

# **Sustainability thoughts 111: Linking perfect sustainability market theory to the circular sustainability based economy**

**By**

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## **Abstract**

Perfect sustainability market theory indicates that when we correct the traditional market pricing mechanism of the traditional market to reflect social and environmental externalities we shift it to a sustainability market model as we are then closing the socio-environmental sustainability gap, creating in the process a model with a closed circular sustainability based economy. As the traditional market price shifts to the sustainability market price we shift from a model with broken circular economy under binding socio-environmental externalities to a model with unbroken circular economy. In other words, the price shift goes one to one with changes in circular economy structures. Hence, there is a need to understand the link between the nature of market prices and the nature of related circular economies when socio-environmental externality accountings becomes binding. For example, what is the nature of the circular traditional economy under no socio-environmental externality neutrality assumption? What is nature of the circular sustainability market economy under no socio-environmental externality neutrality assumption? What is different between those two circular economies in terms of socio-environmental sustainability gaps? Among the goals of this paper is to give answers to these questions.

## **Key words**

Perfect traditional market, perfect sustainability market, circular traditional economy, circular sustainability economy, externalities, environmental externality, social externality, paradigm shift, market price shift, environmental margin, social margin, traditional market price, sustainability market price, sustainability gap.

## **Introduction**

### **A) An economy under socio-environmental externality neutrality assumption**

In a world with three components, the society(A), the economy(B) and the environment(C), it can be said that the economic world under socio-environmental externality

neutrality assumptions is summarized by the traditional market(TM) as indicated in Figure 1 below since in this market only economic goals(B) matter:

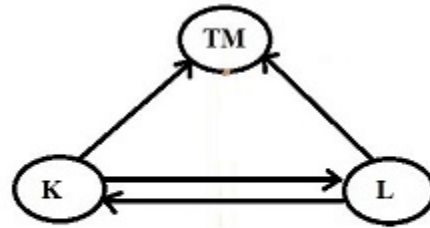


Figure 1 The structure of the traditional market under social and environmental externality neutrality assumptions

Figure 1 above tells us that in the traditional market(TM) traditional production(K) and traditional consumption(L) take place under the socio-environmental externality neutrality assumption so no relevant socio-environmental externalities are created during production and consumption process leading to an unbroken circular traditional market economy between traditional producers(K) and traditional consumers(L) by assumption. In other words, in the traditional market model social concerns(a) and environmental concerns(c) are not important.

### **i) The model structure**

Since the economy(B) is the only relevant component in the traditional market(TM) depicted in Figure 1 above its model structure can be represented as follows:

$$1) \text{ TM} = aBc$$

Expression 1) above indicates that the society(a) and the environment(c) are passive or irrelevant components in this model, and therefore, in this model the society and the environment exists only to support economic goals.

### **ii) The price that clears the traditional market**

Since only economic goals matter, then only economics costs at a profit matter and need to be reflected in the traditional pricing mechanism( $\text{TMP} = P$ ) to clear the market in this traditional market(TM) depicted in Figure 1 above, which can be stated as follows:

$$2) \text{ TMP} = \text{ECM} + i = P$$

Expression 2 above tells us that the traditional market price( $\text{TMP} = P$ ) is made up by economic costs plus profits.

### **iii) The traditional market price-socio-environmental externality inconsistency**

A glance at Figure 1 above tells us that in a world where socio-environmental externalities matter and need to be incorporated in the pricing mechanism of the traditional

market, the traditional market price-socio-environmental externality inconsistency becomes clear; and this inconsistency results in a broken circular traditional economy under no socio-environmental externality assumption, a situation that needs to be corrected by bringing in socio-environmental responsibility in the traditional market. In 2012 the United Nations Commission on Sustainable Development Rio + 20(UNCSD 2012a; UNCSD 2012b) moved to address the traditional market price-environmental externality inconsistency only by calling for a move towards a world under green economies, leaving out of consideration then the possibility of shifting to a world under socially friendly markets or red markets or the possibility of shifting to a world under socially and environmentally friendly markets or sustainability markets(Muñoz 2016a)

