The “Character” of Profit and Loss: Entrepreneurial Virtues

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Abstract: It is common to say that in the commercial sphere of human activity one can be wise or virtuous. We argue that one can be both: the profit motive can be consistent with virtue. Aristotle's concept of a moral mean is an apt description of entrepreneurship, in circumstances we spell out. An honest entrepreneur, in intending only to increase his own profits, cultivates the habits of awareness and alertness to opportunities to correct "mistakes" in resource allocation in the world around him. In every instance where a mistake is corrected, all parties to the exchange are made better off. To the extent that entrepreneurs improve the allocation of resources, they reduce waste and ensure that people do not use resources that other people value more. We consider two problems with defining entrepreneurship as virtue: intention and exploitation. The counterargument we offer is that honest efforts in euvoluntary exchange setting increase the division of labor, thereby expanding both the breadth and quality available to everyone in the

society. Finally, we distinguish profit-seeking and rent-seeking, and concede that much activity that might pass for "entrepreneurship" is in fact vicious and harmful to society.

The Character of Profit and Loss: Entrepreneurial Virtues[1]

Quintus Scaevola, the son of Publius, when he asked to have the price of an estate that he was buying named once for all, and the seller had complied with his request, said that he thought it worth more, and added a hundred thousand sesterces.

There is no one who would say that this was not the act of a good man; but men in general would not regard it as the act of a wise man, any more than if he had sold an estate for less than it would bring. This, then, is the mischievous doctrine, — regarding some men as good, others as wise… Cicero, *De Officiis* (Book III, Chapter 15)

1. Introduction

Entrepreneurs create products, take risks, and arbitrage price differences to earn profits, or revenues in excess of costs. Successful entrepreneurs are "wise," in Cicero's sense, but they might also be called calculating, or conniving. Can a calculating man also be virtuous? Cicero calls the wise vs. good dichotomy "the mischievous doctrine;" we agree. It is at least *possible* to be both wise and good. There are conditions under which entrepreneurship is more, or less, likely to reconcile profit-seeking and virtue.

We first describe what is meant by "virtue" in the context of commercial activity in pursuit of wealth, and rehearse briefly the two arguments--intent and exploitation--for why entrepreneurial profit-seeking is *per se* inconsistent with virtue. The argument from intent notes that entrepreneurs seek profits. Such actions might in principle have good *consequences*, but these are not intentional, so profit-seeking is inconsistent with virtue.

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The second argument is that profits are *per se* exploitative. But to *succeed* the entrepreneur *must* earn positive profits. Therefore, only an unsuccessful entrepreneur could be innocent of exploitation. If virtues are features of excellence in character, this implies a contradiction: One could be an excellent entrepreneur, and make profits, or one could be virtuous, and go bankrupt, but never both.

The paper proceeds as follows. In section 2, virtue, character, and entrepreneurship are defined briefly, and the definition of profit-seeking as creation and correcting “errors” is clarified. Section 3 poses the question of the necessity of intention, and the nature of the goals of entrepreneurs. The fourth section poses the question of profit-seeking as per se exploitation, and discusses the nature of profit as a signal in market economies. To put some flesh on the abstract bones of this argument, we summarize a narrative taken from an article by R.A. Radford (1945), in which "extreme" profits are in fact a signal of the extent of the benefits that traders can confer on others.

Section 5 distinguishes two types of commercial activity, rent-seeking and profit-seeking. In doing so we concede that much of the entrepreneurial activity labeled as vicious is, at a minimum, inconsistent with virtue. But there are also many instances of economic entrepreneurs, people who intended to create new value and who succeeded in doing so. The sixth section concludes.

2. Entrepreneurship and Character

2.1. Virtue as a Habit

Aristotle, in both the *N.E.* (McKeon, 1947) and the *Politics*, argued that exchange to obtain the things that the household--and by extension, the city--requires to satisfy *basic needs* is natural.

Such exchanges can therefore be morally permissible, or even perhaps an excellence (in the sense of a *techne*, though not a virtue).[2]

But exchange *in excess* of what is necessary to obtain the necessities of the good life--i.e., exchange motivated by *wealth-getting*--is unnatural and could never be a routine activity of a virtuous person. Thomas Aquinas gives a nuanced elaboration of Aristotle's argument.

