2.4 Wealth Creation and The Concept of Zero-Sum

Let's play the following game. We'll toss a coin. If it comes up heads, you'll give me a dollar, and if it comes up tails, I'll give you a dollar. This game is a classic example of a zero-sum game. What does zero-sum mean? It means in order for me to win, you have to lose, and vice versa. We cannot win simultaneously. We are not creating any wealth, only redistributing existing wealth.

Now let's look a financial transaction. We haven't yet explained a futures contract yet but you can appreciate the idea without the details. I buy something from you at a certain price. A few days later, the price may be higher or lower, so one of us is at a worse place than we started. Therefore you and I cannot win at the same time. We can't possibly be creating wealth. Right?

WRONG. What happens is that as you and I trade, we are contributing to the formation of prices. In fact, thousands of people around the world make similar trades, through which we, as a society, "discover" prices. The prices that are produced by these contracts benefit the public and allow them to make better decisions. These prices can also be used when making commercial decisions.

Price discovery is probably the biggest benefit to the society but there are many others. Trading can serve as an educational tool, and increase financial literacy. The transparent trading can also incentivize individuals and institutions to act in socially beneficial ways. Contracts can provide portfolio diversification benefits for asset managers. Moreover, the very existence of markets could allow people to choose different careers, be more innovative and lead more productive lives, thereby creating wealth for the public at large. Happiness and productivity are contagious after all.

One must also look at the cost side of the equation. Trading can have unintended effects. Excessive speculative activity can harm other parts of the economy. Trading can also lead to people acting in unethical ways to make money. Clearly, these should be counted as well.

Again – the ultimate question is whether any wealth is created. Wealth is much broader than money, of course. Consider all the advantages and drawbacks, net them out and if that is positive, wealth is created. Zero is the floor, and when positive benefits (wealth) are created we move *away* from zero. And yes – the zero-sum concept is our second Lego piece.

You may have noticed a pattern here. *We only talked about the public benefits and only those that are related to trading.* In other words, somewhere in the world, two people trade something and this affects many people who are not part of the transaction. They may not even be *aware* of that particular contract, but they can still benefit.

But what about the people who traded and shared some risks? What if there is no risk-sharing but people still enjoy trading? Finally, what if trading creates some jobs that result in tax revenues? All of these are potential benefits. Should we count them? This is a very important question, which we will answer in the next chapter.