# Market Myths in Contemporary Economics

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**Abstract**

This paper elaborates on the economic operating system (EOS) the role it can play in growth. It focuses on markets, price determination and forces of demand and supply in order to illustrate how an EOS model offers greater economic growth, stability and safety. This paper delves into market theory to determine whether what is commonly understood about market forces and free markets in contemporary economics is as reliable as might be expected; do free markets encourage or retard economic growth? It is often, for amusement, brought up how modern medicine despite its advances cannot cure the common cold. Contemporary economics has a similar pet peeve; it does not know how to cure common inflation and deflation. The same way medicine leaves the body's immune system to deal with colds until a cure is found contemporary economics leaves inflation and deflation to market forces to sort out with the occasional booster shot of intervention when this process seems to fail. To this day the stand off between Keynesian and Monetarist models demonstrates the irascible nature of this economic bug; is seems in contemporary economics there is only one way to control it and that's do *nothing* about it. This *nothing* in contemporary economics is what is referred to as *free markets*. Allowing free markets to set prices and act as a mechanism for managing inflation works, what doesn't work is that free markets systems based on a Monetarist model lack reliable growth and not being able to do anything comprehensive when market forces begin to act up. In a downturn, suddenly the liberty of free markets can become a threat to economic stability. Free markets may work best in an economic operating system (EOS) model better able to exploit the efficiency of markets whilst accelerating economic growth.

## Introduction

This paper will attempt to examine why such great emphasis is placed on equilibriums and the role of free markets in fostering economic growth. It will analyse how useful markets really are in the current economic model and whether they can function even better in a more advanced economic operating system. The paper examines how contemporary economics may misinterpret or misrepresent the role of market forces and how they function. Price determination is the process by which forces of demand and supply move to find an effective price at which products are bought and sold. The price must be agreeable to both the supplier and the purchaser for an exchange to take place. When market forces are allowed to move without interference this liberty becomes the basis for free markets. Contemporary economics tends to interpret market activity as a process whereby a willing seller and a willing buyer use this mechanism as an instrument through which exchanges taking place do so in equilibrium. If the seller prices the product too high the market will bravely inhibit the sale and the result will be that buyers will not respond and if the buyer insists on a price that is too low the market will courageously protect the seller by inhibiting supply until the price is right; it is only in that moment when both demand and supply are agreeable about price that an exchange will take place. Market forces have a rather romantic description of how market efficiency works explaining; as the price of a product falls it becomes more desirable and more people will want to purchase it thus increasing demand, however, as the price of a product rises it becomes less desirable to buyers and demand for it will fall, however, at higher prices suppliers find a product more desirable to produce and will be willing to supply more of it. This paper will scrutinise these ideas more closely.

### Open Market Operations

Open market operations are a monetary policy process by which a central bank intervenes in the economy when market forces fail to maintain a stable price level. This problem can be caused by either an increase or decrease in demand for base money. The Monetarist Model implies that any changes in money supply will immediately have an inflationary or deflationary affect on the general price level. A central bank responds to this with increases or decreases in money supply by buying or selling government financial instruments and securities. Targets for inflation, interest rates and exchange rates guide this process. Money behaves like a commodity. Commercial banks receive wholesale money from the central bank (base money) and then retail it to the public for a fee (commercial interest rates). Commercial loans represent the demand for money by the public in the economy. When the demand is high commercial banks will require more base money from the central bank, when the demand is low they require less of it. The rise and fall in the levels of base money is basically a decrease or increase in money supply. When interest rates rise money effectively becomes more expensive thus reducing demand for base money effectively lowering money supply; the opposite applies when interest rates fall. When market forces work favourably the general price level remains stable. It must be noted that these open market operations do not regulate implosion; this entails they provide no real managerial control over a national economy. A direct consequence of this is that a government cannot

use money supply to induce growth because fluctuations in market conditions leading to a change in demand for credit in a Monetarist model will immediately cause adjustments in the general price level which require open market operations by the central bank to ensure a stable general price level. This lack of dexterity makes the Monetarist model the most unstable. However, it compensates for this instability by the central bank's capacity to manipulate money supply to maintain a stable general price level. The ability to maintain financial system stability is the benefit of the Monetarist model, its drawback is that this financial stability must be gained at the expense of economic growth. In an EOS model banks do not need interest rates (essentially interest rates are mark ups or the cost plus pricing of money itself) and earn greater incomes redistributing money without interest than they did in the old system *with* interest. This leads to far greater financial system stability than was available in the past. Since Monetary policy does not regulate implosion it must sacrifice growth in order to keep the economy stable. Let us prove this point.

**Scrutinising Free Markets and Market forces**

The Achilles' heel of market theory in contemporary economics is its inability to control the efficiency of money.[1] Being unable to control the efficiency of money causes either inflation or deflation in an economy. The efficiency of money is purely money's capacity to convert financial value into productivity. Ceteris Paribus one unit of currency, e.g. US$1 should be able to generate 1 unit of productivity or more or US$1 worth of output or more, in the operating system this is where $R=2$[2] thus giving productivity the ability to double GDP in the shortest possible time. However, one of the characteristics of money in the CFI is its inability to transfer financial value into productive value or productivity as it functions on R=1 or the MV=PT model (nearly every central bank in the world practices open market operations based on this imperfect system). As a result the phenomenon of inflation and deflation take place. This contradiction makes the MV=PT equation seem useless and is why T in the Fisher Equation in contemporary economics refers to transactions rather than output; where T cannot realistically refer to growth since the system destroys growth through implosion; it is like trying to find a number that is divisible by 0. Implosion is the barrier which effectively blocks the transfer of the work done by financial value; it strips money of its productive efficiency during the transactions creating the systemic rules and fundamentals of a Monetarist system observed as inertia in the laws of demand and supply. Since the real value of money falls to Zero in the $R=1$[3], MV=PT model businesses have to effectively ask more for products than they are worth otherwise they become unprofitable; consequently central banks are directly exposed to the workings of this CFI problem. This problem has been discussed at length in explanations of the expenditure fallacy.[4] The contemporary economic theory central banks use struggles to control inflation, consequently they must rely on market theory and open market operations to compensate for this problem; the fact

[1] See Punabantu, Siize. (2010:51)
[2] See Punabantu, Siize. (September 2010), "The Origin of Wealth"
[3] Ibid.,p.30.
[4] Punabantu, Siize. (July 2010:5)

that to date there has been no alternative operating system to this is possibly why free markets have remained popular.

There are several ways in which contemporary economies inhibit growth. Some of the causes of this are the fact that it pushes businesses toward zero growth through implosion.[5] It should not be forgotten that household demand is predominantly financed in the CFI[6] by payments to labour as a factor of production. These payments are made less deductions to capital[7] as a factor of production. When businesses make allocations to capital expenditure these payments are made less of financial allocations to households. Consequently, supply and demand curves are like crossed swords; the demand and supply curves exhibited in equilibrium are in fact competing for the same financial resources; for the demand curve to be able to shift left consumer incomes have to improve and for the supply curve to shift right allocation to capital expenditure has to increase, but each of these is a factor of production in the CFI and businesses have limited resources to allocate to either factor as a result of the expenditure fallacy. This struggle for financial resources between capital and households becomes evident when trade unions reject it and industrial action occurs. Consequently, trade unions may need to tackle implosion and the expenditure fallacy as the single greatest liability to the welfare of employees. There is a great deal of financial tension or volatility at the equilibrium price level determined by supply and demand even though equilibriums are presented as 'stable and peaceful'. This is due to the fact that implosion places significant limitations on financing available to facilitate both supply and demand. Leaders, directors and managers need to be aware of this loss of financial revenue to implosion. It is made invisible by the expenditure fallacy, which is a process by which the real financial value of money is lost when it is allocated to factors of production and this loss is unseen by businesses due to human psychological and habitual positions in the handling of financial resources developed through history.[8] This inertia affects the real outcomes of cost curves and equations,[9] furthermore, credit creation which was introduced to solve the problem of scarce financial resources, does not achieve what it was intended to. These glitches in contemporary economics are centred on the circular flow of income (CFI) of which the market and the forces of demand and supply at work within it are a significant part. Consequently, to continue this line of argument it is necessary to identify the impact of implosion or inertia in market forces. The equilibrium established by market forces competing for the same financial resources portrayed through demand and supply curves represents inertia since at the market price implosion has cancelled out the real value of money available to the system or the transactors within it. In order for the supply curve to shift right the demand curve has to free up financial resources by shifting left or decelerating its shift to the right and vice versa but in doing so they interrupt the flow of financial resources to each other. The only way businesses have learned to break out of this

[5] Punabantu, Siize. (August 2010:4); Punabantu, Siize. (September 2010:13); Punabantu, Siize. (2010:175-177)
[6] Circular Flow of Income (CFI)
[7] Capital refers to both capital and land as they are both non-human factors.
[8] For a more in depth discussion on this problem read Punabantu, Siize. (August 2010).
[9] Ibid., Punabantu Siize, September (2010:17).

impasse is to work against the economy by cost plus pricing, that is, charging more for products than what they are worth otherwise market forces freeze out economic growth.

In a normal system such as that provided through the implementation of an EOS model[10] for managing the national economy a central bank will spend the majority of its time managing levels of growth in the economy; that is, the rate at which GDP is growing each quarter e.g. 15%, 20%, 45% and so on. If the economy is hit by a recession that slows growth by 8% the central back will simply accelerate growth by a further 8% completely neutralising the impact of the recession on the economy; it effectively has the financial resources with which to ward even the worst down turns in economic history. It does not guess what the economy will grow by; it effectively induces the financial resources equivalent to the level of GDP it would like to see in a quarter. In the EOS model if a central bank informs the public the economy will be growing by 25% this quarter, it is effectively saying the calibration of the economic operating system (EOS) is such that finances equivalent to 25% of GDP are being circulated throughout the economy at constant price for that quarter, with the ability to influence growth in this way by as much as 100% of GDP each fiscal year.

Why is this kind of economic muscle impossible to achieve managing an economy on a Monetarist model? The answer to this is that the Monetarist model nearly all governments use in the world today encourages central banks to manage inflation and deflation while inertia (growth rates close to zero) function in the economy despite market efficiency being obtained. As explained, inertia becomes characterised by zero growth; to escape it businesses find they have to charge above cost price for the products they sell, banks are no exception to this problem, they charge interest as their unique form of cost plus pricing involving money. Punabantu (2010:95) explains "a zero growth equilibrium in macroeconomics will be established where aggregate supply equals aggregate demand. Should companies try to grow by increasing supply the aggregate economy will resist this growth by lowering price (deflation) by which profitability is killed off forcing firms to cut production thus returning the economy to either the *zero growth* equilibrium or normal profits." For banks this would represent high levels of competition that forces banks to lower interest rates in order to remain competitive even if this adversely affects their bottom line. In this scenario despite having the capacity to supply more goods and services or loans businesses or banks will be forced to cut back production to avoid causing a situation in which lower prices impact their returns. They may even have to warehouse useful goods from electronics to food; while banks will have to return base money to the central bank. The market has thus succeeded in impeding growth by denying the economy's capacity to produce more to exploit its full growth potential. Deflation can often be an indication that the technology paradigm of an economy has advanced beyond the scale of the circular flow of income. Deflation in Japan for example may be an indication of an economy capable of producing much more than the circular flow of income is designed to

[10] All the inferences and arguments of this paper are drawn from: Punabantu, Siize. (2010). "The Greater Poverty & Wealth of Nations: An Introduction to Operating Level Economics. *How every economy has the latent financial resources with which to finance the doubling of its GDP in one year at constant price.* ASG Advisory Services Group: Lusaka, [ISBN: 978-9982-22-076-7]

accommodate. As a result this extra capacity, instead of translating into growth, begins to bleed out as deflation. The problem may have little to do with demand being insufficient, but rather it is the incapacity of market forces to balance out the contemporary economy. This is strange since balancing demand and supply through price determination is precisely what the market is thought to do for contemporary economics. In the MV=PT model trying to control inflation is like trying to squish a balloon, no matter how any attempt may be made to trap the air it bulges out in some other part of the balloon. Punabantu (2010:140) refers to processes such as this as the law of conservation of resources. An increase in resources is an increase in growth. "In Physics this process is called the 'law of conservation of energy'; in Operating Level Economics (OLE) it is referred to as the 'law of conservation of resources' (LCR) a good parallel for the limitations in scarce resource theory reflected in the Natural Sciences. SRT and LCR are therefore synonymous. Markets function on the *law of conservation of resources,* this means that they do not create new resources, but rather transfer (allocate) them from one state, company, client or use to another. *The limitations of SRT and LCR cause the transfer of these same resources from one client to another thus causing the shifting fortunes experienced in the market. Fundamentally, as is observed of superslow annual growth rates in GDP which is an aggregate indicator, despite high levels of trading on the market floor little or no real growth may be taking place in the general economy."* Wealth in a model such as this can neither be created nor destroyed; even by free markets, which is why inflation, deflation, surpluses and shortages may occur to abide by the economy's zero growth calibration. To escape this debilitating law businesses including banks circumvent it by cost plus pricing, but this generates tiny gains in GDP per annum averaging between 0% to 6% per annum (inertia). Since contemporary economics has no tools to directly control inflation it has no choice but to place itself at the mercy of market forces and fight fires through open market operations to keep the price level stable. However, by placing itself at the mercy of market efficiency a central bank must also accept zero growth along with this package. As a result, like credit creation, a service provided by the banking sector, a market equilibrium, through price determination, is a service it is expected a central bank provides. Nevertheless, if market forces and open market operations could regulate inflation the result would be true price consistency, that is, a price plane[11] would arise from market forces and a central bank would instead focus on accelerating growth in the economy. However, it is obvious from the running battles with inflation and deflation central banks must endure while growth level tend to remain low, the market does not function as it is supposed to in the same way that credit creation provided by the banking sector does not solve the problem of inadequate financing. The consequence of this operational flaw in market efficiency at the aggregate levels of macroeconomic is curve tectonics.[12] Punabantu (2010) describes curve tectonics as the involuntary or unsupervised (natural) movement of aggregate demand against aggregate supply and vice versa. Like an earthquake curve tectonics are a deadly force capable of wrecking or unseating even the most sturdy and developed of economies sometimes without warning. In the same way tectonic plates move against one another and cause havoc through earthquakes and tsunamis, aggregate demand and supply grating against one

[11] Punabantu, Siize. (2010:200-202)
[12] Ibid.,p.183.

another cause havoc in the financial system through inflation, deflation shortages and surpluses any economy regardless of how developed may inevitably face the wrath of.

