Conversations with Bill Kristol

Guest: Martin Feldstein, Professor of Economics, Harvard University; President, National Bureau of Economic Research (1977-1982 and 1984-2008); Chairman of the Council of Economic Advisers (1982-1984)

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I: The Crisis of '08 and the Economy Today (0:15 – 30:11)

KRISTOL: Hi, I'm Bill Kristol. Welcome to CONVERSATIONS. I'm very pleased to be joined today by Harvard economics professor Martin Feldstein, who served as President Reagan's Chairman of the Council of Economic Advisers. I won't even begin to detail all your honors and awards. A major economist in America and someone I've learned an awful lot from over the years. So, thank you for joining me.

FELDSTEIN: Delighted to be with you.

KRISTOL: Now you're going to explain everything here.

FELDSTEIN: As much as I can.

KRISTOL: That's great. Why don't we begin with the 2007, 2008 crisis, which I think called into question, for a lot of people, what we thought we knew. Very talented economists were there at the Fed and in the White House, and friends and students of yours, and suddenly we – and people allegedly worked out all these questions of risk and the international financial system – and suddenly we were very close to a – I guess we really were pretty close, weren't we, to a real financial crash and a great depression. So, how did that happen? What are the lessons?

FELDSTEIN: Well, of course we don't –

KRISTOL: Were we that close? Let's talk about it.

FELDSTEIN: I don't know whether we really were that close, but there's no doubt that it was a very serious downturn. And so, how did we get there? Well, basically, assets in general were overpriced. Stocks were overpriced, bonds were overpriced, but the thing that was probably most overpriced was individual homes, owner-occupied homes.

That was in part because the Fed had kept interest rates exceptionally low, so it was easy to get mortgages. It was in part because of government programs designed to get low-income people to borrow in order to own a home. And so, what happened was, house prices got bid up way, way beyond the cost of construction. So you knew something was wrong.But the public policy was aimed at promoting housing and allowing people to get mortgages equal to, say, 90 percent, 95 percent of the value of their homes.

And then, the bubble burst, and house prices started coming down. And when they did, what was a 95 percent loan-to-value ratio became a 110 percent loan-to-value ratio. So these people owed more than their houses were worth. And at a certain point they said, "Well, why am I paying on this mortgage when I owe more than the house is worth?" And you could actually find a website called "youwalkaway.com," which explained to people that they had the right to not pay and to walk away, and all that the banks could do was take the home. So you owed $120,000 and your house was worth 90, you walked away from that $120,000 in debt.

So, that triggered a lot of speculation in financial markets – saying, "Well, if *that* was overpriced and the mortgages based on that and the bonds based on those mortgages were overpriced, then maybe a lot of stuff is overpriced." And so we had a meltdown, not just in home prices but across the board.

KRISTOL: So yeah, I mean, listening to this as a layman, I think most laymen think of it as financial crisis or Wall Street crisis. But I think what you're saying is that it's a housing crisis that became a financial crisis?

FELDSTEIN: Yes, very much so.

KRISTOL: And is that widely accepted or is this –

FELDSTEIN: Yeah, I think so. And, you know –

KRISTOL: Was it at the time, do you think? People saw that?

FELDSTEIN: Yeah, I think they did. The banks froze, because they had all these mortgages, they didn't know what they were worth. They didn't know how far house prices would fall, so they didn't know how much capital they had. The banks didn't know how much potential lending they could do, and they certainly didn't know what other banks' financial position was because it wasn't what they reported, it was what these mortgages would eventually be worth. So, banks stopped lending to each other, and *that's* really what brought the crisis on.

KRISTOL: So it was policy mistake – I mean, one has, presumably, business cycles and recessions, but you think it was policy mistakes that really triggered –

FELDSTEIN: I think it was the policy mistake of allowing super-high loan-to-value ratios. And it was the policy mistake, before '07, '08, of keeping interest rates super low, so that mortgage borrowing was encouraged by people who wouldn't be able to afford it with normal interest rates.

KRISTOL: And these were bipartisan policy mistakes, presumably?

FELDSTEIN: Right.

KRISTOL: But liberal in the sense – I mean, I don't mean this is a polemical way – but trying to be generous, let's say, to people, to make more people be able to afford houses and to make it cheaper to buy a house. I mean –

FELDSTEIN: Yes, but it wasn't ideological; it was that the realtors, the homebuilders, all those folks were leaning on their congressmen to keep these policies in place. And, you know, the sad thing is we've done it again. After the recession ended and started back up, we said, "Well, we're not going to make that mistake again. We're not going to let people borrow 90 percent of the value of a home." But you can now.

And low-income people can once again get, thanks to Fannie and Freddie and the federal home-loan program, they can get 90-plus percent. And so, if house prices come down again, we'll see people under water; we'll see people owing more than they have.

