

The Theology of Economics

Interview with Duncan Foley

Is mainstream economics failing the original purposes of the classical economists like Adam Smith, David Ricardo, and John Stuart Mill? Duncan Foley has written a new history of economic thought for the layman, called Adam's Fallacy, which argues that it is. Can following one's self interest truly lead to a good society? Foley says it is not an adequate guide to how we should live.

Q Let us begin at the beginning. I sense that you had a pedagogical mission in writing your new book, *Adam's Fallacy*. You are trying to make accessible to readers your view of the history of the development of economics, much along the lines of Robert Heilbroner's book, *The Worldly Philosophers*.

A. *Adam's Fallacy* and Heilbroner's wonderful *Worldly Philosophers* are both introductions to political economy organized around the work of great economists. They differ significantly in the range of thinkers surveyed. *Adam's Fallacy* focuses on what I think is a common thread in this history, the efforts of political economists and economists to come to terms with the moral contradictions of capitalism in the very intellectual effort they made to understand capitalist economics analytically.

DUNCAN FOLEY is the Leo Model Professor of Economics at the New School, and author of Adam's Fallacy, A Guide to Economic Theology (Harvard University Press, 2006).

Q. Obviously the title *Adam's Fallacy* is eye-catching, but so is the subtitle, and I would just like you to explain what you mean when you say *A Guide to Economic Theology*. Are you saying that much of the way economics is practiced today is faith-based in some sense rather than based on rational thinking and empirical evidence?

A. Theology is a rational discourse at a certain level. Once you accept the starting point of theological discourse, the arguments themselves are quite rational. But I think economics is theological in ways that, say, physics is not. In economics, the questions of how things are and what laws govern outcomes are inextricably mixed up with how we feel about the institutions of modern capitalism, the market, money, and so forth, and also about what is the right way to live your life. Those seem to me to be theological questions.

Q Could you elaborate? What does an economist mean, in your view, when he is talking about the right way to live in a theological sense?

A. Adam Smith may have put it most clearly because he was writing at the beginning of the whole discourse and therefore had the fewest inhibitions about saying just what he was thinking. He argues that when people interact through competitive markets, certain moral questions can be suspended. Issues of moral conduct that have to be taken into account in all the other spheres of life, in particular the acceptability of the single-minded pursuit of self-interest, are somehow solved by the market in Smith's vision. But in life in general, our self-interest has to be weighed against our regard for others.

Q. Is this what you mean by Adam's Fallacy?

A. In a broader sense, I think of Adam's Fallacy as the idea that there is an economic sphere of life that, in moral or scientific terms, can be separated from the other spheres of social life. One of the points of the book is to show, by going through the work of these great economists, that they were each grappling in some way or another with that issue. That is, can we separate off an economics sphere, how do you treat it morally, and what is the right way to reconcile the strange laws of the economics sphere with the rest of human life?

Q. Early on, you use the example of Say's Law to explain Adam's Fallacy. Can you amplify?

A. I use the term "Adam's Fallacy" as a way of describing contemporary economics and political economy, because I see the whole body of thought as the development of that central point. Say's Law is the notion that the willingness of individuals to supply goods or services to the market immediately constitutes a demand for services, and therefore there cannot be any gap between aggregate demand and aggregate supply. That idea appears in Adam Smith. It appears again in David Ricardo's work, and it became codified in the work of the French economist J.B. Say, whose name is attached to it. The idea runs through many but not all of the thinkers I discuss in the book. It has very powerful consequences. Take the example of growth in imports, which can create unemployment. If Say's Law really holds, an equal amount of employment will be created to offset whatever jobs are lost through trade competition. That is a very powerful argument and certainly has influenced people's moral judgments about trade policy.