> [T]rade, considered in itself, contains a certain unseemliness, inasmuch as it does not essentially involve any honorable or necessary end. Still though gain, which is the end of trade, does not essentially involve anything honorable or necessary, neither does it essentially involve any element of vice, or aught that is opposed to virtue. Hence there is nothing to hinder gain from being referred to an end necessary or even honorable. And thus trade will be rendered lawful: as when one refers the moderate gain that he seeks from trade to the sustenance of his family, or to the relief of the distressed; or once more, when one applies to trade on behalf of the public interest, that the necessaries of life may not be wanting to his country, and seeks gain, not as an end, but as the wages of his labour. (Aquinas, *Summa Theologica*, #77).

Virtue is not a single moral choice. Virtue is an aspect of *character*, a habit of right action that is the consequence of conscious reflection and examination. Virtue is not the absence of vice, but is rather intentional and conscious. Moral virtues, in particular, are states of harmony that can be marred by excess or deficiency. Thus, neither the coward nor the fearless fool can be virtuous. The virtue—bravery—is a moral mean between these extremes.

This suggests the following definitions:

Virtue--*a habit of right action, cultivated as an intentional product of reasoned reflection, in a social setting. Right action balances between vices, which are deficiencies or excesses of the particular virtue.*

Character--*a collection of traits of a person, both in terms of visible actions and the internal motivations that cause those actions. Character results from the repetition of choices in a variety of settings, as a product of right reason. Virtues are individual habits of right action; character is the overall set of virtues and vices exhibited by a person.*

A person of good character cultivates virtue in a way that promotes mutually beneficial exchanges through honest efforts and creative productivity. Thus, entrepreneurship is *itself* a

[2] Aristotle, *Politics*, Book I, Chapter 3, n. 11.

habit, rather than a single act based on a principle invoked by a "moral feeling." Aristotle's notion of character calculating a moral mean is also an apt description of the *art* of entrepreneurship. Aristotle's virtue of "liberality" lies between the shortcoming of meanness (taking too much, spending and investing too little) and the excess of prodigality (overspending, failing to watch costs, and so on). Successful entrepreneurs have a character that cultivates the virtue of liberality.

Having defined virtue and character, we now turn to the definition of entrepreneurship.

2.2. Entrepreneurship as a Habit of "Right Action"

The origin of "entrepreneurship" is contested, possibly deriving from the French verb *entreprendre*, “to undertake.”[3] J.B. Say (1803) claimed that "An entrepreneur is an economic agent who shifts economic resources out of an area of lower and into an area of higher productivity and greater yield." Buying low and selling high might simply be called “arbitrage,” another French loanword. Say’s conception is not wrong, exactly, but it ignores the most important aspect of entrepreneurship: imagining an alternative future. As Joseph Schumpeter put it:

> The introduction [of new products] is achieved by founding new businesses, whether for production or for employment or for both. What have the individuals under consideration contributed to this? Only the will and the action; *not the concrete goods, for they bought these*—either from others or from themselves; not the purchasing power with which they bought, for they borrowed this—from others or, if we also take account of acquisition in earlier periods, from themselves. And what have they done? They have not accumulated any kind of good, they have created no original means of production, but have employed existing means of production

[3] The French verb “entreprende” appears to have been associated with creating musical or artistic “undertakings.” We might now call such people “impresarios” or promoters.

There is a phrase in Sanskrit, “antha prerna,” which sounds like “entrepreneur,” and means “self-motivated,” but it this connection is likely coincidental. The first printed *use* of the word was apparently in the French *Dictionnaire Universel de Commerce* of Jacques des Bruslons, published in 1723.

Richard Cantillon describes “entrepreneurs” in his 1755 book, *Essay on the Nature of Commerce* as being agents who purchased or created a product at a known cost to sell it later at an uncertain price, encompassing "traders" as well as cobblers, coopers, hatmakers and others who manufactured products for sale.

differently, and more appropriately, more advantageously. They have "carried out new combinations." They are entrepreneurs. And their profit, the surplus, to which no liability corresponds, is an entrepreneurial profit. (Schumpeter, 1934; 132; emphasis added)

This was echoed, at a more popular level, by Peter Drucker: "An entrepreneur searches for change, responds to it and exploits opportunities. Innovation is a specific tool of an entrepreneur; hence an effective entrepreneur converts a source into a resource."

