

Common Misconceptions about economics and their rebuttals.

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90% of macroeconomics comes down to understanding and being able to apply a number of basic concepts.

Through these examples, the primary principles and concepts of macroeconomics are illustrated.

If this topic interests you, or you want more detailed and thorough explanations and examples, I highly recommend Basic Economics by Thomas Sowell.¹

Economics can be defined as the allocation of finite resources which have alternative uses.

The resources are both limited and can be used elsewhere.

As you will see in each section, **incentives are core to every macroeconomic problem.**

When thinking about any economic issue, policy, or scenario, the incentives of every party involved are what should be evaluated. Not the goals of the policy, the emotional weight of the issue, or the status of the groups involved.

The zero-sum fallacy

This fallacy (usually believed implicitly) asserts that when there is money in one place, it must have been taken from somewhere else. When one individual gets rich, another becomes poor. When one company succeeds, another must be failing.

To understand what is wrong with this reasoning, we first have to understand what money actually is. **Money is value**, or more precisely, it is a representation of value. The reason it represents value is simply because we all agree that it does.

Value can be created: If I make a new product that people like, then the money I earn (value I create) is not being taken away from anywhere else; it is instead brand new value being injected into the economy.

Another component of this fallacy is the idea that in a transaction, there is a winner and a loser. This is almost never true in a free market. Why would I sell something to someone else for less than it cost me? Conversely, why would I buy something for more than it is worth to me? **The**

point of a transaction is that the subject of the transaction is worth more to one party than it is to the other.

If I make bread for a living, and a starving man arrives at my bakery, the bread is worth more to him than the \$5 I'm selling it for. But the \$5 he offers me is worth more to me than the bread, which I have so much of already.

This is the foundation of basically all transactions in a free market.

'Exploitation' and '(un)fair prices'

These are terms very commonly used when talking about economics. The issue with them is that they don't really have any solid meaning within the field, which is probably why politicians use them so often.

Usually, these terms are used together in a form such as this: "Party X is exploiting party Y by charging unfair prices".

In economics, there is no 'fair' price. The price of a good or service is decided by what the buyer is willing to offer and what the seller is willing to accept. If I charge \$30 for one loaf of bread at my store, I'm not exploiting anyone; I'm probably just a terrible businessman. As soon as I set that price, no one will want to buy bread from my store, because the buyer is not willing to offer that much money, and I am not willing to accept any less.

A common counter-argument would be that people need bread (take food more generally for a more complete example) to survive. The reasoning here would be that if all the bakeries are charging \$30, people would be forced to 'overpay'.

This reasoning is flawed because it ignores the incentives of the parties involved. If all the bakers are charging \$30, then each one has an incentive to set their price just a little lower than all the other bakers. If one undercuts the price to \$27 dollars, everyone will want to buy from that baker. Then someone undercuts the price again, and again, and so on. Eventually, the price approaches the actual cost of making bread (and other costs such as maintaining the property, etc). Not only does this mechanism keep the price close to the cost, but it also gives a constant incentive to find ways to reduce the cost of making bread, and/or to increase the quality of the bread. (innovation)

The free-market system is very well positioned to counter these 'overpaying' issues.

There are scenarios in which such a discrepancy can occur, both theoretical and historical, but their causes are often misidentified. It is almost never due to the nature of the system that such discrepancies occur, but due to a disruption of that system. Common examples are monopolies, cartels, corruption, etc...

Misidentification of 'exploitation.'

Not only can the causes of these problems be misidentified, but their existence is misidentified just as much, if not more often. A great example of this is when (usually Western) 'anti-exploitation movements' will boycott a company operating factories in developing or poor countries.

Let's say you see a headline in the news that says something like: "Large multinational company X only pays their workers \$5 a day in developing country Y". A headline like that is meant to evoke an emotional reaction out of the reader. We tend to use our internal conception of what a 'fair wage' is based on our own experience. But let's think this through rationally first. What people often don't realise is that \$5 a day is actually way above average in country Y, often double or triple what workers would earn otherwise.² We also tend to do this with working conditions. The working conditions in these factories may be horrendous by our standards, but they are often great compared to the working conditions in local farms, businesses, and other lines of work.³

A common counterargument to this reasoning would go something like: "The pay may be higher than average, but it is still far less than what company X could be paying the workers".

The 'could be paying' part is important here. This reasoning essentially has the same flaw as in the previous example; it ignores the incentives of the parties involved. If they 'could be paying more', without getting too close to the profit line, then why aren't they? Why isn't the wage going up towards that line? The answer is that it already has, it simply costs that much to operate a factory in country Y. This increased cost comes from a variety of places, usually including but not limited to: bribes for corrupt politicians, high security costs due to high crime rates, transportation costs, risk adjustment costs...

