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Abstract

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This paper discusses some of the more prominent arguments for and against the justification of profits. Early in the paper several different types of profit are distinguished to set the stage for the normative evaluation. Then arguments like utilitarianism and Pareto–efficiency, evolutionism, rights and free exchange, fair exchange, "sweat–of–the–brow", and discovery are analyzed. The paper raises the important issues with which any normative theory of profits must deal.

Key words: Ethics and economics, morality of profits.

JEL classifications: K10; P16; Ethics and Economics (no JEL number).

On August 1, 1990, the day before Iraq invaded Kuwait, the benchmark price for crude oil, West Texas Intermediate, was $21; on August 6, five days later, the price was $28. Quarterly profits for the big oil companies rose dramatically in the third quarter of 1990, and shortly after the profit statements were released, there was a public outcry. This outcry represents a not-uncommon feeling that somehow large profits, especially those of big business, are immoral, or undeserved. Deciding whether this is in fact the case is a difficult task, for it involves not only theoretical investigation into the nature of morality as it relates to profits and profit-making; but also an empirical investigation of the nature of actual profits, such as those of oil companies, and how those profits relate to the moral theory. This essay provides an overview of issues related to profits and morality, more in the spirit of raising questions and problems than providing answers or solutions.

At the outset, it is important to distinguish between the notions of immoral, moral and morally supererogatory. The distinction between moral and immoral exists in that morality forbids some actions and requires others, while simply allowing yet others. This is a distinction that is common, and, as a distinction, is well-understood. An action is considered morally supererogatory if it is 'above and beyond the call of duty'. Morally supererogatory actions are not required by the strict application of moral rules, but are nonetheless considered morally good. The soldier who jumps on the grenade to save his fellows, or the pilot of a crashed airplane who gives his parka to one of the passengers, both perform supererogatory actions—they are not required by morality, but are considered to have been morally good things to do. This relates to the issue of profits in the following way. If beneficence, for example, is a supererogatory virtue, then walking past the beggar on the street may not violate the moral code, but it may not be the kind of action that deserves praise. It is not the sort of behaviour that we would encourage, or that, perhaps, we would look for in our friends. Similarly, it may be that while declining to make profits out of the invasion of Kuwait is morally supererogatory, making profits instead does not break any moral strictures. If this is the case, we might not like the fact that the oil companies have made large profits, and we may think that beneficence or generosity would require that they did not, but at the same time we would find ourselves unable to apply moral censure on the basis of those profits. Absence of moral supererogation on the part of particular companies may be good reason for taking our business elsewhere, but it does not justify condemnation of their actions or profits as immoral.

The central focus of the papers in this book is not whether profits are supererogatory, even though this may be the issue that drives public sentiment. The focus here is, rather, on the other distinction, namely whether profits and profit making are moral or immoral.

It is also important to note that arguments for or against the morality of profits can be over-ruled by other moral arguments. Even if profits are in general morally acceptable, there will be some profits, for example those due to theft, that we may wish to rule out immediately. Arguments for the morality of profits in general are likely to be over-ruled in cases where profits are obtained through activities that violate other parts of the moral code. Furthermore, it may be that profits in general are not immoral and thus that the makers of them are, *prima facie,* entitled to keep them, but that in order to right some grievous moral harm some profits must be confiscated, as when Exxon was forced to pay damages for spilling oil into Prince William Sound.

In cases like these, particularly the latter, what we observe is the conflict of two or more moral principles. This type of conflict is relatively common, and can only be resolved by appeal to higher principles. We often find ourselves bound both by the duty to tell the truth, and by the duty not to hurt peoples' feelings unnecessarily. Resolving that conflict in any particular case does not involve denying the existence of one of the *prima facie* duties. Whatever the resolution of such conflicts in the case of profits, either to leave the profits in the hands of their holders, or to right the other wrong, the first level case for the morality of profits is not affected. It would remain true that *prima facie*, making and keeping profits is acceptable. It is simply also true that not all *prima facie* duties or obligations are duties or obligations all things considered.[1].

The subject that deals most explicitly with profits is economics. And for Neo-Classical economics pursuit of profits, self-interested behaviour, and use of the market to allocate goods are all tightly linked. The usual criterion by which economists judge outcomes of markets is Pareto optimality. An outcome is said to be Pareto optimal if no one's utility can be increased without decreasing someone else's. Suboptimality implies that it is possible to increase one person's utility and decrease no one's.[2] Pareto optimality emerges as a criterion through concern with one aspect of Utilitarianism, namely the need to compare (in order to add up) the utilities of different individuals. Economists are generally uncomfortable with interpersonal utility comparisons, but tend to believe that utilities of individuals are nonetheless central to the rankings of various social outcomes. Economics shares with utilitarianism the view that, all else equal, increasing the welfare of one individual is morally desirable. This is the Pareto criterion. Economics tends to be unwilling to take the next step, however, which demands the maximization of the (weighted) sum of utilities.[3]

Using the Pareto criterion, economists believe the market to be a very good mechanism for allocating goods and services. Indeed, under certain conditions, any market allocation is Pareto optimal. A market system, though, pre-supposes certain 'rights', such as property rights, but for a Paretian, these rights are purely instrumental. If

[1] See Ross on the distinction between *prima facie* duties and duties all things considered.