## B) An economy without socio-environmental externality assumption

In a world with three components, the society(A), the economy(B) and the environment(C), it can be said that the economic world with no socio-environmental externality assumptions is summarized by the sustainability market(SM) as shown in Figure 2 below since in this market all social goals(A), economic goals(B) and environmental goals(C) matter:

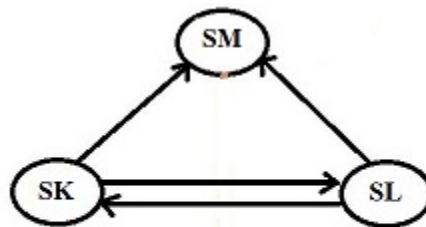


Figure 2 The structure of the sustainability based economy(SM) under no social and environmental externality assumptions.

Figure 2 above says that in the sustainability market(SM) sustainability production(SK) and sustainability consumption(SL) take place under no socio-environmental externality neutrality assumption so that all relevant socio-environmental externalities that are created during production and consumption process are reflected in the pricing mechanism of the sustainability market( $SMP = SP$ ) leading to a unbroken circular sustainability market economy between sustainability producers(SK) and sustainability consumers(SL) by assumption correction. In other words, in the sustainability market model socio-environmental concerns(AC) are important.

### i) The model structure

Since the society(A), economy(B) and the environment(C) are relevant components in the sustainability market(SM) depicted in Figure 2 above its model structure can be represented as follows:

3)  $SM = ABC$

Expression 3) above says that the society(A), the economy(B) and the environment(C) are all active or relevant components in this model, and therefore, in this model both the society(A), the economy(B) and the environment(C) exist only to support sustainability market goals through win-win-win coexistence and choice.

## **ii) The price that clears the sustainability market**

Since here the social(A), economic(B) and environmental(C) goals matter, then social costs(SM), economics costs(ECM) and environmental costs(EM) at a profit matter and need to be reflected in the sustainability pricing mechanism(SMP = SP) to clear the market in this sustainability market(SM) depicted in Figure 2 above, which can be stated as follows:

$$4) \text{ SMP} = \text{SM} + \text{ECM} + \text{EM} + i = \text{SP}$$

Expression 4 above indicates that the sustainability market price(SMP = SP) is made up by the sum of all costs plus profits.

## **c) Linking the traditional market price shift with the sustainability market price**

If we look at both, the traditional market price and at the sustainability market price we can see that the traditional market price is a lower market price, which can be indicated as follows:

$$5) \text{ TMP} = \text{P} = \text{ECM} + i < \text{SMP} = \text{SP} = \text{SM} + \text{ECM} + \text{EM} + i$$

Notice that to correct that inequality to make it equal we only need to add the social margin(SM) and the environmental margin(EM) to the traditional market, which leads to the following:

$$6) \text{ TMP} = \text{P} = \text{ECM} + i + \text{SM} + \text{EM} = \text{SMP} = \text{SP} = \text{SM} + \text{ECM} + \text{EM} + i$$

Expression 6) above indicates that when socio-environmental externality accounting becomes binding the only thing we need to do is to correct the traditional market price(TMP) to account for the social margin(SM) and the environmental margin(EM); and when we do that the model structure(TM = aBc) and its traditional price structure(TMP) shifts towards the model structure of sustainability markets(SM = ABC) and its sustainability price structure(SMP). The shift from traditional market pricing to sustainability market pricing means that the nature of the circular economies they drive also shift or change. In other words, the price shift goes one to one with changes in circular economy structures. Perfect sustainability market theory tells us that when we correct the traditional market pricing mechanism of the traditional market to reflect socio-environmental externalities we shift it to a sustainability market model as we are then closing the socio-environmental sustainability gap, creating in the process a model with an unbroken circular sustainability economy. How a perfect sustainability market would look like(Muñoz 2016b) and how it should be expected to behave under perfect sustainability market

competition(Muñoz 2019) as well as what the nature of perfect sustainability market as a fully inclusive and responsible model(Muñoz 2020) have been pointed out just recently.