KRISTOL: I want to come back – well, that's worrisome – to come back to that. But this is a good case; this is a political science sort of matter. But you've studied political economy, not just economics. I mean, obviously, citizens are happy to be able to buy houses more cheaply, both because of low interest rates and subsidies.

FELDSTEIN: Sure. Especially if they can walk away if things go wrong. It's a one-sided bet.

KRISTOL: Right. So that's also a policy matter, right? That those loans are different from other loans?

FELDSTEIN: Right, exactly.

KRISTOL: What do they call them, no re–

FELDSTEIN: No-recourse loans.

KRISTOL: So you can't be – your other assets can't be taken.

FELDSTEIN: Right. Not that these people have a lot of other assets, but the U.S. is unusual in having this free pass of this no-recourse loan.

KRISTOL: Which isn't true for other loans. Another loan you take out, if you're – they can –

FELDSTEIN: They can come after you for other things.

KRISTOL: So mortgages are just treated [differently]?

FELDSTEIN: Right.

KRISTOL: So that's a public policy question.

FELDSTEIN: Right.

KRISTOL: So we have a – go ahead.

FELDSTEIN: Even in those states – it differs by state – even in those states where the bank can come after you, there's very tight limits on what they can do. So, they can take so much a week from your paycheck or they can – so, it's – again, it's very generous to the borrower.

KRISTOL: So you have a bunch of public policies that are generous to borrowers, because most people are borrowers, and the interest groups have their own interest in selling.

FELDSTEIN: Right.

KRISTOL: So you have – all that comes together to create this – now what would – now, normally, one would say, in a kind of pluralistic, you know, interest-group, Madisonian system, there should be others who check, who lean the other way. Right? You know, so to speak – you know?

FELDSTEIN: Yeah. It's not clear that they're –

KRISTOL: But who would be leaning against them? Well, the Fed I guess, in the old days. I mean, shouldn't they be worried about the overall –

FELDSTEIN: Yes, they should. But, Janet Yellen said – a few years ago, two or three years ago – she said in a major speech at the IMF she said, "Financial stability is not our responsibility." Pretty amazing. She said that's somebody else's responsibility. Our mandate is to have low unemployment and price stability. And so, that's what we're trying to do.

Now, recently she's been saying we have to start raising interest rates more rapidly, because one of the things to worry about is inflation and another thing to worry about is financial stability. But, in the run-up to '07, the Fed was not trying to raise interest rates in order to reduce this, or to put policies in place, or to advocate policies which would limit this kind of very high loan-to-value-ratio borrowing.

KRISTOL: And Congress was leaning that way too.

FELDSTEIN: Right.

KRISTOL: So, I suppose though, one could say, okay, well, that's a housing bubble and –

FELDSTEIN: Biggest asset for almost all Americans.

KRISTOL: But it is the big – but it's an unusual asset. So it's different from other bubbles, I guess.

FELDSTEIN: Right.

KRISTOL: Different from a commodity or whatever, price spike or something. But then, I suppose, what triggers the real crisis is the financial institutions freezing up, as you said.

FELDSTEIN: Right.

KRISTOL: Now, is that – that's also a policy matter, presumably, or is that inevitable? Is there other – Have we, A) I guess, could that have been dealt with? And have we figured out how to deal with that?

FELDSTEIN: So, what has happened since then is the banks have been required to have much more capital. So, if you start the game with a lot more capital, even if you have significant losses, it's not such a big problem. And the problem that occurred before – of high loan-to-value ratios, mortgages under water, and all that – there's much less private securitization, much less creation of bonds backed by these high-risk mortgages.

So it's now all in the hands of Fannie Mae and Freddie Mac: meaning the government, meaning you and me – the taxpayers – who will be in trouble if there's another meltdown.

And so, Wall Street is much less worried about it this time. I think probably wrongly, because if there is another meltdown in house prices, which probably is less likely now, but if there is, then if Joe walks away from his house, which is under water because he owes more than the house is worth, and when they go to sell that house, it's a distressed sale, prices are driven down, the neighbors' houses' prices are driven down. And so even though the mortgages are held on the subprime, the low-quality mortgages may be held by Fannie and Freddie, driving down house prices, more generally, creates a problem for the financial institutions and for the economy as a whole.

KRISTOL: So we're not –

FELDSTEIN: We're not out of the woods.

KRISTOL: – out of the woods.

FELDSTEIN: Right. But I wouldn't say that that today is the largest financial risk. I would say it's more generally other kinds of assets that are priced way out of line with historic experience.

KRISTOL: And that combined with the amount of debt, I guess, public and private, is worrisome? Or just the assets by themselves?

FELDSTEIN: Well, it's just the assets by themselves. So, stock market is roughly 70 – the price-earnings ratio – the ratio of share prices to the underlying earnings – is about 70 percent higher than it's been on average, historically. 70 percent. So that's just way out of line.