[2] When goods are infinitely divisible this is sometimes stated as there being opportunity to make everyone better off, hurting no one. To move from making one person better off to making all better off, simply take the winnings of the winner and divide it among all those who did not win. Infinite divisibility ensures that all can gain.

[3] This paragraph contains many generalizations which obviously do not apply to all economists. Nevertheless, it is probably a fair description of the prevailing view, especially as presented in the textbooks.

there were a way to get to Pareto optimality without them (or without markets) these rights would not exist. These are not the sort of rights that a rights-theorist thinks of. Traditional economics, then, insofar as it treats and defends the morality of profits, presupposes a particular moral view, a weakened Utilitarianism, to which many moral philosophers have objected. (See text infra.) Because the moral theory underlying the Pareto criterion is often found lacking, a discussion of the moral status of profits must look beyond traditional economics. Economics will, however, give important insights into the nature of profits themselves, and to this we now turn.

Types of Profits

Economists usually identify several different types of profits.

Normal Profits

Normal profits are the return to the owner of a firm that operates in a perfectly competitive market, in long run equilibrium. In a perfectly competitive market, when a firm maximizes profits, each factor of production will receive a per unit payment exactly equal to what it produces at the margin. The market price, or the cost of a factor is equal to the value of its marginal product. Thus the return to capital, what it produces, is exactly equal to its opportunity cost, what its owner could receive in the next most profitable use, that is, in investing it at the market rate. When firms are earning normal profits, net *economic* return is zero, since revenues exactly equal costs, where costs include the cost of capital, which is the market rental rate of capital.

SuperNormal Profits

These are profits in excess of normal profits, and occur when revenues exceed costs, again including the cost of capital. In principle, supernormal profits cannot exist in perfectly competitive markets. If some firm were making supernormal profits new firms would enter the market, thus bidding down the price of the output, and bidding up the cost of capital, until there was no incentive to enter. There is no incentive to enter when profits in this market are equal to those in other markets, that is to say, when profits are normal. Supernormal profits are often identified with monopoly profits, even though monopoly power may be temporary.

Rents

Rents are the returns to ownership, and accrue when an agent owns a good that has a special characteristic which, through no effort of the agent, is valuable.[4] Professional athletes or musicians are often given as examples of recipients of rents, but the owner of a quota to import a good or a quota to produce a quantity of milk, for example, may also be receiving rents. Typically in these cases, the quota or skill is not enough to generate income; it must be accompanied, in the musician's case, with a considerable amount of practice. It is true, though, that for most people, no amount of practice will produce piano playing of the quality produced by Alfred Brendel. Some of Brendel's income is a return on the investment he has made through practice, but some of it, the part due to his special physical and mental abilities, which most of us are incapable of supplying, is rent.

While this list exhausts the types of profits that economists usually define and discuss formally, there are two other types (which may be normal, supernormal or rents) which it is appropriate to distinguish in a discussion of profits and morality.

Profits from Immoral Activities

There are members of our societies who have made considerable profits from extortion, selling what is euphemistically known as protection. On the face of it, it seems clear that profits from immoral activities must themselves be immoral. Any justification

[4] In discussions of rents in the context of ethics, examples of rent producing goods are typically of the type given here, but it may simply be that the "special characteristic" is that the good has a vertical supply or demand curve.

of the morality of profits that uses a deontological ethical starting point almost certainly rules out these sorts of activities.[5] A teleological, or consequentialist, ethics, though, may open the door for these sorts of profits.[6] In principle, if the profits are used for sufficiently good works, or if the social system that encourages profit-seeking has sufficiently good long-run effects, profits may thereby become morally acceptable. A railroad, perhaps, steals land from farmers. One result of this action is that costs of construction of the line are low, and consequently, costs of moving freight on this railroad are also low. This clearly will have a benefit to many actors in the economy. If these benefits are large enough, a purely consequentialist theory will judge the profits to be morally acceptable, since they were the result of an action that itself had overall good effects. Allowing profits from apparently immoral activities in by the back door, so to speak, is intuitively unappealing perhaps, but it is a possibility that arises when the underlying moral theory is consequentialist in nature.

Windfall Profits

Windfall profits arise purely from changes in external circumstances. The OPEC oil embargo of 1974 presents an example. Immediately following this event, the value of oil held by oil companies increased dramatically, through no efforts of their own, and presumably to their complete surprise. Had the oil companies made no changes in their oil-selling plans, with a pricing strategy described as charging what the market will bear, they still would have made large profits that were directly attributable to OPEC's actions. It is true that the profits that were made followed some decisions to sell the oil, but it seems completely unreasonable to ascribe *all* those profits to the entrepreneurial acumen

[5] In a deontological ethical theory acts are good or bad in and of themselves, due to some characteristic they have or fail to have. Contrary to the view of consequentialist theories, the goodness of an action is not entirely dependent on the non-moral goodness or badness it produces. Kirzner and Narveson are explicit that their theories rule out profits from immoral activities.

