedy (2005:41) observes, “Religious hostility to the green shoots of trade illuminated what was at stake in the contest between the idea that commerce was a source of evil and greedy corruption, and the new ideas favoring wealth creation as a material benefit for ordinary people, who were otherwise condemned to a (short) life of poverty and misery.”\textsuperscript{19}

In the short-term, economic growth might produce more revenue for the Church; but in the long-term, it would foster the rise of new and powerful groups whose interests opposed and potentially threatened those of the Church (I demonstrate this conclusion using simple games below). For example, had the medieval Church wanted, it could have promoted greater liberty for the people through long-term leases. Indeed, it did just this later in the period as a means of gaining more revenue (cites). Leases granting

\footnotesize{\textsuperscript{18}I develop a simple model of Smith’s logic on this point in the context of his arguments on slavery (see Weingast 2015b). More generally, Smith’s logic fits with a range of recent arguments in the political-economics of economic growth, such as Acemoglu and Robinson (2006,2012), Bates (2001), Besley and Persson (2011), and North Wallis and Weingast (2009, ch 2-3).

\textsuperscript{19}Kennedy (2005:40) further observes that Smith, “knew the relevant biblical verses too: ‘Lay not up for yourselves the treasures upon the earth, where moth and rust doth consume, and where thieves break through and steal’; ‘you cannot serve God and Mammon’; ‘And I say unto you, It is easier for a camel to go through a needle’s eye, than for a rich man to enter into the kingdom of God’; ‘For what doth it profit a man, to gain the whole world, and forfeit his soul’; ‘The Bishop therefore must be without reproach ... no lover of money’ (some translations give ‘filthy lucre’ for money); ‘For the love of money is a root of all kinds of evil: which some reaching after have been led astray from faith.’ Such themes brook no compromise. For many, the commercial ethos was incompatible (and for some, it still is) with Christian life, and that was that.”}
peasants greater security would have provided them opportunities to improve their production, position, and to accumulate wealth.

Economic development produces new interests as groups formerly without resources come to obtain them. Resources, in turn, produce power. In particular, greater liberty for the masses would allow them independence from both the secular lords and the Church. The masses would accumulate wealth and power, thus limiting their dependence on the Church for their livelihood or for charity in bad times. Independence, in turn, would remove the ability of the Church to manipulate the peasants, ultimately threatening the existing power structure, the Church in particular. Because these interests would constitute a direct threat to the Church, it sought to prevent them from gaining power.

For these reasons, the Church suppressed liberty, the foundation of markets and wealth – or, in Smith’s terms, of commerce and opulence. This environment was inhospitable to the enforcement of contracts and the development of markets. Law and justice in medieval society protected the interests of the powerful. Independent courts were unknown. As exercised by both secular and ecclesiastic lords, the provision of justice involved moral hazard: in cases involving themselves or those close to them, both sets of lords biased outcomes in their favor.

3. The Political Accommodation between the Secular And Ecclesiastic Lords as an Equilibrium

This section models as a game Smith’s account of the stability of cooperation between the secular and ecclesiastic powers during the Middle Ages. The game relies on Smith’s insights into the strategic interests and opportunities of the various players.
The advantages of making the game explicit are fourfold. First, it allows us to see that the behavior of the major groups in society fit together in a common, interlocking logic. The behavior of each group depends on the behavior of the others, and in a particular manner emphasized by the game. Second, the game goes well beyond a verbal analysis of incentives. Because players have mixed motives – for example, some players have incentives to defect – cooperation as an equilibrium is not assured but must be demonstrated. Third, the game highlights the incentives facing each group to play their role, contingent on the other groups playing theirs. These incentives are essential to understanding the stability or equilibrium interaction among the groups. Demonstrating the existence of an equilibrium explains why this pattern of behavior is stable. Finally, the game emphasizes the logic of how authority could be divided between the secular and ecclesiastic lords in which, on balance, the two sets of authorities accommodated one another without constant conflict.

The game has three players, a local Lord \((L)\) representing the feudal hierarchy of secular lords and their retainers; the Church \((C)\) representing the various elements of the Church hierarchy; and the peasantry or masses \((M)\), largely tied to the land as serfs and most living at subsistence.