Ten-year treasury bonds pay a yield of less than two and a half percent. You would think in an economy at full employment with moderate but rising inflation that number should be four, four and a half percent. If that interest rate on those bonds went up to four, four and a half percent, you would see a sharp fall in the value of the bonds. So all of that is, to my mind, the biggest financial risk that's out there.

KRISTOL: And this is a risk that somehow just, this is just the nature of modern economies or modern political economy, or is this –?

FELDSTEIN: It's the result of 10 years of super-low interest rates. If you'd keep interest rates at almost zero at the short end and two percent at the long end, all these other asset prices are going to fall in line.

KRISTOL: And that's a policy choice?

FELDSTEIN: And that was a policy choice, in order to drive down the unemployment rate.

KRISTOL: So, bad policy choices that led up to '07, '08; we're making slightly different bad policies – well, related but not that different – bad policy choices now?

FELDSTEIN: Yes, that's right. No, because we had similar things in, you know, '04, '05, '06—very low interest rates driving up house prices.

KRISTOL: I suppose the politics of that is people like low interest rates because why wouldn't they?

FELDSTEIN: Right. On the other hand –

KRISTOL: Savers you'd think might not like them, but they don't seem to have the political power of borrowers, right?

FELDSTEIN: Right. Well, savers – savers almost can never win. So, in the bad old days, which they thought were the good old days, they got interest rates of, say, 7 percent, but inflation was 7 percent; so, on a real basis, they weren't getting anything. And what's more, unless they had it in an IRA or some fancy thing like that, they had to pay tax on the 7 percent. So, on an after-tax basis, they were getting a negative return. Now they get zero, but they don't have to pay any tax on the zero. So they're actually better off now than they were then.

KRISTOL: But as a matter of overall political economy we have not – you're not super confident that we've fixed the system or all is well?

FELDSTEIN: No, not at all. Not at all. I mean, the economy now is in great shape – looks good, low unemployment, moderate but rising inflation, profits up, business investment up – but very fragile. Because of all of these mispriced assets.

KRISTOL: So that's interesting because that's different from the conventional, I'd say, account of the economy, which is almost the reverse: Well, we fixed the Wall Street Stuff – Dodd-Frank, you know, and et cetera. But people, lower-income, working-class people have had no wage growth, everyone's very familiar by now – with Trump's victory, especially – you know, this kind of narrative, you might say, about the economy. What about that side of it? How worried are you about sort of people's incomes, jobs, mobilization, automation, all that stuff? I mean that's a big question, but –

FELDSTEIN: So, there will obviously be some people who will suffer from all of that. But you have to start with the fact that the economy is essentially at full employment. 4.7 percent is probably unsustainably low unemployment. For college graduates, two and a half percent. Yes, some people have stopped looking, so they're not counted as unemployed, but that's a very small number.

KRISTOL: So you don't buy this argument that – I mean, Trump has now joined what had been traditionally a sort of argument on the left, I'd say, that, you know, there are all these people out there who are unemployed and underemployed who aren't getting counted. That, you think that's exaggerated?

FELDSTEIN: It's a small number, but it's a – if you look at people who are less than a high-school education, it's a very high number, but that's fortunately a very small part of our population. And the general proposition that real incomes haven't been rising for decades is just a reflection of the way the government creates the statistics.

KRISTOL: Okay, well, that's interesting. So explain that.

FELDSTEIN: Yeah.

KRISTOL: Because it's become such a talking point. As I say, in a way it was always more of a, I think, a lefty-criticism-of-America-type talking point, and Republicans could be counted on to say "no, no," you know, "the markets are working." But now, of course, we have an unusual Republican president, so everyone's saying it.

FELDSTEIN: You look at the official statistics and they tell you that over the last 30 years real GDP per capita, real income per capita is up about one and a half percent. And if you throw in the notion that the top income groups have gotten a disproportionate share of that, then it's easy to say, "Well, the people in the middle are hardly getting any increase at all in their incomes for the last several decades."

So what's wrong with that? Basically, the way the government creates the measure of real income has two serious problems: One is what do you do about quality change, and the second is what do you do about new products? And I think we knew these were problems and that they were difficult, and so, maybe, they didn't quite get it right.

And so I've been studying it in detail, and it's worse than not quite getting it right; it's just plain wrong. So let me tell you a little more –

KRISTOL: Yes, please.

FELDSTEIN: – about this. So, the Bureau of Labor Statistics, in the Department of Labor, follows a large number of individual products. And they asked the manufacturer, or in the case of services, the producer of the service, they say, “Did your product change since last year?” And if the product changed, they say, well, “How much more did it cost to make this year’s version than it would have cost to make last year’s version?”

So, what’s the extra cost from whatever change you’ve made? And if the manufacturer says, “Well, it didn’t really cost any more; we just came up with a way of making a better product,” then the BLS says, well, “Then there’s no quality change.” So that’s nutty. See –

KRISTOL: So the iPhone, if it doesn’t cost more, is no better than the BlackBerry of many years ago?