[6] See Cooter and Gordley, and especially Rizzo, this volume.

involved in selling oil at higher prices.[7] It is important to notice that windfall profits are different from speculative profits. Speculative profits are made when a gamble pays off; in this case, the profit maker performed an action precisely in order to make profits if some specified event occurs. That it comes about is expected, though the expectation is generally probabilistic. Not so with windfall profits—the event causing the profits is a complete surprise to the profit maker.

Profits For and Against

Arguments about the morality of profits are often not explicit, but are rather part of larger arguments for or against economic or political systems (especially the decentralized market system), or for or against particular ethical structures. Arguments against the morality of profits especially, tend to couched in terms of attacks on arguments for profits or free markets.

Efficiency

For economists, arguments about profits are tied up in arguments about economic efficiency. The ethical criterion used in modern welfare economics is a weakened form of utilitarianism, namely Pareto efficiency. Pareto efficient allocations are considered to be good, and the closer to Pareto efficiency, the better. Thus economists have been concerned with the conditions under which Pareto efficiency will obtain. A common argument in economics, often referred to as an efficiency argument, is that the pursuit of profits regulates an economy in such a way that it can never stray far from efficient allocations. When an inefficiency exists (for example a shortage of some good), a re-

[7] This may be a case of an event with two causes. The higher profits were caused both by OPEC's actions and by the decision of the oil company to sell its oil at a new, higher price. The claim here is that while the decision maker's actions are clearly responsible for determining exactly how much more profit the company makes, it is also true that the action of OPEC "sets the ball in motion", and so deserves to be considered a major cause of the higher profits.

allocation of productive resources (to produce less of a good in surplus and more of the good in shortage) will be a Pareto improvement. In a market economy the existence of such an inefficiency typically indicates a profit opportunity. The alert entrepreneur, seeing the opportunity, performs the needed re-allocation of resources, which not only makes profits for him, but also generates an ethically superior final outcome, assuming all agents consume both goods. Profits, then, are central to the process whereby Pareto efficient outcomes are achieved. Such Pareto improvements are morally desirable, and until Pareto efficiency is reached, the outcome is not considered morally acceptable. Thus Pareto efficiency is thought to be necessary for moral acceptability, since in an inefficient allocation at least one person's utility could be increased without decreasing anyone else's.

Sufficient versus Necessary Conditions for Moral Acceptability

This line of argument is attacked in several ways. First, while Pareto efficiency may be necessary, it is not sufficient for a morally acceptable outcome. There are many possible Pareto outcomes in which an economy can find itself. An allocation in which one person owns everything, assuming that he is not sated, is Pareto efficient. Pareto efficiency is consistent with extremes of destitution, and thus the criterion is not enough. Economists are aware of this, and have shown that with the appropriate initial redistribution of resources, any Pareto efficient outcome desired on moral grounds can be supported as the outcome of a market economy. They can then argue that pursuit of profits, perhaps with some initial redistribution of resources will generate ethically good outcomes. This raises another objection. The technical assumptions about production technology and people's preferences required to get these results are very strict, and are unlikely to be met in the world. It is thus unclear exactly what force these arguments about the merits of markets and the pursuit of profits have. [8]

[8] See Hammond, this volume.

Pareto Optimality and Utilitarianism

A second type of attack on the efficiency argument sketched above focuses on the moral criterion. As a moral theory, utilitarianism, which underlies the Pareto criterion, is thought to have failings which simply cannot be ignored. Because of the consequentialist nature of the criterion, the theory has extreme difficulty coping with rights as generally understood. It could be, for example, that by confiscating some property from which a person gets no utility, and redistributing it to another, we can generate a Pareto improvement.[9] Such a confiscation, though, would be a violation of property rights, and would violate any rights against coercion in general. On the other hand, some argue, leaving the good in the possession of the original owner may be the source of a violation of (positive) basic rights to food and shelter. Though an allocation may be Pareto optimal, it can involve a morally unacceptable amount of destitution. Redistribution to alleviate this suffering would not in general be a Pareto improvement, and therefore is not justifiable under the Pareto criterion.[10] Utilitarianism, and thus the Pareto criterion, fail to consider aspects of morality that many feel are very important.

Only in special cases will the efficiency argument hold, which raises questions about its moral relevance. But even when the argument is relevant, problems arise from the consequentialist nature of the underlying moral theory.[11] The arguments given by standard economics in defense of profits are thus weak at best.

[9] It is more difficult to create examples of this sort that argue against the Pareto criterion than against Utilitarianism, since if the original owner gets any utility, however small, from the good, redistribution (without side-payments) will not be Pareto improving, even though it may have an enormous positive impact on total utility.

[10] This principle appears in Rawls as his difference principle applied to primary goods. See also Dworkin, Goodin and Sen (1985).

[11] See Hammond, this volume for a more detailed and thorough development of these arguments.

Evolutionary Arguments

A related, though distinct, type of consequentialist argument for profits takes place at a different level. It concerns the ability of a moral system to adapt to changes in the world. New technologies for human reproduction have generated a significant amount of ethical debate in the last decade or so. How our moral system will eventually respond is unknown, but it will have to respond somehow. Given that we live in a world in which this sort of "external" change takes place, it is important that our moral system be able to respond without completely breaking down. Thus an important criterion by which we must judge a moral system is its adaptability.