To model the interaction among the players, I make some assumptions, each based on Smith's text. \(L\) cannot pacify or suppress \(M\) alone; \(L\) needs \(C\)'s help to contain \(M\). The elite players, \(C\) and \(L\), would like to vanquish each other. Yet, they value cooperation to exploit \(M\) over fighting over the allocation of various powers. Both have incentives to defect from cooperation.
Consider the sequence of moves or action in the game. \( L \) has the first choice and must decide whether to respect \( C \)'s rights and privileges, including subsidizing \( C \) by an amount \( s (s \geq 0) \); or \( L \) may attempt to capture some of \( C \)'s rights and privileges (see figure 1). \( C \) moves next, and must decide whether to accept \( L \)'s authority in its domain and, at the same time, whether to provide direct benefits to \( L \), including salvation and pacifying \( M \). Alternatively, \( C \) can reject \( L \)'s authority and, at the same time, withhold salvation and urge the masses to rebel against \( L \). Finally, \( M \) has the last move of the game and must decide whether to rebel against \( L \) or to acquiesce and accept its lot.\(^{20}\)

Next, consider the players' preferences over outcomes. The logic of the game tree implies that we do not need full preference orders over outcomes.\(^{21}\) The following assumptions about preferences are sufficient to calculate the equilibrium of the game. First, consider \( L \). \( L \) most prefers \( E \) (see table 1); that is, to add to its authority by capturing some of \( C \)'s rights by choosing to challenge \( C \) and then have \( C \) and \( M \) both acquiesce. By a similar logic, the worst outcome for \( L \) occurs when \( L \) accepts \( C \)'s rights and privileges while \( C \) challenges \( L \)'s authority backed by withholding salvation while \( M \) rebels against \( L \). Further, \( L \) prefers \( E \) to \( A-s \); that is, it prefers gaining from \( C \) to respecting \( C \)'s rights and privileges, granting \( C \) a subsidy \( s \geq 0 \), and having \( C \) acquiesce, provide salvation, and pacify \( M \). \( L \) also prefers \( A \) to \( H \). Finally, \( L \) prefers \( H \) to \( D \); that is, if \( C \) and \( M \) choose to resist to \( L \), prefers to have challenged \( C \) rather than not having done

\(^{20}\) Uncertainty is implicit in \( M \)'s choice of rebellion. As is standard, we model this uncertainty as a form of lottery between success and failure of the rebellion; namely, if \( M \) rebels, then with probability \( p \) the rebellion succeeds; and with probability \( 1-p \) the rebellion fails. To simply the analysis, I suppress this lottery, assuming that the players' evaluation of the relevant outcomes are the expected values of the lottery.

\(^{21}\) To see this, observe that at each of the four terminal nodes of the game, \( M \) chooses between one of two options. Because the option not chosen by \( M \) can never occur, we do not have to know the complete preference orders for \( L \) and \( C \); instead, we need only know their preferences over the four choices made by \( M \) at the four terminal nodes. Similarly, because \( M \)'s potential choices are confined to \( A \) vs. \( B \), \( C \) vs. \( D \), \( E \) vs. \( F \), and \( G \) vs. \( H \), we need know only \( M \)'s rankings over these four pairs. Finally, attempting to make complete preference orders requires information not supplied or inferable from Smith's narrative, and hence the choice of preferences would be arbitrary.
Next, consider $C$'s preferences. When the subsidy, $s$ is small (i.e., $s < s^*$), $C$ most prefers outcome $D$, where $s^*$ is calculated as part of the equilibrium. The reason is that $C$ is best off when $L$ respects $C$'s rights and it coordinates with $M$ to challenge $L$. When $s$ is sufficiently large (i.e., $s \geq s^*$), $L$ most prefers outcome $A$: $L$ accepts $C$'s authority, $C$ accepts $L$'s authority, provides salvation, and pacifies the masses who acquiesce. Although $C$ would prefer to have $L$ choose to respect $C$'s rights while $C$ and $M$ successfully challenge $L$, the challenge is risky, and $C$ might lose. It therefore prefers

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22 This ranking assumes that the probability that $L$ wins a challenge is higher when $L$ has challenged.
Table 1: Players' Preferences.

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<th>Player Preferences</th>
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<td><strong>Worst:</strong></td>
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To D when the subsidy, s, is sufficiently large (i.e., s ≥ s*). Similarly, C prefers A to B; that is, if L and C accept each other's authority, C prefers that M acquiesce rather than revolt. C also prefers D over C; that is, if L accepts C's rights but C has chosen to challenge L, then L prefers that M revolt rather than acquiesce. A variant on this logic shows that C prefers E to F and H to G. Finally, C prefers H to E: if L challenges C's rights, C prefers to resist L's challenge, withhold salvation, urge M to rebel, and for M to choose to rebel over it (i.e., C) choosing to acquiesce to L's challenge, continue to pacify M, and have M choose acquiesce.