FELDSTEIN: That’s right. Right. Right. Or whatever else it may be. If they – if it didn’t cost more, it’s not any better. So, they just miss. And they have a name for this: They call it the “resource cost method of quality adjustment.” But it’s got nothing to do with quality; it’s got to do with the cost of making it.

So in an economy in which smart companies, smart technologists keep improving products, it just doesn’t register. So, I think we’re substantially underestimating the growth of real incomes because we’re not picking up these quality improvements.

KRISTOL: Now would the same be true, for example, for pharmaceuticals? That if a drug doesn’t cost anything more today than it did 20 years ago –

FELDSTEIN: So that’s a great example.

KRISTOL: – but it’s much more effective at preventing me from having a heart attack –?

FELDSTEIN: Right. So, that’s the perfect example. I like to give that example about statins—the drugs that keep us both alive.

KRISTOL: Yeah.

FELDSTEIN: So, when statins came along, they – of course there was some dollar amount of sales. They added that to GDP, but nothing for the fact that we would pay a lot for the fact that these drugs will reduce our risk of dying or having a heart attack or a stroke.

Eventually, the statins became the largest-selling class of pharmaceutical drugs. And of course, by then, they added it to the price index that they use for doing these calculations. So, when a statin went off patent and, therefore, its price fell, they said “Aha! There’s a real income increase, because the cost of buying that drug is now cheaper.”

But nothing at all for the lifesaving, nothing for the hospitalization cost reduction, nothing, nothing, nothing. So that’s true of all kinds of new products. They just miss it. They don’t try, even, to get the extra value that’s created in that way.

So I don’t know how big these two things are, but I think they are enormously important, and we’re missing them. So when we say per capita income up one and a half percent on average over the last 30 years, well, maybe it’s three and a half percent; maybe it’s five and a half percent.

KRISTOL: It could be that much off?

FELDSTEIN: It could easily be that because, think about it, there’s nothing for the actual quality improvement, and there’s nothing for the value of newly create products. So –

KRISTOL: So I mean, yeah, it just seems like, in a common sense way, you're living in a bigger house, you have a car, you know, you have all this technology you didn't have 30, 40 years ago.

FELDSTEIN: Right.
KRISTOL: You have – for all the problems with the health care system – you have better medical care, in the sense that people are less likely to die from various things early and stuff. Yeah, but that's not really captured.

FELDSTEIN: Not captured. Not captured.

KRISTOL: Yeah. And does that have much of an effect, do you think, on our actual policies or in politics? I guess it does.

FELDSTEIN: I think it does. I think it does, because I think people when – one of the interesting things, if you do surveys, you look at the surveys, people are asked, well, "How is your family doing relative to five years ago?" And the overwhelming answer is "Okay. We're doing okay." Of course, there are some who are saying "we're struggling," but the overwhelming majority – the Federal Reserve does this survey every few years – people are saying "we're doing okay."

Then you ask people in these surveys – Gallup does it and others – "How do you think the U.S. economy is doing?" "Oh, terribly. Terribly." So of course, people know how their own household is doing; they don't have a clue how the economy as a whole is doing. All they know about the economy as a whole is what they hear on television, or read in the newspapers, or hear from politicians.

So, I think it very much affects their view of how the economy is doing and how we're doing as an economic system. Is capitalism working? Are we benefiting from it? And they know that, personally, they must be doing all right—but, of course, they're nervous about their kids. You know, overwhelmingly, people say, "My children won't be as well off as I am." The chance of that being true is about zero.

KRISTOL: Is that right?

FELDSTEIN: Yeah.

KRISTOL: Because that is a big deal, I think, people who study public opinion think. In the last few years, they say – for the first time, maybe – that, you know, that number really started to go up, the pessimism about the future.

FELDSTEIN: So if you look at people who came out of the Depression – as my parents did, your father did – then, of course, they had seen this overwhelming improvement. There was no doubt about it.

KRISTOL: Right.

FELDSTEIN: But it slowed down, relative to coming out of the depression. But I think there's no doubt – especially if you correct for all these things that we just talked about – there's no doubt that we're going to be seeing higher real incomes. And, of course, if you're at the 50^{th} percentile in the income distribution and your kids are in the 30^{th} percentile, well, they won't get the full benefit of whatever this increase is. But it would be very hard, cumulatively, over a matter of decades, for your kids not to be – I don't mean your kids or my kids; kids in general – not to do as well as their parents.

KRISTOL: And this despite, presumably – or maybe you want to challenge, this isn't quite right either – the greater advantages to education, and a greater income disparity and life chance disparity, even. And I mean, is some chunk of the country right to be sort of deeply pessimistic about *their* futures and *their* children's futures, assuming their children, let's say, are at the same sort of educational level?