Some argue that the market system is very flexible, and allows a maximum freedom of choice of action, at least in the economic realm. Experimentation with new types of behaviour (new types of production, or new types of contracts, for example) is relatively easy. Ease of experimentation encourages a fluidity in the structure of the economy, and so in the social structures surrounding it. Profits, then, are valuable not in that they maximize total utility or wealth, though they may do so, but rather in that profit-seeking is the type of behaviour that will cause the evolution of the moral system. On the other hand, the logical extreme of flexibility in the moral system is moral anarchy. If evolution comes about through experimentation, then having many moral standards in a society is a good thing. Any moral code can, in principle at least, be justified as a contributor to the future good of society because it challenges ingrained, and possibly pernicious, behaviour. If moral anarchy would not be a good thing, this type of argument for profits must argue that profit-seeking behaviour does not lead to it.[12] Finally, the strongest possible version of this argument would also have to show that economic

12 See R.C.O. Matthews for an argument that for efficient operation of the market system, the prevailing moral code must contain strictures against some particular types of behaviour, and encouragement of others. Also Rizzo, in this volume, argues that the stricture he calls Spencer's law must be maintained throughout the process of experimentation.

systems that do not encourage profit-seeking behaviour lack precisely the flexibility that it provides, and have no other way of encouraging moral evolution.

Both of the arguments just considered have been embedded in a consequentialist moral view. The argument to which we turn now, the free exchange justification of profits, is explicitly non-consequentialist, employing a deontological moral theory.

Rights and Free Exchange

Concern with rights, while a source of argument against standard efficiency defenses of profits, is itself a source of a different defense. Property rights, sometimes seen as a necessary extension of rights against coercion, will almost certainly include the right to transfer.[13] When property rights exist, then, there seems to be a strong case for the moral acceptability of profits arising from free exchange. If two parties agree to an exchange in which there is no coercion (which implies that they both expect to be better off after the transaction), and in which there are no third party effects, why should anyone object to it on moral grounds; on what grounds could it be forbidden? One response is that some such transfers could be forbidden in order "to induce a pattern of exchanges that is better on the whole." [Gibbard, 1985 p.25] Here we see a conflict between consequentialism and deontology. If consequences matter at all, it may be that by preventing some voluntary transactions we can produce another set of transactions that generates an outcome that is superior (on non-Paretian grounds). Certainly the law tries to prevent some transactions—indentured servitude, or voluntary slavery, for example.

The Nature of Property Rights

Gibbard also argues that property rights, on which the free-exchange-justification rests heavily, are a complex social institution under which an allocation of resources is, in

[13] See Nozick, for example.

essence, a set of restrictions on members of society. My owning something places restrictions on what you can do to, or with it. When two agents trade goods, they are simply changing to a new set of restrictions on who can do what to the goods they trade. Since the essence of property rights, on Gibbard's analysis, is to prohibit certain ways of changing these restrictions (for example, theft or extortion are not acceptable ways to change restrictions on who can do what to the good), why not prohibit others? Gibbard suggests that the reason we restrict certain exchanges of labour—those that take place for wages less than the minimum wage—is to generate more exchanges that take place above the minimum wage. The moral acceptability of profits from free exchange is predicated upon a certain institution of property rights. Other institutions could exist, though, so this one must be justified, and how else but by appeal to consequences?[14]

What is Free Exchange?

If Gibbard's charge can be parried, there is another attack that is sometimes levelled, this one on a more procedural level. What, exactly, does "free exchange" mean, and how prevalent is it? This line of attack has several branches. First, free exchange is often thought to include full knowledge, and absence of coercion. But how much must a buyer or a seller disclose before being guilty of fraud? With full disclosure, would any exchanges take place? If the buyer is buying to take advantage of a profit opportunity, if that is disclosed, the seller will not sell, but rather make the profits himself. Demanding full disclosure removes much of the incentive to trade, not to mention making most contracts impossible to write. Something short of full disclosure is necessary, but just how short is far from obvious.[15] Second, what counts as coercion? If a landlord offers to rent a piece of land only on the condition that the tenant buy seed from him (at inflated prices) does this count as coercion in the seed transaction? Does it matter if the tenant

[14] See Nozick, for example, for an attempted justification.

[15] See Kronman for a discussion of this problem.

has no other source of livelihood, but perhaps another source of seed? Finally, to what extent are transactions free of third party effects. Technological externalities, such as the production of pollution, are acknowledged as violating free exchange. When two parties trade, and in doing so create pollution, a third party involuntarily becomes party to the transaction. This is not denied, and the free exchange justification would rule out profits from such transactions. It may be, though, that pecuniary externalities constitute third party effects from a moral point of view.[16] If my buying a particular house prevents you from buying it, is that a third party effect? Concerns about pecuniary externalities lead procedural (free exchange) theories of justice, and some contractarian theories, to demand provisos on original acquisition. There may be no technological externalities involved, but when one ship-wrecked sailor appropriates the only can-opener, the other, can-holding, sailors suffer fairly sever pecuniary externalities. (This can be seen as a pecuniary externality in that the holder of the can-opener is able to drive down the "price" of the resources held by the other sailors by threatening to refuse to let them use the can-opener.) This is the sort of situation that many of the provisos seek to rule out.[17]

