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MD INTERVIEW

AN INTERVIEW WITH MARTIN FELDSTEIN

Interviewed by James M. Poterba
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Martin Feldstein is one of the most influential empirical economists of the late twentieth century. In the 1960's, as a research fellow at Oxford University, where he earned a D.Phil. in Economics, he pioneered the empirical analysis of production functions for hospitals and for other health care providers. In the process, he helped to launch the modern field of health economics. In the 1970's, shortly after moving from Oxford to Harvard, his research expanded from health economics to a broader range of social insurance programs, particularly Social Security and unemployment insurance. He developed theoretical models for analyzing how these programs affected the incentives facing households and firms, and then marshaled empirical evidence to document the substantive importance of these program-induced distortions. Feldstein's work sparked an active public policy debate on the economic effects of these programs, and this debate continues to the present day.

Feldstein was one of the first to use household-level data from surveys and administrative records to analyze how taxes and government transfer programs affect household behavior. His research contributions, and his pedagogical role in training dozens of graduate students, accelerated the diffusion of new empirical strategies in the field of applied economics. Researchers in public finance still make widespread use of the TAXSIM computer model, a household-level program for computing tax liabilities, which Feldstein began to build during the 1970's.

In the early 1980's, Feldstein spent two years as the Chairman of the Council of Economic Advisers. During that time, he warned frequently of the long-term economic costs of large budget deficits, even though this was a very unpopular view on political grounds. Feldstein's time in Washington expanded his interests still further, to encompass international economic policy issues as well as domestic questions. When he returned to Harvard and the NBER in the mid-1980's, Feldstein directed several projects on the sources of, and policy responses to, international economic crises.

Throughout the late 1980's and early 1990's, Feldstein continued to make central contributions to his primary field of public finance. In a series of papers on how

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Figure 1. Martin Feldstein.

taxable income responds to changes in marginal tax rates, Feldstein developed a new framework for evaluating the efficiency cost of income taxation. These papers also contributed in a very significant way to the debate on how congressional tax analysts should compute the revenue effects of tax reforms. He also continued his long-standing interest in social insurance policy. His 1995 Ely Lecture to the American Economic Association was a clarion call drawing economic researchers to the analysis of Social Security reform proposals, and it anticipated the very active policy debate of the last half decade.

Feldstein has been actively involved in both undergraduate and graduate teaching during his 35 years on the Harvard faculty. He has served on the dissertation committees of more than 60 graduate students, and he has trained many of the current leaders in the field of public economics. He currently directs and lectures in Harvard's Principles of Economics course, which is the largest undergraduate course at Harvard.

Martin Feldstein has made landmark contributions in many subfields of applied economics. He has also played a critical role in shaping the direction of economic research more generally in his position as President of the National Bureau of Economic Research, a post he has held since 1977. Feldstein has made the NBER a clearinghouse for a wide range of current policy-relevant economic research, and he has directed numerous research projects that have generated important new economic insights. During Feldstein's tenure as NBER president, yellow-covered NBER working papers and, increasingly, the NBER internet site, *www.nber.org*, have become standard starting points for researchers investigating many topics in applied economics.

In 1977, Martin Feldstein received the John Bates Clark Medal from the American Economic Association, recognizing him as the outstanding economist under the age of 40. Twenty-five years later, in 2002, he was elected president of that association.

This interview was conducted at Martin Feldstein's office at the NBER. One wall of the small conference room in which we worked is decorated with original drawings of some of the political cartoons that lampooned Feldstein's deficit worries during his time at the Council of Economic Advisers. Outside the conference room, a glass case contains literally hundreds of books that are the results of NBER research studies dating back to 1920. The interview follows a loose chronological pattern.

Keywords: Feldstein, Public Finance, Applied Econometrics, Social Security

Poterba: Marty, let's start talking about how you became interested in economics. You began your economics career as a health economist, and your undergraduate economics thesis was about health issues. What drew you to these issues?