FELDSTEIN: I haven't really – I haven't studied – well, at the same educational level –

KRISTOL: There's more people.

FELDSTEIN: Then I would say – yeah, more people are having higher education.

KRISTOL: Right.

FELDSTEIN: But I would say, unless we're looking at, say, the bottom 10 percentile of where people are – [they] have a much higher probability of being unemployed; we're seeing evidence of much more drug and alcohol abuse, and higher mortality rates, and so on. But that's a pathological, small part. We should care about it as a nation, but it's a small part of our overall system. It's not the middle class.

KRISTOL: And more, it sounds like you're saying, a cultural and social problem, perhaps, than a pure economic-opportunity problem.

FELDSTEIN: Yeah. I mean, why are people dropping out and not finishing high school?

KRISTOL: Yeah, that's not right.

FELDSTEIN: Is it ability? Is it cultural?

KRISTOL: Yeah. That's not in their interest, so it's not an economic –

FELDSTEIN: Right.

KRISTOL: Now I am struck by, in the public discourse today, the kind of nostalgia for a certain time. It's not clear exactly *when* it was when there were all these wonderful, working-class jobs. Now you and I are old enough to remember that these working-class jobs weren't thought to be so wonderful. At the time I went to college, I read all these books from the preceding 10 and 20 years, sociologists about the anomie, the alienation of, you know, assembly line life, which was not false, incidentally.

FELDSTEIN: Right.

KRISTOL: It wasn't the greatest thing in the world to, you know, move one part to another part for eight hours a day. It wasn't good for you physically. It wasn't satisfying.

FELDSTEIN: Exactly.

KRISTOL: When Trump goes around talking about "I'm going to bring coal mining back," it's like, *Do we want to bring coal mining back*? I think you die at age 50 of black-lung disease. I mean, but I'm a little struck, aren't you, that people are sort of responsive to that message?

FELDSTEIN: Well, it was a guaranteed life income. That's what it really meant. You went to work for an individual company. The job may not have been fun, but you had friends on the line, and you sat with your lunch pail and you talked over lunch, and then you went back to work, and you knew the job would be there next week, next year.

And but, you know, it's a tiny fraction now of the total workforce—something like eight percent. Eight percent of total employment are manufacturing-production workers. So that's history. That's not a question of coming back or preventing the loss of or stopping competition. It's eight percent. So it's nothing.

KRISTOL: So your message to a, I don't know, working-class American or, let's say, a recent immigrant – just to take away all the history here – who comes and, presumably, let's just say, has a working-class-type job, you know, driving a cab or something like that –driving an Uber, I guess – would be: "Yes, if your kid who stays through high school, gets a decent education, has good work habits and that kind of thing, doesn't…"

FELDSTEIN: [You] stay out of poverty if you do three things, right? You finish high school; you get married before you have children; and you get a job before you get married. You do all of that, I think the evidence is – that doesn't mean you're going to be rich, but it does mean you will be out of, you'll stay out of poverty.

KRISTOL: Are you worried about the apparent figures of a decline of social mobility or is that also a little overdone in your opinion?

FELDSTEIN: So, my student Raj Chetty, who is a brilliant guy and a creator of some of those statistics, found that, if I can remember correctly, found that absolute social mobility – the probability that if you were in the 30^{th} percentile, your child would be below the 30^{th} percentile – I think his findings were that that wasn't happening.

KRISTOL: The *lack* of mobility wasn't –

FELDSTEIN: The lack of mobility was *not* happening.

KRISTOL: That's interesting.

FELDSTEIN: People were as mobile as they used to be. And that hardly got any press attention. So, he's now been working on – I forget what he calls it – "dynamic mobility" or something like that. And that is whether, taking into account growth, your children will be better off than you were at the same stage in your life. And that depends critically on what the underlying growth rate is.

So if you take the official numbers – the growth rate is one and a half percent – then there's a good chance that if your child falls from – if you're in the 50^{th} percentile and your child falls from the 50^{th} percentile to the 30^{th} percentile and there's hardly any growth, they will be worse off. But that's only because of this mismeasurement of the underlying trend. So if the trend is three or four percent higher, then it's very unlikely that the next generation will be worse off.

KRISTOL: So basically, the sort of old cliché that a rising tide lifts, if not all boats, most boats.

FELDSTEIN: Right.

KRISTOL: And the best thing you can probably do is provide the rising tide and not try to, you know, micromanage everyone's boats – if I could torture this metaphor – you sort of think there's a lot of truth to that?

FELDSTEIN: I think that's right. Yeah.

KRISTOL: And it's been too quickly – I'm struck how many people these days sort of just say, "Oh, well, we used to think a rising tide raises," you know, "lifts all boats, but now we know so much better about the losers from globalization," et cetera. You hear this so much in Washington, you know.

FELDSTEIN: Right. Right. Small numbers.

KRISTOL: You think small numbers. And so your advice to a policymaker – and leaving aside the politics for a minute – would still be get growth?