Evidence of the "squished balloon" or law of conservation of resources is widespread. "Should growth be attempted by an increase in demand, the aggregate economy will naturally counter this by increasing price (inflation) until it becomes too costly to consume forcing consumers to stop buying; demand is forced back to the natural *zero growth* equilibrium. In contemporary economics (CE) this is referred to as *'overheating'*. Rising demand is countered by the economy's natural resistance to growth using this approach as the economy attempts to grow rapidly against the market's resistance, that is, it's the zero growth position generated by market efficiency. This phenomenon is common in fast growing economies that may inevitably have to slow themselves down despite the fact that they have not reached their desired per capita income and growth targets."[13] For the banking sector this takes place when the demand for loans accelerates above the supply of credit which leads to money becoming more expensive. Interest rates climb and force consumers to stop asking for loans. Implosion causes demand and supply to compete for the same scarce resources increasing curve tectonics and blocking this avenue to growth. Consequently, implosion is directly linked to inflation and deflation. "Businesses backed into a corner may then attempt to increase profitability by reducing supply side costs - a common method for escaping the crunch of market forces. However, cutting supply to increase price or reduce costs and thus induce profitability will generally cause a decline in demand at the industrial level thus restoring zero growth. This is due to the fact that if a business cuts costs to lower TC (or the cost of supply) this raises internal profitability, but the external economy kills growth in this way by causing supply side factors to be dumped such as jobs, machinery, plants, factories and so on. Hence, unemployment levels begin to rise in the economy."[14] A commercial bank in this very same situation will find itself operating unprofitably and will consequently attempt to lower its internal costs by closing branches, calling in loans, off-loading assets, laying off staff, reducing the range of financial products and services it offers. Clearly this current system is not one administrations around the world can rely on as its design will frustrate their attempts at steering the economy to prosperity whilst encouraging poor economic performance to be accepted as the price of achieving market efficiency.

On the other hand "some may argue that when demand exceeds supply price goes up encouraging new businesses to enter the market hence stimulating growth. However, when it does, supply increases and price declines to original levels forcing them back out. Inevitably the economy's equilibrium may close them down or force them to relocate due to lack of profitability. The so called equilibrium is never stable or able to sustain long run confidence in the market."[15] For the banking sector a high demand for loans in an economy can lead to high levels of profitability, however, these profits easily attract new local and international commercial banks into the economy increasing competition and the supply of

[13] Punabantu, Siize. (2010: 95)
[14] Ibid.
[15] Ibid.

loans and competition may even find some banks having to bow out of the business. It can be further noted that "there is a belief excess supply is naturally discouraged by falling prices, which forces businesses out of industry. Supply is reduced by the equilibrium to a level equal to lower levels of demand, but how is this beneficial? Shrinking supply is an indication of declining growth. It means industries are closing, plants are shutting down, employees are being laid off and the economy is declining or contracting. The equilibrium is thus working against businesses and banks by stunting growth yet the *interpretation* in CE is that it is achieving something desirable as it is maintaining a 'balance'. This reasoning is ill conceived."[16] Governments will consequently be asked by this system and its adherents to tolerate the unemployment, business closures, poverty and suffering it may cause since the 'balance' provided by market efficiency is maintaining the value of the national currency.

Should governments or the private sector try to intervene in price, supply or demand to save the economy, interfering with market forces easily squishes into surpluses or shortages of goods and services. For the banking sector this would be reflected as a shortage of loans or a surplus of credit; if the surplus is acute it can lead to the issuance of junk bonds as was seen in the recent recession. Contemporary economics has simply not had the tools with which to enable governments to adequately protect their economies and the people whose livelihoods the economy safeguards. If market forces left to function freely can have a tendency of restraining growth why is this problem not emphasised? As explained earlier, contemporary economics does not have the tools with which to comprehensively control inflation. Secondly, the problem with market forces is not emphasised as a result of the need for businesses and banks to exploit the market mechanism through cost plus pricing. This liberty or freedom is used to legitimise charging more for products than they are worth using the pretext that the price set by the market determines value rather than value itself. This position places emphasis on the ability of buyers and sellers to negotiate. Whoever is better at haggling, whether it is at the local meat market, stock exchange, the commodity exchange or in the price tags of products in the isle of supermarkets walks away with the prize, for businesses this prize is profit or at least what they wrestle away from implosion. Banks and businesses operate around profit as a means of escaping zero growth; they work to prevent an economy functioning against them from shutting them down and have no choice but to charge more for products than they are worth to do this, they cannot really be to blame, it's the structure of the system they are forced to work in. However, it has been shown they gain very little real income through this economic model. The model creates a highly pressurised economic culture aggravated by the expenditure fallacy and limitations observed in the circular flow of income (CFI) since, as proven using cost curves,[17] in a corrected system businesses can charge cost price for their products yet earn a greater income than they did when they were marking up in a contemporary economic model. Market forces refers to the behaviour of demand and supply, essentially a free market is one where the market is left to function without interference in the hope that buyers and sellers agreeing on value is a shortcut around the failure of contemporary economics to control inflation. This is a shortfall representative of the shortcomings in circular flow of

[16] Op.cit.
[17] Punabantu Siize (September 2010:17)

income (CFI). On the other hand the economic operating system (EOS) incorporates the tools with which to manage inflation in the national economy as demonstrated by the new equation of exchange.[18] When the economic operating system is used to manage the economy by means of its capacity to neutralise implosion it directs the laws that govern demand and supply toward positive rather than a negative impact on growth.

A free market system is a force for good. However, the liberty it has functions in a contemporary economic model where financial resources are rendered scarce and where demand and supply compete for the same scarce resources. The solution is not to take away the liberty and benefits of price determination and market efficiency, but to afford them the opportunity to function in an economic model where financial resources are abundant such as that offered by the EOS model.

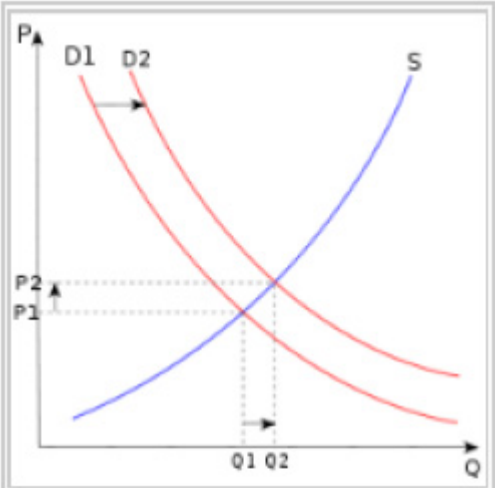
It is fundamental to the capacity of an economy to provide for its population that planners understand the role, workings and limitations of market efficiency. If an economy is managed on a Monetarist model for which price stability is the objective through open market operations then financial system stability must be gained at the expense of economic growth. In other words financial stability will be gained with the prevalence of zero growth (GDP growth rates on average ranging between 0%-6%). Having price stability through monetary policy, but with low growth will force economies to rely on external resources to grow, primarily, exports and foreign direct investment. Consequently, the economies that will benefit from monetary policy are few; they will be countries with a comparative or absolute advantage in an area of economic value from which they can gain wealth from an external source since the domestic economy functions on a contemporary economic model that renders it inert. These exports can include commodities such as oil, gold, diamonds, copper or can be capital, vehicles, equipment, technology, textiles or services related e.g. financial services. A country having an area of comparative or absolute advantage in trade is like having a rich uncle, not every country will be blessed to have one. Many countries enjoying market efficiency and stagnant economies may lack an area for comparative or absolute advantage through which to benefit from international trade, and secondly the income earned from international trade though lucrative may be small in comparison to the real income the economy could earn from domestic trade managed on an EOS model. There is a need for leaders in diverse environments to understand how market forces can slow down economic growth because it predetermines their capacity to implement the policies that will improve the standard of living and business environment. Just because a national currency has had a steady value for a long period should be just as alarming as if its value has been fluctuating, since price stability is not a substitute for growth. Many worry when a country's currency shows signs of inflation or deflation, however, if the economy they oversee is managed or supervised using Monetary policy, as is the case with most economy's in the world today, they also need to worry when the value of the currency remains stable over long periods, even if it is as a result of open market operations aimed at maintaining financial system stability. This is the case for the simple

[18] Punabantu Siize (September 2010:29); See also Punabantu (2010:246).

reason that a Monetarist model gains its objectives at the expense of economic growth. Let us examine this problem more closely.

**The Hidden Problem with Laws of Supply and Demand**

First let's begin with the fundamentals of market forces with which the reader is likely to be familiar. Here is the list of market forces principals commonly thought of in contemporary economics as the laws of demand and supply.[19] This is the list associated with misconceptions the majority of adherents of market theory are taught.




The price P of a product is determined by a balance between production at each price (supply S) and the desires of those with purchasing power at each price (demand D). The diagram shows a positive shift in demand from $D_1$ to $D_2$, resulting in an increase in price (P) and quantity sold (Q) of the product.

Source Wikipedia[20]

- Suppliers will eventually produce a greater quantity (Q) of a good if they believe they can get a relatively high price (P) for it ;

- Suppliers will eventually produce a lesser quantity (Q) of a good if they believe they will get a relatively low price (P) for it;

- Consumers will eventually demand a greater quantity (Q) of a good if they believe they can obtain it for a relatively low price (P);

[19] Wikipedia (2010) "The Laws of Supply and Demand."
[20] Ibid.

- Consumers will eventually demand a lesser quantity (Q) of a good if they believe they can only obtain it for relatively high price (P);

- Suppliers will lower their asking price (P) for a good when demand (Q) for it (at current price) is lower than expected; and

- Consumers will increase their asking price (P) for a good when supply (Q) of it (at current price) is lower than expected.[21]

What exactly is contemporary economics trying to explain with demand and supply? The initial problem with these laws is immediately evident with the use of "at current price" for the purpose of explaining market efficiency. As long as Price (P) changes e.g. P1-P2, whether it is at the microeconomic or macroeconomic levels it is no longer current otherwise this is an oxymoron or the application of unashamedly incoherent logic. It's like someone spewing out an endless diatribe who says, "I'm going to shut up now." And then keeps talking. Is it to be assumed by an audience they are able to shut up and talk at the same time? If the general price level is a measurement of inflation based on aggregated forces of demand and supply it follows that every individual component that makes up the aggregate through its price related behaviour or practices is partly responsible for the general level of inflation even if the inflationary impact is not immediate; therefore for contemporary economics to use "at current price" in this way is not only misleading, but may be construed as being devious. If the general price level rises or falls this entails the prices (P) at the microeconomic level have changed. Constant price or "at current price" is not applicable in the real analysis of these conditions. Microeconomic inflation and deflation needs to be accounted for in these laws or they are immediately rendered obsolete, that is, they become demand and supply laws interpreted for convenience contemporary economics uses to convey ideas on market forces that may be jaded and defective simply to promote market efficiency and free markets. These laws, with which most are familiar, make sense when understood from the perspective of equilibriums between demand and supply. However, they are nothing more than this; consequently there is a grand misconception that borders on misinformation arising from their role and how it is interpreted even at this basic level of contemporary economic theory. Before national economies can be managed using a system conducive to economic growth there is a need to debunk some of these misconceptions. Let's begin as follows:

### *The 1st Myth*

The first market myth in contemporary economics that disguises inertia or zero growth in the circular flow of income (CFI) is the law of demand. "Consumers will eventually demand a greater quantity of a good if they believe they can obtain it for a relatively low price and Consumers will eventually demand a lesser quantity of a good if they believe they can only obtain it for relatively high price."[22] The law of demand basically states that as price falls the demand for a product will increase and as price increases the demand for a product will fall. An equilibrium

[21] Wikipedia. Op. cit.
[22] Ibid.

creating force is therefore set forth in the economy by which higher prices will be countered by lower demand and lower prices will be rewarded with higher demand. Unfortunately what is concealed is the fact that this equilibrating force is gained at the expense of economic growth.

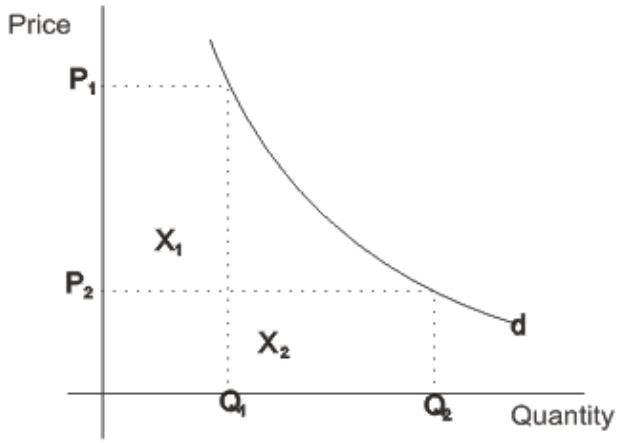



**Diagram 1**

Note that the despite this rise and fall of price and changes in quantity the area created by X1 (P1xQ1) and X2 (P2xQ2) remains a constant size. This area represents inertia or zero growth, since implosion is not neutralised the real value (in the area PxQ) of resources in the economy cannot increase to the benefit of banks and business. What the demand curve demonstrates is how demand responds to microeconomic inflation. Demand prefers lower prices therefore it promotes depreciation, that is, at lower prices consumers demand more. Contemporary economics should make it clear that though price can rise or fall the role of the economic system (CFI) is to ensure price remains stable and consistent over time allowing demand to grow through a shift in the curve to the right which is able to take place at constant price. It's nice to know the workings of the law of demand, but it is a secondary action to the primary trigger of a price change that makes the public believe changes in price are made a positive trait because of the way demand responds to them, or how they respond to demand. In this case contemporary economics marvels at how demand dodges the bullet (price changes) by either increasing (ducking) or decreasing (diving) when the point that is disturbing is that the gun should not have been fired in the first place, that is, the price level should not be able to change so easily. This problem should have been addressed at the trigger or price level, before it ever had to be addressed by market forces. Contemporary economics seems to succeed in convincing the public that "shooting at people" using monetary policy to see if they can dodge bullets by "ducking and diving" is a respectable sport in line with market theory.