Feldstein: Well, actually, my undergraduate thesis grew out of the fact that I was a premed student and I had worked during the summer for a cancer research organization at Sloan-Kettering. I knew something about cancer research and I guess it has always been a habit of mine to build on real-world information.

Poterba: What issue in health economics did you study?

Figure 2. Left to Right: Michelle White, Wen Hai, Gay Auerbach, Roger Gordon, and Martin Feldstein during June 2001 NBER–Chinese Center for Economic Research Joint Conference.

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Feldstein: The thing that I looked at was how much the government should spend for cancer research. In retrospect, it was a very naïve thesis. I did a survey of people who had National Institutes of Health cancer research grants. I asked them if the government spent twice as much or five times as much, what would be the probability of various kinds of outcomes.

What I learned was that if the spending numbers were 50, 100, and 250, you got certain answers. If you multiplied those all by two and asked the same questions, you got the same answers at the same relative points. So that was good evidence that these people had no idea of the payoff from research spending, and that my question was very naïve. This was not a way in which you could find out what the payoff was for additional spending on research. Of course, that was not what I expected to find when I started the research.

Poterba: What was your economics training as an undergraduate at Harvard like? Was there any discussion of statistics, any discussion of mathematics in what you studied?

Feldstein: There was no undergraduate econometrics course. Those few people who were more mathematically inclined could presumably find their way into the graduate program, although I think, truth be told, it was not very mathematical at the time either.

Poterba: Now after this undergraduate experience, you headed off to England to do graduate work. Can you say a bit about how that came to pass?

Feldstein: Well, I thought I was going to be a doctor. I had been admitted to Harvard Medical School, but I thought taking a year off to see the world would be a good idea. And the people at the Fulbright Commission were nice enough to accommodate that. So I packed my bags and went off to Oxford, expecting that I'd come back at the end of one year and go to medical school.

Then I discovered I rather liked this economics work and decided to spend more time in Oxford. I wrote to Harvard Medical School and they agreed to postpone my admission for another year. And we repeated that process so that I'd been admitted three times before I worked up the courage to say, no, I was going to be an economist.

Poterba: When you were at Oxford, your graduate advisor was Terence Gorman, who is known primarily for his work on demand systems. How did he affect your development as an economic researcher?

Feldstein: The first person I had as an advisor was actually Ian Little. He was an expert on welfare economics, and I think he had an important impact. I didn't spend a lot of time with him, nothing like what I did with Terence, but Ian had written a book called *The Critique of Welfare Economics*, which essentially developed the theory of the second best, arguing that you can't make welfare judgments about specific public policies if there are any imperfections in the economy.

But Ian was too smart to settle for that conclusion. Having written a brilliant book, he then went on to do applied welfare economics. He wrote a book about the nationalized coal industry in England. He acknowledged in the introduction all of the things that he had written before—that in a "second-best" world it is

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not possible to make rigorous judgments—but then he proceeded to give sensible comments. And I suppose that has been my attitude: I understand that welfare economics is an approximation but I believe it can be useful.

Terence was a phenomenon. He showed me in a way that nobody at Harvard had what technical professional economics was all about. He also introduced me to econometrics. He was a one-man show: He taught us linear algebra, mathematical economics, and econometric theory.

Poterba: What was Terence teaching in econometrics?

Feldstein: His teaching in econometrics built on linear algebra rather than on mathematical statistics. In addition to the traditional OLS estimator, we studied instrumental variable estimation and saw LIML as a special case of the k-class linear estimators. Although big macro models were in vogue at the time, Terence was very much a single-equation man who thought that the chance that you could specify one of these large systems well enough to gain anything from cross-equation restrictions was very small. I'm sure that lesson stuck with me.

Poterba: Were there other key figures in your graduate school experience who affected the way you came to do research?

Feldstein: I went to John Hicks' seminar and to the Nuffield College economics seminar, but the major stimulus was talk with some of my fellow graduate students—particularly John Flemming and John Helliwell.