Lastly, we come to M's preferences. The four terminal nodes require that M rank four pairs of alternatives: A vs. B; C vs. D; E vs. F; and G vs. H. In each case, M must
choose between acquiescing and rebelling. Because rebelling without the support of $C$ is highly costly, $M$ will rebel only when $C$ urges $M$ to challenge $L$. Hence, $M$ prefers $A$ to $B$, $D$ to $C$, $E$ to $F$, and $H$ to $G$.

These assumptions about preferences are sufficient to solve the game. We do so using backward induction starting at the four terminal nodes and working backwards. At each decision node, the player making the choice must be able to predict the consequences of its actions with each choice. We therefore need to solve for the choices at every decision node even though the choices made along the equilibrium path will bypass some of the decision notes.

At each of the terminal nodes, $M$ knows the history of the game and hence knows the choices made by $L$ and $C$. Because $M$'s choice cannot influence any future choices by $L$ or $C$, it will choose at each node the alternative it most prefers. The analysis of preferences shows that, at the first terminal node ($A$ vs. $B$), $M$ chooses $A$; at the second terminal node, $M$ chooses $D$; at the third terminal node, $M$ chooses $E$; and at the bottom terminal node, $M$ chooses $H$ (see figure 2, which displays the players’ choice of action in bold). Next, consider $C$’s choices knowing $M$’s subsequent behavior. At $C$’s first decision node, $C$’s choice depends on the size of the subsidy from $L$. If $s < s^*$, then $C$ prefers outcome $D$ over $A$; it thus will reject $L$’s authority and encourage $M$ to challenge. If instead $s \geq s^*$, then $C$ prefers $A+s$ over $D$, so it will accept $L$’s authority and pacify $M$, yielding outcome $A$. At $C$’s other decision node, it prefers $H$ over $E$; that is resisting $L$’s challenge, withholding salvation, and urging $M$ to rebel over accepting $L$’s challenge, pacifying $M$. Finally, moving to the first node, $L$ prefers accepting $C$’s rights and granting a subsidy $s = s^*$, knowing that $C$ will choose to respect its rights, provide
salvation, pacify $M$, and $M$ will acquiesce – to challenging $C$’s rights, knowing that $C$ will resist and urge $M$ to rebel and $M$ will rebel.

To summarize. [Add statement of the full equilibrium here?] Along the equilibrium path, $L$ respects $C$’s authority and provides subsidy $s = s^*$; $C$ accepts $L$’s authority and pacifies the masses; and $M$ acquiesces.

The logic of the game reveals the incentives prompting the secular lords and the Church to cooperate in respecting each other’s prerogatives within their separate domains and, jointly, to exploit the masses. The critical strategic choices are as follows. The Lord chooses to accept the accommodation with the Church by respective its rights

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Figure 2: The Equilibrium of the Game.
and privileges, including sufficiently large subsidies. The Church cooperates with the Lord by accepting the Lord’s authority in the secular realm and by providing benefits to the Lord in the form of pacifying the masses. In face of the cooperation between Lord and Church, the masses are forced to acquiesce to their poor lot in life.

Although both the Lord and the Church have opportunities to defect from cooperation, each has a strategy to defend itself. If $L$ defects by challenging the $C$’s rights and privileges, $C$ and $M$ will coordinate and resist $L$’s challenge. $C$ also has the opportunity to defect; that is, to choose to resist $L$’s authority and to coordinate with $M$ against $L$. Because $C$’s rights and privileges involve subsidies from $L$, this revenue serves as part of the incentives for $C$ to accept the accommodation with $L$ rather than challenge. Therefore, both $L$ and $C$ choose not to exploit the other because that leads to a costly breakdown of cooperation.

Subsidies from the Lord to the Church represent a critical feature of the game, especially with respect to $C$’s decision to cooperate with $L$ or to defect. The preference ranking above presumed that $C$ prefers outcome $A+s$ to $D$. For this to hold, the subsidies from $L$ to $C$ must be sufficiently large to overcome $C$’s temptation (i.e., $s \geq s^*$), where defection means that $C$ chooses to challenge $L$’s authority, withhold salvation, and encourage the masses to rebel. This formulation implies that if the subsidies to $C$ are too small (i.e., if $s < s^*$), then $C$ prefers to defect, resulting in outcome $D$. Because $D$ is $L$’s worst alternative, it prefers to subsidize $C$ sufficiently, resulting in outcome $A$. The gains from cooperation between $C$ and $L$ make this outcome possible.