### *The 2nd Myth*

The second market myth hidden from contemporary economics is how market forces inadvertently hide inertia or zero growth in the CFI; "Suppliers will eventually produce a greater quantity (Q) of a good if they believe they can get a relatively high price (P) for it and Suppliers will eventually produce a lesser quantity (Q) of a good if they believe they will get a relatively low price

(P) for it."[23] The law of supply basically states that as the price of a product increases more of it will be supplied and as the price of a product declines supply will fall. To achieve this balancing act national economies must once more gain stability at the expense of growth in the economy.

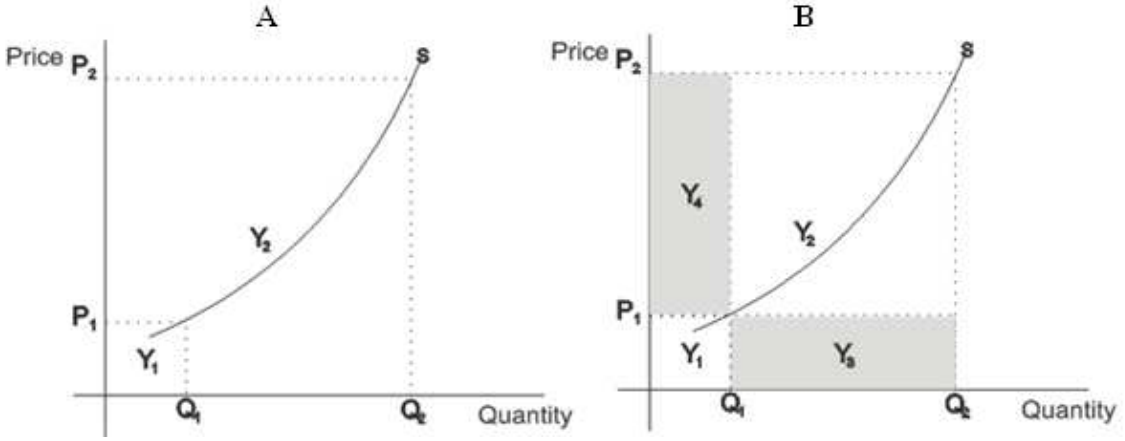



**Diagram 2**

The simple supply curve is not as simple as it looks. The supply graph (Diagram 2) shows that businesses supply more of a product at higher prices or basically there is a correspondence between inflation and growth; this coincides with the Operating Level Economics (OLE) concept that business must use cost plus pricing or use price inflation to grow or they will fail to break even. Consequently, it implies that any increase in price shown in the supply curve could be considered as inflationary. It would be incorrect to assume it is not inflationary simply because the demand curve is representative of conditions at the microeconomic level. Furthermore, it would not be incorrect to view changes in price P1-P2 used in the law of demand as a price mark ups. It is not possible to include "at current price" in 'ceteris paribus' were the law of supply is concerned since it becomes nonsensical to apply logic to the supply curve, as long as price rises, e.g. P1 to P2, this is inflationary and as long as price falls (P2-P1) this is depreciation, it is not possible to say price is constant while these price changes take place since price itself is what is being discussed. The illusion is that as price increases with a corresponding increase in quantity supplied the size of the smaller area Y1 (in part A of Diagram 2) grows to become the larger area Y2; it does not remain stagnant as did the area X observed when discussing the law of demand in Diagram 1. In reality any increases in quantity supplied (Q1-Q2) followed by an equal increase in price (P1-P2) ensures inflation will negate gains to the quantity supplied at the deflated price resulting in inertia. It is intriguing to note that when Y1 grows to Y2, and Y2 is adjusted for inflation the area Y3 (in part B of Diagram 2) is gained; this area of growth is gained purely from inflation or a 'mark up' of prices giving a basic indication there is a fleeting relationship between real growth and inflation. The sales at P2 when deflated to P1 prices shows that removing inflation reduces gains to areas Y1+Y3, which would be representative of economic growth generated by cost plus pricing. Firstly, it must be noted how inefficient

[23] Wikipedia. Op. cit.

this method is at creating growth as observed when Y2 is deflated and shrinks down to Y1+Y3. Secondly, Y3 is not sustainable for businesses as it represents a hidden excess supply (area Y3) which will cause businesses to return to Q1 levels of supply, basically back to their original inert state at Q1. At Q1 businesses might prefer the price level P2, however, even if they were able to access this price level and gain (Y1+Y4) they would earn no more than they were earning before in Y1+Y3. Confronted with the two scenarios businesses would prefer the inflation prone area Y1+Y4 since they will earn the same amount with less effort (output). This scenario is closer to realty. Unfortunately this means there will ultimately be much fewer goods in the economy than businesses are capable of producing in that they can produce Q2, but why should they when they can produce Q1, charge more at P2 and earn more by cost plus pricing in this way; inflation is not a sufficient deterrent from doing this since at this level it is not viewed as inflation but profit or marking up, something businesses need to do to survive. They would rather have idle factors of production or goods and services sitting on the shelf and in the shop window, that is, operate with less output and cause inflation through higher profits than with greater output and gain deflation with lower profits. What the supply curve demonstrates is that businesses promote inflation; the way they respond to price, that is, being willing to supply more at higher prices encourages inflation. Businesses will tend not to relate microeconomic inflation with macroeconomic inflation and will consequently fail to see how price increases which appear to work in their favour by increasing their profits will inevitably use inflation to wipe out their gains. The reason for this gullibility, as explained earlier, is likely to be directly traced to the desire by contemporary economics to use 'at current prices' in ceteris paribus where it is clearly inappropriate to do so for price. The fact that they operate in a CFI inevitably makes them victims of their own increases in price, which they cannot do without since they operate in a system which does not allow them to sell goods and services at cost price and remain profitable. It has been mentioned that growth in contemporary economies is created by cost-plus pricing (price inflation) and the yield from this model is very low averaging from 0-6% in GDP. Businesses using price for gains (being willing to supply more at higher prices) or a cost plus pricing system or model will tend to function at their lowest output potential (Y1) and the highest possible price level (P2) which is far below their real potential (Y2) as long as the preference for high prices or cost plus pricing makes them psychologically feel it is profitable for them to do so in a flawed contemporary economic model every country in the world today follows. As a result it is rational and it pays for businesses to deliberately under-perform making commerce naturally insufficient to deal with underemployment when left to its own devices. It is difficult to see how any economy, whether developed or developing, can eliminate poverty, unemployment and inadequate productivity when the economy is systemically designed to reward getting cosy with these problems.

The supply curve shows that businesses are able to reside over an increasing area Y1-Y2. However, they can only harvest these gains if ultimately there are increases in quantity supplied at a constant price that does not erode earnings from sales. The problem is that implosion blocks the transfer of increases in price to businesses by eroding the value of the money they earn thereby ensuring market forces enforce inertia or zero growth. This means at any point in time an economy will be performing far below its potential levels of

productivity; if P2 were the general price level the economy would on only produce Q1 levels of output as it is satisfied with the gains from profits. What is the point of selling more at a higher price when at the end of the day the real income earned remains worth the same (inertia) as a result of higher levels of inflation or producing more at a lower price when depreciation does not prove an efficient or rewarding position to operate from? This should be no surprise since, as explained, businesses will naturally seek the highest possible profit margins with the least possible output (effort) through cost plus pricing in order to make the most from their products whilst escaping the economies relentless attempts at shutting them down through zero growth; meanwhile economies will run to and fro trying to control inflation and deflation using monetary policy and open market operations with which they will hope to gain financial system stability, without realising it is at the expense of economic growth. In all fairness, can there honestly be a less practical system than this?

Once again it is evident that prices rising and falling are a primary trigger to which the secondary response is the behaviour of either demand or supply and in order to maintain an equilibrium economies that use this system must sacrifice increases in GDP or basically forfeit their ability to grow, at the aggregate level this would entail shrinking GDP from Y2 to Y1. Financial system stability gained through Monetarist approaches sacrifice badly needed growth for stability, with the explanation that growth cannot take place without stability; this logic is not only confusing it can be misleading to governments implementing monetary policy. For example, if the IMF, guided by contemporary economic theory (as would be expected of any organisation today) were to insist that in order to gain economic growth governments must have mixed economies, devalue their currencies to become more competitive, rely on monetary policy and free markets some discretion is necessary. As demonstrated here, free markets gain financial system stability, but wipe out economic growth by inducing inertia. Consequently, this advice if given to governments may be both logically and technically flawed, yet it is this very same kind of advice that in the past has been given to developing countries. After restructuring and ‘modernising’ their economies along these lines they may find themselves still stuck in a rut as they wait for an economic providence that may never come. Developed countries that initially benefit from cheap natural resources as result of devaluation may find themselves eventually besieged with low cost, more efficiently produced finished goods and services.

Contemporary economics has no direct control over the trigger (changes in price) and has to rely on how market forces (the secondary response to the trigger) to react as a defence that curtails the negative impact of either inflation or deflation. Unfortunately this approach means growth must be suspended. It is expected certain responses in demand and supply will take place when the central bank engages in Monetarist open market operations otherwise they would be ineffective. Market forces are not the only guide for pricing money, goods and services. In the same way that cost price plus the mark-up helps businesses determine what to charge for their products cost price and competition in comparison to the growth needs of business can also function as aids for supply and demand setting prices in a market that does not need cost plus pricing to function efficiently and effectively. Even if the response to changes in price induced in supply may be considered positive traits the logic has a bias that distracts the public from the fact

contemporary economics does not know how to control price (P), if it could there would be a steady general price level even without a need to rely on Monetarist open market operations. Its like a prize fighter in a boxing match knocked out by upper cuts and jabs insisting he be taken back from the infirmary into the ring; saying he didn't lose, he wasn't knocked out, that was just how he 'rolls' with the punches. Consequently, contemporary economics needs to think demand and supply responses to price fluctuations make price changes acceptable; they can't be controlled so let's pretend they don't need to be controlled. Ideally, in an EOS model businesses should be able to establish prices based on or close to cost price for most normal goods and services, and only where market conditions are affected by issues such as delays, quality, type of goods, rarity of goods and services can price determination lift price above normal levels; otherwise there is no point as businesses selling products at cost price or close to it generally can earn a greater income than they did selling them with mark-ups (see Diagram 10) and even luxury goods which in the past were not accessible will tend to become more affordable. This is due to the fact that in an EOS model as any products become more expensive incomes increase maintaining a balance between available products and affordability (see Diagram13). If a bank can earn a greater real income redistributing money through credit creation without charging interest than it did with interest it has no psychological or financial impetus to charge more for money than its cost price effectively wiping out inflation induced by the pressure of interest rates on money supply. And since implosion is removed from the economy businesses do not necessarily have to cut back on factors of production to remain profitable. However, price stability of this kind is impossible for a central bank to gain without implementing the economic operating system (EOS)[24] through which the capacity to manipulate implosion is gained.

It is common knowledge a shift in either the supply or demand curve to the right can create an increase in output at constant price as shown in Diagram 3.

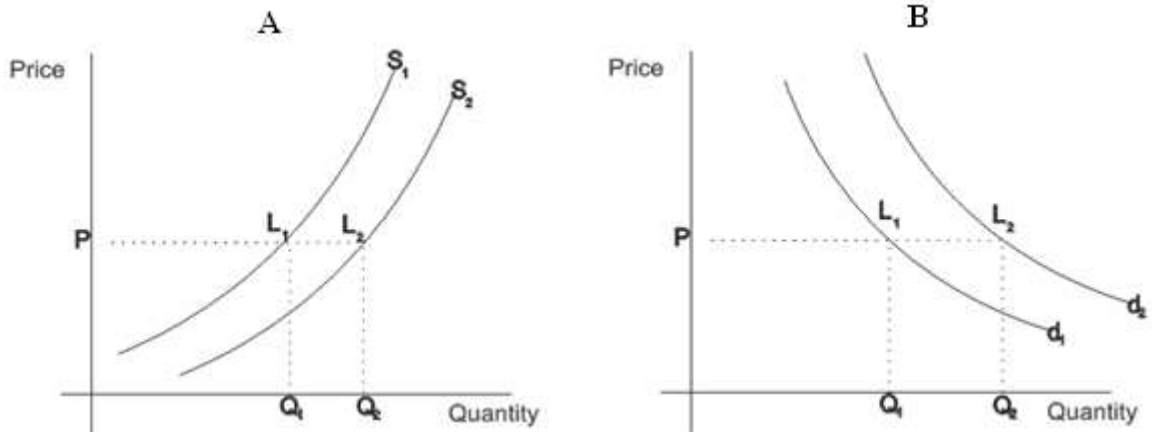



**Diagram 3**

From these diagrams it can be seen that economic growth can be obtained if both demand and supply shift to the right at a constant price. This has lead to contemporary economics

[24] See Punabantu (2010) on Operating Level Economics (OLE).

concluding that maintaining price stability is the most important pre-requisite to achieving economic growth. However, as has been explained, the benefit of growth becomes misconstrued logic when thought to apply to free markets in equilibrium.

Therefore, the third market myth that hides inertia or zero growth from contemporary economics is that market forces or 'free markets' which rely on the belief that if market forces (demand and supply) are left to maintain price stability the result will be economic growth as observed in the Diagram 3 showing shifting supply curves. The third myth implies that market forces naturally create an equilibrium through price determination. The right price is the one where demand and supply meet at L.