Poterba: What did you learn in your doctoral dissertation research on the British National Health System?

Feldstein: Well, I discovered that you could do useful econometric research about a health care system. That hardly comes as a surprise now since many people now do research on health care, but it was very novel at that time, in the United States as well as in England. The British system was good in that it had a lot of microeconomic hospital data that were publicly available.

One of the specific things that I looked at was the effect of resource availability on patterns of utilization. Different areas of England were differently endowed with hospitals and doctors. I studied how these differences in endowments in a nonmarket system affect the amount of care given to different kinds of illnesses. I showed clinical people the results and asked whether the things that were most sensitive to resource supply were the things that should be most sensitive. The answer was "certainly not."

I also studied questions such as economies of scale and optimal hospital size. I estimated cost functions, and production functions with multiple inputs so that I could evaluate the marginal product of nurses and doctors in the production of case-mix-adjusted output.

Poterba: After six years in the United Kingdom, you returned to Harvard. Were there major challenges in shifting from a research program on health economics in the United Kingdom, where health care was largely provided in the public sector, to studying health economics in the United States?

Feldstein: No. It was much easier here because health care was provided in the market. There were prices so there were more questions. It wasn't just about studying the technology. You could actually ask what does insurance do, and why do people buy insurance, and why are the prices rising faster in one area than in another? There were a whole set of questions that came very naturally to an economist. So I stopped doing the kind of microtechnology things that I had done in England.

Poterba: Had anyone done empirical work on these issues about insurance and related things before?

Feldstein: Not much. Ken Arrow had written a paper about the theory of health insurance. There were two or three economists who were working on the economics of health, but it was just not a field and there was no modern econometric research.

Poterba: Did any of the work that you did on insurance or health economics in the late 1960's and early 1970's give you any insights on what was going to happen in the health care economy for the next three decades, in particular, the rising share of GDP we devote to health care and the shift toward managed care?

Feldstein: Well, the rising share I think was foreseeable. In the hospital area, which was the big expenditure area, there was a dynamic in which the higher the price the more insurance you wanted, and the more insurance you had the higher the equilibrium market price. I wrote a few papers that worked that out and showed how tax rules were driving the demand for insurance. Moreover, my estimates implied that the existing system was on an explosive path in which some exogenous force would be needed to stop the rise in the relative cost of hospital care.

I did not see managed care as a solution. My view—and I think it was true of other economists who, by then, were joining the fraternity—was that more co-payment and deductibles would make the health care market work better. Although managed care and HMO's have been used to limit costs, public dissatisfaction and changing technology may lead to renewed interest in co-payments.

Poterba: Let me shift for a moment to the Harvard Economics Department that you returned to in the late 1960's. This was a time of great change at Harvard. You, Ken Arrow, Zvi Griliches, and Dale Jorgenson all arrived within a few years of each other. Was there a sense that you were part of a wave of change in the way economics was being taught and practiced?

Feldstein: Sure. It was an explicit decision by the department to go out and recruit. These people didn't just happen to come; they came as a package. I wasn't part of that package, but I came at the same time and I knew they were coming and that was part of the lure of Harvard. It was clearly a revolution in the way in which the first-year courses were going to be taught.

In the 1960's, the first-year course was being taught by people such as Wassily Leontief. Wassily was a Nobel prize winner with a great track record behind him, but he was not the person to teach current microtheory. He may have been communicating more wisdom than the average microtheory course, but he was not teaching the material that graduate students needed to know.

Poterba: You mean students were not getting modern tools.

Feldstein: Right. Then a group of young Turks took over. Within the first year or so that I was at Harvard, Sam Bowles and Herb Gintis were teaching the introductory micro course and had written a little textbook for that purpose. And, no doubt, this brought the students closer to the frontier, but it wasn't the same as having Ken Arrow doing it.

