

Economics 1 – The Basic Economics of Trade and Wealth

Three men, Charlie, Fred, and Gary, are shipwrecked on a small deserted island. Each of them possesses \$100. Charlie is a construction worker, Fred is an expert angler, and Gary is a gardener. For the first week, the men stay pretty much to themselves. Charlie builds himself a sturdy hut, Fred catches fish to eat, and Gary begins gathering and planting island vegetation.

Charlie has shelter but nothing to eat. Fred has fish to eat, but no shelter. Gary has vegetables to eat, but also no shelter. After one week, the men are miserable and they still have \$100 apiece.

Then they decide to work together and trade their skills. Charlie constructs sturdy huts for the other men. Fred catches enough fish for them all. Gary collects vegetables and shares them with the other men. After the second week, all three men have improved their lives. They still have \$100 apiece.

At the beginning of the third week, some men wearing blue hats stop by from a nearby island. They want to trade. The men offer Charlie, Fred, and Gary a small boat, and handcrafted clothes and bedding, in exchange for some fish, vegetables, and assistance with hut construction. At the end of the third week, Charlie, Fred, and Gary have additional clothing, beds to sleep on, and a small boat to use for fishing and visiting the other island. The quality of their lives has improved significantly since they arrived on the island. They each still have \$100.

The next week, Charlie, Fred, and Gary hike to the other side of their island, and spot another island on the horizon. They decide to row their boat to the island, and discover several people there wearing yellow hats, who are hungry and struggling to survive. The people have little to offer Charlie, Fred, and Gary except a small basket of berries they picked, and some of the money they had when they arrived on the island. Charlie, Fred, and Gary offer to build the yellow-hat people one sturdy hut, catch some fish, and harvest some food in exchange for a basket of berries and \$300, which is \$100 apiece. In addition, they agreed with the yellow-hat people to continue this arrangement each week in the future.

At the end of the fourth week, the men were not much better off than they were at the beginning of the week – they finished the berries in a few minutes. However, they now had \$200 apiece. In addition, the yellow-hat people told Charlie, Fred, and Gary about another island

nearby, with people wearing red hats that are always eager to trade. Charlie, Fred, and Gary hope they will be able to trade with the red-hat people, and purchase additional supplies, or acquire more cash.

On the island of the people with yellow hats, the people there now have enough food to survive for one week, and have at least one well-constructed hut. The quality of their lives has improved, and their needs are satisfied for a week. However, they have \$300 less than they did a week earlier. Fortunately, the yellow-hat people still have some cash remaining for future trading. However, they realize that if the trade deficit persists, eventually they will run out of money. Once that happens, they will have nothing to trade, and they will return to their lives of poverty.

Charlie, Fred, and Gary learned some valuable lessons. The first is that they needed to make themselves some color-coordinated hats if they were going to be taken seriously by nearby islanders. More importantly, they learned that trade increased the quality of their lives. It gave them what they wanted and needed, in exchange for either their own goods and services, or money. The larger the pool of trading partners, the more options they had to improve their lives.

However, trade did not necessarily increase their wealth. The one and only way they could increase their wealth was to provide goods and services in exchange for money, with people who had little to exchange other than cash and a basket of berries. By engaging in trade surpluses with such people, Charlie, Fred, and Gary realized that eventually the quality of their lives would not only be better but they would acquire all the money too.

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