Finally, the game answers the question about how the Church defends itself against the Lords given their comparative advantage in violence relative to the Church,
the Lord’s defection outcome. As just shown, the value of cooperation between Lord
and Church to the Lord prevents him from using this violence potential to attempt to
force the Church to grant it some of the Church’s rights and privileges. A critical reason
for this cooperation involves the issues of salvation and the masses. The Lord lives in
fear of losing salvation in combination with rebellion by the masses, and the Church
plays an important role for the Lord by providing salvation and helping to pacify the
masses. When the masses are pacified, both the secular lords and the Church can
exploit the masses. But this behavior by the masses is not inevitable. If the Lord
threatens the Church, the Church can, instead of providing salvation and pacifying the
masses, withholds salvation while urging the masses to rebel. This choice holds high
risks for the Lord. The Church thus holds important weapons with which it can defend its
prerogatives and authority. The logic of the game shows that cooperation between the
Lord and the Church, in which each respects each other’s rights, privileges, and
authority within their own domains, is an equilibrium and hence stable.

Putting these points together, the strategic incentives of the game induce the
Lords to subsidize the Church and reframe from using its comparative advantage in
violence against the Church. The Church, in turn, provides essential benefits to the
Lords by providing salvation to the Lords while also pacifying the masses and protecting
the Lords’ property and income. Both elite groups thus cooperate to exploit the masses.

4. The Changing Industrial Organization of Religion

With the rise of powerful, alternative religious organizations during the
Reformation, the Church lost its monopoly position. The Church successfully
suppressed competing religious organizations throughout the Middle Ages. Why did it fail to do so during the Reformation? Smith’s approach provides an answer.

**Changes in the Environment Erode the Church’s Authority**

Smith’s arguments tie directly to those in Book III of the *Wealth of Nations*, which studies the stability and then fall of feudalism in response to the rise of commerce and the growth of towns. An explicit political exchange between town and king underpinned town growth: the exchange granted the towns independence and liberty; and the king, more power and authority over the lords.23 The rise of commerce also transformed the feudal hierarchy, at least in those areas adjacent to the towns. The towns provided local security, including disarming local lords. This environment removed the need for the secular lords to maintain a large retinue to defend itself. The security afforded by the towns to neighboring areas also underpinned the transformation of the local peasantry from poor self-sufficient, agricultural producers living at subsistence to specialists in a market whose division of labor afforded peasants higher incomes.

As Smith emphasizes, the towns also offered new opportunities for luxury, which induced the lords to exchange their expensive retainers for consumption on “trinkets and baubles.”24 Similarly with the Church: the clergy discovered new luxury for which they could exchange their revenues.25

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23 See references in note **, infra.
24 The larger passage that contains this quote: “Having sold their birth-right, not like Esau for a mess of pottage in time of hunger and necessity, but in the wantonness of plenty, for trinkets and baubles, fitter to be the play-things of children than the serious pursuits of men, they became … insignificant” (WN III.iv.15:421).
25 In Smith’s words, “The gradual improvements of arts, manufactures, and commerce, the same causes which destroyed the power of the great barons, destroyed in the same manner, through the greater part of Europe, the whole temporal power of the clergy. In the produce of arts, manufactures, and commerce, the clergy, like the great barons, found something for which they could exchange their rude produce, and thereby discovered the means of spending their whole revenues upon their own persons, without giving any considerable share of them to other...
of the local lords, and with it, their contributions to the Church and, ultimately, the power of the Church. At the same time, the Church reduced its charity due to declining revenue and due to increased expenditure on luxury. Less charity reduced the dependence of the masses on the Church, as did rising incomes and independence of the peasantry within the security orbit of a nearby town. In reaction, the Church sought additional revenue from its tenants. But, given that the Church’s interests already drove it to extract the maximal revenue from the peasantry, raising rents alone would not raise more revenue. Additional revenue required that the Church alter institutions and the incentives they produce; for example, by granting greater rights and benefit to its tenants, the Church could induce tenants to pay higher rents. The principal means of doing so involved extending long-term leases to the tenants. Although providing additional revenue to the Church, these leases also restricted the Church’s predatory behavior. Long-term leases reduced ability of the Church qua landlord to expropriate the value of investments made by tenants (WN V.i.g.25:803).

Smith concludes that these changes diminished the Church’s power. “The ties of interest, which bound the inferior ranks of people to the clergy, were in this manner gradually broken and dissolved” (WN V.i.g.25:803-04).

people. Their charity became gradually less extensive, their hospitality less liberal or less profuse. Their retainers became consequently less numerous, and by degrees dwindled away altogether” (WN V.i.g.25:803).

26 The editors (WN V.i.g.25:803) cite Smith’s argument (LJ (A) iii.121;189), “that the clergy encouraged the relaxation of the authority of the great proprietors over their villeins as a means of reducing their power and that: ‘They saw too perhaps that their lands were but very ill cultivated when under the management of these villains. They therefore thought it would be more for their own advantage to emancipate their villains and enter into an agreement with them with regard to the cultivation of their lands. In this manner slavery came to be abolished.’”