John Meyer and Hank Houthakker were the teachers of econometrics, and that wasn't really their specialty in the sense that it was for Zvi and Dale. So, the arrival of the new faculty produced a real change in the way the first year was structured.

Poterba: Now, also about this time, around 1970, the set of issues you were working on seemed to broaden enormously. You moved beyond health economics and began thinking about topics in corporate finance, in macro, in labor economics, and even in theory and theoretical econometrics. What accounted for this shift?

Feldstein: Well, some of it had actually happened earlier. I started working on issues in public finance and wrote several papers about cost–benefit analysis while I was still in Oxford. They all grew out of an interest in the question of how costs and benefits should be discounted. Also, while I was still in England, I did some work on dividends and the British tax law. So I really had been working on a fairly wide range of things before I came back. And I think I more or less kept them going in parallel.

Poterba: Was the technology of using graduate students in the research process different at Harvard than at Oxford?

Feldstein: I was one of the unusual researchers in Oxford. For five shillings an hour—that was 70 cents at that time—I got some very bright undergraduates who worked for me. And of course everything then was very labor-intensive. There was no such thing as machine-readable data.

When I came back here, it was more or less the same. The computers were somewhat better, and you had punch cards instead of punch tape, but you still needed people to transcribe things from books.

Poterba: When students and researchers read your papers from the 1960's and 1970's today, they read them primarily for their contribution to substantive issues such as taxes and health insurance or the effect of tax policy on corporate investment. When you were doing this work and presenting it within the economics profession at the time, was it viewed as econometrics research or was it typically in an allied microeconomics workshop?

Feldstein: In England, it was certainly econometrics. The thesis that I did there was published by North-Holland in their series of econometric monographs. I used to go to the European econometric society meetings and places like that. And I cared a lot about heteroskedasticity corrections and the autocorrelation corrections When I came back here, I remember very distinctly that people seemed much less interested in the econometric techniques. It was taken for granted that applied work would use the state-of-the-art econometrics. Although I was an active participant in the Harvard–MIT econometrics seminar, I wasn't a technology maker. I wanted to study substantive issues. I wanted to use whatever was best-practice technology. So I was a consumer of econometrics.

Poterba: Can you say a little bit about the change in econometrics sophistication in applied economics that you have seen take place over the past three decades, and reflect on the benefits that we've taken from that or any costs that there may have been?

Feldstein: I think it's been enormous. Every graduate student now comes out with quite a lot of technical sophistication. But there have been waves of fashion, if you want to call it that. As I said before, big macroeconometric models were very much in vogue at a certain point. That then faded away. And there's still the ongoing debate between the people who want fully specified parametric structural models, and those who rely on the difference in difference estimates.

But the graduate students seemed very comfortable with all of that. Part of it is the software, too. Today, you decide what you want to do, you press a button on your PC, and it happens. That was certainly not true 30 years ago.

Poterba: Let me now shift to some of the substantive issues that you've worked on. In the early 1970's, after you did an influential study of the unemployment rate for the Joint Economic Committee, you began working on unemployment insurance (UI) issues and the role of UI in affecting temporary layoffs. That's a topic that has continued to attract your interest for nearly 30 years. You've worked recently on unemployment insurance savings accounts. What do your broad research findings suggest about the right way to design an unemployment insurance system?

Feldstein: I distinguish two ways to think about reform: parametric reforms within the given program structure and changes in the basic structure itself. Within the existing structure, there is a trade-off between protection and distortion. More complete insurance provides more protection but also distorts more, causing greater efficiency losses. The research suggests ways to change the parameters of the program to reduce distortion and indicates how protection would be affected. Such changes include the level of benefits and the time until benefits are paid (like the deductible in an insurance policy). I've also studied the incentive effects of the employer tax and the experience rating system.

Unemployment benefits are now part of taxable income. In the past, when they were not, some individuals could actually get more net income by remaining unemployed than by returning to work.