Israel Kirzner proposed a theory of entrepreneurship that combined the idea of arbitrage, innovation, and imagination:

Let us consider the theorem which Jevons correctly called "a general law of the utmost importance in economics," which asserts that "in the same open market, at any one moment, there cannot be two prices for the same kind of article." …[T]he initial imperfection in knowledge is to be attributed, not to lack of some needed resource, but to fail to notice opportunities ready at hand. The multiplicity of prices represented opportunities for *pure entrepreneurial profit*; that such multiplicity existed, means that many market participants (those who sold at the lower prices and those who bought at the higher prices) simply overlooked these opportunities. *Since these opportunities were left unexploited, not because of unavailable needed resources, but because they were simply not noticed, we understand that, as time passes, the lure of available pure profits can be counted upon to alert at least some market participants to the existence of these opportunities*. (Kirzner, 1978; emphasis added)

Kirzner defined entrepreneurship as "awareness," the constant searching for profit opportunities. But Kirzner conceived of errors much more broadly than the above passage would suggest. Rather than simply "correcting" errors in the price system, and causing the convergence of prices of a single existing commodity, entrepreneurs imagine alternative futures, new products, and possible new ways of organizing production, much like Schumpeter's "new combinations."

The distinction matters. An entrepreneur does not (just) take advantage of errors (i.e., differences) in prices. An entrepreneur cultivates a character of alertness, anticipating what consumers want. But that means that the system is ultimately driven by consumers, not entrepreneurs. Entrepreneurs are the active agents in the system, but consumers decide what firms produce and which productive activities will be rewarded and which punished.

Successful economic entrepreneurs are alert to entirely new possibilities, to products and innovations that consumers may well not even be aware that they *could* have, much less want. Steve Jobs, of Apple Computer, famously observed that entrepreneurs could not rely on static conceptions of "demand": "You can't just ask customers what they want and then try to give that to them. By the time you get it built, they'll want something new." (*Inc*., 1989). A decade later, Jobs went further: "But in the end, for something this complicated, it's really hard to design products by focus groups. A lot of times, people don't know what they want until you show it to them." (Business Week, 1998).

Of course, this means that entrepreneurship is in some ways quite destructive. The Sony "Walkman" was an extremely popular (and profitable) device that allowed people to move around or even exercise while listening to the radio or to cassette tapes (later, the "Discman" played CDs, also). At one point in the early 1990s Sony had captured more than 50% of the "mobile music" market.

But then MP3 players were invented.[4] And even though people didn't know that MP3 was how they wanted to buy, store, and carry their music, it turned out to be so. The most successful MP3 player, since 2003, has been the iPod made by Apple. Steve Jobs, and the Apple engineers, imagined a different arrangement of productive resources. None of the resources needed to be

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[4] MP3 is short for MPEG 3, an abbreviation for "Motion Picture Expert Group" codings. Codings are means of reducing the amount of information (bits of stored digital information) to encode a song without losing quality. The first patents for MP3 encodings were issued in the U.S. in the late 1980s and the early 1990s. MP3 data was generally burned onto CDs, but there was no need to keep it there; in principle other storage and retrieval media were superior, because there was no need for the moving parts used in a CD player. The first commercially viable MP3 players went on sale in the late 1990's, and by 1999 they were relatively common in stores. The first iPods from Apple were released in January 2001; by the end of 2002, 600,000 had been sold, at prices exceeding $400 in nominal terms.

invented, and none of the digital processes for storing the music were especially difficult or innovative. But the package, the iPod, and the seamless delivery system called iTunes, were new.

And what about the Walkman? Sony lost billions of dollars, and was unable to offer a competitive product for much of the period when MP3 players were being sold to people who were buying one for the first time. Sony laid off at least 10,000 workers, and closed two large production facilities, causing at least 100,000 people to suffer significant economic harm. If Steve Jobs caused that much harm, how could entrepreneurship be a virtue? Most importantly, perhaps, the harm was intentional: Apple had specifically targeted Walkman as the consumer electronic device they wanted the iPod to replace.

We turn now to intentions.