27 As a matter of timing, Smith states that the Church’s power decline antedated the decline in power of the temporal lords. The “ties of interest” that bound the masses to the Church: “were even broken and dissolved sooner than those which bound the same ranks of people to the great barons: because the benefices of the church being, the greater part of them, much smaller than the estates of the great barons, the possessor of each benefice was much sooner able to spend the whole of its revenue upon his own person. During the greater part of the fourteenth and fifteenth centuries the power of the great barons was, through the greater part of Europe, in full vigour. But the temporal power of the clergy, the absolute command which they had once had over the great body of the people,
The Rise of Competition among Religions

A variety of institutional and organizational changes also occurred in this environment. Recall that the Church’s monopoly was not permanent but contestable. New and powerful religious sects grew up to challenge the Church’s authority in the form of the Protestant Reformation. Moreover, in many states that maintained a Catholic monopoly, such as France, the secular authorities asserted more control over the Church within its domain; for example, control over the choice of bishops and the abbots, thereby diminishing the independence of the Church.

Combining Smith’s argument about the town’s escape from feudal equilibrium in WN Book III with his argument about the decline of the Church in WN Book V leads to the following predictions, although Smith does not state them. Rising incomes and security of the towns, in comparison with the more stable feudal areas of the hinterland, imply that peasants in these areas should gain independence of the Church and be the most attracted to religious sects competing with the Catholic Church, particularly ones emphasizing austerity (i.e., lower rent extraction by the clergy). Similarly, the clergy in and near the towns should be the most susceptible to luxury due to its availability. Long before Weber (1905) opened the debate about the “Protestant Ethic and the Spirit of Capitalism,” Smith developed an approach that suggest the connection. The mechanism identified by Smith holds that the Church kept the peasants poor so that the Church’s charity became a tool with which the Church could manipulate peasants.

* was very much decayed. The power of the church was by that time very nearly reduced through the greater part of Europe to what arose from her spiritual authority; and even that spiritual authority was much weakened when it ceased to be supported by the charity and hospitality of the clergy* (WN V.i.g.25:803-04).
Economic independence would loosen the Church’s grip on the masses. And independence arose first in the areas surrounding the towns.

In the faces of these changes, the people no longer “looked upon that order, as they had done before, as the comforters of their distress, and the relievers of their indigence. On the contrary, they were provoked and disgusted by the vanity, luxury, and expense of the richer clergy, who appeared to spend upon their own pleasures what had always before been regarded as the patrimony of the poor” (WN V.i.g.25:804). As I have shown, Church institutions during the Middle Ages created dependency of the masses on the Church, allowing the Church to exploit them but also to force them to support the Church against secular authorities when the latter sought to challenge the Church. The institutional changes – less charity from the Church, lower revenue to the Church from the secular lords, long-term leases granting the masses greater independence, the rise of towns – altered the masses’ incentives. Less dependence on the Church diminished the poor’s incentives to adhere to the Church’s demands. The change in the poor’s behavior, in turn, altered the relationship between the secular and ecclesiastic lords: “As the clergy had now less influence over the people, so the state had more influence over the clergy. The clergy therefore had both less power and less inclination to disturb the state” (WN V.i.g.26-28:805).

In short, a series of factors combined to weaken the Church relative to the secular lords. This provides the background to understanding the rise of competitive religious sects.
Implications for the Changing Industrial Organization of Religion: The Rise of Competition

Smith’s argument about the rise of competition among religious organizations during the Reformation is an extension of the argument just discussed about the change in relative power between secular lords and the Church. In Smith’s view, the secular lords gained power at the expense of the Church before the Reformation. The rise of Protestant organizations occurred subsequently to that change (WN V.i.g.26-28:805).

Power grabs by the secular lords occurred in many areas of Western Europe. In some areas, notably, France and Spain, the secular authorities bargained with the Church for greater powers and control over the Church within their domain. In these areas, the Church retained influence, but on terms much more favorable to the secular authorities (WN V.i.g.31:806),

In other areas, the secular authorities allied with the new sects, allowing these authorities together to survive. “The authority of the church of Rome was in this state of declension, when the disputes which gave birth to the reformation, began in Germany, and soon spread themselves through every part of Europe. The new doctrines were everywhere received with a high degree of popular favour. They were propagated with all that enthusiastic zeal which commonly animates the spirit of party, when it attacks established authority” (WN V.i.g.29:805).