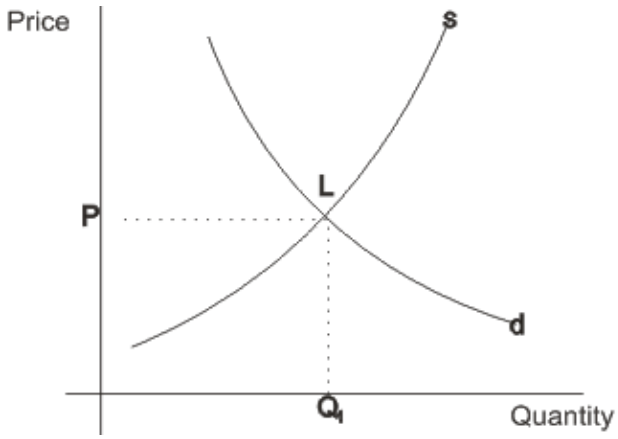



**Diagram 4**

Since contemporary economics does not have the means with which to directly control inflation it must rely on market forces to act as a natural defence, valve or regulator of depreciation and inflationary forces. Supply and demand have alternate objectives and by having to rely on the same scarce resources for survival are by nature confrontational. By working against one another they are expected to naturally or 'freely' regulate inflation and depreciation making a free market system seem the only other appropriate mechanism for achieving price stability. However, the consequence of following this logic is the implementation of a weak Monetarist model prone to instability and poor growth rates (0%-6%). Hence, when a monetarist model reaches its highest level of market efficiency it will generate stability in an economy, but with no growth; the lack of growth may then force a government to attempt price interventions that affect exchange rates using currency, interest rates or government financial instruments, however, this intervention implies monetary policy is counter productive. Furthermore, stagnation in the domestic economy resulting from the equilibrium sought by monetary policy will lead to these economies having to rely too extensively on external sources of financing to grow such as exports and FDI, which in turn become caught up in the intrigues of currency stability which are inevitably impacted on by the foreign exchange market leading back to monetary policy; it seems there is no escape, even in the escapism of exports and FDI. The steady depreciation of the dollar has given the yuan pegged to it a strategic advantage in terms of the trade relation between the US and China, however, the fall in value at the same time erodes the value of dollar currency reserves. Xin and Rabinovitch (September 2010) write "The Chinese

government's currency reserves, the world's largest such stockpile at $2.45 trillion, are held roughly in line with what was described as the global average: 65 percent in dollars, 26 percent in euros, 5 percent in pounds and 3 percent in yen…. Hu Xiaolian, a vice governor with the People's Bank of China, warned that depreciation loomed as a risk for foreign exchange reserves held by developing counties…Once a reserve currency's value becomes unstable, there will be quite large depreciation risks for assets," she wrote in an article that appeared in the latest issue of China Finance, a Chinese-language magazine published under the central bank." [25]

It is not uncommon to hear appeals for the price of money to be left to the system to freely determine without government interference. This may be part of the ongoing argument between the United States and China. The BBC (September 2010) reports "China pegged the value of the yuan to the US dollar in 2008 in order to keep its exporters competitive amid falling demand in the global recession."[26] In this scenario the US would like market forces to determine the value of the yuan as it is felt the currency is undervalued. Monetary policy depends on market forces to create a fair price or 'equilibrium price', however, the equilibrium price or value of the yuan for China will lead to the inertia associated with using market forces and translate into slower economic growth. For China to allow its currency to devalue to the equilibrium in this way is orthodox monetary policy. In the 1990s the deliberate devaluation of national currencies in order to make exports cheaper and imports seem more expensive was a requirement of the International Monetary Fund (IMF) with the advice it would increase demand for exports such as natural resources; it is a classic approach once used by the IMF as a pre-condition for developing countries struggling to cope with economic decline to access IMF loans. The problem with monetary policy is that its tendency to cause zero growth will force countries to rely on external resources for growth such as foreign direct investment (FDI) and exports. China and The US are trading partners, they both need each others economies to grow; this dependency between economies is recognised globally and the World Trade Organisation (WTO) was created to provide laws and an environment conducive to international trade. However, laws and rules will not achieve their objective or withstand a flawed system that, in the same way the expenditure fallacy forces supply and demand to compete against one another, places countries at odds with one another. The system has to change and a new approach put in place that allows both the US and China to achieve the growth objectives they require for their people. Monetary policy has becomes too obsolete a tool in economic theory to create an environment for international trade that is mutually beneficial to trading partners. The limitations of monetary policy are clearly illustrated by this problem. Even if the US allows the dollar to devalue, as it has done, the problem is that the yuan is pegged to the dollar and moves accordingly effectively blocking the US's ability to use monetary policy to counter the impact of the yuan on the US economy; the only monetary mechanism to avoid this would be for a sharp rise rather than a fall in the value of the US dollar that would require the yuan be unshackled from the dollar as there are limits to the extent to which it could follow this trend, however, the consequence would be a loss of competitiveness for US exports. China

[25] Zhou Xin and Simon Rabinovitch (September 2010) "Heavy in dollars, China warns of depreciation"
[26] BBC (15 September 2010) "China currency stance 'impeding reforms', says Geithner."

on the other hand allows the yuan to follow the value of the dollar to protect growth in its economy as a monetary strategy. This currency stand off between the US and China is a classic example of why monetary policy is obsolete. Earlier in this paper it was mentioned that the general price level should not have to change at all for an economy to maintain economic growth as China requires or to increase domestic economic growth as the US presently requires. In an EOS model, to be examined shortly, neither the US or China would need to devalue its currency in order to become more competitive, however, in a monetarist model they do not have this option. Here we observe one economy that wants to see the price of money rise whilst the other desires this price to fall, in a classic rendition of demand and supply competing for the same scarce resources. At the microeconomic level businesses work to push prices upward since the economy tries to shut them down while consumers are forced to try to lower prices due to lack of affordability forced on them by same system. Similarly banks desire higher interest rates while borrowers seek lower interest rates. Market forces are basically an inflation/deflation valve which, since contemporary economics does not have the means to adequately control price or keep it stable, it leaves it to the market or to open market operations to determine.

Furthermore, at L in Diagram 4 the product be it money or goods and services though exchanged at a price agreeable to both buyers and sellers is not being sold for its real price since it is being marked-up through cost plus pricing or, if it's a bank, interest rate charges. L is not the real price of goods and services or money therefore it also does not represent real demand, it represents the psychological price, or the inflated price not the real market price. Every economy in the world follows this price inflated system. The price P gained at the equilibrium depicted in contemporary economics is flawed for the simple fact that this is the inflated price not the real price (cost price) of money or goods and services in economies, consequently market forces cannot fully manage or counter inflation and deflation, even when they are in their ultimate state, that is, in equilibrium and left to function as free markets in a mixed economy; consequently the concept of market efficiency in this model is inherently bogus; but it is fine in contemporary economics to ignore this then pretentiously give advice on how to use market efficiency to manage economies. It is fundamentally flawed for any economy in the world to claim it has no inflation even where it experiences depreciation since its general price level is not simply an aggregate equilibrium for demand and supply, it is an aggregate of all the mark-ups in the economy. A Monetarist model cannot ultimately control inflation since cost plus pricing, an inflation trigger, is an integral part of market forces in this model. Since the contemporary economy is flawed, it pushes businesses, banks and governments toward zero growth hence they have no choice other than to defend themselves from the economy by being forced to constantly charge more for products than they are worth while consumers fight back by demanding less of products that may have prices inflated beyond their levels of affordability. Despite demand fighting back it must always lose since supply comes pre-inflated with mark-ups and as a result the balance or 'just price' observed in market forces in this model is not just at all as it is not real. This loss can be observed in the fall out of consumers no are longer able to afford the same monthly basket of goods and services or who have to pay more for the same basket thus depriving them of income they once had for other expenditure or savings. On the other hand if mark ups are decelerating and free

markets are causing deflation or appreciation, as is the case with the Japanese economy, instead of inflation the loss will be observed in the negative impact this deflation has on the affordability of its exports and relevant incomes earned by businesses. As a result of the market system causing inertia at its equilibrium and consequently impacting negatively on economic growth the Japanese economy will have to resort to another monetary policy tool, namely open market operations, as way of intervening in the high value of the yen. Sam Coventry (September 2010) explains that "Perceiving the yen as being too expensive the Japanese government proceeded to sell off their currency - estimates on how much yen selling Japan had done in Asia varied widely. Forex dealers cited talk of 300-500 billion yen ($3.6 billion-$6 billion) although some reports put it closer to 100 billion yen. The intervention helped send the euro, Australian dollar and sterling sharply higher on the day against the Japanese currency, although traders doubted Japan had bought anything other than dollars for yen."[27] The problem with monetary policy, as we have seen in the market myths, is that it cannot be used to regulate growth without numerous side effects where a person or country benefits at the expense of another leading to an unnecessary and never ending economic struggle.

Historically consumers came to accept that the market price is flawed by mark-ups, and accepted to purchase goods they can afford even though the market price[28] is not representative of the real price of the goods and services they purchase on the understanding the system could not function any other way since businesses would fold,[29] that is, trade in general would collapse in the current system, if products were sold at cost price. This discrepancy in the market causes a wobble effect[30] that keeps the contemporary economy unstable since it is off balance from the very start. This makes the idea of balance through an equilibrium brought about by market forces in free markets an oxymoron, a sham or simply widely accepted propaganda that can only end when the system is corrected to allow businesses to sell products at their real prices; the market cannot determine real prices when they enter the market with cost plus pricing. Clearly, from the onset, market forces work in disequilibria despite demand and supply being portrayed as an equilibrating force which keeps central banks around the world, despite having implemented Monetarist models for gaining price stability, in running battles with inflation and deflation to put out fires that may destabilise the economy. Mark-ups lower affordability of consumers, but they also inevitably lower the real earnings of businesses as a result of inevitable inflation which contemporary economics rail-roads away from common sense when it applies "current prices" to demand and supply logic effectively misinforming basic monetary policy. This entails that the activity levels observed in free market economies is far lower than it could be as cost plus pricing can easily be a logical substitute for productive efficiency; a simple supply curve was earlier used to illustrate how this happens. On the other hand monetary policy can cause an over reliance on export earnings, for which the inevitable consequence

[27] Coventry, Sam. (15 September 2010) "Japanese Yen depreciation more to do with US Dollar weakness."
[28] See appendix for URL on Punabantu, Siize (August 2010), "Financing the doubling of GDP in one Year." for lengthy analysis concerning the evolution of cost plus pricing.
[29] See Punabantu, Siize. (September 2010) where the discussion on cost curves demonstrates how the EOS model can create more resilient businesses.
[30] Punabantu (2010:8;93); Punabantu (July 2010:10); Punabantu (September 2010:16)

of success is deflation as observed in Japan. The fact that Japan experiences deflation yet still grapples with weak economic growth rates is a clear indication of inertia in monetary policy. However, even with price mark-ups attributed by businesses to goods and services and which the banking sector attributes to money, financial losses to the economy as a result of implosion severely impair growth at the macroeconomic level. Combined, this double whammy leads to the difficulty economies face in sustaining growth leaving millions of households and businesses outside the economic safety net. The law of supply is a clear indication of the limitations of monetary policy when microeconomic changes in price are seen as mark-ups or price inflation.[31] The way markets behave, their unpredictability and tendency to swing into highs and lows is a consequence of contemporary economics not having the means to directly regulate the negative impact of market forces when they aggregate at the general price or trigger level without relying on the intervention of open market operations and free markets for price stability.

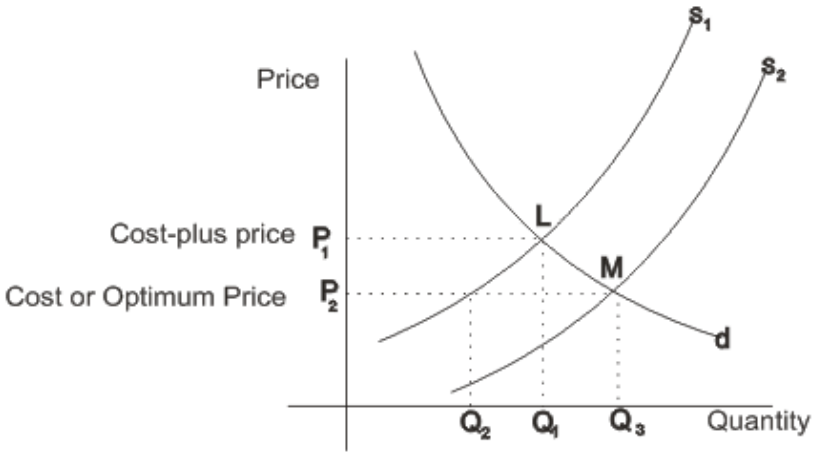



**Diagram 5**

Market equilibriums may be considered to be at their most efficient, for example at L, in Diagram 5, however, several reasons why this is untrue have been identified.

1. At L the market price is not the real price or cost price of a product (money, goods & services) seen at M. L is also the psychological price. The supply price includes a mark-up businesses require to break-even. As a result products in equilibrium at L do not represent the most efficient application of market forces since the *current economic model forces* businesses to use the cost-plus-price to take more than they deserve for the product from buyers, and in order to make this gain the loss will be the quantity of people unable to afford the product as a result of the mark-up. Businesses must do this as a result of implosion and the expenditure fallacy or they will fail to break even. Technically at L both businesses and consumers are trading

[31] See Diagram 14 in this paper.

inefficiently and a "wobble-effect"[32] is introduced to the economy. Unfortunately this is the ineffective system every country in the world follows today.

2. In order for businesses to implement the cost-plus-price P2-P1 the economy must shake off consumers Q1-Q3 who are worse off as they generally cannot afford products. The supply price P2 as a loss for businesses of Q1-Q2 and the market equilibrium at L are irrelevant since in an EOS model businesses can sell their products at the optimum price P2 yet earn a greater income than they earned in the old system at a price of P1. Consequently market forces implementing mark-ups in the flawed current economic model are not a Pareto improvement[33] in fact they represent a weak Pareto Optimum (WPO).