3. Intention

Must the entrepreneur consciously intend to improve the welfare of his customers? Or is it sufficient that an honest entrepreneur, intending only to increase his own profits, cultivates the habits of awareness and alertness to opportunities to correct "mistakes" in resource allocation in the world around him, thereby anticipating what consumers want?

It may depend on what we mean by "self-interest." If a person is an altruist, then serving others is what makes that person happy. Now, an altruist who serves others makes them better off. But this is an accident of intention, just like the effective and honest entrepreneur? If Mother Teresa had two glasses of wine, she might admit, "My main concern for other humans is that I can avoid going to hell, and be assured of going instead to heaven." Would we think less of her charity, and good works, if her *primary* intention were her own salvation?

George Stigler famously claimed that self-other dichotomy is false: most motivations are combinations. As Stigler (1963) put it: "The violent endeavors of an athlete to defeat his rivals are much admired, providing the contest is more or less fair, even though the winner is expected not to say, 'I am glad I won chiefly because I'm vain, but secondarily for the honor of Sheboygan High School.'" We all understand the athlete may be motivated by personal glory, and yet we don't blame the athlete for his intentions to defeat his opponent.

The intentions of the entrepreneur may well be--at least in part--the betterment of mankind, with profits no more than side effect. A famous example is the creation of "Kellogg's Corn Flakes," one of the most popular, and profitable, breakfast cereals in the world. In 1894 two brothers, J.H. Kellogg (a physician and director of a sanitarium at Battle Creek, Michigan) and W.K. Kellogg tried to design a breakfast food that would suit the needs of the vegetarian diet prescribed by their Seventh Day Adventist religious beliefs. Dr. Kellogg also believed that spices, sugars, and other additives were unhealthy and even "roused the passions."

The brothers prepared a wheat mush, but then left to tend to some other duties in the sanitarium. On their return, the mush had gone quite stale. Nonetheless, having the virtues of frugality and persistence, they processed the mush through rollers to make "breakfast crackers." Unexpectedly, the wheat fragmented into "flakes" on being cooked. Rather than throwing the failed crackers away, the Kelloggs recognized that their mistake was an innovation. Experimenting with other grains, they eventually settled on corn, and called the product "Corn Flakes" (they may have lacked the virtue of imagination). Today, nearly 120 years later, Kelloggs Corn Flakes sells more than 8 million boxes per week worldwide, and the innovation of "flakes" as a way of making breakfast cereals is involved in perhaps 10 times that amount of sales each week.

Were the Kelloggs virtuous, or entrepreneurial, or both? Their intentions were to improve the diets and health of the patients in the sanitarium. In addition, they hope to popularize a cheap and healthy breakfast for everyone. Further, and no less important, they cultivated habits of hard work, accurate research methods with record-keeping, and even "liberality." They did not overspend, and were in fact quite thrifty in their habits. But once they hit upon a successful recipe, they went all in, investing in expansion and inventing a series of mechanical improvements to the production process.

Our conclusion? An intention to do good is not of itself virtuous, at least not in the realm of economic activity, because success requires the technical excellences of creating useful products and controlling costs. A good person must also be wise. On the other hand, the intention to earn profits is not of itself vicious, because the strenuous exertion of honest effort in a successful attempt to create useful products and control costs can be virtuous. Intent has little to do with entrepreneurial virtue.

4. Exploitation

There are several forms of the argument that profit is inherently exploitative, or (in effect) coercive. On this account, even if the entrepreneur intended only to benefit society, the fact that profits are extracted is *per se* evidence of exploitation.

The standard form of this argument is that of Marx, derived from Adam Smith's "labor theory of value." In this view, wages are the fundamental payment for the value of goods created, and other "payments" (interest, payments to land, profits) are diversions from what should properly be labor's share.

Marx claimed that in the pre-capitalist economy, workers created commodities, sold these commodities for money, and then used that money to buy other commodities. In the capitalist economy, by contrast, the labor of workers itself becomes a commodity that is bought and sold, so that the factory owner (for example) uses money to hire labor at an hourly rate, and then takes the commodities produced in the factory and sells them for money. But there is no necessary connection between the wage required to buy the labor commodity (the subsistence wage) and the actual value of the labor (embodied in the value of the resulting commodity sold by the entrepreneurial capitalist). Thus, the factory owner takes the excess of his revenues over his costs--profits--out of the value created by labor. Labor is then exploited in precisely the ratio that profits result: more profits, more exploitation.