Tactically, the advocates of the new doctrines had several advantages over the established Church. They were better steeped in ecclesiastical history, granting them advantages in disputes.28 Their austerity generated support among the people, provided

28 “The teachers of those doctrines, though perhaps in other respects not more learned than many of the divines who defended the established church, seem in general to have been better acquainted with ecclesiastical
a striking contrast with that of the luxury of the Church. The Church’s reduced generosity combined with the appearance of self-indulgence and lavishness to put it at a further disadvantage. Indeed, the established Church seemed ill-prepared to deal with the new competitors and their alliances with local princes.

In many areas, the new doctrines succeeded in gaining adherents, especially where the princes had been on bad terms with the Church. In England, Henry VIII took advantage of the weakened Church.

Though he did not embrace himself the greater part of the doctrines of the reformation, was yet enabled, by their general prevalence, to suppress all the monasteries, and to abolish the authority of the church of Rome in his dominions. That he should go so far, though he went no further, gave some satisfaction to the patrons of the reformation, who having got possession of the government in the reign of his son and successor, completed without any difficulty the work which Henry VIII had begun (WN V.i.g.31:806).

Smith also observed that the decentralized nature of the Reformation had important consequences for governance of the new sects, including the emergence of a degree of competition, which the Catholic Church had previously been able to stifle. When doctrinal disputes arose among the new Protestant sects, for example, the absence of a central authority made it difficult to settle them. Unlike the centralized hierarchy of the Catholic Church, the decentralized, competitive nature of the new sects meant the absence of a mechanism to adjudicate doctrinal disputes.

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29 "The austerity of their manners gave them authority with the common people, who contrasted the strict regularity of their conduct with the disorderly lives of the greater part of their own clergy. They possessed too in a much higher degree than their adversaries, all the arts of popularity and of gaining proselytes, arts which the lofty and dignified sons of the church had long neglected, as being to them in a great measure useless" (WN V.i.g.29:805-06).

30 "The court of Rome had disobliged some of the smaller princes in the northern parts of Germany, whom it had probably considered as too insignificant to be worth the managing. They universally, therefore, established the reformation in their own dominions" (WN V.i.g.30:806).
When the followers of the reformation in one country, therefore, happened to differ from their brethren in another, as they had no common judge to appeal to, the dispute could never be decided; and many such disputes arose among them. Those concerning the government of the church, and the right of conferring ecclesiastical benefices, were perhaps the most interesting to the peace and welfare of civil society. They gave birth accordingly to the two principal parties or sects among the followers of the reformation, the Lutheran and Calvinistic sects, the only sects among them, of which the doctrine and discipline have ever yet been established by law in any part of Europe (WN V.i.g.33:806).

One feature of this decentralization is that it allowed members of the same sect but in different secular realms to sustain doctrinal differences. This, in turn, allowed them to adapt their doctrine to the needs of their members in a manner not possible within the more rigid hierarchy of the monopoly medieval Church.31

The alliance between the princes and the new sects led each to support the other in the face of existential threats from the Catholic Church and its secular allies. Violent disputes between secular and religious authorities would advantage their mutual enemies, giving both sets of authorities to cooperate. As Smith concludes, “This system of church government was from the beginning favourable to peace and good order, and to submission to the civil sovereign” (WN V.i.g.34:806).

5. The Response of the Political Accommodation
As a Comparative Statics Result

The game studied in section 3 demonstrated the existence of an equilibrium in the political accommodation between the secularly and ecclesiastic lords. The main

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31 The logic of decentralization combined with the political structure (small or large secular states) to affect the political and organizational structure of the new sects. “The followers of Luther, together with what is called the church of England, preserved more or less of the episcopal government, established subordination among the clergy, gave the sovereign the disposal of all the bishopricks, and other consistorial benefices within his dominions, and thereby rendered him the real head of the church; and without depriving the bishop of the right of collating to the smaller benefices within his diocese, they, even to those benefices, not only admitted, but favoured the right of presentation both in the sovereign and in all other lay-patrons” (WN V.i.g.34:806).
implication was that both parties to the political accommodation had incentives to cooperate with one another; that is, to respect the rights, privileges, and powers of the other.

This section explains how that accommodation fell apart in response to the environmental changes described in section 4. The rise of towns and their expanding security umbrella transformed the local countryside. Longer leases for the masses made them, along with other tenants, less dependent on both the secular and ecclesiastic lords. The Church’s expanding desire for luxury along with their diminished charity reduced the people’s dependency on the Church. These changes, therefore, diminished the ability of the Church to mobilize the peasantry against the secular lords. At the same time, power of the Church fell relative to that of the king and the secular lords. The secular authorities forced the Church to accept a redefinition of their accommodation. In France and Spain, the Church remained but on much less favorable terms. The princes in Northern Germany and the King of England took more radical action, kicking out the Catholic Church and allying with new sects (in Northern Germany) or helping to forge a new one (in England).