Provisos on Initial Acquisition

The free exchange justification is strongest when both parties to a transaction have just title to the goods being traded. Intuitions are strong that the profits made by selling stolen goods are morally unacceptable. It is thus important that we ground the exchange process on just beginnings. Provisos added to prevent illegitimate beginnings to the free exchange process cannot be justified on procedural grounds though. They rule out certain starting points *a priori*. But if reasons exist for ruling out original allocations *a priori*, why

16 See Hausman for an argument that pecuniary externalities are pervasive and morally significant.

17 See for example, Locke or Gauthier. Locke's proviso states that an initial acquisition is acceptable, provided that in the acquisition of the good, the acquirer leaves for his neighbour "as good, and as large a possession (after the other had taken out his) as before it was appropriated." p.22. There must be "still enough, and as good left; and more than the yet unprovided for could use." p. 21.

cannot similar reasons be applied to intermediate or even final allocations? The response that later positions are arrived at through free exchange has been accused of circularity.[18]

Original acquisition, we should note, can take place at any time: economies are privatized; new goods are invented; and new ways of assigning property rights are discovered. We tend to think of physical goods as the things being acquired, but in fact the class at issue is the class of economically valuable things. This may include relatively abstract things like monopoly power. There can obviously be original acquisition of monopoly power, and this, by definition, will not leave as good and as much for the rest.[19] If acquisition of monopoly power is ruled out, then it seems that acquisition of market power should be ruled out as well. Transactions having pecuniary externalities are now in trouble. What this line of argument suggests is that if to make the free exchange justification work it is necessary to restrict original acquisitions, we may have to treat pecuniary externalities the same way as technological externalities. The upshot would seem to be that only normal profits can be justified by free exchange.

If the arguments above are correct, then the free exchange justification, when Lockean-type provisos on original acquisition are added, leads us to the following position. If the accumulation of market power is morally unacceptable, then all agents are price takers, and thus none can change the price. Thus either we are in, and have always been in perfectly competitive equilibrium, with only normal profits being earned, or we must continue to live in a world of economic maladjustment, since it is morally unacceptable to acquire the power to change prices.

[18] See Reiman.

[19] Nozick states that cornering the market for life-necessities (like insulin), even through free exchange, is ruled out by his version of the Proviso. It is difficult to see why his arguments do not apply to life-*enhancing* goods as well.

These concerns about the free exchange justification do not make an argument, but suggest that free exchange, though elegant in its simplicity, must take account of deep, and perhaps troublesome issues.

Fair Exchange

Another objection to the free exchange justification is that it is too simple. Free exchange, it is sometimes claimed, is not necessarily fair exchange. "Fairness involves not simply a gain to both sides from a trade, but also an equitable distribution of the gains." (Romer p.59) Every transaction involves a surplus—the buyer pays less than the good is worth to him, and the seller receives more than it is worth to him; otherwise there is no incentive to trade. Thus there is a surplus of "worth" created by a trade, which will be distributed between buyer and seller.[20] Experiments performed by economists and psychologists suggest that considerations of how the surplus is distributed are important in subjects' evaluation of whether or not a trade should take place. Subjects are unwilling to allow exchanges in which one party gets too much of the surplus, even if refusing the exchange makes oneself materially worse off. It is difficult, of course, to decide whether the subjects were motivated by moral consideration or by something else, but the results of the experiments fit well with intuitive notions of fair trade.[21]

More generally, it is often argued that for free exchange, and the distribution of surplus that goes with it, to be fair, the exchanging parties must somehow be "equally situated". (Hardin p 133-34) Often, though, parties are not equally situated in the relevant sense and this causes what appear to be inequitable distributions of the surplus. It is sometimes claimed that free exchange can, and often does, lead to situations in which one party has little choice in whether to make the exchange or not. When a worker either works or starves, he is in a weak position from which to bargain over wages if the

20 We refer here to "pure surplus", which arises simply from differential valuations of a good.

21 See Frank for a discussion of some of these experiments.

potential employers have any monopsony power. In situations like this, it is reasonable to expect that because the two parties are differently situated—one needs the exchange and the other does not—the employer would get the lion's share of any surplus.[22] More extreme examples might be of the following sort: A very sick (but not terminally ill) person can be saved by use of a drug owned by someone who is well, and extremely unlikely to contract the disease. Assume that the drug was delivered fortuitously to this person. The former is clearly willing to pay a very high price to obtain the drug, and suppose he does so. Here, the exchange is free, exhibits no coercion, and both parties benefit from it. On the face of it, though, one can see why the gains from trade appear to be unfairly distributed. On the part of the buyer, a high price was paid for something valuable—good health, but on the part of the seller, a high price was obtained from something of very little use value—a drug he was unlikely to use, (and perhaps would never use, and is thus of no value, if he is guaranteed never to get the disease). Intuitions that arise in cases like these argue that free exchange is not enough to guarantee fair exchange; something more is needed. Often, the market takes care of this problem, by providing substitutes for the drug so that the seller cannot demand such a high price. In cases of monopoly buying or selling, or with thin markets in general, it is more difficult to make this kind of defence work. This having been said, it has proved extremely difficult to pin down what more is needed to make free exchange fair. While many have attacked the free exchange justification on grounds of fairness, attempts to lay out what, exactly, a fair exchange is, have had difficulties of their own.