3. At L demand and supply are under intense economic strain since at the factor of production level they subtract resources from one another and compete using these same financial resources to be able to achieve the market equilibrium. This loss of real financial resources (implosion) makes economies extremely difficult for governments to manage and steer towards prosperity.

These problems that impact governance negatively are not evident in contemporary economics therefore adminstrations will receive little assistance from conventional planning in solving the socio-economic difficulties they create and will need to make an effort to push the frontiers of how national economies are managed.

Earlier we saw how if the demand and supply curve are looked at individually, changes in supply and demand take place in inertia, that is, without growth since any growth is not systemic or is wiped out by either inflation or deflation. In Diagram 3 we looked at how shifts to the right of the supply curve and demand curve at constant price can lead to economic growth. When these curves were combined we saw how market forces created an equilibrium price level at L. However, it was noted that this equilibrium is rendered defunct in that despite supply being equal to demand the price is integrally inflated by cost-plus pricing which may entail the Monetarist model the majority of central banks use to maintain financial system stability is inherently faulty. Let's examine this process further.

### *The 4th Myth*

The fourth myth that hides inertia caused by free markets and market forces from contemporary economics is through the explanation that an increase in demand will amazingly cause price to increase so that fewer people can buy the product thus bringing the economy back to a satisfactory equilibrium.

[32] The Wobble-Effect is general economic instability caused by markets trading out of synchrony see Punabantu, Siize. (2010:93) & Punabantu (September 2010 :10)

[33] A **Pareto Improvement** is an allocation that makes a person or group better off without making another person or group worse off. A **Weak Pareto Optimum** is an allocation that makes a person or group better off whilst making another person or group worse off.

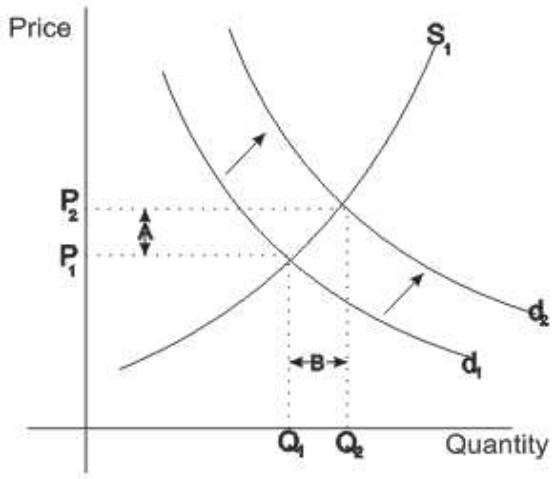



**Diagram 6**

The fact is that a result of an increase in demand causing growth as observed in the increase in output at B or Q1 to Q2, money will lose efficiency and destroy the benefits of growth by causing a change in A or P1 to P2. This inflation of price naturally kills off any further growth in demand and if sustained will eventually cause contraction due to lack of affordability. Therefore, potential growth in B is neutralised by implosion that uses inertia to commute the benefits of an improvement in demand to inflation at A thus worsening market conditions. A combined simultaneous shift to the right of both demand and supply would create the growth Q1 to Q2 at constant price, for banks this would represent an increase in the supply of loans in tandem with an increase in borrowing and output, however, this will tend not happen since the two forces require the same scarce financial resources to make that shift therefore they will restrain one another from positive shifts effectively preventing growth at a stable price in the economy. When demand shifts right it will subtract from supply the resources it requires to do the same, vice versa; this constricting force that promotes market failure and instability is what has been referred to as implosion in the circular flow of income (CFI). Business remain oblivious to the losses caused by implosion as a result of the expenditure fallacy. They create an artificial limit to economic growth that is observed in the Keynesian L shaped curve at the point where it changes from being infinitely elastic to being perfectly inelastic. This may not occur as a result of the economy reaching its resource limit as thought in contemporary economics; it may occur as a result of demand and supply operating in a system or model where they increasingly subtract financial resources from one another until their positive shift to growth is incapacitated.

### *The 5th Myth*

The fifth myth that hides inertia caused by free markets and market forces from contemporary economics is the explanation that when demand falls the “heroic” market will jump in and cause a fall in price that will once again restore demand and the original

equilibrium. "Suppliers will lower their asking price for a good when demand for it (at current price) is lower than expected."[34]

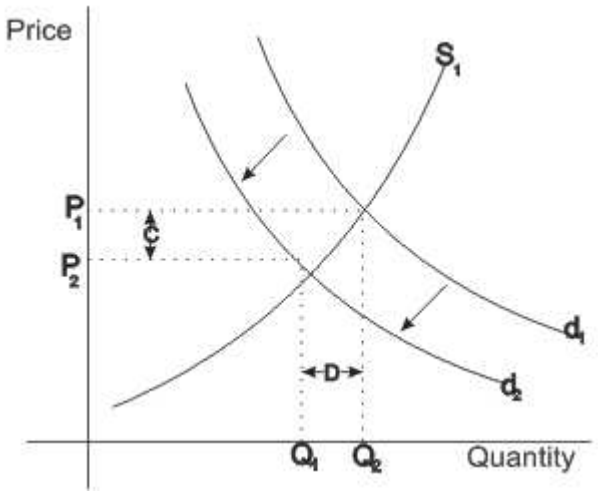



**Diagram 7**

If demand for a product is falling how can a fall in price be useful to the sustainability of businesses? For example, if the demand for loans is falling and the market system causes a corresponding decline in interest rates this is a double whammy that will hit the banking sector harder than is necessary. This simple problem indicates that contemporary economics places market equilibriums before growth in what would be nothing short of bizarre if the limitations of contemporary economics were not understood; in contemporary economics falling price as a result of falling demand is a "good scenario" as it is moving to the "right equilibrium". Once again "at current price" is used inappropriately to create a model interpreted using incoherent logic; price cannot realistically be tagged as current when it is clearly moving P1-P2. The simultaneous fall in both demand and price can cause the premature failure of businesses and banks. A fall in demand is a movement toward negative growth for them which the market instead of countering rewards with a fall in price consequently accelerating rather than decelerating the rate at which businesses and banks decline or an economy in general sinks toward recession. In a normal EOS model the central bank would be able to immediately stop this decline through recalibration in the CFI, however, contemporary economics does not have an economic model capable of doing this, it has one whose main purpose is equilibrium, consequently it is convenient to make stability more important than growth, even if it entails businesses and banks are closing down, people are losing jobs and households are being deprived of economic security. This problem is hidden by the ruse that lower interest rates will encourage more borrowing and lower prices will encourage higher demand eventually restoring the 'balance' of the equilibrium. The simplicity of this logic and its misinterpretation is alarming. The fact that the monetary system used to regulate price stability is flawed creates a 'damned if you do, damned if you don't' scenario where unfortunately there is no 'right' position for a government in the 'to intervene or not to intervene' debate. If markets are left free they will

[34] Wikipedia. Op. cit.

gain the much desired equilibrium, but will stagnate compelling governments to need to intervene, if governments intervene it can cause distortions in markets. Unfortunately governments considered responsible for growth and stability will receive the blame from analysts when economies go awry when in fact limitations in the tools commonly used in economic management today, such as monetary policy, are squarely to blame. Steve Chapman (25 September 2008) does this when he mistakenly blames US government policy rather than the system. He writes "…in their proposed rescue of financial institutions. They predict dire consequences if they don't get their way. But the consequences of letting them have their way are so awful that the alternative doesn't look so bad. What they prescribe is for the federal government to buy $700 billion worth of assets from banks and other lenders, exposing taxpayers to a potentially crushing liability. This plan would nationalize the money-losing part of the financial sector, to the benefit of capitalists who have made spectacularly bad decisions—fostering more bad decisions in the future. It would add to the liabilities of a government that is already living way beyond its means. It would give unprecedented power to a couple of officials who have proved highly fallible in trying to avert this alleged crisis. And it poses the risk of abuse and corruption because the government has no way to gauge the value of what it will buy."[35] The confusion market forces cause in the public arena distorts how planners are able to rationalise how market related problems can be solved. Christine Stebbins (May 18 2009) reports " 'There is a growing role for governments everywhere. That seems the fashion. But...history is replete with lessons, especially in the food and agricultural sector, where the distortions caused by government interventions actually reduce, rather than improve, food security,' said Penn, a former chief economist at the U.S. Department of Agriculture. 'We should avoid market interference in the consumption sector -- food price controls, export taxes, export embargoes -- and avoid government intervention and market distortions in the production sector,' Penn said."[36] The logic in this statement may be sound, but leaving markets to themselves to freely find their equilibrium naturally leads to economic stagnation making this a vicious cycle of limitless logic switching on and off. As a result there is really no solution other than to change the system being used to manage the national economy. It is not difficult to find those who, like Chapman, may insist that businesses folding during a recession or in a downturn should not be bailed out; since the economy is moving to a natural equilibrium these businesses and job losses are not as important as the equilibrium the market is trying to gain by getting rid of them therefore they feel a government should not interfere in this market process. In reality this process demonstrates market problems have no real monetary policy solution. It demonstrates how market forces and free markets fundamentally gain stability at the expense of growth and how human psychology has been conditioned to interpret this process in its own interest sometimes using government as a scapegoat and creating an endless argument with no right answer. These endless arguments seem to defy reasonable outcomes as they tend to be incapable of solving real problems and this issue is dealt with in the planning paradoxes. As long as the monetary system and economic model used to manage national economies is not changed unfortunately they will

[35] Chapman, Steve. (25 September 2008) "The Case Against the Bailout - Why the government shouldn't save businesses from their bad choices"
[36] Stebbins, Christine. (May 18 2009) "Agricultural leaders see free trade as buffer against recession"

remain the single greatest liability to the longevity and public perceptions concerning the ability of administrations to manage national economies since governments will receive unnecessary blame for economic problems to which the current monetary system and contemporary economics are designed to have no comprehensive solution; myths 1-8 are proof of this fact.

***The 6th Myth***

The sixth myth that hides inertia caused by free markets and market forces from contemporary economics is the explanation that as supply increases the price of a product will fall thus making it more affordable therefore sustaining balance in the economy. This is the most difficult or 'cunning' myth to decipher as lower prices brought about by increasing the supply of a product are often viewed as an opportunity for the public to gain access to a product since it becomes more affordable. These benefits are a smoke screen that leads monetary policy into misadventure as will be discerned below.

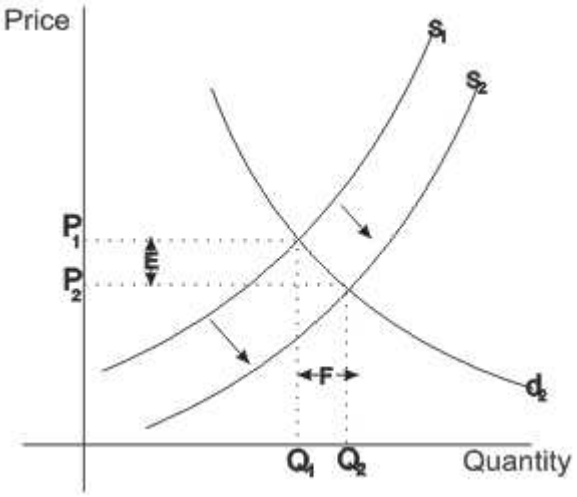



**Diagram 8**

An increase in supply of loans or goods and services will lower price and lower income businesses and banks earn thus discouraging suppliers from providing more of the product. Consequently, the increase in growth at F will be neutralised by implosion causing the increase in price seen at E or P1 to P2 that interrupts economic growth Q1 to Q2. There may be more goods in the economy, however, deflation ensures businesses and banks will not have the additional income they need to grow. The argument may be that lower prices increase affordability, but what contemporary economics is doing is it is conveniently choosing the winning side when it examines the benefits of free markets and market forces in general. In this case it lauds the benefits to consumers whilst disregarding the fact that suppliers are being placed at a disadvantage using the ruse of this being fine since it is placing the economy in equilibrium. In an EOS model the economy does not need lower prices to function efficiently since the model naturally increases incomes of consumers in the CFI at constant price thus increasing affordability and negating the need for a fall in prices to provide the same benefit to consumers. As a result business, banks and consumers

all benefit equally from rightward shifts in the demand curve unlike a contemporary economy where growth shifts of this kind lead to lower price thus giving consumers an advantage over businesses when growth takes place in this manner. The manner in which contemporary economics uses the "the equilibrium price" of market forces to justify the negative externalities that hurt either businesses or households is not only disingenuous, it's rather shabby.

### *The 7th Myth*

The seventh myth that hides inertia caused by free markets and market forces from contemporary economics is the explanation that a drop in supply will cause the free market to jump in heroically and raise prices so that it becomes more attractive for businesses to sell more of a product. "Consumers will increase their asking price for a good when supply of it (at current price) is lower than expected."[37]

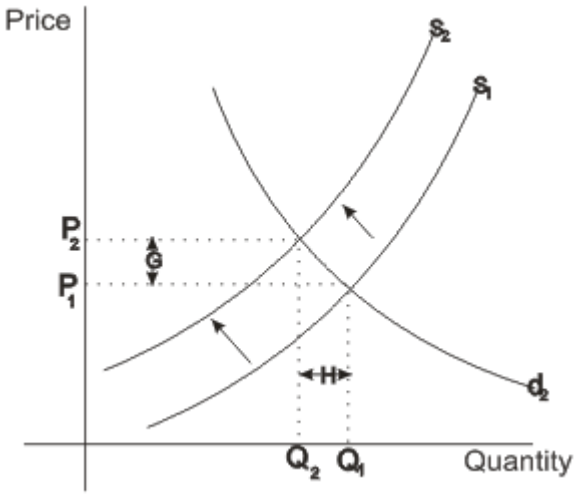



**Diagram 9**

Once again contemporary economics, for convenience, switches alliances and lauds the benefits to suppliers whilst disregarding the disadvantages to consumers justifying their demise with the excuse that a just equilibrium has been created by market forces. The fact is that the change at H is a contraction of growth that the inertia prone contemporary economy is designed to encourage, the economy thus functions contrary to the objective of growth desired by banks, businesses and governments in general. Consequently, it supports a fall in output by raising price making products less affordable further accelerating decline in the economy. For banks this would be a rise in the level of interest rates the benefits of which are killed off by a drop in demand for loans. Implosion negatively affects the efficiency of money in terms of how it is able to translate productivity and consumption into growth. The use of "at current price", as explained earlier is logically incoherent since price (P) *does change* and even though observed at the microeconomic level is a component of the general price level.