In terms of the game, these trends reinforced one another. As their effects cumulated, at some point they grew sufficiently strong as to alter the payoffs and hence the equilibrium of the game. Recall that the political accommodation during the Middle Ages depended on the threat of $M$ to $L$ and on the ability of $C$ to pacify or mobilize $M$. This ability, in turn, allowed $C$ to keep $L$ in check so that $L$ chose to respect rather than challenge $C$’s authority. The environmental changes had the following implications for
the players’ preferences. With growing independence of $C$, $M$’s payoffs rose. At some point, $M$ no longer preferred to challenge $L$, even with the urging and cooperation of $C$.

To see the implications of these changes in preferences, consider figure 3, which shows the new equilibrium of the game. The choices in the game are similar to those in figures 1 and 2, but with a few critical differences. These occur in the subgame that begins with $C$’s decision after $L$ has chosen to challenge $C$’s authority. In the revised game, $C$ must choose between acquiescing to less power or to resist, urging $M$ to join it, but knowing $M$ will not challenge $L$. Because $M$ will not join $C$ to resist $L$, a challenge by $C$ is not likely to succeed. $C$ therefore prefers $G$ over $E$.

As before, we solve the game by working backward. At each of the terminal nodes, $M$ no longer prefers to challenge or rebel against the lords with the urging of $C$. Thus, $M$ will choose to acquiesce at each terminal node; that is, $M$ will choose $A$ over $B$, $C$ over $D$, $E$ over $F$, and $G$ over $H$. These choices are depicted in bold in figure 3. Moving backward to $C$’s choices, $C$ has two potential decisions. If $L$ has chosen to respect $C$’s rights, $C$ prefers to accept $L$’s authority and to attempt to pacify $M$. If $L$ has chosen to reject $C$’s authority, $C$ prefers to acquiesce to reduced authority. Finally, at the first decision node, and knowing the full consequences of his actions, $L$ must choose between respecting or rejecting part or all of $C$’s authority. $L$ will choose to reject some of $C$’s authority. Along the equilibrium path, the players make the following choices: $L$ chooses to reject $C$’s

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32 An interesting question is what determines analyze the secular leaders’ choice between rejecting the Church’s authority in part or in toto? As Smith makes no attempt to answer this question, we leave the question unanswered and interpret $L$’s choice in a binary fashion.
authority; C acquiesces to L’s reduction in C’s authority; and M chooses to acquiesce rather than challenge L’s authority.

**Figure 3: Comparative Statics: Equilibrium Change.**

The logic of the new equilibrium shows that as the masses became more independent of the Church, their payoffs rose and their grievances with the secular lords diminished. At some point, the masses no longer preferred to challenge the secular lords, even with the urging and cooperation of the Church. Following this change in preferences, the Church lost its ability to defend its privileges and authority against the secular Lords. The lords then took advantage of the Church’s diminished power, challenging and absorbing rather than respecting the Church’s authority, allowing it to
assume important privileges of the Church (as with France) or to remove the Catholic Church altogether (as in England and parts of Germany).

6. Conclusions

Adam Smith argued that multiple sets of interrelated medieval institutions hindered the long-term development of medieval Europe; in this role, he discussed feudalism, slavery, and the Catholic Church in detail. Smith’s ideas on the first two are relatively well-known, while those on the third, considerably less so.

In an effort to help right this imbalance, I develop in this paper the logic of Smith’s approach to the medieval Church. Smith addresses a series of questions about the Church: how the secular and ecclesiastic authorities maintained their separate powers; why the secular authorities not only refrained from using their comparative advantage in violence to capture some or all of the Church’s authority but also subsidized their ecclesiastic rivals; why the Church’s interests led it to suppress liberty and economic growth; and why the Church’s monopoly fell apart in the Reformation.

The Church’s principal interest, as with most organizations, was to maintain itself and, in this case, its monopoly position (as the work of Anderson, Ekelund, Iannaccone, Hébert, Tollison, Stark and Bainbridge argue, among others in the new social science of religion). In particular, Smith suggests that the Church sought to maintain its authority with the people. The approach of this paper demonstrates why this authority was so central to the Church’s survival.
Smith addresses the principal questions by explaining the interaction of three groups, the secular authority, as embodied in the secular lords, the ecclesiastical lords, and the people. The political exchange underlying the feudal society of the 10th-13th centuries involved an accommodation between the Church and the secular lords. In simple terms, the Church helped pacify the population of poor, rural peasants, tailoring its doctrines in part to serve this purpose. The Church supported the secular authority, including helping to preserve the very unequal distribution of land and wealth. In return the secular lords helped finance the Church and respected its authority within its realm. Both sides had incentives to maintain this bargain, which allowed them to exploit the peasantry.