Q. But how does seeking our self-interest fail us in this regard?

A. Say you are an entrepreneur and you have an idea that is going to consolidate production of some line of products at a slightly lower cost. Say you are going to reorganize and manufacture some products in other countries. You know that you will be able to charge consumers slightly less, but along the way you will destroy an awful lot of jobs in existing profitable production facilities. In ordinary life you might think twice about the morality of doing that. Adam's Fallacy says no, go right ahead, as long as you make money, because you are ultimately going to benefit society. And that argument does depend critically upon Say's Law, that somehow the jobs you destroy through competition will be replaced somewhere else.

Q. And you are arguing that it may be detrimental to the general good.

A. I would not venture to decide in every single case whether this is a good or bad thing. Obviously some investments of that kind have huge social payoffs. What I am questioning is the doctrine that you do not have to worry about it because the market will take care of itself.

Q One subject that occupies a lot of attention in your book is the value of labor. Value in this context is a notion that mainstream economists prefer to avoid. Why is a concept like the labor theory of value so important in the history of economics?

A. It is typical in economics that a single word can have two very different sets of connotations. Economists tend to think of value as money value or exchange value, what something is worth in economic terms, a price. The value of labor (which Marx argues is better understood as the value of labor power) is what people are willing to sell their labor power for, the level of the wage. The important insight of the classical/Marxist tradition is that, on average, the value of labor power falls short of the value that labor produces, thereby creating the possibility of profit.

However, by value we also mean the things we care about and think are worth pursuing. Economics is a value-laden subject. You cannot escape its discussion of values in that second sense as well.

Q. What is generally meant in economic theory by the labor theory of value?

A. The book goes into the labor theory of value in some detail because it is a story that by and large gets lost in the way economics is taught today. I think the beginning of the labor theory of value in Adam Smith and David Ricardo was the idea that if labor was freely mobile—that is, workers were no longer serfs, for example, but could move from employment to employment and place to place—there would be a tendency for wages to equalize. If wages in turn were the major part of a product's value, then products would tend to be exchanged in proportion to the labor that was expended in producing them. That conclusion leads to a rather complicated question of what happens when there is also free movement of capital and equalization of the profit rate. In this setting, the importance of the division of value created between wages and profits is inescapable.

Q. Describe how this labor theory of value has evolved and changed in people's minds over the course of what amounts to 225 years.

A. It dropped out of the mainstream economic discussions to a considerable degree after Marx, but it has a very interesting place in history before that. The labor theory of value was key to Adam Smith's whole reorientation of economics toward labor productivity. Smith's big message is that the source of a nation's wealth is the organization of its human resources, not its natural resource endowments or the amount of gold that the king has in his coffers. This was a realistic and healthy idea to inject into the discussion of economic policy. From today's vantage point, we can see that the organization of human resources, labor, is the reason that relatively resource-poor countries like England and Japan became so successful. They were able to organize their labor effectively. Marx saw the labor theory of value as explaining exploitation and the class divisions of capitalist society. His focus is on the fact that when means of production are privately owned as capital, labor does not get the whole value that it produces, and the gap between the value that labor produces and the value of labor power is the key regulating factor in capitalist societies.

Q Let me ask you a little bit about Marx and the Marxist achievement, because you spend a lot of time on Marx in the book. In the end, what do you think is Marx's legacy?

A. It is complicated and important. Let me just summarize a few points I make in the book. Marx's economic analysis represents a coherent version of macroeconomics and growth theory, which has insights that are still quite important and relevant today. The essential insight is that you cannot understand macroeconomics without beginning from distribution, from the division of value between wages and profits. That line of thinking is still alive, for example, in the work of my colleagues Lance Taylor and Anwar Shaikh at the New School, but it tends to be overlooked in mainstream economics.

I also discuss the roots of Marx's views of revolution in his economic analysis, and the turns in economic history that frustrated the processes Marx foresaw and eventually forced him to reorient his economic analysis away from a law of increasing surplus value to a law of the falling rate of profit.