[37] Wikipedia. Op. cit.

To a very limited extent free markets and the Monetarist model may protect economies from inflation and deflation in the market, however, central banks should move on from the use of this processes to run national economies as it is irrational since, as we have seen, this benefit comes at a hefty price in that to have price stability growth must become secondary. Financial system stability of this nature makes way for inertia or zero growth that kills off businesses and banks; contemporary economics cuts off its nose to spite its face so to speak. Market forces are an excellent method for managing an economy that has arrived at its optimal or maximum levels of growth where planners now want the economy to hover or slow down whilst remaining stable yet looking at poverty levels and unemployment around the world, contemporary economies are far from reaching a favourable economic position such as this. Punabantu (2010:33) writes of the approach in free markets, "If an analogy were used the lethargy in this approach resembles the brakes on a vehicle to slow it down and keep it from moving" and; "Are markets useful and what purpose do they serve? This can be answered with another question. Are breaks on a car useful, or do they just slow it down?"[38] Real growth requires a stable general price level. However, this is practically impossible to achieve without neutralising implosion. Implosion acts through market forces as a brake or valve that strips money of its productive efficiency and instead of growth the result is either inflation or deflation each acting inversely to retard rather than support the effort of banks, businesses, governments and consumers who become casualties of market forces. When an enquiry is made as to why these casualties are suffering the common misguided response from contemporary economics is that their tragic demise is necessary for financial system stability gained through the equilibrium created by market efficiency.

***The 8th Myth***

There is further evidence of inertia. The eighth myth that hides inertia from contemporary economics is its belief a government can intervene in free markets to establish economic growth as observed in a mixed economy. When market forces are interfered with the theory of conservation of resources or value[39] (inertia) still kicks in. Rather than translating into growth the market will instead attempt to redirect any changes induced in the economy to either shortages or surpluses where demand exceeds supply or supply exceeds demand. The demand and supply graphs in myths 1-8 demonstrate why it is practically impossible for governments to supervise or control an economy using present day monetarist and Keynesian models.

[38] Punabantu (2010:96)
[39] Ibid.,p.140.

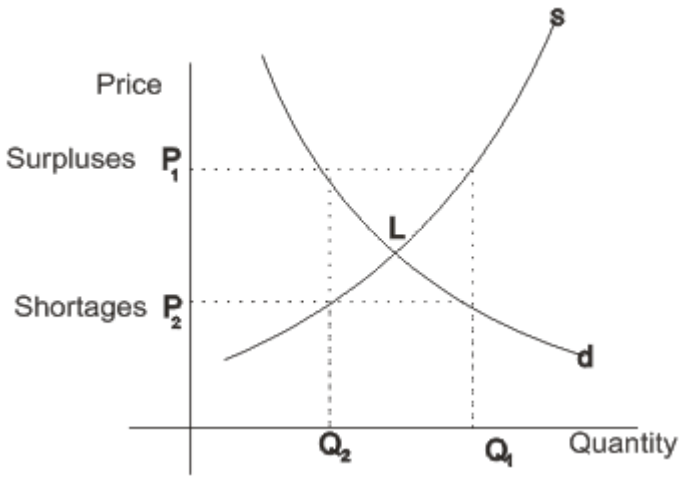



**Diagram 10**

Through the 8 myths it can be determined that market efficiency even in its highest form will create an equilibrium but with this perfect “tranquillity” will come a self defeating economic stagnation. The fact that demand and supply compete for the same financial resources has the capacity to reduce the stability of the equilibrium leading to price fragility. Curve tectonics may consequently take place at both micro and macro economic levels when prices wrestling for a better grip of the same financial resources (implosion and the expenditure fallacy) consequently diverge from the equilibrium, sometimes with a dangerous abruptness. When policy makers mistake financial system stability for growth, the more efficiently they manage markets, the more stagnant or inert an economy is likely to become with growth rates on average at 6% or less. Should government departments attempt to impose lower prices for goods or cheaper credit on the economy as a means of improving affordability the market will block this by creating shortages of the products in question (P2); banks will simply cut back on the issuance of loans blocking this avenue to inducing growth. Should authorities attempt to encourage higher prices as a way of encouraging productivity the economy will cut-off this approach to inducing growth by creating a surplus (P1). As a result government departments face the alternative and unsustainable approach of using subsidies to either make it possible to purchase excess supply (stimulus spending) or lower costs of production; both of which are extremely costly approaches to intervening in the economy. These interventions can lead speedily to budget deficits and inordinate levels of government borrowing that ransack the national treasury, but may be unavoidable. The budget deficit faced by Greece is an example of how government support to an economy can be costly. Adrian Ash (April 25 2008) sums up the incoherence in markets when he writes “Store manager Stephanie Gordon then told CBS News that in 21 years with the company, she's never "seen it like this before." Indeed, "we're actually starting to see shortages here in the US ," confirmed Scott Faber of the Grocery Manufacturers Association on Monday's Early Show . Then on Wednesday, Wal-Mart said it's rationing rice sales at its Sam's Club chain of wholesalers.... Shortages on US shelves make for great headlines of course. They also make it easy to blame third-world food riots and protests on a shortage of supply as well. But "there is food on the counters and on the shelves in stores," said Paul Risley, a spokesman for the UN's World Food

Program this week. The problem in Asia, instead, is that at these soaring prices, "there is a certain population that cannot afford that food."[40] When market forces are left to function as free markets the economy fails to grow as a result of myths 1-7. Should the economy be left free to determine the price L it will become stable, but lack economic growth. When a mixed economy is in place and government using the Monetarist and Keynesian models attempts to intervene in the economy the likely result may be either surpluses or shortages; as explained in myth 8. A consequence of market policy causing stagnation and stunting growth in the domestic economy will result in a tendency of economies to escape this stagnation through external means leading to an over-reliance and indulgence of national economies on exports and foreign direct investment. However, this escapism inordinately exposes open economies to the foibles and risks inherent in an economy being over dependent on international rather than domestic trade. Economies managed using These myths demonstrate that the models used today to manage national economies is incorrigible in that there are no satisfactory methods in which authorities can apply them to effectively manage a national economy leading to criticisms they do not deserve, but that all the same threaten the capacity of an administration to steer an economy to prosperity. Is it any wonder that a majority of countries striving to end poverty have been unable to do so despite the best institutional advice, reforms and restructuring in contemporary economics? The new Punabantu equation of exchange[41] demonstrates that it is possible to change this scenario. To be able to achieve real growth with stability a new economic model would need to be introduced. An economy that is much more favourable for banks and businesses in general to operate in can be implemented. The EOS model is able to rectify the problem of surpluses and shortages through adjustments made to the operating system. With an economic operating system (EOS)[42] managing an economy the market related problems identified in this paper that contemporary economics grapples with would be out of the way.

The first humane rule in managing an economy would be to stop the monetary policy “firing squad” that turns price stability or the management of inflation and deflation into a sport, after all, this sport does not bring about growth instead it can generate stagnation and a fragile economic peace. The economy shooting different prices for businesses and consumers to dodge by ducking and diving (demand and supply) should be superseded by a more advanced system. The EOS model gives economies an opportunity to achieve the objectives of monetary policy without the compromising economic growth. For all the curve movements discussed thus far to have a positive impact on businesses and growth they would have to take place in a stable price plain freed from implosion as observed in an EOS model elaborated on next in this paper.

**The Economic Operating System (EOS)**

When the economic operating system (EOS) is introduced to an economy and national financial system a central bank or federal reserve for the first time in history will be able to

[40] Ash, Adrian. (April 15 2008), “Government Bailouts Weapons of Mass Inflation”
[41] Punabantu, Siize. (2010:246); Punabantu, Siize. (September 2010:29).
[42] Ibid. (For details on the Economic Operating System (EOS) see Punabantu (2010) GPWN).

manage the economy from a price plane that is not easily at the mercy of how the laws of demand and supply respond to changing market conditions. It allows free markets to operate unhindered without damaging the economy and a central bank is able to intervene positively whenever market forces exhibit dysfunctional behaviour. The price plane is the trigger level of market forces before the secondary response (changes in demand and supply) kick in as a result of changing market conditions.

To begin with the EOS model does not need market forces or monetary policy to maintain price stability; it instead focuses on accelerating economic growth. The EOS model can naturally maintain price stability according to the requirements of a central bank or federal reserve. Market forces continue to operate freely and price determination continues to take place, however, the free market cannot hijack the economy and push it to the brink by responding inappropriately (abandoning growth in order to gain stability) to changing market conditions as it does today. At the microeconomic level each individual businesses no longer faces an upward sloping supply curve, but now has an infinitely elastic supply curve since it no longer faces implosion to the extent that it does not require mark-ups or cost plus pricing to break even. It is able to earn a greater income selling its products at cost price than it did with mark-ups in the old system.[43] Microeconomic inflation no longer contributes to macroeconomic inflation creating a stable general price level even though a free market continues to function. With the expenditure fallacy resolved as a result of the factors of production capital and households (labour) no longer competing for the same scarce resources demand generates its own supply. This entails that as long as there is demand for a product businesses are better able to supply it, consequently businesses compete for demand before price.

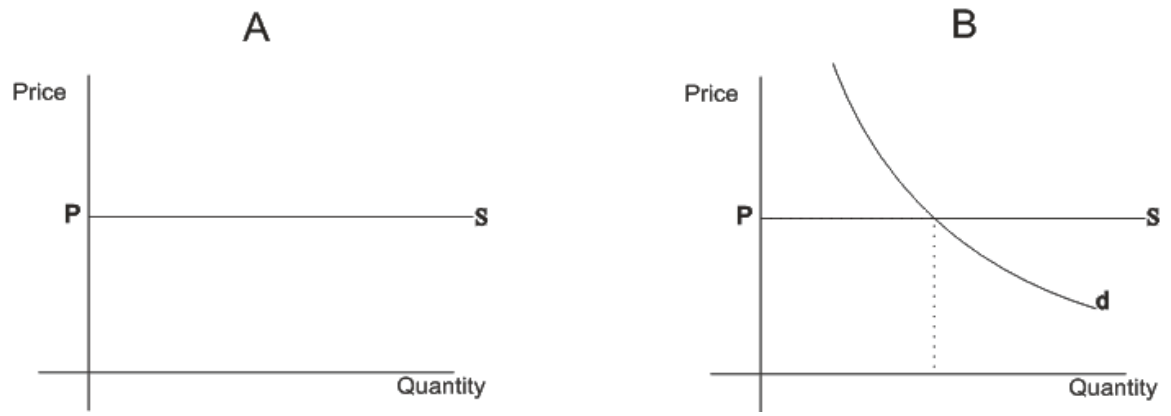



**Diagram 11**

A business sets its own individual prices according to competition in the industry, location, demand and other market conditions without the need for uniform prices as each business has an individual price plane tempered by the market. These same advantages apply to

[43] See the "profit", break even and shut down points discussed in Punabantu (September 2010:17;23).

money as a product issued through loans. Since banks and other financial institutions earn greater income charging no interest than they did charging interest the value of a currency has a tendency of remaining stable over time as its value is less inclined to be influenced by demand side influences or speculation. If the demand curve in graph B of Diagram 11 shifts right it does so at current or constant price; price (P) actually doesn't change making it theoretically sound. Though money is cheaper for consumers it is more profitable for banks creating an ideal financial market. The market functions freely through price determination as it has always done except that instead of fuelling inflation, as they did in the old archaic system, businesses, banks and other financial institutions now fuel growth. Any speculation is made on how performance affects growth rather than price. Demand falling or rising does not affect an individual business or a bank's price level bringing about financial system stability which will not require persistent open market operations and other monetary policy interventions by the central bank; it can now focus on advancing real growth in the economy through calibration of the economic operating system. Punabantu (2010:201) explains "..there should be no increase in the price level as long as there is no increase in cost that creates a decline in profitability great enough to motivate suppliers to seek compensation through a higher price. Unlike a CE system the profit margins are not as narrow in an OLE system thus making members of the supply chain slower or less inclined to increase price. In addition to this, if the system neutralises cost to a value below the psychological and economic need to compensate for cost or *zero* at every and any stage of a sale in the production process and supply chain then there should not arise a motive for producers and suppliers to increase price even if there is an increase in money supply" consequently the aggregate supply (AS) curve becomes infinitely elastic.

By adjusting the economic operating system any undesirable deviations from projected growth targets caused by unstable market forces can be countered by the system. In an EOS model aggregate demand balances out supply to the degree desired by a government through the central bank. When demand increases it does not compete with supply for the same limited resources. Shifts in the aggregate supply (AS) and aggregate demand (AD) curves are freed from implosion. This means demand and supply will tend to remain in a perfect equilibrium gained as a result of market efficiency, but with growth rather than without it as is the case with current economic models. The EOS economy will naturally seek to return to equilibrium *with* growth when it is disrupted. This creates a stable price plane as shown in Diagram 12.