Hence, there is a need to understand the link between the nature of market prices and the nature of related circular economies when socio-environmental externality accountings becomes binding. For example, what is the nature of the circular traditional economy under no socio-environmental externality neutrality assumption? What is nature of the circular sustainability market economy under no socio-environmental externality neutrality assumption? What is different between those two circular economies in terms of socio-environmental sustainability gaps? Among the goals of this paper is to give answers to these questions.

### **Goals of this paper**

i) To point out the structure of the circular traditional economy when under no socio-environmental externality neutrality assumption; ii) To highlight the structure of circular sustainability market economy when under socio-environmental externality neutrality assumption; and iii) To stress difference between those two circular economies in terms of socio-environmental sustainability gaps.

### **Methodology**

i) the terminology and operation concepts used in this paper are introduced; ii) the structure of the traditional market under no socio-environmental externality assumptions is shared; iii) the structure of the circular traditional market economy under no socio-environmental externality neutrality assumption is shown; iv) the structure of the circular sustainability market economy under no socio-environmental externality neutrality assumption is highlighted; v) the structure of these two circular economies are compared to highlight that one has no socio-environmental sustainability gap; and vi) some food for thoughts and conclusions are provided.

### **Terminology**

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A = active social system

a = passive social system

B = active economic system

b = passive economic system

C = active environmental system

c = passive environmental system

TM = traditional market

SM = sustainability market

K = traditional producers/supply      L = traditional consumers/demand  
SK = sustainability producers/supply      SL = sustainability consumers/demand  
SEEM = socio-environmental externality management       $M_i$  = market type i  
E(AC) = externalization of A and C      I(ac) = internalization of a and c  
TMP = traditional market price      SMP = sustainability market price  
SESG = socio-environmental sustainability gap      E(T) = externalization of T  
SEEG = socio-environmental externality gap      I(t) = internalization of t

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## **Operational concepts and externalization and internalization rules**

### **i) Operational concepts**

- 1) Traditional market**, *the economy only market*
- 2) Sustainability market**, *the socially and environmentally friendly market.*
- 3) Traditional market price**, *the general market economic only price or the price that covers the cost of production at profit( $TMP = ECM + i = P$ ) or zero profit( $TMP = ECM = P$ ).*
- 4) Sustainability market price**, *the price that reflects the economic, social, and the environmental cost of production or the price that covers the cost of socially and environmentally friendly production.*
- 5) Cost externalization**, *the leaving out of the pricing mechanism of the market relevant costs associated with production.*
- 6) Social cost externalization**, *the leaving out of the pricing mechanism of the market the social costs associated with production.*
- 7) Environmental cost externalization**, *the leaving out of the pricing mechanism of the market the environmental costs associated with production.*
- 8) Economic cost externalization**, *the leaving out of the pricing mechanism of the market the economic costs associated with production.*
- 9) Cost externalization assumption neutrality**, *the assumption that production has minimal or no cost impact on external factors to a market model.*

**10) Full costing**, *the reflecting in the pricing mechanism of the market all cost associated with production; there are no market distortions.*

**11) Partial costing**, *not reflecting in the pricing mechanism of the market all cost associated with production; there are partial market distortions.*

**12) No costing**, *not reflecting in the pricing mechanism of the market any costs associated with production; there is full market distortion.*

**13) Full inclusion**, *all factors are endogenous to the model, there are no exclusions.*

**14) Partial inclusion**, *some factors are exogenous to the model, there are some exclusions.*

**15) Fully independent development choices**, *when we have individual development choices unrelated to each other or pure choices such as society only(A), economy only(B), and environment only(C). In this world only fully independent development choices exist so the set = {A, B, C}. This is the world of the Arrow Impossibility theory and theorem.*