The magnitude of the distortions in unemployment is critical to the policy decisions and my research focused on measuring those distortions.

If we can think about restructuring UI and not just changing the parameters of the existing system, then some form of unemployment insurance savings accounts makes a lot of sense.

Poterba: We've had a lot of debate in the United States in the past few years about what the NAIRU is. What's your guess about the impact of policies such as unemployment insurance on the level of the NAIRU?

Feldstein: I think that the changes in the unemployment insurance system have probably reduced the NAIRU by about a half a percent, perhaps even more. It doesn't sound like a lot, but 1% is more than 1 million unemployed people.

Poterba: Let me ask a particular question about the unemployment insurance saving accounts that you recently suggested. Is unemployment distributed widely enough in the U.S. population to make such mandatory self-insurance a feasible option?

Feldstein: Well, the data that we looked at, which was for male heads of households, certainly indicated that it was. More work needs to be done on other population groups.

Poterba: Let me move on now to Social Security, one of the other issues that has attracted your interest for many years. How did you first become interested in the issues surrounding that program?

Feldstein: Again, this goes back to England. I was lecturing about consumption behavior. I read the studies by Milton Friedman and others and was very impressed. They had a theory of consumption and analyzed data that supported their theory. But I then realized that Social Security wasn't in their analysis even though Social Security was the major form of "saving" for most people. So I first began research on Social Security in order to improve the specification and estimation of the consumption function. I'm sure I thought of Social Security because I was teaching public finance while others with a more purely macroeconometric perspective had not thought of it.

The same sort of thing happened when I did this work for the Joint Economic Committee. They didn't say, "Go study UI." Quite the contrary. They said, "Tell us how we can get the unemployment rate down to 3%," hoping that I would say stronger expansionary macro policies. But with my public finance hat on, things like UI jumped up at me.

Poterba: So when someone reads the 1974 *JPE* paper on Social Security today, one can think of it essentially as taking the Ando-Modigliani style of consumption function that was a building block in the macro models, recognizing that there was a missing variable, Social Security wealth, measuring that variable, and plugging it in.

Feldstein: Right, but once I got started on that, it became clear that Social Security was an interesting thing in itself. And like all interesting things in economics, its effect cannot be decided by theory alone. Social Security arguably could displace ordinary savings, but when one took into account the induced retirement effect, it could lead to more savings.

Poterba: Was the concept of Social Security wealth a concept that was discussed before your work?

Feldstein: No. I remember one day when I was thinking about how to introduce Social Security into a consumption function, I realized that the natural way to do so was a "wealth" variable, the present value of benefits that individuals can expect to receive.

Poterba: What's your current best estimate of the amount by which an additional dollar of unfunded Social Security wealth reduces national saving?

Feldstein: I think that a marginal dollar of Social Security wealth reduces private wealth accumulated by about 50 cents.

Poterba: The work that you did on Social Security and consumption behavior sparked a substantial empirical debate in the 1970's and early 1980's with people estimating those types of models and debating the coefficients. There's relatively little recent empirical work on that question. Why do you think that happened? Is it a shift away from single-equation consumption function models? Is it a change in interest in the underlying issue?

Feldstein: Well, a lot of work has been done. When people can read survey articles about it they might ask, "Do I really want to write another paper about this?" I can imagine another paper on this that would be different and that would build on some of the more recent work on savings behavior and would utilize some of the new data. So, researchers may come back again to this issue.

Poterba: Looking back on the work you did in the 1970's and also more recently on individual accounts in Social Security, how would you say the research that you and others have done has affected the public policy debate?

Feldstein: It's always hard to know. Even when you're a very active participant in it, it's hard to know what exactly affects it. But the policy debate today—for example, the Presidential Commission on Social Security—puts a lot of emphasis on the savings effect of all tentative reforms and on the need to increase savings in order to offset the dissaving effect of an unfunded program. Would that all have happened anyway? Maybe. It's very hard to know.