Marxian attacks on the moral status of profits take a different form, and point to another problem with which the free-exchange justification must deal. The fundamental

22 See Reiman for a development of this argument, and an attack on Nozick's response to it.

Marxist theorem states that exploitation exists if and only if profits are positive.[23] It is not the case, however, that every instance of exploitation is unjust. "The injustice of an exploitative allocation depends upon the initial distribution [of productive assets]." (Romer, p 57) Exploitation can exist if there is inequality in the distribution of capital holdings. Whether the exploitation that follows is just or unjust depends how the initial distribution came about. If it came about through a process considered immoral, then the exploitation (and so the profit that comes with it) that follows will be immoral. The crucial questions are two: In general how has the unequal distribution of capital come about? and Is this process immoral?

Differential Links Between Profit and Holder

The importance of the initial distribution from which exchanges take place is widely acknowledged (see above)—no one would claim that the profits arising from the free exchange between thief and fence are moral. Thus while it may be that the disposition of justly owned assets (where all parties to the transaction have entered voluntarily) generates morally acceptable profits, it does leave the problem of how just ownership comes about in the first place. [24] Kirzner points to the common intuition that "in order for an individual to have a just claim to a certain holding, he must be able, in principle, to establish some differential link to that holding that sets him significantly apart from others." (Kirzner, 1989 p 136) Any old link will not do though—being the only person to have stolen a particular object is not the kind of link we want. Intuition makes two strong suggestions for the kinds of links we believe generate acceptable moral

[23] An input is said to be exploited when the payments it receives are less than would be necessary to reproduce itself. Romer notes that "exploitation" is an unfortunate word, as it comes loaded with ethical baggage whereas it is in fact a technical term. He also notes that not only labour, but any input good can be exploited.

[24] Here Nozick's strong demand that the entire history of an asset, and the inputs that went into producing it be untainted, is often weakened, in favour of a more intuitive notion that demands only an examination of relatively recent history. Historical wrongs cannot be righted.

claims to an object: that the owner have worked for it; or that the owner have found or discovered it. Both of these types of links have been used as moral justifications of profits.

Sweat of the Brow

P.T. Bauer , while not defending profits *per se*, but rather a more general inequality of income distribution, states that on the whole incomes are earned. What people own or receive they have worked for. Incomes are returns to factors of production and are thus simply what a particular factor has produced. This might be called the "sweat of the brow" justification of profits; if an agent works hard to produce something, and in selling that thing makes a profit, surely he is entitled to the profit, he deserves it, and justice demands that he get it. This intuition is strongest when imagining Robinson Crusoe alone on his island, working by himself with tools that he made. Most production, however, is joint. It involves many different factors and typically many different agents. It is not possible, in this situation, to determine how much of the total production should be ascribed to each factor. The marginal calculus used by economists to determine profit maximizing allocations states that the per unit payment to an input should be set equal to the marginal product of that input. Adding one more unit of labour, for example, should increase output (in value) equal to the wage paid to that additional unit. The additional labour cannot be said to produce that output, though, for the marginal product presupposes some amount of capital (and perhaps other inputs) which is also contributing to production. While intuitions about sweat of the brow justifications are strong, they run into trouble in the face of sorting out exactly who produced what, when production is joint.

Creation or Discovery

The second type of significant link between owner and object mentioned above was one of creation or discovery. The creator of an object certainly seems to have a very strong claim to ownership. Similarly, a person who discovers something, assuming this discovery is *de novo*—there are no previous claims to it, has what appears to be a very strong moral claim to the object. That this principle applies explicitly to pure profits has been argued by Kirzner (see Kirzner this volume). Pure profits arise when an alert entrepreneur discovers a profit opportunity and acts on it. In making this discovery he is, in effect, creating an economically valuable commodity where none before existed.[25]

Two things are worth pointing out in response to this line of argument. First, this is not merely the sweat-of-the-brow justification in a different guise, though there may be an element of sweat of the brow in the entrepreneur's implementation of the opportunity. Second, ideas from action theory, with its emphasis on the intentions of agents, suggest new insights into the nature of this justification of profits.

Windfall profits are often thought to be morally different from other profits because of the weakness of the link between windfall profits and their owners. These profits are neither the result of working for them, nor the result of speculative investments. The link between owner and profits seems to be morally weak, and not enough to provide a strong justification for ownership.[26] A link between object and owner is considered strongest when the owner is the primary source of actions undertaken in order to secure the existence of the object. The owner is the cause of the existence of the object. Another strong link exists when the rightful owner deliberately gives the object (either as a gift or in a trade) to a new owner.[27] Windfall profits, of course, have neither of these features. Oil companies were not the cause of the OPEC oil embargo

[25] Clearly he is not involved in the physical creation of goods out of nothing, but he is involved in transforming a non-economic item into an economic one, and, depending on the metaphor, either adding a new object to the economic world, or adding to an object a property—that of being economically valued—that it did not have before.

