Free Exchange Is Win-Win

With the possible exception of the political class and its cronies, most of us would be healthier, wealthier, happier, and freer if the public knew how to engage in "the economic way of thinking." The late Paul Heyne, who wrote a popular textbook by that name (now in its 13th edition thanks to Peter Boettke and David Prychitko), summarized the economic way of thinking by writing, "All social phenomena emerge from the choices of individuals in response to expected benefits and costs to themselves."

I think of Heyne's title whenever I encounter an example of failing to understand this. Unfortunately, our society is rife with examples and resulting bad government policies, which tells you a lot about why we suffer periodic hardships like the current inflation. The lockdowns during the COVID-19 pandemic were a spectacularly tragic example of the failure to engage in the economic way of thinking.

Other instances of that failure are so thoughtless as to be ludicrous. Take the wealthy business owner who donates a large sum of money to a worthy cause. The fallacy occurs when the donor or someone else inevitably says that the charitable act was motivated by a wish to "give something back," presumably to society or the community.

What's wrong here? It suggests that the donor wants to show gratitude for his fortune by reciprocating. But that makes no sense because the donor's wealth was not the result of people handing over money as a favor and getting nothing in return. Those people were customers, not donors. They bought something they wanted and must have liked the terms of exchange. So there is nothing to pay back. (I have in mind only people operating according to just-market principles: no force, fraud, or favors coercively provided by politicians.)

In the marketplace, profits come from voluntary exchange, which requires that buyers and sellers freely choose to transact business. Why would they do that? They do it because each party expects to benefit — to be made better off — by giving up something they own for something that they would rather own. This is clear with barter, but it's equally true when one party trades money. Money, a medium of exchange, expands the opportunity for exchange by enabling people to get what they want even when they don't have the particular items that their available trading partners want.

When Smith trades a sum of money to Jones to acquire shoes, Smith demonstrates that he prefers those shoes to anything else he might have feasibly used the money for, including holding on to it. Jones demonstrates the opposite preference.

Unfortunately, since they are fallible, Smith or Jones (or both) might realize later that he made a mistake. That's life, but it does not change the fact that at the moment of exchange, both sides *expected* to gain. If they are right, they have a happy win-win, or positive-sum, situation. Both sides *profit*, not just the one who obtains money because both come out ahead. (The competitive quest for profit has brought us liberal return policies, so the fallibility problem long ago became much less severe. John Stossel likes to point out that at the supermarket, both checkout clerks and customers typically thank each other.)

Free exchange produces mutual gain. If we could quantify the gain (we can't), we would say that after the exchange, the two people have more total value between them than they had before the exchange. This is remarkable, considering no new stuff was created by the transaction. Possession of the product and the money simply changed hands.

To put it qualitatively, we can say that through the exchange, both parties climbed higher on their respective value scales, giving up a subjectively lower-ranking value for a subjectively higher-ranking one. (What counts is how *the parties* evaluate things.) For this to occur, we need first, two parties with different preferences and, second, freedom, including property rights. Before you can justly trade something, you must own it.

In light of the two-way gain through free exchange, the wealthy seller has no reason to "pay back." He is successful because he provides value to his customers, who are happy to exchange their money.

It's too bad that people who earn fortunes justly are made to feel guilty about their success. (Ayn Rand and Ludwig von Mises did their best to teach honest producers they had nothing to be ashamed of.) We consumers never feel guilty about the profits we reap. Why should the sellers?