Many authors have contested this claim, but perhaps the most persuasive refutation is that supplied by Reisman (1985). He claims that Marx (and Smith) are quite right about the justness of the distribution of the "surplus" in the pre-capitalist stage of economics, where all proceeds go to the person who created the commodity. But it's a mistake to call that surplus a "wage," because the person who makes a commodity at a known price to sell it later at an unknown price is not a worker, but an entrepreneur. What producers earned in pre-capitalism were *profits*, not wages. And if this production activity is consistent with virtue, as Marx claims, then clearly profits can also be virtuous.

Of course, entrepreneurs in capitalist systems buy wage labor. Such contractual relations could well be exploitative, if they involve fraud, coercion, or asymmetries in bargaining strength, and so are no *euvoluntary*, or truly voluntary.[5] Still, our focus is on the question whether profits are *per se* exploitative. They are not.

[5] See Munger (2011) and Guzman and Munger (2014).

To put some flesh on the abstract bones of this argument, we summarize a narrative taken from an article by British economist R.A. Radford (1945), in which "extreme" profits signaled the extent of the benefits that trade, and therefore the trader, can confer on others, provided the exchange is euvoluntary.

While serving in Libya in 1942, Lt. Richard Radford was captured and placed in a series of German P.O.W. camps. Radford was interested in the universality of the practice exchange that he saw, because he knew--as a Cambridge-trained economist--that voluntary exchange always makes both parties better off. The interesting thing about the prison camp setting is that each prisoner had precisely the same total "wealth," because they received:

(a) identical (and often scanty) daily rations from what Radford delicately calls “the detaining power”

(b) sporadically, but regularly enough to be relied upon, the contents of a Red Cross packet: tinned milk, jam, butter, biscuits, tinned beef, tinned carrots, chocolate, sugar, treacle, and cigarettes.

If I like carrots more than milk, and you like milk more, we can trade. Not trading would be a “mistake, ” in fact, because the distribution of resources is not as good as it could be. If I consume the milk you value more than I do, I'm wasting milk. Your consumption of the carrots that I value is likewise a waste, a mistake. Allowing exchange creates no more food overall, but the total welfare of the group is improved if each person is allowed to correct mistakes.

Radford makes a striking observation in this regard, adding a moral dimension: “Very soon after capture people realized that it was both undesirable and unnecessary, in view of the limited size and the equality of supplies, to give away or to accept gifts.... ‘Goodwill’ developed into trading as a more equitable means of maximizing individual satisfaction.” In other words, these desperate people realized exchange is *more equitable* than relying on gifts or charity. The surplus created by the exchange is divided between the two traders.

Now, suppose a middleman (entrepreneur) emerges, someone who corrects "mistakes" by brokering voluntary exchanges, creating value for both parties. Radford describes a priest with a sharp eye for exchanges: “Stories circulated of a padre who started off round the camp with a tin of cheese and five cigarettes and returned to his bed with a complete [Red Cross] parcel in addition to his original cheese and cigarettes.” These are clearly profits, in the context we have been discussing. Did the "itinerant padre" exploit the other prisoners?

The answer in Radford's account is ambiguous. The prisoners had no quarrel with any of individual transactions brokered by the padre--there was no fraud, and no force--but they seem to have thought the total amount of profits that resulted were excessive. This seems paradoxical: how can many transactions, each of which was truly voluntary, be harmful? Isn't the fact that the padre accrued so much profit actually a sign that he created lots of value for the entire camp?

Of course, it may be true that the padre was not motivated by benefitting others, but rather by improving his own consumption opportunities. But why would this matter to the people with whom he traded? The padre created value by finding (say) Allan, who was willing to *pay six or fewer cigarettes* for a tin of beef. If the padre earlier met Barry, who had a tin of beef and would *sell for three or more cigarettes*. Of course, if these two traders had happened to meet each other, they would have exchanged directly. But finding just the right person to trade with is time-consuming at best, and may not happen except by chance. The padre, by searching across trades, arbitraged the difference: He could sell the beef to Allan for five cigarettes after buying it from Barry for four. Thus, both Allan and Barry are better off by at least one cigarette and the padre “profits” one cigarette by finding the voluntary exchange opportunity. All three people, Allan, Barry, and the padre, are better off by one cigarette for having made the trade.