**16) Partially codependent development choices**, *when we have mixed/paired development choices such as socio-economy(AB), socio-environment(AC), and eco-economy(BC). In this universe only codependent development choices exist so the set = {AB, AC, BC}. This is outside the normal world of the Arrow Impossibility theory and theorem.*

**17) Fully codependent development choices**, *when all development choices are mixed together such as the socio-economy-environment(ABC) model. In this paradigm only fully codependent development choices exist so the set = {ABC}. This is outside the world of the Arrow Impossibility theory and theorem.*

**18) Full cost externalization**, *all costs associated with production are not reflected in the pricing mechanism of the market.*

**19) Partial cost externalization**, *some costs associated with production are not reflected in the pricing mechanism of the market.*

**20) No cost externalization**, *all costs associated with production are reflected in the pricing mechanism of the market.*

**21) Full cost internalization**, *all costs associated with production are reflected in the pricing mechanism of the market.*

**22) Partial cost internalization**, *some costs associated with production are reflected in the pricing mechanism of the market.*

**23) No cost internalization**, *all costs associated with production are not reflected in the pricing mechanism of the market.*

- 24) Externalities**, *factors assumed exogenous to a model*
- 25) Full externality assumption**, *only one component is the endogenous factor in the model; the others are exogenous factors.*
- 26) Partial externality assumption**, *not all factors are endogenous factors at the same time in the model.*
- 27) No externality assumption**, *all factors are endogenous factors at the same time in the model.*
- 28) Economic externality**, *the economic costs associated with production not reflected in the pricing mechanism of the market.*
- 29) Social externality**, *the social cost associated with production not reflected in the pricing mechanism of the market.*
- 30) Environmental externality**, *the environmental cost associated with production not reflected in the pricing mechanism of the market.*
- 31) Green or environmental margin**, *to cover the extra cost of making the business environmentally friendly.*
- 32) Social margin**, *to cover the extra cost of making the business socially friendly.*
- 33) Economic margin**, *to cover only the economic cost of production*
- 34) Profit**, *the incentive to encourage economic activity*
- 35) Full cost price**, *a price that reflects all costs associated with production.*
- 36) Some cost price**, *a price that reflects only some costs associated with production.*
- 37) No cost price**, *a price that does not reflect any cost associated with production.*
- 38) Circular market illusion**, *the idea that production activity can take place without producing relevant externalities.*
- 39) Circular traditional economy illusion**, *the idea that production activity can take place without producing relevant social and/or environmental externalities.*
- 40) Circular sustainability based economy**, *the idea that market prices reflect the cost of making business social and environmentally friendly in order to cover the cost of dealing with the social and environmental externalities they create to close the free market cycle production-consumption-socioenvironmental externality.*



**41) Circular socio-environmental externality management based market illusion**, *the idea that you can solve a socio-environmental externality problem by dealing with the consequences of that problem, not the cause.*

**42) Circular sustainability economy inclusion**, *the idea that sustainability production and sustainability consumption can take place when internalizing social and environmental impacts( $E(AC) = 0$ ).*

### **ii) Externalization rules**

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, C = active component, and c = passive component, then the externalization rules(E) work as follows:

1)  $E(A) = a$  ----→ *relevant social costs(A) are assumed irrelevant*

2)  $E(C) = c$  ----→ *relevant environmental costs(C) are assumed irrelevant*

3)  $E(AC) = ac$  ----→ *relevant social costs and environmental costs(AC) are assumed irrelevant*

### **iii) Internalization rules**

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, C = active component, and c = passive component, then the internalization rules(I) work as follows:

4)  $I(a) = A$  ----→ *irrelevant social costs(a) are now relevant*

5)  $I(c) = C$  ----→ *irrelevant environmental costs(c) are now relevant*

6)  $I(ac) = AC$  ----→ *irrelevant social costs and environmental costs(ac) are now relevant*