[26] It may be, of course, that ownership comes by default—no one else has a claim to the profits, but this could not be called a strong claim to ownership.

[27] There is some debate about whether this is an acceptable source of a link when the gift is an inheritance.

(which caused a world shortage, causing prices to rise), nor were the actions of OPEC deliberately aimed at raising the profits of the oil companies. Thus one might feel that the claims of the oil companies to these profits are weak.

Profits from apparently entrepreneurial activities can be divided in two ways. Consider profits arising from the purchase of a piece of land which increases in value. Under the first division these profits can be intentional, where the expectation of the profit motivated the purchase; unintentional, where the profits, while expected, did not motivate the purchase; or accidental, where the profits were a complete surprise. Accidental profits have the features of windfalls discussed above, and perhaps should be characterised as such, even though they followed the action of the entrepreneur. The different moral implications of intentional and unintentional actions have been widely discussed, both in the ethics literature and in the literature on tort law. Briefly, while agents must take responsibility or credit for unintentional consequences of their actions, the moral link between agent and consequence is stronger when the consequence motivates the action than when it does not.[28] It would seem to follow that the link generating the moral claim of an agent to his profit is stronger when the profit motivates the action than when it does not.

The second division focuses on an agent's beliefs about how the profits will come about, and so does not apply to accidental profits. Suppose the agent expects the value of the land to increase because a shopping mall will be built nearby. If the mall is built, the projected causal chain materializes and profits are made. But suppose that the mall is not built; a housing development on the other side of the land is built instead. The

[28] Clearly, an agent is not legally or morally responsible for *every* unintentional consequence of his actions. Some consequences are simply too far removed. For a discussion of this point see Hart and Honoré, pp. 259-284.

entrepreneur's projection of the causal sequence is incorrect, but profits emerge nonetheless.[29]

That this second distinction may be morally relevant can be seen by examining the nature of discovery, and what is discovered. What entrepreneurs discover is not simply a profit opportunity *per se*, but rather a fact or facts about the world—a potential sequence of events or causal chain at the end of which is a pot of gold. Discovery does give claims, it is true, but only to that which is discovered—the pot at the end of this particular chain. When the shopping mall is not built, though, that causal chain is broken, and profits associated with that chain do not materialize. To the good fortune of our agent, another one does, but not one that he can claim to have discovered. The sequence of events leading to his profits, then, has two aspects. First, that of a failed investment; what the entrepreneur expected to happen fails to happen—the expected shopping mall does not materialize. But the second aspect is that of a windfall. A set of events quite different from those expected took place, and from these events profits arose. The profits in this case, then, are like those that arose from owning oil on the day of the OPEC embargo, there was no other party whose goal it was to give profits to the maker of them, and the cause of the profits was unexpected and unplanned-for by the maker of them. A significant part of the cause of these profits was "pure luck".

Making these distinctions about the types of profits that can follow what are normally called entrepreneurial actions suggests that discovery as a source of justification for profits must be used carefully.[30] The intentions of the entrepreneur may be important, but his beliefs are also very important. Profits that follow apparently

[29] This distinction among the five types of entrepreneurial intentions is due to a discussion with Michael Bratman.

[30] One should note, of course, that the importance of these distinctions may be different depending on whether one is considering legal or policy aspects of profits, or whether one is considering fundamental moral justification.

entrepreneurial actions may in fact be windfalls, in which case the claims of the entrepreneur to those profits are significantly weaker.

This summary of arguments attempting to justify profits is exhaustive neither in the sense of considering all possible positions from which to argue nor in the sense of considering all possible arguments for or against these positions. It does, nonetheless, indicate that a wide variety of ethical starting points can be used to argue for the moral acceptability of profits and profit-making, and that an equally wide variety of arguments can be deployed on the other side. As was suggested above, many arguments about the moral status of profits are by-products of arguments about more general issues. The papers in this collection address the general issue of the moral status of profits explicitly, and in doing so, they address many of the arguments described here.

The Papers in this Collection

The moral status of profits is a complex issue, understanding of which demands examination both of profits, and of some aspects of morality. All of the papers in this volume deal explicitly with profits and morality , but do so from different points of view. Because the issue is complex, different papers focus attention on different aspects of it. Some have little to say explicitly about ethical theory but much to say about the nature of profits, and some the reverse.

Papers by Kirzner and Hammond do not attempt any innovations in ethical theory. They are both discussions of profits, and the way profits originate and function. Papers by Narveson, Mack, Rizzo, and Cooter and Gordley, by contrast, are explicitly about ethics. These four papers take questions about profits as answered, and argue for various ethical views, showing how profits fit into these views.

The papers that focus on profits, by Kirzner and Hammond, employ different ethical positions. Kirzner uses the finders-keepers rule as his guiding principle, while

Hammond uses a modified Pareto principle. Within the papers that focus on ethics there is similar variety, Narveson building a deontological theory, Mack making an argument about contractarianism (by appeal to rights), and Cooter and Gordley making a utilitarian argument, and Rizzo developing a more general consequentialist or evolutionary theory. The collection of papers, then, covers a wide range of starting points for this discussion.