[44]

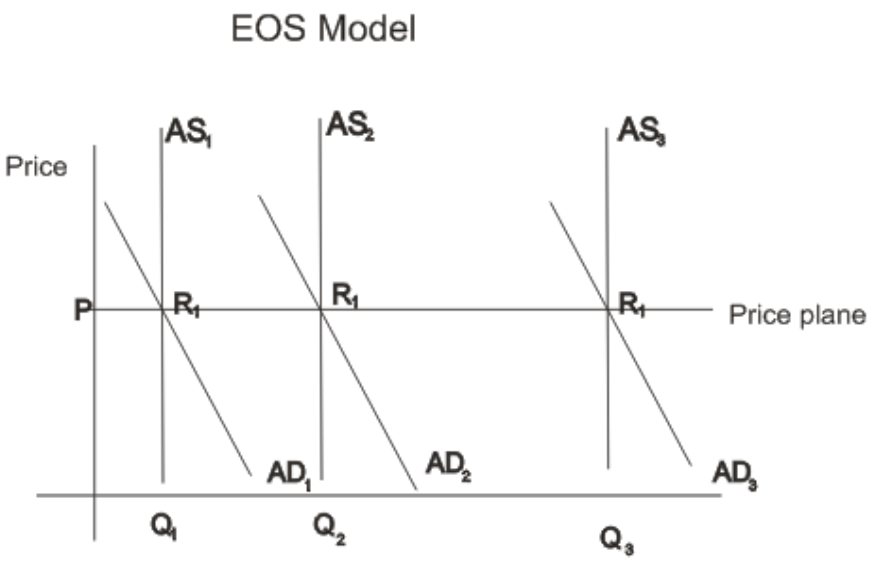



**Diagram 12**

Consequently, the aggregate supply curve behaves as though it is infinitely elastic. This price plane corresponds with the new Punabantu Equation of Exchange. The stability generated allows a free market to continue to operate freely as it has done in the past, however, in the EOS model market forces are unable to threaten the economy (creating economic busts and crunches) and can be easily restored to normalcy; they are not outside the scope of supervision by a central bank as is the case today. Price stability is improved, and the economy functions as shown in Diagram 12. Suppliers establish a price plane since they will tend to have no psychological or financial impetus to deviate from the prices they set meanwhile rather than pushing businesses to failure, the economy is instead constantly pushing them towards the growth target calibrated by the central bank. Changes in demand do not affect price since supply is compensated for by any changes in demand.[45] This is due to the fact that, as a result of the neutralisation of implosion, demand and supply are no longer competing for the same scarce resources. Even banks, like businesses selling goods and services, gain the ability to earn greater income redistributing money at its cost price than they did charging interest for it.[46] The result is financial system capable of close to perfect price stability as demonstrated in diagram 13.

[44] Punabantu, Siize. (2010:184).
[45] This creates a price plane, that is, a consistent general price level.
[46] See Punabantu, Siize. (September 2010) for the EOS model cost curves.

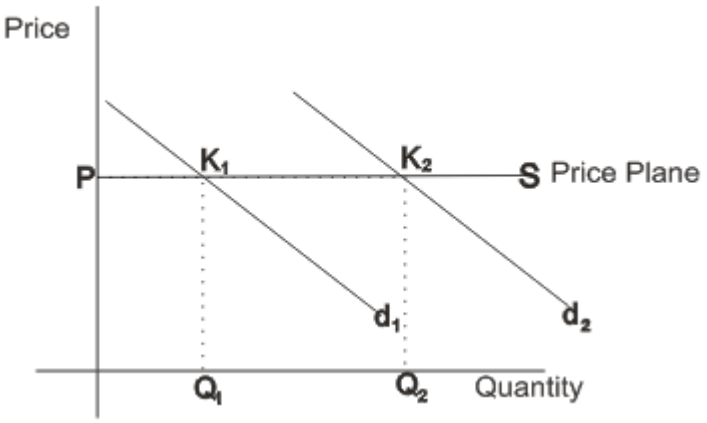



**Diagram 13**

With the changes brought about by the EOS model the economy emerges from turbulence (wobble effect, deficits, inflation, deflation, shortages, surpluses, implosion, expenditure fallacy etc) into the stability of clear skies. The neutralisation of implosion allows the supply curve to move toward becoming infinitely elastic shutting down unplanned inflation and deflation. Consequently the losses to implosion between the cost of supply and price are reduced; businesses become more resilient and gain the capacity to naturally (i.e. without impetus) sell products at or close to their cost price[47] leading to the natural stabilization of prices. Price determination continues to function, however, being freed from implosion, the market can now trade at the real rather than the psychological measure of value for determining prices. Competition will tend to keep prices stable and stave off price increases furthermore price increases have a lower impact on affordability since incomes will naturally increase should prices have to rise. In an economy in which implosion is perfectly neutralised businesses do not need cost plus pricing to stay afloat, in fact they earn a greater income charging cost price in the new EOS economy than they did in the contemporary economy charging more for goods and services than they are worth, furthermore, their earnings are protected from being eroded by inflation. Even though a free market is in place, financial system stability is maintained by a consistent price level as observed in the Diagram 13 where inflation and deflation are now regulated at the trigger level. This 'super' stability is created by a price plane, even if businesses charge more or less for a product and banks charge more or less interest and, increase or reduce supply the market will have a tendency to create a new long term price plane thereby protecting growth. The levels of productivity in the economy are driven by demand without incapacitating supply. In the EOS model when demand falls, price does not fall and when demand increases price does not increase lending steady support to growth of banks and businesses in the economy; the reason for this is quite simple. Firstly, unlike in a contemporary economy businesses and banks in an EOS model do not need higher prices or high interest rates to perform at their optimum, because of the economic operating system (EOS) they already earn better than optimal incomes and have higher levels of tolerance for

[47] See cost curves in Punabantu, Siize. (September 2010), "The Origin of Wealth"

changing market conditions. Secondly, consumers do not need price reductions (other than where prices are returning to normal levels) since the EOS model naturally increases affordability. The more consumers demand loans and other products the greater the capacity of businesses and banks to supply them thus neutralising the need for businesses to rely on mark ups and banks to rely on high interest rates. This takes care of myths 1-7. The EOS model also prevents the economy from reaching the resource limit expected in the L shaped Keynesian aggregate supply curve taking care of myth 8; governments using the EOS model will be able to intervene by accelerating or decelerating growth without causing shortages and surpluses and without having to spend any finances from the treasury.

Note how the new EOS model operates completely differently from the inflation prone Monetarist Model.

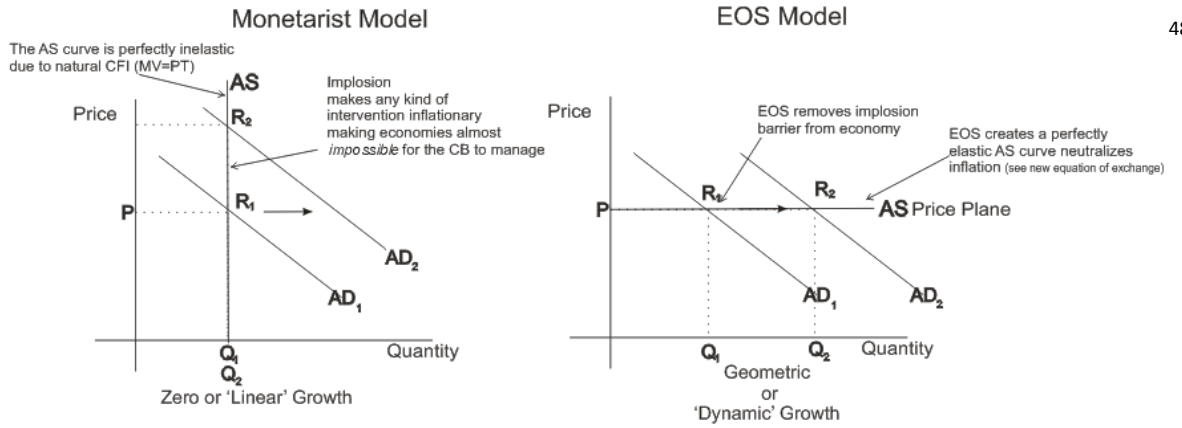



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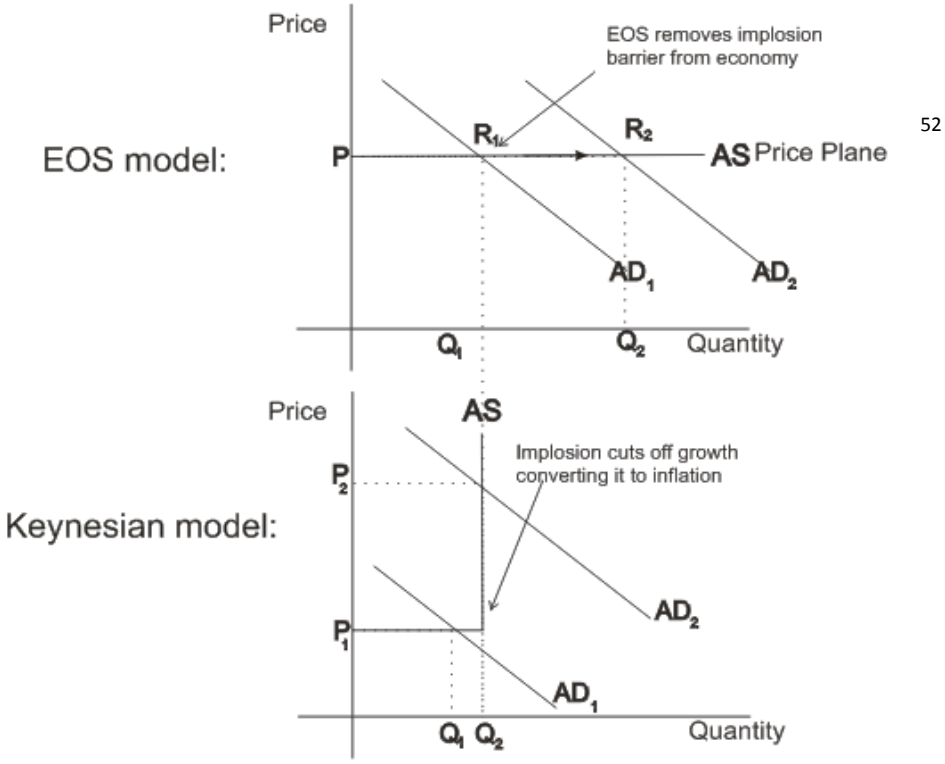
**Diagram 14**

The Monetarist model predicts its own volatility in that it clearly demonstrates (see Diagram 14) any changes in market conditions will have an immediate impact on price stability. The EOS model on the other hand predicts any changes in market conditions will *not* have an impact on price stability, consequently achieving the objective of monetary policy; yet both are predominantly free market systems. This should give the planner an idea of how much more advanced the EOS model is for managing the national economy than contemporary CFI models.[49] The proof of price plane stability provided by the economic operating system (EOS) is demonstrated by the new equation of exchange where growth can take place in the economy without a change in aggregate price levels.[50] Any institution engaged with managing a national economy that is seeks growth would need to be able to see how this transformation from the contemporary economy to the economic operating system (EOS) is a real change from poverty stricken and inflation prone mechanisms for managing economies currently in use. The L shaped Keynesian model is constrained by attempting to accelerate growth without first removing implosion. As a result money operates

[48] Punabantu, Siize. (2010:234)
[49] Contemporary CFI Models refers to Monetarist and Keynesian Models.
[50] The new Punabantu Equation of Exchange see Punabantu, Siize. (September 2010:29-31)

inefficiently, the economy arrives at its growth limit too early causing the economy to deteriorate rapidly into inflation, whereas the EOS model, which neutralises implosion restores the efficiency of money and does not face the same severe limitation to accelerating growth; it accelerates growth at constant price.[51] The EOS model is capable of outperforming both Monetarist and Keynesian models when it comes to achieving growth and financial system stability as shown below. The main function of market forces operating freely is to allow them to determine the correct levels of output for prevailing or anticipated demand in the economy; for contemporary economics to use them to regulate general price stability through the monetary policy is a misuse of the market mechanism that leads to socio-economic distress amongst populations exposed to the current system.



[52]

**Diagram 15**

The contemporary economy has very small profits margins[53] thus giving firms and the banking sector specifically very low tolerances when it come to changes in cost or variations in economic conditions. The ability to move beyond Q2 at constant price in the EOS model is made possible by improved incomes gained by businesses and the advantages of growth with price stability implemented by the central bank managing the economy using the EOS model. The new equation of exchange demonstrates this stability. An EOS model has higher income margins that give firms a much greater tolerance for changes in economic conditions

[51] See Punabantu, Siize. (September 2010:29-31)
[52] Punabantu, Siize. (2010:234)
[53] See cost curve yields EFAB against ABIJ in Punabantu, Siize. (September 2010:17)

thus making them able to maintain a consistent price plane. The EOS model sets aside the differences, leaves the worst and takes the best of Monetary and Keynesian models by accelerating growth whilst maintaining price stability.

The economic operating system (EOS) can be the first economic model designed that is capable of creating an infinitely elastic supply curve. It can create either a consistent pro growth (new equation of exchange) system or the current normal zero growth (MV=PT) relationship between money supply and inflation simply by the central bank calibrating[54] the economic operating system to the desired outcome; consequently "there should be no increase in the price level as long as there is no increase in cost that creates a decline in profitability great enough to motivate suppliers to seek compensation through a higher price. Unlike a contemporary economic (CE) system the profit margins are not as narrow[55] in an OLE system thus making members of the supply chain slower or less inclined to increase price. In addition to this, if the system neutralises cost to a value below the psychological and economic need to compensate for cost or *zero* at every and any stage of a sale in the production process and supply chain then there should not arise a motive for producers and suppliers to increase price even if there is an increase in money supply. This distinction entails that when the efficiency of money improves money supply can increase quantitatively without there being an increase in inflation; rather than an increase in inflation there should arise a corresponding increase in productivity or growth."[56] Furthermore, "each supplier in an OLE supply chain experiences no significant erosion of value and profitability. This removes the psychological and economic motivation to increase price. Even where a price increase may take place for a given reason anywhere along the chain there may be no motive further down the supply chain to increase price thus creating a new price plane and neutralizing the domino effect that [normally] fuels inflation."[57]

**Conclusion**

When it comes to governance an administration should have an opportunity to deal with how to invest and implement adequate financial resources than face an economic model that makes it struggle to raise the very resources required to build a brighter future for the economy and the people whose welfare it oversees. It is more fortuitous that administrations be empowered to leave a legacy of how they chose to invest vast resources at their disposal than have their work tarnished by an economic model plagued by scarcity and inconsistencies and that does not serve the effective purpose of governance. The fact that the current Monetary and Keynesian models for managing national economies tend to have no satisfactory solution to economic problems related to eradicating poverty, business failure and unemployment makes tainted forces of demand and supply ineffective in that they become unable to empower governments around the world with sound financial

[54] See how the process of calibration is linked to the new Punabantu Equation of Exchange; Ibid pg 29-31 & Punabantu, Siize. (2010:246)
[55] See cost curves area AFAB against area ABIJ in Punabantu (September 2010:17)
[56] Punabantu, Siize. (2010:201)
[57] Ibid.

systems endowed with the growth they need to make governance practical. The inconsistencies in interpretation of market forces in contemporary economics may compel Goodwin et al to note that "If we mistakenly confuse precision with accuracy, then we might be misled into thinking that an explanation expressed in precise mathematical or graphical terms is somehow more rigorous or useful than one that takes into account particulars of history, institutions or business strategy. This is not the case. Therefore, it is important not to put too much confidence in the apparent precision of supply and demand graphs. Supply and demand analysis is a useful precisely formulated conceptual tool that clever people have devised to help us gain an abstract understanding of a complex world. It does not - nor should it be expected to - give us in addition an accurate and complete description of any particular real world market."[58]

Let us at this point try to examine what there can be to look forward for economies that opt to advance from the present system to an EOS Model.