FELDSTEIN: Get the economy to grow.

II: (30:11 – 1:10:30) On Technology, Trade, Taxes, and Regulation

KRISTOL: And globalization – just to touch on that for a minute – globalization and technology, these two villains, you would also make the case that they've been good, right?

FELDSTEIN: They basically have been good. I don't think anybody denies – well, of course, you can see people lost jobs because of technology, but a politician can't rant against technology. There's no evil, something to stop. I guess the notion of taxing robots is the closest we've had in that direction of silliness.

But, so I would say, economists have said historically "Trade is good." And what they meant is that, in the aggregate, Americans are better off because of trade. And we never made much of a thing of the fact that some people will be worse off, but if pressed, you would say – as I would say in teaching – of course, some people will be worse off. But the others who are better off are better off by enough that they could compensate the losers and everybody would be better off. But of course, we don't have programs to compensate the losers. And we have –

KRISTOL: We have some. We have some attempts.

FELDSTEIN: We have trade-adjustment legislation.

KRISTOL: Right.

FELDSTEIN: But my judgment about that is if somebody loses their job because some new technology comes along, are we going to compensate them? You can't do that. So then, why should we compensate their brother who lost a job because some product came into the country from outside?

So I think it's impossible to do that compensation; so what you have to hope is that the rising tide, as you said, rises fast enough that the guy who loses his first job finds another job which is as good.

KRISTOL: I do think it requires the politicians [give] a little more of a, let's say, a tough-love message with a little emphasis on the toughness, which people seem very incapable of doing these days. Which, I do think Americans traditionally had a certain understanding of life's tough; it could be unfair. I mean it sounds terrible to say it if you're sitting in a comfortable chair here, but I mean – and people may have to move.

FELDSTEIN: Empathy. Empathy, that's what politicians have to sell.

KRISTOL: But it really hurts people if the empathy, don't you think, if the empathy leads to telling people, "No, stay where you are; the job will come back."

FELDSTEIN: Yeah.

KRISTOL: Don't encourage your kid to leave Scranton, Pennsylvania. Well, not to pick on Scranton, Pennsylvania, but whatever. Canton, Ohio, someplace that's declining, you know, Detroit. And go somewhere where there are more jobs. You're not doing the kid a favor or even the parents a favor to say, "Stay there and we'll increase the trade-adjustment toll or, you know, a stipend or…"

FELDSTEIN: I think that's right.

KRISTOL: I mean that really is – I think that's a political problem, though, that it's gotten harder somehow to – people think government can fix everything. And in the old days, there was a certain – this was sort of a byproduct, I think, of kind of a limited-government attitude, which was, you know, you just have to sort of accept it and move on kind of thing.

FELDSTEIN: Do we have an administration which is talking or has talked tough about trade, and if they are seen as having tried, then maybe we finish doing that tough talk about trade?

KRISTOL: Though I think – don't you think that – I'm struck – on the trade issue, in particular – the total failure of political leaders in both parties to defend trade, which has really been good for the country and *really* good for the world. I mean, for Asia, you know –

FELDSTEIN: Yeah, sure.

KRISTOL: It's a great moral achievement to take hundreds of millions of people out of poverty.

FELDSTEIN: Absolutely. Absolutely.

KRISTOL: We get – And not that *we* did it; *they* did it, but we helped by providing this international order.

FELDSTEIN: Helping them get into the WTO is really what turned China, Chinese manufacturing around.

KRISTOL: And India became a more capitalist country, and that changed them around.

FELDSTEIN: Yes. Yeah.

KRISTOL: And we take no – But no one thinks that was a good thing, and people talk about it as if it was entirely a problem, not an achievement.

FELDSTEIN: Well, I think some of us talk about those two as good things.

KRISTOL: No, we try to. but I'm saying, politically, it's sort of –

FELDSTEIN: Right.

KRISTOL: I mean, you know. And watching Hillary Clinton – who can't possibly believe that it was a bad thing to have an Asia trade agreement, both geopolitically and economically – sort of have to walk away from that, I think makes you wonder, worry whether you could have now generations of politicians who just think you can get away with being anti-trade and not pay some price for it. But –

FELDSTEIN: And why did Obama not – I mean, he introduced the Asia trade agreement, but then he never really pushed for it until the last few weeks of his [presidency].

KRISTOL: His own party was against it. I mean, yeah. I don't know. That, I think, that strikes me as a case where you can say, well, it was kind of a lazy consensus to be pro-trade and all that, but it was probably a healthy consensus for the country.

FELDSTEIN: Yes. Yes.

KRISTOL: How much do you worry about that? I mean, how important as an actual matter of economic policy, you know, more of fear rather than less free trade?