That, we claim, is the proper conclusion about virtue in entrepreneurship. So long as the entrepreneur creates value in every exchange, then his actions are consistent with virtue. And the more value-creating exchanges the entrepreneur engages in, the more value he creates. Profits can be, though they are not necessarily, a measure of the value created for society.

5. Rent-Seeking and Profit-Seeking

Entrepreneurship is an act of conceiving something new, of imagining something. This is more than a *techne*; true entrepreneurship in the larger sense of creation is *phronesis*, or practical wisdom. Steve Jobs, in recognizing that people wanted something they had never even imagined owning, was seeking profits by cultivating a virtue, *phronesis.*

The problem we face is that many acts that appear on their face to be entrepreneurial are something else: rent-seeking. And rent-seeking is never virtuous.   "Rents," as opposed to the classical notion of profits, require state action and protection. Entrepreneurs are virtuous if the exchange relations they enter into (1) are euvoluntary, and (2) pursue profits as opposed to rents. The requirement that the exchanges be euvoluntary rule out exploitation. The distinction between rent-seeking profit-seeking ensures that there are new social value being created.

Profit-seeking involves *creating a new product*, a better product, or a cheaper product that consumers want to buy. The competition is positive-sum. Consequently, profit-seeking (for economists, at least) generally implies net positive effects.[6]

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[6] Assuming externalities are internalized by bargaining, regulation, or taxation. Otherwise, it is perfectly possible that a profit-maximizing producer may cause net harm to the society. But the possibility of net harms is less likely than a reading of the "market failure" literature might lead one to believe. It is certainly true that the invention and popularization of the internal combustion engine as a means of moving cars, trucks, and buses created a problem of pollution. But the net effects have still been enormously positive.

Rent-seeking involves *manipulating the rules* of competition to one's own advantage, or pursuing some other artificially created prize or benefit created an authority with the power to effect this transfer. The competition is at best zero-sum, and because substantial resources are generally consumed by the competitive activity may be negative sum with a large magnitude. Consequently, rent-seeking is generally associated with negative effects.

Tollison (1982) defined rent-seeking as competition for an artificial prize, created by state action, rather an increase in value for the society. The money for the "rent" is taken from tax revenues, or else is created by laws the suppress competition or protect favored entities. Rather than creating value, rents are at best a transfer. And to the extent that competition in seeking after the rent dissipates some, most, all, or even more than all the amount of the transfer, rent-seeking can even destroy value (Tullock, 1967; Krueger, 1974; Buchanan, et al., 1980).

Entrepreneurial profit-seeking is completely different. Profits and losses thus assume a social function in the sense that they guide the allocation of resources in the economy (Mises 1951; Kirzner 1978). The subjective nature of the individual decision-making process, and the fact that it is undertaken within the context of an uncertain environment is especially important to underscore regarding the public benefits of competition as a discovery process. [7]

Folsom (1989) givens an example of both profit-seeking and rent-seeking, occurring at the same time in the same industry, early steam ships carrying passengers and cargo. Folsom's account has four main characters: two rent-seekers (Cunard and Collins) and two profit-seekers (Vanderbilt and Inman). The account is worth quoting at some length.

Those who tried to succeed in steamboating primarily through federal aid, pools, vote buying, or stock speculation we will classify as [rent-seekers]. Those who tried to succeed in steamboating primarily by creating and marketing a superior product at a low cost we will classify as [profit-seekers].

[7] See Mises (1952), Kirzner (1978), Baumol (1990), and Carden (2009; 2011) for links between profit and loss and "right" action by entrepreneurs.