### **iv) Model structure and externalization rules**

Let's assume we have the following three market structures  $M1 = ac$ ,  $M2 = Ac$  and  $M3 = AC$ , then the following holds true:

7)  $M1 = ac = E(AC)$  = *a fully irresponsible market as all costs are externalized*

8)  $M2 = Ac = [I(a)][E(C)]$  = *a partially responsible market as social cost is internalized*

9)  $M3 = AC = [I(a)][I(c)]$  = *a fully responsible market as all costs are internalized.*

### **v) Reversing externalization rules**

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, C = active component,

and  $c$  = passive component, then the process of reversing externalization-internalization rules works as follows:

The case of internalizing the externality: if  $E(AC) = ac$ , the following holds true:

**10)  $I[E(AC)] = I(ac) = AC$** , internalization-externalization forces cancel each other out

The case of externalizing the internality: if  $I(ac) = AC$ , the following holds true:

**11)  $E[I(ac)] = E(AC) = ac$** , externalization-internalization forces cancel each other out

### The traditional market under no socio-environmental externality assumptions

When accounting for social and environmental externalities becomes binding then the circular economy depicted in Figure 1 in the introductions above breaks as in reality relevant socio-environmental externalities[ $E(AC)$ ] are being produced and externalized, as indicated in Figure 3 below:

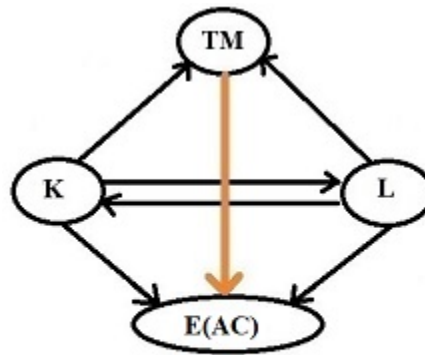


Figure 3 The structure of the traditional market(TM) under relevant social and environmental externalities[E(AC)]

Figure 3 above tells as that there are relevant traditional production(K) and traditional consumption(L) socio-environmental externalities being produce as economic activity takes place as indicated by the continuous black arrows from K and L to E(AC), but they are being externalized as indicated by the continuous brown arrow from TM to E(AC) because they were assumed to be irrelevant in the traditional market model(TM).

### The circular traditional market economy under no socio-environmental externality neutrality assumption

The externalization of relevant socio-environmental externalities[ $E(AC)$ ] indicates that there is a disconnect between the pricing mechanism of the traditional market(TM) and the

relevant externalities[E(AC)] when socio-environmental externality accounting matters, which leads to a broken circular traditional economy, a situation that can be represented as in Figure 4 below:

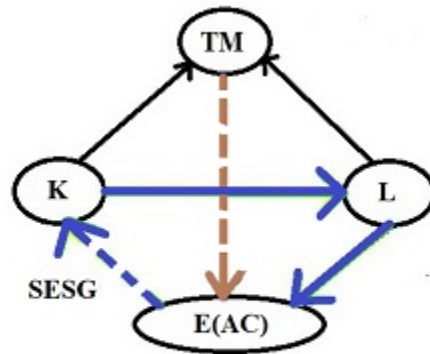


Figure 4 The socio-environmental externality gap(SESG) embedded in the circular traditional market(TM) illusion

Figure 4 above points out that the disconnect between the traditional market pricing and externalities indicated by the broken brown arrow creates a socio-environmental sustainability gap(SESG) breaking the production-consumption-socio-environmental externality cycle, which affects the sustainability of the traditional market. In other words, externalizing relevant socio-environmental externalities[E(AC)] leads to a socio-environmental sustainability gap(SESG) that breaks the circular structure of the traditional market(TM).