FELDSTEIN: No. Forgetting the benefits to the other countries – just thinking about the U.S. – the U.S. is such a large economy that a lot of the benefits of trade are second order. So if you're Belgium, then it's a big deal that you have competition and that you import cars rather than trying to make it for your little market, and so on. But, for the U.S., we don't need foreign competition to make our domestic producers more efficient.

Now obviously, the Japanese and the Korean carmakers did do that. But as long as we have an open system with multiple car manufacturers and we enforce antimonopoly provisions, then we don't need trade to do that. So, imports are 15 percent of GDP, and exports are about 12 percent of GDP.

So if you say, well, "What if we didn't do that? What if we just kept it all here? How much better use of those resources are we getting by making stuff for the other guys and bringing stuff in?" Double? So maybe it's double. I have no idea.

KRISTOL: Right.

FELDSTEIN: Let's say it's double. So that means that, if we took away trade, our GDP would be 15 percent lower, roughly. It's not that the exports would be 15 percent lower, but the value of the products that we would make in the United States with those same resources, instead of making stuff that the rest of the world wants to buy and getting cheaper goods from the rest of the world. Well, that's not a big deal. I mean, in the grand scheme of things –

KRISTOL: That's not going to end trade. I mean –

FELDSTEIN: We're not going to do it, but I'm just saying [in the] U.S., the hypothetical –

KRISTOL: So a marginal change, a marginal change in reduction of free trade is not going to be dramatic.

FELDSTEIN: But even if you completely eliminated it and you said, "Where would the economy be now if we had eliminated it 30 years ago?" We would be 15 percent poorer. I'd be thrown out of the economics profession for saying this, but I do say it in class—or I did say it in class when I taught the introductory course.

So we shouldn't overstate it. Obviously, it's a plus, and it's certainly a plus for these other countries, but it's – and it would be a plus for any small country that needs trade to enforce competition. So for us, it's important, but it's not a big, big deal.

KRISTOL: But I suppose the trade argument has to be made a little more geopolitically and strategically, also.

FELDSTEIN: Yes. Well, that is certainly true.

KRISTOL: That it's good for the world to have this, you know.

FELDSTEIN: Yes. Right. Right.

KRISTOL: And technology, the other – so globalization is one sort of villain. I mean, it's not going to go away anyway, but there are people, who are serious people, who really think we've gotten very used to not worrying too much about technology. New jobs come along to replace the old ones; maybe we're at a different inflection point with self-driving cars, artificial intelligence.

FELDSTEIN: It's hard to know. Hard to know.

KRISTOL: It's sort of a big leap, you know.

FELDSTEIN: Yeah. Hard to know. We haven't been there, so we don't know.

But certainly, in the past, decades ago, we said, "Automation is coming to factories; people in the factories are no longer going to have jobs." And what's true is *they were right*.

So the factory jobs, they said, production workers, eight percent. So we've lost those. Go back a generation and say the same thing about agriculture. Where, you know, what's going to happen to all these farmers? Well, somehow or other they and their children found other jobs. So, I have a feeling that the people who are driving Uber cars or taxis will find something else. What happened to the elevator operators? What happened to the switchboard operators? What happened to – now I see McDonalds is going to have machines that will take your order and package it and do all that. But the world keeps going on and finding new occupational opportunities.

KRISTOL: I flew up here last night and, you know, you just forget how many people used to work at airline counters, right?

FELDSTEIN: Right. Right.

KRISTOL: You know, processing by hand all those things that –

FELDSTEIN: Right. You do it yourself.

KRISTOL: Now, there's one person there to help out, you know, but you do it yourself.

FELDSTEIN: Right.

KRISTOL: And presumably it's a huge net increase in efficiency, and presumably, those people are getting other jobs. One hopes that pay [comparably].

FELDSTEIN: Two and a half percent unemployment rate among college graduates. So they must be finding something else.

KRISTOL: Right. Well, that is really remarkable. So you're not pessimistic? I mean, you're reasonably optimistic about that – I mean, I think you have criticisms with the policy world because you do think it's fragile.

FELDSTEIN: And I'm also nervous about the fragility of the financial sector with overpriced assets.

KRISTOL: Right. But on the kind of stuff that's been getting so much attention.

FELDSTEIN: Right. I'm optimistic.

KRISTOL: You actually – you are, and you remain kind of convinced that the core teachings of the economics profession that, you know, markets work and, you know –

FELDSTEIN: You know, and I look at Europe, where, I mean – Take Italy, wonderful country, wonderful country. They've had no growth at all since they joined the Eurozone. None. Zero. That's terrible. Now, that may be mismeasured also.

KRISTOL: Right.

FELDSTEIN: And so, maybe they're getting some. But, by the standard in which other countries are getting two percent, they're getting nothing. And why? Because they have terrible rules about protecting jobs, protecting product markets. And so, it's this unwillingness to bring competition into these industries that makes it very hard for them to get growth.

KRISTOL: And you were critic of the euro early on.

FELDSTEIN: Yes.