[Cunard] convinced the English government to give him $275,000 a year to run a biweekly mail and passenger service across the Atlantic. Cunard charged $200 per passenger and 24 cents a letter, but still said that he needed the annual aid to cover his losses…

[Collins] said that America needed subsidized steamships to compete with England, to create jobs, and to provide a military fleet in case of war. If the government would give him $3 million down and $385,000 a year, he would build five ships, deliver mail and passengers, and outrace the Cunarders from coast to coast…[H]e built four enormous ships (not five smaller ships as he had promised), [and] covered the ships with plush carpet and brought aboard olive-wood furniture, marble tables, exotic mirrors, painted glass windows, and French chefs. [The] ships used almost twice the coal of the Cunard Line…

Folsom notes that with the enormous subsidies, neither Cunard nor Collins had any incentives to innovate on quality, safety, or lower costs. Instead, they used their revenues to lobby Parliament, and Congress, for even larger subsidies and stronger protection from competition. But Cornelius Vanderbilt challenged the system, using exactly the avenues of improved service and lower fares. Congress denied Vanderbilt subsidies, so he was forced to compete against a subsidized carrier entirely on his own. But this may have been lucky for Vanderbilt, and surely was lucky for the U.S. shipping industry. “The share of prosperity which has fallen to my lot,” said Vanderbilt, “is the direct result of unfettered trade, and unrestrained competition. It is my wish that those who are to come after me shall have the same field open before them.” (Folsom, 1987, p. 7).

Vanderbilt undercut Collins by more than 50% on fares, and introduced a new class of service, "steerage," making sea voyages possible for even the poorest travelers. Collins was set up to compete for subsidies not customers, and he was soon bankrupted. This is a general problem for rent-seeking competition: The existence of the rent diverts talented agents from productive activity, leading to the dissipation of the rent and loss of value for the society.

6. Conclusion

In setting up the conception of entrepreneurial virtue, we have tried to isolate the conditions under which profit-seeking is a socially positive force. We have done this in a rather roundabout way, by identifying the conditions under which entrepreneurship is a virtue. Those conditions are (a) exchanges are euvoluntary, so that the products and services produced and sold create real value for consumers; and (b) the goals of the entrepreneur really are profits rather than rents obtained by suppressing competition through monopolizing tactics or using the power of the state.

Interestingly, Adam Smith—often seen as the chief advocate for capitalism—had quite a nuanced view of the “character” of business people. He recognized the potential for attempts at collusion if "people of the same trade" meet together, and did not think that any special trust to forebear the benefits of price-fixing was justified.[8] Smith's main point, however, was that society should try to prevent the formation of guild-like arrangements, or to divest them of power where they already exist. If workmen, shopkeepers, and entrepreneurs can be forced compete, with none of the exclusive privilege conferred by guilds or monopoly corporations, they will be forced—perhaps against their own urges to rent-seek—*to depend upon their character*!

This is a remarkable claim, and demonstrates just how far into the human element of market competition Smith was able to see. Smith appears (Otteson, 2002; Hanley, 2009) to have intended “character” to have at least two shades of meaning. One was habit, in a sense very close to the Aristotelian notion of virtue we discussed earlier. But the other was reputation, or the perception that other people had that this person could be relied upon to carry out promises.

The two notions are related, of course. But Smith saw the “character” of market participants to be plastic, or at least contingent (for a modern, and insightful, view of the value

[8] Smith, 1776, Bk I, Chapter X, Paragraphs 82-86.

situational character, see Doris, 2002, and Crockett and Anderson, 2004). Everyone was capable of acting virtuously, but everyone was also capable of acting badly. The institutions of the society played a key role in determining what sort of character a person cultivated. Like the famous difference between the porter and philosopher, Smith thought character was a product of development rather than determinism. Smith’s contribution was to notice that the sanction on entrepreneurs exhibiting bad character would take the form of loss of business. Character, and virtue, are rewarded with profits, and vice and deceit are punished with losses.

It is useful to close by recalling Cicero's observation about the wise man and the good man. The same theme was taken up in Deirdre McCloskey's book *The Bourgeois Virtues*, in which she deftly contrasts profit-seeking and rent-seeking.

> Modern capitalism does not need to be offset to be good. Capitalism can on the contrary be virtuous. In a fallen world the bourgeois life is not perfect. But's better than any available alternative…
>
> Countries where stealing rather than dealing rules become poor and then remain so…It doesn't matter what kind of predation/stealing it is--socialist stealing such as in Cuba, or private/governmental stealing such as in Haiti, or bureaucratic stealing such as in Egypt of today or of ancient times, or…stealing at the point of a pen by CEOs in America during the 1990s. By doing evil we do badly. And we do well when we do good. …[C]ommercial societies make virtuous citizens (McCloskey, 2004; 334).

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