The book looks at the way Marxism has actually functioned in world history as a path for traditional societies to come to terms with modern global capitalism. The growth of global capitalism poses a terrible dilemma for traditional societies by destroying the viability of their economic and political equilibria. The Marxian vision of socialism shares many features with Marx's analysis of capitalism, particularly the idea that society has to generate and reinvest a surplus product in order to expand and grow, and that, as a result, workers cannot directly claim the fruits of their labor. These ideas provided a way for nationalist political movements in China, Cuba, Russia, Indochina, and other countries to come to terms with global capitalism without surrendering to its hegemony. Up to this point in history we have seen different outcomes to these various Marxist socialist experiments: restoration of a dysfunctional capitalism in Russia, vigorous capitalist accumulation in the framework of a communist-led state in China and Indochina, and romantic nostalgia for the Soviet system in Cuba. In the book I try to show how the seeds of these various historical outcomes are already present in Marx's economic analysis.

Q. After your treatment of Marx, you move on to the marginalist economists. I have always had trouble defining marginalism in one easy sentence. Please explain what that revolution represented and how it led to a kind of quantification of economic uses, which you think is oversimplified.

A. I explain marginalist economics as a retooling of Adam's Fallacy. The ways that Ricardo and Smith dealt with the problem of distribution had lost their theological or ideological potency by the last third of the nineteenth century. Marginalism represents an attempt to keep alive the core theological belief that there is an economic system, separate from the rest of social life, that abides by different rules of morality. Marginalism was an effort to express these basic ideas of Adam's Fallacy in new concepts and new language, particularly the language of mathematical physics.

The focus of marginalism is on the subjective increase in well-being that the division of labor and the resulting exchange of goods on markets makes possible. It is based on the sensible insight that in a society

with a highly developed division of labor, people will come together in markets to exchange the products they have produced in excess of their individual needs for the products they need. Market exchange tends to make their offer prices for goods and services equal. This is what marginalists think of as equilibrium. Adam's Fallacy reenters in the marginalist claim that the market is distributionally neutral, that differences in what people take away from market exchange reflect only differences in what they bring to it. Marginalist analysis, following Léon Walras, assumes people already know the equilibrium prices when they make exchanges. But they do not; in fact, as a result they make trades at disequilibrium prices that have important distributional consequences. The market is not a distributionally neutral reallocation mechanism.

Q. Can you illustrate that with a real world example?

A. Anyone who buys and sells assets, such as houses, experiences this problem. In buying and selling houses, price discovery is a huge issue, and those people who are in a hurry or do not bother to inform themselves carefully of all their alternatives can come out on the short end. The same thing is true with financial assets. The bewildering variety of products, and the fact that many people do not understand very well what they are actually buying and selling in financial transactions, means that it is easy for a few traders to make enormous profits by taking small amounts of money away from a large number of people.

Q. Many economists believe that this issue is largely a question of a lack of information. Can such disequilibria be reduced to a matter of information?

A. Economists always have the hope that some assumption like full information can exorcise these problems. But in fact that is just another version of Adam's Fallacy. The person who puts this point of view forward most clearly is Friedrich Hayek, who was a quite conservative economist and is a patron saint of contemporary neoconservatism in economics and politics. Hayek insisted that the function of markets is primarily informational. His argument here intersects with the story of Marx and socialism, when Hayek claims that the reason that even

market socialism cannot work is that socialist managers do not have anything at stake when they make transactions.

Q Can you use labor markets as an example where this breaks down? Are people not receiving a proper wage because they are really, in effect, making their transactions at nonequilibrium prices or nonequilibrium wages?

A. Labor markets are particularly prone to redistribution through disequilibrium trades because people have to make very large investments in skills and education to compete for higher-paying jobs, to become professionals, or to reach certain levels of executive power. People have to make that investment as a speculation. They do not know exactly how much their medical skills or lawyering skills or economist's skills are going to be worth when they are forty years old. They have to guess and make commitments that may or may not turn out to be justified.