Poterba: In the mid 1990's, your Ely Lecture was an early wake-up call about the importance of Social Security reform. When you talked about those issues, there was relatively little attention to them in the economics profession. That has changed dramatically since then. If you were going to dictate policy today, how would you reform the current U.S. Social Security system?

Feldstein: I would move gradually to a mixed system that preserves some of the current pay-as-you-go structure but at a reduced level and combines it with personal retirement accounts so that, in the long run, it's possible to meet essentially the current kinds of benefit replacement rates without raising taxes. That option is now in the public policy debate because research has shown that it is feasible in a way that was not understood just a decade ago.

Poterba: Moving beyond Social Security, the rate of national saving has been another long-standing concern of yours. You generally argue the United States saves too little. Can you explain why you believe that's the case and whether you believe it's the case today?

Feldstein: Yes, I think it's the case today. I think one way of summarizing it is to say the marginal product of capital is quite high relative to what I would regard as relevant rates of substitution between current and long-term future consumption. This is a reflection of the tax wedges created by the corporate and personal income taxes.

The Social Security system puts a lot of people essentially at a corner solution where the only saving they do is for precautionary purposes. They don't have to do life-cycle saving. And yet they could provide the same retirement income at lower cost if they saved more. So I would say yes, there is too little saving today.

Poterba: What are the policies you would offer to raise national saving?

Feldstein: Tax reform comes high on the list, moving in the direction of a consumption tax or reducing the rates of tax on investment income. Social Security reform with individual accounts would be another thing. You would not get a lot of saving out of a system of unemployment insurance saving accounts, but that would also basically be moving in the right direction.

Poterba: On a somewhat different topic, one of your most successful papers was your 1980 study with Charles Horioka on the cross-national relationship between national saving and investment. I remember that when you were working on that paper, a number of the graduate students were surprised that you had shifted fields and were writing a paper on international economics.

This was your first foray into open-economy macro and it was a paper that subsequently stimulated a great deal of work. Did you have any idea when you were writing that paper that it was going to be such an important contribution?

Feldstein: No, not at all. It was published in the *Economic Journal* and it was delivered at a seminar at Queens University in Canada, so it was not exactly presented in a way that would maximize its impact. It grew out of going to an OECD meeting at which all the participants had the view that the global capital market was completely integrated so that capital earned the same real rate of return everywhere.

That struck me as really very, very important if true. If it were true, why bother to raise the saving rate in the United States? Most of the money would go elsewhere. And why worry about Social Security depressing saving? Foreign money would come in. Government policy should focus on investment: the money would come from elsewhere to finance desired investment and the corporate tax paid on the existing resulting profits would remain here as well. So that made me wonder whether in fact it was true. It struck me that it was probably just not true, given the little bit that I knew about the current account balances.

Charles Horioka was a Harvard graduate student at the time. It was very easy for us to put together the OECD data to study the relation between investment and saving. That, I think, also contributed to the popularity of the research because everybody could put those data together and reexamine our results. And it really was a very striking result and very robust.

Poterba: Now, along with Social Security, the effects of taxation on household behavior has been a repeated theme in your research, first on charitable gifts, then on portfolio investment and capital gains regulation, and then on total taxable income. Yet, despite the research by you and many others, there seems to remain a tremendous amount of empirical controversy over some of these basic relationships in empirical public finance. How do you explain this? Is it because the questions are complicated, the data are weak, or because tax policy changes too infrequently or too little?

Feldstein: Tax policy changes frequently enough, so that one, I wouldn't put on the list. Having good panel data would make a tremendous difference in this area, and we don't have very much of that. Also, some of the behavior is very complicated. Think of labor supply—we don't begin to know how to measure it.

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So, the endless amount of study of "labor supply" that focuses on hours and participation strikes me as a very small part of the true dimensions of labor supply.