The Church also helped maintain the people in a position of dependence through a variety of weapons. For example, Smith argued that its charity maintained most of the poor; the Church provided religious services, including salvation and comfort in times of death; and, a large portion of peasants made their livelihood by working on Church land. Although each of these elements provided valuable benefits to the peasantry, the Church could withdraw these benefits if the peasants failed to cooperate with the Church. These benefits were therefore also weapons that afforded the Church a credible threat over the people; those who failed to heed its interest risked dire consequences.

Smith’s logic implies that this pattern of interaction was a stable equilibrium. Were a secular lord to attempt to challenge the Church’s authority, the Church would bring all its weapons to bear in retaliation. The Church would brand the lord as heretical; it would withhold its services, such as salvation; and, instead of pacifying the people, it
would rally them against the lord. Smith illustrated this point with Robert of France (discussed above in section 2). In the face of these threats, most lords did not challenge the Church, and those that did challenge typically backed down.

Smith’s approach also affords an explanation for the rise of religion competition during the Reformation. At the same time that the Church experienced losses in revenue, new forms of luxury arose along with the rise of towns and commerce. The expanding market for luxury gave Church officials new items to purchase for themselves, especially those clergy living in or near the commercial cities and towns. Charity diminished. Finally, in search of greater revenue, the Church granted peasants long-term leases, which afforded the peasants greater independence.

In combination, these three changes weakened the Church’s authority and credible threats over the people. This diminished authority, in turn, had a major implication for the relationship of the secular and ecclesiastical lords: it removed the Church’s ability to mobilize the peasants and hence its credible threat over the secular lords. The lords responded to the new environment by demanding and receiving new authority over the Church (e.g., in France and Spain) or by removing the Catholic Church altogether (England and Northern Germany). The result was the Reformation and the rise of powerful competitors to the Church.

I incorporate Smith’s logic into a simple game of strategic interaction among three players, the secular authorities, Church, and the people. The advantage of the game is that it demonstrates that Smith’s logic underpins a stable equilibrium. The equilibrium shows why each of the three players had incentives to play their roles in maintaining the equilibrium. Smith thought systematically about the problems of religion
in moral and theological terms and in terms of power and bargaining between the Church and the secular lords. The game also provides a comparative static result that shows how, as the Church’s authority over the people diminished, their credible threat over the secular lords diminished, allowing them to successfully challenge the Church.

Finally, Smith explains that the stable equilibrium surrounding the Church in the Middle Ages had long-term economic consequences. Smith characterizes the Church as a “formidable combination” against both civil authority and the rise of liberty. The Church’s authority over the people was central to its credible threat over the secular authorities, granting the Church the ability to retaliate against a king or lord who sought to challenge it. During this era, fostering greater liberty and independence among the people would have removed the Church’s most important weapon in its relations with the secular authorities, much to the detriment of the Church. The Church therefore suppressed liberty, economic growth, and development.

Smith’s industrial organization of religion is part of his larger project on the logic underlying the differential wealth or nations; or, in modern terms, the political-economics of development. Smith’s approach to economic development is well-known, including the division of labor and capital accumulation (Ekelund and Hébert 2007, ch**; Hollander 1973). Less well-known are Smith’s studies of political development, often because he embeds his theoretical observations in historical narratives – that is, Smith’s historical jurisprudence (Haakonsen 1981:ch 7).

Smith’s focus on a variety of medieval institutions relies on logic that presages the modern literature demonstrating the impediments to development (see, e.g., Acemoglu and Robinson 2006, 2012, Besley and Persson 2009, North, Wallis, and
Weingast 2009). Smith's approach to feudalism, the medieval Church, and to medieval slavery reveals different forms of systematic impediments to development. Common to each of these topics is the idea that political interest lead groups to favor institutions by suppressing growth but which further their interests (Acemoglu and Robinson 2006, North, Wallis, and Weingast 2009,ch2). Another important aspect of Smith's work is that he also focuses on how particular groups escaped the impediments to growth, such as the rise of towns out of the feudal equilibrium or the demise of the Catholic Church's monopoly in the Reformation.

References

R.1. The works of Adam Smith.

All works of Adam Smith are from the Glasgow edition, as reprinted by Liberty Fund.


R.2. Other References.