### **The circular sustainability market economy structure under no socio-environmental externality neutrality assumption**

When the society(A) and the environment(C) matter; and therefore, we internalized the cost of the relevant socio-environmental externalities[I(ac)] in the pricing mechanism of the traditional market(TM) we shift to the world of sustainability markets(SM), a world that can be expressed as in Figure 5 below:

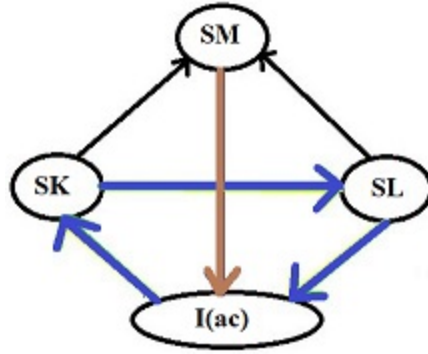


Figure 5 The structure of the circular sustainability economy(SM)

Figure 5 above says that the internalization of the socio-environmental externality [I(ac)] closes the socio-environmental sustainability gap (SESG) that existed in the circular traditional economy leading to an unbroken or continuous circular sustainability economy. In other words, the internalization of relevant socio-environmental externalities [I(ac)] leads to the closing of the production-consumption-socio-environmental externality cycle.

### Comparing the circular traditional economy with the circular sustainability economy

Therefore, in the circular sustainability market (SM) there is no socio-environmental sustainability gap (SESG) as there is no disconnect between the sustainability market price and the relevant socio-environmental externality while the opposite is true in the circular traditional economy when relevant externalities must be accounted for, a situation that can be easily appreciated in Figure 6 below:

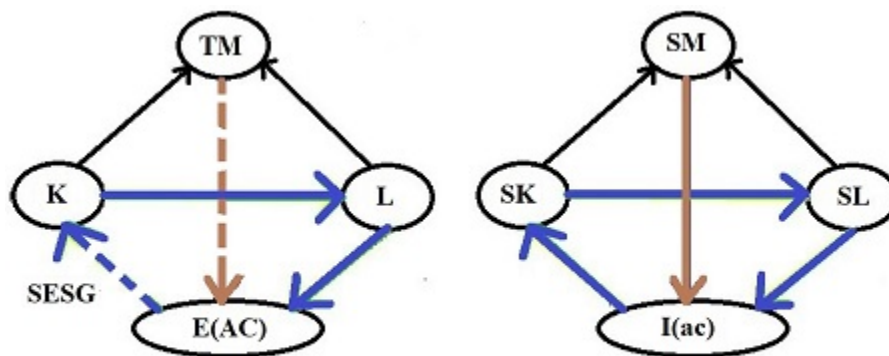


Figure 6 Comparing the structure of the circular traditional economy(TM) on the left with that of the circular sustainability economy(SM) on the right.

Comparing the two circular economies in Figure 6 above it is clear that only in the traditional market (TM), figure to the left, there is a disconnect between pricing and relevant externalities as relevant externalities are being externalized as indicated by the broken brown

arrow from TM to E(AC); and therefore, only in the traditional markets there is a socio-environmental sustainability gap(ESG) as indicated by the broken blue arrow from E(AC) to K.

### **Food for thoughts**

a) Are sustainability markets full responsibility based markets? I think yes, what do you think? and b) Are socio-environmental externality management markets consistent with free market thinking? I think no, what do you think?

### **Conclusions**

It was highlighted that when socio-environmental externalities need to be accounted for the traditional market illusion of socio-environmental externality neutrality breaks. It was stressed that the disconnection traditional market price-socio-environmental externality creates a socio-environmental sustainability gap breaking the circular traditional economy cycle. It was indicated that when internalizing the socio-environmental externality the traditional market price shifts to the sustainability market price closing the socio-environmental sustainability gap that was present in the circular traditional economy. It was shown that when comparing the structure of the circular traditional economy and of the sustainability economy only the traditional economy has a price-socio-environmental externality disconnection; and therefore, only the circular traditional economy has a socio-environmental sustainability gap when socio-environmental externality accounting is binding.

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