To begin to understand the advantages of the EOS model the reader needs to be familiar with previous discussions covering the evolution of profit, the expenditure fallacy, implosion, zero growth, technology paradigm, the new Punabantu Equation of Exchange and cost curves.[59] Once an economy through a central bank or federal reserve implements the EOS Model it is important to understand that a *new system* will be in place for managing the national economy. This new system will not have the same limitations as those observed in economies today. The new system is not resource constrained and entails poverty and economic strife caused by economic scarcity, post implementation, should no longer continue to persist. As will be seen in the next paragraph attainable GDP and per capita income levels in an EOS model are expected to be far greater than any levels found in contemporary economic models.

Thus far it has been explained at great length that the contemporary economy wastes as much as 100% of its useful financial resources per annum[60]; that is, 100% of GDP is annually lost to implosion. The EOS Model introduces a financial instrument that enables a central bank or federal reserve to recover this loss at constant price. This is demonstrated in the new equation of exchange and denoted by the factor R, which represents the calibration of the economy's operating system.[61] Managing a national economy on an EOS Model will mean that at the beginning of each fiscal year a government has at its disposal financial resources worth upto 100% of its existing GDP with which to accelerate growth and manage any undesirable changes in the national economy at constant price be they from recessions, natural or man made disasters, planned or unplanned crises and so on. At present every economy in the world functions on a natural circular flow of income (CFI) that makes it prone to economic instability which it often does not have the necessary financial

[58] Goodwin et al. (2009)
[59] See Punabantu, Siize. (2010) GPWN; Punabantu, Siize. (August 2010); Punabantu, Siize. (September 2010:17); the URLs for these materials are found in the reference section.
[60] See Punabantu, Siize. (August 2010)
[61] Economic Operating System – EOS.

instruments to deal with. Furthermore, the current system only allows for very small percentage increases in growth often averaging between 0%-6% of GDP (classified as zero growth in an EOS model), in addition to this GDP gains are predicted through a process of speculation that tries to guess how well or how adversely the economy will perform for the month, quarter or year. These archaic tools are insufficient to cope with the demands of the present day and the future needs of governments and populations. The EOS Model providing governments with 100% of GDP at the beginning of the fiscal year, *every year* with which to manage and supervise the economy entails governments that adopt this new system will be in a better position to improve the livelihoods of nationals than they presently are. These post implementation finances do not come from the treasury which entail government programmes will not be interfered with since in times of economic crises financial resources will not have to be diverted from budgeted for programmes. These resources though available to the economy are rendered useless by inertia and inaccessible by current systems used to manage national economies. However, governments that can opt to implement the EOS model can access these financial resources simply by adjusting the value of the economic operating system (R) which in the present day CFI is naturally set at R=1[62] or the limiting MV=PT model. Once an EOS model is implemented this adjustment will be no different from how a central bank or federal reserve adjusts interest rates depending on prevailing economic conditions. With an EOS Model in place, when an administration through its central bank or federal reserve forecasts growth of 20%, it means it will adjust the economic operating system to R=1.2 modelled on the new equation of exchange. This calibration releases financing equivalent to 20% of GDP in the economy thus practically guaranteeing this growth will take place; it is not guess work as is the case in the present system. To give an idea of the kind of economic muscle the EOS Model has, if the US government managed its economy on this model and experienced the current post recession sluggishness the Federal Reserve would simply adjust the operating system and accelerate growth by 20% of current GDP which stands at US$14.26 trillion. This would amount to injecting financing worth US$2.92 trillion at constant price throughout the US economy effectively lifting the entire economy, all 50 states, out of recession and back on the road to stability and prosperity. It would be expected that it would do so without having to touch a cent from the US Treasury.[63] With an annual growth rate that is capable of increasing geometrically,[64] that is, doubling time at constant price in one year there is no

[62] R=1 is the weakest level of the operating system where the CFI does not generate any growth in an economy. Every economy in the world functions naturally on this zero growth position which is why governments in general find it difficult to positively manage growth in a national economy even after economic reforms.

[63] Once the EOS model is implemented in an economy a government will no longer have to divert funds from the treasury for the purpose of providing planned or unplanned economic stimulus, henceforth, the operating system finances this with little or no cost to a government through the process of calibration.

[64] Geometric simply means the economic operating system reduces doubling time to one year. At R=2 the operating system should be able to raise US$14.26 trillion for the fiscal year, at the end of the year if fully applied the economy would grow to US$28.52 trillion, the following year it could double this value, however, the central bank is expected to regulate the growth rate, for instance it could calibrate for the economy to only grow by 10% (R=1.1). The limit to this expansion is the technology paradigm faced by an economy which in its early stages may be unable to usefully absorb such high levels of financing consequently a central bank

economic model, national economic management system or theory available today with this kind of power or precision. The need for countries to rely on exports and FDI as a result of monetary policy and the CFI in contemporary economics in general leading to stagnant domestic economies will remain a problem for economies managed using monetary policy. An EOS model is able to push growth to the psychological limit, that is, the highest standard of living desired by a government, its markets and population, whereas the monetarist model has a futile objective which is to push price to the highest psychological limit observed through the process of cost plus pricing only to have its gains eroded by inflation and stagnation when market efficiency is reached which leads to an economy which deliberately under-performs (high potential for productivity, but low output and high prices - see Diagram 2).

An economy capable of growing as fast as that managed on an EOS model needs to know when to slow down and when to stop further growth if necessary. An EOS model relies on the highest existing average standard of living to provide guidelines as to what extent an economy should accelerate economic growth referred to as minimum financing[65] and an international financing standard (IFS). Punabantu (2010:44) explains that, "In bridging the DREG[66] deficit the minimum financing value is derived from the top performing economies of the year, not only in per capita Income terms, but also in terms of the standard of living (HDI). These economies set the pace for the global level of financing and the national level of financing for the next financial year to ensure that the differences in growth and living standards between counties are not extreme. Countries are not expected to accelerate their economies beyond these per capita income or growth rates unless the group per capita income target exceeds that of the domestic economy. Nevertheless, the per capita incomes in the wealthiest nations today are themselves still far too low due to the primitive limitations of current scarce resources theory (SRT)[67] approaches to growth. These levels of income are considered high and advanced only as a result of the limitations arising from inordinately high levels of scarcity found in contemporary economies. "The circular flow of income followed by contemporary economies entails there are only economies facing varying degrees of scarcity with the least impoverished being countries labelled as "developed" and the most impoverished labelled the "least developed".[68] The US economy could have gained a GDP of US$15.779 trillion in 2004 compared against US$11.5 trillion the US faced for the same period due to approaches based on contemporary economics (CE)

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calibrates appropriately. Maximum country growth targets are generally to be limited by population size and IFS group targets.

[65] Punabantu, Siize. (2010:44)

[66] DREG stands for Damage or Repair to Economic Growth. The DREG deficit is basically the level of financing an economy requires to become aligned with the highest prevailing international per capita incomes.

[67] Scarce Resource Theory (SRT) is the process contemporary economics uses to manage national economies. It is a process whose fundamental belief is that its role is to manage resources which will always be inadequate for human needs, for instance, the basic economic problem is that "resources are scarce, human wants are infinite." In Operating Level Economics (OLE) this approach is not only seen as rationally flawed, but self inhibiting in the sense that contemporary economics cannot solve a problem related to scarcity which it inherently or fundamentally believes and teaches in colleges, universities and elsewhere cannot be solved. See Punabantu (2010:9;34;48) for further reading.

[68] Punabantu, Siize. (September 2010:6)

and scarce resources theory (SRT). A country should not be financed by less than the value of minimum financing (DREG and IFS) at constant price to ensure that the living standards, wages and opportunities that exist within it provide all of humanity equally with the quantity and quality of resources relevant to the needs of that prescribed period in history." The economic models used today simply do not have the financial muscle to achieve this kind of growth, stability and productivity. The IFS for the US economy in 2008 would have required the US's GDP to stand at US$27.7 trillion, this represents a per capita income of approximately US$70,800,[69] which for an EOS model is still very low, but it lingered at US$ 14.26 trillion and a GDP per capita of US$46,859[70] as a result of the current economic model in use. The IFS for the UK in 2008 should have been US$4.4 trillion, it remained at US$2.7 trillion. The IFS for France in 2008 should have been US$4.61 trillion, but it was US$2.86 trillion. Russia's IFS in 2008 should have been US$10.44 trillion, GDP lingered at US$1.68 trillion. Brazil's IFS should have been US$13.6 trillion, GDP remained at US$1.753 trillion. The IFS for Germany in 2008 should have been US$5.81 trillion, its GDP for this period was only US$3.7 trillion. For China the IFS,[71] being per capita income based, would have required China's GDP to have been US$37.44 trillion[72] in 2001, yet in 2001 it was only US$1.2 trillion. This value represents an international standard that recommends national economies were to be accelerated to a per capita income of US$28,807 for the year 2001, which for an EOS model, is not particularly high or difficult to accomplish as the model is expected to be capable of achieving far greater per capita income growth than this and its limitations are dependent on desired growth and the technology paradigm rather than resource constraints seen in under-performing economic models in use today. Since an EOS model does not face the same scarce resource limitations as either Monetarist or Keynesian models the per capita income deficit (DREG deficit) is intended to give governments a group target to which to accelerate their economies; it also entails that, except in exceptional circumstances, a countries maximum GDP will be guided by the size of its population: consequently, the smaller the population the lower the GDP an economy is entitled to. Since the economy has fewer people to care for, its productivity and industrialisation is tailored by the economic operating system to provide resources that accommodate the existing population size according to the targeted living standard or per capita income group target for that period. In 2008 per capita income in China stood at US$3,315. This created a per capita financing deficit (DREG deficit) of US$67,485 (US$70,800-3,315) for that particular period. In other words, the EOS model would have indicated there was US$67,485 per capita worth of financing missing from China's domestic economy (CFI) in 2008 to bring it upto par with the group of countries setting living standards for that particular period. The central bank would then use this figure as a group target for calibration of the economic operating system (EOS) and ease geometric growth rates toward obtaining this per capita income target. Calibration of the economic operating system allows this to be achieved in a reasonable period of time. Domestic productivity would respond by shifting productivity and

[69] Punabantu, Siize. (2010:40)
[70] IMF 2008
[71] IFS stands for International Financing Standard. "An International Financing Standard is the minimum value or volume of currency measured in GDP circulating through an economy" at constant price, See Punabantu, Siize. (2010:19)
[72] Ibid.,p.37.

domestic markets to acquire this development target. This approach satisfies the 3rd Planning Paradox in Operating Level Economics (OLE) which does not accommodate ambiguity or accept endless arguments or approaches in economic thought to act as road-blocks to accelerating real economic growth and development at the national level.[73] Furthermore, it should be noted that these low per capita incomes are still based on archaic Monetarist and Keynesian models where growth is implosionary and minimal at best; the EOS model per capita income group targets are expected to be significantly more advanced. Consequently, it demonstrates how far behind economies may be and where they could be; as far as economic growth and development are concerned they are generally lagging far behind unnecessarily prolonging the distress of households and businesses. The EOS model restores the functionality of domestic productivity which the monetarist model withdraws from countries coercing them into relying too heavily on exports and FDI as some of the only feasible options for achieving economic growth rendered stagnant by the equilibriums of market efficiency which though useful are defectively interpreted and applied in monetary policy as observed in myths 1-8.

There are many positive potential developments such as greener technologies and greener economic models. The current economic model does not generate sufficient financial resources to allow these technologies to be widely implemented. This prevents them from having a widespread impact that will alleviate the pressure on global warming and other side effects of industrialisation and productivity in general. "Operating Level Economics (OLE)…[provides] a renewed opportunity to make a significant contribution to the development agenda. Having had to do *without* in economies grappling with scarcity in both the developed and developing world has given the public a chance to identify what is most pertinent to them, clearly some of the most pertinent issues of 2009 [for example] were unemployment, poverty and climate change. Through OLE, for the first time, it is possible to be placed in a position where the lack of resources is not a hindrance to achieving national and international development objectives. OLE should not be confused with other types of economic interventions; it offers a geometric growth rate or…the potential for financing the doubling of GDP in one year (every year). Whether countries actually double GDP depends on the economy's absorption capacity, the extent to which the economic operating system is distributed throughout an economy (coverage),the quality of ICT infrastructure in place to support the system and the rate at which a government chooses to accelerate economic growth"[74] each fiscal year. This level of financing faster doubling times is merely a form of spare capacity that would allow much greater flexibility when it comes to setting national growth targets.

[73] To read the about the planning paradoxes see Punabantu, Siize. (August 2010:14-15) & Punabantu, Siize. (2010:100-103).
[74] Punabantu, Siize. (2010:202-203)

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