At a fundamental level, what matters is the effect of tax rates on taxable income. That is what we should care about, both because we care about revenue effects and because of the effect of taxes on deadweight losses. For both, what matters is how tax rates affect taxable income. And if the world were relatively static, if there weren't the opportunity to move money over time, then I think we know how to estimate that with existing data. But what we don't know is the extent to which high-income people also reduce their taxable income by perfectly legal tax avoidance strategies that defer income in a tax-favored way.

We also don't have good capital gains tax data. We have realizations, but we don't know what people are holding. We often do not know what the basis is for what they hold. So, it's really hard to do research on capital gains in a totally convincing way.

And then these are very "political" subjects in many cases. They involve income distribution and the rich and the poor. That creates an emotional response to a lot of these questions that make people very hard to convince of the facts.

Poterba: Now, a hard question, given your interest in taxes and health insurance, taxes and savings, and similar issues. If you were going to pick only one aspect of the current U.S. income tax to change, what would it be?

Feldstein: This assumes that it was going to be revenue-neutral, I assume.

Poterba: Absolutely.

Feldstein: I would move toward a consumption tax, toward a more unlimited deduction for saving.

Poterba: Essentially expanded IRA-type accounts.

Feldstein: Right.

Poterba: Let me now shift to the NBER. You've been President of the NBER since 1977 and during that time the organization has gone through a truly remarkable transition. I remember walking around in 1050 Massachusetts Avenue when it was still being renovated to become the new home for the Bureau. Which of the NBER's many achievements during your tenure as President would you say you're the proudest of?

Feldstein: I would not do it in terms of any specific project. I would say that it is creating this environment that reinforces empirical research in so many different ways. That was the goal and it has worked. Empirical research is hard because if you don't know the institutions and you don't really know the data, there's a good chance that you'll make mistakes. So, having a group of people who know a subject is much more important than it is in theoretical research, where if you specify an interesting model and you don't make a mistake, you get an acceptable answer. But the chance that there will be two people in an economics department who are experts on a particular applied subject is very small. So, by bringing together people from dozens of departments, we create a national community of researchers working on similar topics.

Poterba: So this is essentially the creation of the program meetings where people come together, and of the Summer Institute, which is a clearinghouse for empirical research.

Feldstein: Right. And then the "top-down" projects became a way of picking really important subjects that people may have found interesting but were reluctant to start working on. Someone might say: "Pensions are important but I don't know enough to venture into studying pensions. But if 12 of us are doing it, then I've got other people to talk to." In that way, NBER projects actually move the direction of research. The Bureau cannot tell people what to do because the researchers are certainly not employees in the normal sense, but being able to create teams and to create the sense that this is going to be an interesting group and an interesting subject has been very effective.

Poterba: Have there been major challenges that you have faced in leading the NBER?

Feldstein: Well, at first there was a credibility problem. Would this really work? Would top-quality researchers really want to sign up and be part of this? That was a challenge, but it didn't last long. I recruited program directors in the first instance who were very good and who brought credibility with them. They offered me good advice about who to bring into their programs, and we had enough resources that we could start interesting program meetings. We had enough credibility, plus the good name of the National Bureau, to go out and raise some money for projects, things like capital formation and international policy coordination, that people wanted to work on, so we could move forward.

Poterba: Let's shift and talk for a minute about Washington. Your most direct involvement in policy was during your stint as the Chairman of the Council of Economic Advisers in 1982–1984. What were the central macro policy challenges during that time in Washington?

Feldstein: I arrived in the Fall of 1982 and we were certainly still worried about inflation and inflation expectations and whether they had really been brought down. We also worried about the recession getting worse. And it soon became clear that the budget deficit was going to be an enormous problem. Even after the economy began to recover, and the cyclical deficits went away, there would be large structural deficits to be dealt with.