The effects:

In some cases, these boycotts work. Company X has a specific value attached to their public image. When the damage to their public image begins to outweigh their profit from these factories, they will do one of two things (or a combination of both): 1) Shut down these factories, leaving thousands of workers without a job, and if they do find work again, their pay will be much lower. 2) In order to avoid potentially tarnishing their image further by shutting down factories in poor countries, they raise the pay of workers to Western standards, and simply fire the vast majority of their workforce to offset the pay increase.

All in all, these boycotts usually result in more stagnation, more poverty, and less opportunity for local workers.

The stock market

Many people view the stock market as a betting market, a way to make money without really working for it. But the stock market is fundamentally different from a betting market. A betting market only provides any value to the people betting; it provides entertainment. Whether that is healthy or not, and whether it should be legal or not, are separate questions beyond my purview.

The stock market, however, provides value in more ways. Let's think about what the incentives here are. The investors want to invest in stocks that will go up. The best way to do that is to attempt to predict which stocks will go up. What does a stock going up in value mean? It means that the company is doing well, selling more/better/cheaper merchandise, providing more/better/cheaper services, etc. So in essence, investors have the incentive to attempt to predict which companies are about to do well. Once they identify those companies, they invest. What does investing mean, fundamentally? It means the investors are providing those companies with resources to expand their business in the form of money.

Now let's go back to our definition of economics: "The allocation of finite resources which have alternative uses". The market has finite resources (represented in the stock market as money), and any resource provided to one company has other uses in other companies. To summarize: **investors have the incentive to identify those companies that will create the most value for society at large, and allocate finite resources towards those companies, while identifying waste in the form of soon-to-fail or failing companies and taking resources away from them. Meaning that on a macro-economic level, the stock market is essentially a way to optimize that allocation of resources.**

To be clear: this mechanism is often indirect, shares are usually being transferred between investors, not directly bought from the company.

Opportunity cost

A common fallacy is to reason about costs and benefits under the assumption that the resources used are not limited, or that they have no alternative uses.

For example, let's say we want to prevent the degradation of the environment. We do some studies, and we conclude that a significant portion of pollution is directly caused by gas-powered cars (whether this is true or not is, again, beyond my purview). So naturally, we try to find ways to prevent this pollution. One of the ideas proposed might be the replacement of all petrol cars with electric vehicles. And so we estimate the cost of this idea, we factor in the cost of electricity,

infrastructure, R&D, the downsides of electric cars,... We factor in every cost, and conclude that it would be cheaper to replace all petrol cars with electric cars now than to pay for the damages caused by pollution in the future (property damage, health risks, etc,...).

Now, a question: Does that conclusion mean that we should implement this plan?

The answer is no.

Answering yes would assume that those resources could not be more useful elsewhere. Maybe it is even more efficient to use another form of propulsion, or to use a different power source, or some other alternative. We can even look outside of the original cause; maybe it's more efficient to prevent pollution by switching to nuclear power, or to import energy from elsewhere.

This is an example of opportunity cost. Resources can always be used elsewhere, and just because one idea is 'worth it', does not mean that it is the most efficient usage of those resources.

These were some of the most fundamental misconceptions, but there are many more.

A future essay will cover more examples, centered around interventions and disruptions in free markets.

References

1. Thomas Sowell, *Basic Economics: A Common Sense Guide to the Economy*, 5th ed. (New York: Basic Books, 2014).
2. Benjamin Powell and David Skarbek, "Sweatshops and Third World Living Standards: Are the Jobs Worth the Sweat?" *Journal of Labor Research* 27, no. 2 (2006): 263–274; and Benjamin Powell, "In Defense of 'Sweatshops,'" *Library of Economics and Liberty (Econlib)*, June 2, 2008, <https://www.econlib.org/library/Columns/y2008/Powellsweatshops.html>. Powell and Skarbek found that apparel-industry wages exceeded the national average income in every country studied—and exceeded three times the national average in roughly half of them; for firms specifically accused of being sweatshops, wages in Cambodia, Haiti, Nicaragua, and Honduras were more than double the average national income. See also Sowell, *Basic Economics*, ch. 22, noting that multinational firms typically pay around double prevailing local wage levels.
3. Benjamin Powell, *Out of Poverty: Sweatshops in the Global Economy* (New York: Cambridge University Press, 2014); and Benjamin Powell and Towhid Iqram Mahmood, "No Sweat? Living Standards and Sweatshop Wages in Developing Countries," *The Independent Review* 29, no. 1 (2024).