Kirzner and Hammond both simply state an ethical position, and argue about how profits fit into this position. For Kirzner, the position, or guiding ethical principle, is the finders-keepers rule. Concerned with the creation of a morally significant link between entrepreneur and profit, Kirzner suggests that it is intuitively appealing that the creator of an object takes moral responsibility (either praise or blame, reward or punishment) for it, and that this is enough to create a differential link and so create ownership. This link formed by creation or discovery corresponds to what is colloquially known as finders-keepers. Kirzner argues that profits, when properly understood, should be seen as the creation of a new object. He argues not for finders-keepers, but rather that finders-keepers applies to pure profits, when profits are not simply returns to factors of production.

The ethical position adopted by Hammond is the Pareto principle, but to this general principle Hammond adds the proviso that there not be extremes of poverty and degradation. Using this as his ethical criterion, Hammond asks what economic theory tells us about the pursuit of profits (and other rewards) as a means of promoting ethically acceptable outcomes. Hammond raises objections, some of them suggested above, to the blind application of efficiency arguments in order to justify profits morally. Even using the ethical principle common to standard welfare economics, Hammond argues that only in very special cases will the pursuit of profits lead to the ethically desired outcome.

Both Kirzner and Hammond argue about the nature and function of profits, but they use different ethical yardsticks, and arrive at different conclusions about the precise status of profits. Both acknowledge, though, that their conclusions are only as strong as the ethical premises on which they are based.

Narveson, Mack, Cooter and Gordley, and Rizzo all employ simple definitions of profits and raise different ethical criteria by which to judge them. These four papers are not intended to offer insights into the (non-moral) nature or function of profits; they are explicitly about ethics. In Narveson's paper, profits are defined as the net monetary gain from free, voluntary exchange, and encompass all of the types described above with the exception of profits from immoral activities. His moral criterion is desert, and Narveson asks whether profits are morally deserved. To address this question, the paper includes a detailed examination of the nature of desert. This examination concludes that the place of the bestower of the thing deserved is often neglected in discussions of desert, but that this role is an important one. Disposition of justly owned assets, or free exchange as it was described above, occurs when each party to the exchange believes that trading with the other will further his own ends, and thus that the other deserves his custom. When custom is deserved, so are the profits arising from it. When trade is viewed this way, and the role of the "customer" is acknowledged, the conclusion that profits are deserved follows.

From a rights-based position, Mack argues that agents who earn economic rents are morally entitled to keep them. This paper attacks a position defended by Gauthier, namely that the confiscation of rents—payments derived purely from ownership—is morally justified. Gauthier arrives at this conclusion through a distinction between 'rights in' and 'rights to'. If this distinction stands, then confiscation of rents, (but not payments for services rendered) is morally justifiable as part of the social contract. After describing an internal inconsistency in Gauthier's account, Mack argues that this distinction between rights in and rights to, at least when applied to one's natural endowments, cannot hold. It follows, then, that rents are the rightful property of their owner.

The paper by Cooter and Gordley, while similar to those of Narveson and Mack in arguing about ethics, differs in that it adopts a more consequentialist morality. This paper argues for the existence of 'merit goods' and models their existence as a form of externality. Profits here are defined as pure rents, and are significant in the model as a means of lowering the relative prices of merit goods: They are used, for example, to endow libraries and universities, and similarly subsidize other merit goods. Profits attain moral acceptability, then, by the way they are used, that is, by encouraging the production and consumption of socially valuable goods.

Rizzo also adopts a consequentialist philosophy. His emphasis is on the pursuit of profits as a means of enhancing adaptation to change. In this he follows the Austrian view of the function of profits elaborated by Israel Kirzner. Profits are made by correctly adapting to future changes. This has a moral value because it creates wealth, and thereby increases the probability of survival. The latter is the standard of morality in an evolutionary theory. The pursuit of profits also serves a long-run function in imposing costs on those who adhere to rules of conduct that have lost their ability to help agents adapt to change. So profits, in Rizzo's view, have two moral functions. First, they create incentives to apply those existing rules that enhance adaptation to change. Second, they create incentives to change the moral rules themselves, insofar as they are deficient in their ability to promote adaptation.

Each of the papers attacks the issue of the morality of profits from a different starting point and a different perspective. The collection does not exhaust all of the possible points of entry to the problem, but it does represent a very broad spectrum. Because each paper focuses its attention narrowly on a particular issue, the general applicability of each paper's conclusions are dependent on some issues not discussed. (Each conclusion has its own 'To the extent that...' clause.) Some of the issues not directly addressed by the papers are empirical, (Do profits support merit goods? Are profits the result of free exchange? Are the survival-tendencies generated by evolutionary forces overcome by other forces?), and some are theoretical, (What counts as free exchange? Is utilitarianism, with the 'non-extremes' proviso, an acceptable moral theory? Is finders-keepers more than just intuitively plausible? Are rights-based moral theories workable? Why should individuals worry about species-survival?). Many of these issues have been extensively discussed elsewhere, and the specific conclusions of each paper about the morality of profits may rise or fall with the resolutions of these other questions. In the course of coming to their conclusions, though, the papers examine many important issues which must be addressed in any attempt to understand the moral status of profits.

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