So those three things—inflation, the recovery, and budget deficits—were the challenge. A fourth one was the dollar and the trade deficit. And in Washington the trade deficit was often viewed as the result of actions by foreign governments. I had a hard time persuading people that the reason for the trade deficit was the strong dollar. They also didn't understand why the dollar was so strong if we were having large budget deficits, since in the third world countries' large budget deficits usually had the opposite effect. I spent a lot of time trying to persuade people that it wasn't because of the evil actions of other governments that we had these large trade deficits.

Poterba: Did the research that you did before going to Washington help in any way to improve your effectiveness as the CEA Chair?

Feldstein: Sure. You don't accumulate a lot of technical economic information on that job. The fact that I knew a lot about things meant I could deal with them. And you don't get a lot of time to go and study the literature either. So you use your human capital. But previous research and teaching allows you to speak with authority and to structure decisions and analysis.

Poterba: How would you say your Washington experience affected either the type of research you did when you came back to academic life or the kinds of projects you encouraged others at the NBER to become involved in?

Feldstein: I don't think it changed the basic research that I did personally all that much, but it did get me more interested in international issues. And I wrote about that, about international policy coordination, about the dollar, and so on, but none of that was research in the normal sense of the word. Similarly, I felt much more comfortable with monetary economic issues after my weekly breakfasts with Paul Volcker and just more at ease in dealing with the macro numbers. But again, I don't think that specifically changed the kinds of things I was doing. I think the work I did on taxes and inflation and social insurance all began prior to my Washington experience.

What did it do to the research agenda of the Bureau? Well, I would say things like the work on international policy coordination grew out of my time in D.C. Having heard an endless amount about what I thought was an empty shell, it seemed worth our exploring that in various ways. I'm sure Washington broadened my interests and therefore the scope of things at the NBER.

Poterba: When you were in Washington, you were criticized, at least by political figures, for your concern about budget deficits. History certainly proved your concerns to be well grounded. If your concerns had been heeded in 1982 and 1983, how do you think fiscal policy would have evolved over the subsequent 20 years?

Feldstein: We would have had smaller budget deficits. Over the period from 1977 to 1997, we accumulated more than $3 trillion of national debt. We wouldn't have accumulated that much.

Poterba: That little statistic brings me to the issue of data availability. It is a constant concern for empirical researchers. Do you think the federal government currently spends enough, too much, or too little on data collection? If you were going to change our statistical infrastructure in any way, how would you do it?

Feldstein: I think I would make more of the existing data available. In mean, in our field, in public finance, it would be nice if we had better access to the kind of data that the Treasury research staff has internally. And it wouldn't surprise me if there were similar things in other areas that I know less well.

But, in general, of course, researchers have enormously more data now than we had 30 years ago, and that has made a tremendous difference. For today's researchers, its hard to imagine what empirical research was like then. My generation of researchers was the first to have machine-readable data. I recall the excitement of getting access to a CPS tape, to the TAXSIM data, and to the Federal Reserve

Board's 1962 survey of consumer finances. So, the world of economic research has come a long way since then.

Poterba: One of the most notable features of your research is the constant focus on issues that are first-order topics in public policy. In many cases, this work was years ahead of the policy debate. Can you offer any advice to younger or older researchers who are trying to learn the art of choosing which topics to work on?

Feldstein: Pick real issues as opposed to issues that just are currently consuming the journals. Pick big issues. And if possible, pick new issues, issues that people aren't working on.

Poterba: Are there topics that you would have liked to work on but that given all the other things you were doing you simply never got around to tackling?

Feldstein: Well, there's always some new thing coming along. I've been doing work on the Social Security reform for the past few years. I've asked myself why didn't I do it earlier? One reason is that I didn't understand conceptually how to structure the transition that has been the focus of my recent research.

A broad topic, that I've thought about for the past several years but that I'm only now starting to do something about, is the economics of national security. This is a subject that is the ultimate public good and yet it's a virtually empty slate in terms of economics. It's real, it's big, it's new. I think economists should be able to contribute to this important subject.

Poterba: On that note, thank you very much.

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