Q In the end, what have the contributions of neoclassical economics been? Are there ways to compensate for what you think are their inadequacies?

A. In the book I present neoclassical economics as basically technocratic in that it looks at economic relationships almost as mechanical or physical relationships. These can theoretically be adjusted to make the economy run more efficiently and more smoothly, and to squeeze more subjective surplus out of it. Neoclassical economics is an economics of constant tinkering with the outcome of markets through legislation, subsidies, taxes, and so on to correct what economists think of as market imperfections. As a result, neoclassical economic analysis fits very well with the politics of liberal democracy, which is largely a matter of shifting economic surpluses from one set of interests to another.

By contrast, I try to stay away from detailed commentary on current policy issues in the book, because I was trying to take a long view. What appears right now to be the hot current policy issue will

not be in ten or twenty years, as has certainly happened in my lifetime. I wanted to have a book that gave people a way to think about economics and economic analysis without a particular set of issues being too obtrusive.

Q. But what is the alternative to tinkering with the distribution of surpluses? If capital is making too much, we usually say, let us try to give labor a bigger share. Or if some people at the high end are making a lot, as has been the case for twenty-five years now, then the middle and the lower ends need some help. But what is an alternative to that, even though you may not be prescribing it right now?

A. Tinkering with surpluses has too narrow a scope. We think of surpluses going back and forth from one region to another, from one class in the society to another. We do not think about the connection of capital accumulation, globalization, and the laws of the market to how we want to live, what kind of society we want to have. What, in the broader sense, are our goals for social justice or being responsible to each other? In tinkering with the distribution of surpluses, we sometimes make problems of social justice worse. For example, United States policy with regard to intellectual property in recent years has tried to shift large surpluses toward drug companies in the hope of increasing incentives for drug research. Here the laws of the market inevitably collide with problems of distribution, as sick people are priced out of access to drugs they need. We need a broader understanding of what we mean by individual and social health, how distribution of health services, including drugs, will serve the society as a whole.

Q. Let us return to the question of the achievements of neoclassical economics. Do we know more about how to help economies grow? Do we know more about how to keep unemployment low? Do we know more about avoiding or ameliorating recessions?

A. I would say no to all of those things. Neoclassical economics, in accepting Say's Law, sees unemployment as an equilibrium phenomenon that is presumably optimal from the point of view of economic efficiency. The neoclassical mainstream says recessions are viewed as equilibrium-efficient responses to shocks in productivity. The message,

quite predictably from an Adam's Fallacy perspective, is that there is not much to be done about economic fluctuations. Other thinkers and other traditions of economics that I treat in the book, particularly the Marxian and Keynesian analyses, tell us much more about those macroeconomic issues you mention.

What neoclassical economics does focus on, if rather obsessively, is the intricacy of market interactions, and it has thrown some light on the nature of market equilibrium and its pathologies. If we are going to organize life as much as we do through markets, those are important things to know. But they are not the whole story of economics and certainly not the whole story of social interaction. Some proponents of extreme forms of Adam's Fallacy argue that if you get market relations straight, you can solve all problems of human relations. I hope the book makes people wary of that conclusion.

Q. For whom did you write this book?

A. This book is for people who are interested in economics but do not necessarily know anything about it, and for people who know about mainstream economics but would like to understand other alternatives. The book makes its arguments in ordinary language, without relying on mathematics and graphs.

Q What is the final point you would like the reader to take away from this?

A. I wrote the book to help people understand economics in enough depth that they will be less vulnerable to smooth, facile, but one-sided arguments about economic policy. I would like people to have the confidence to make up their own minds about economic issues and not feel that economists or economic science has worked out economic laws that prescribe how we have to organize society and conduct our lives. If the book helps people gain more confidence to do this and express their opinions, I will be happy.

To order reprints, call 1-800-352-2210; outside the United States, call 717-632-3535.