KRISTOL: And I think you've been pretty well vindicated on that. I mean, isn't that one of the reasons Italy doesn't have growth, incidentally? That they –

FELDSTEIN: Well, yes. I mean –

KRISTOL: They can't export because the –

FELDSTEIN: Well, they would be able to export more if they had a more competitive currency. And – But, if you look at Germany, Germany is doing reasonably well. Europe as a whole, the Eurozone as a whole has an unemployment rate which is about twice ours. So, if we are at 4.7, they're close to ten. And but Germany is around six.

So, they have figured out how to improve their education system, how to improve all kinds of structural policies to allow them to compete within the Eurozone and globally. And others have not done it because of just entrenched unwillingness to take on the unions, which are much, much more important in a country like Italy than they are here.

KRISTOL: How worried are you about Europe, as a whole, going forward? I mean, do you think it's sort of more of the same? Or is this sort of a tipping point problem, where they –

FELDSTEIN: Well, I think politically – I think the tipping point is political. I think the growth rate, you know – again, barring all these measurement problems – the growth rate may be low, and in some countries very low, and the employment rates—that's where part of the problem is. You look at the unemployment rates in Italy or Spain among young people, 25 percent, 30 percent. It's hard to know how much of that is real and how much is underground economy.

But, what is clearly real is the political uncertainty in those countries: the probability that some group will come to power that says we've had enough of the euro and the Eurozone and let's get out. And then the whole thing begins to collapse.

KRISTOL: So despite having been a critic of the euro, you're not a big fan of people exiting from that organization?

FELDSTEIN: No, I am not one way or the other on that. I think, you know, I think the problem is it was a mistake, in some sense, to create the euro. It made it more likely that they would have higher unemployment rates. And on the other hand, taking it apart is not an easy thing. On the other hand, we're seeing – well, of course Britain was never in the euro; they were in the EU. So they wisely stayed out.

KRISTOL: Yeah. And had pretty good growth, actually, over those years. And became sort of a financial hub.

FELDSTEIN: Yes. Right. Right. And now they're doing –

KRISTOL: So, it turned out not to be that important to be in the euro, even. Right?

FELDSTEIN: Right.

KRISTOL: Yeah. So, it seems to me if you step back from this – you, actually, are not very sympathetic to it personally. But, in a way, opposite of this, what has become the conventional wisdom, which I would say is – and correct me if I'm wrong about this – but I think you would say is that the conventional wisdom is too complacent about the policy errors that have been made: financial risk, bubbles and so forth. But too worried, in a way, or too alarmist, about the technology, globalization, you know? No one's ever going to – your kids are never going to live as well.

FELDSTEIN: Low growth.

KRISTOL: Right.

FELDSTEIN: Yes, I would say that's right.

KRISTOL: And I think that's actually a problem because, A) maybe it's wrong, just analytically; but, B) I think it leads to a bad kind of politics. Which neither fixes what can be fixed, but is also sort of semi-hysterical about things that it shouldn't be hysterical about.

And you end up, if I can put it in shorthand, with Trump on the one hand and Sanders on the other, you know. You end up with sort of – you don't end up with a healthy debate of okay, well, let's – how do we increase – I mean, am I right? How would you –

FELDSTEIN: Well, except having said all that, I don't know – I didn't pay enough attention to Sanders' campaign to know what he was actually proposing to do. But Trump is clearly, and congressional Republicans are clearly, proposing policies that will increase the growth rate.

KRISTOL: Okay. So, let's talk about that. Because you said that was, how important – at the end of the day, you do think government can really make a difference there? We're not just swept along by technology?

FELDSTEIN: Yeah. Well, it can make a difference for the better or for the worse. And if you have a corporate tax rate of 35 percent, which is the highest in the industrial world, that doesn't help. So, bringing down the corporate rate is a big deal.

If you have a tax system that tells subsidiaries of American companies operating abroad that when they earn their profits, they shouldn't bring them home because if they bring them home, they'll get whacked with another heavy tax, well, that again contributes to investment in the rest of the world, contributes to rising productivity, stronger GDP growth and all that. So there's more than $2 trillion of U.S. subsidiaries' assets outside the U.S., because of our tax system.

So, fixing those two things, bringing down the corporate rate, and changing to a tax system that encourages bringing back funds or doesn't discourage bringing back – I think those are key parts of what was or what is the House Republican plan. We don't know exactly where the administration is going to come out, but I suspect it's not going to be far from that.

KRISTOL: And you think that would make a real difference?

FELDSTEIN: I think that would make a real difference, right. I think there are other things in the Republican tax plan, and potentially, in the administration's tax plan, that I think have a lower chance of getting through the political process. But I think those two things – bringing down the top rate and changing the tax treatment on foreign profits brought back to U.S. – I think those would make a big difference.

KRISTOL: And other things that are arguably doable, even if they're tough politically –

FELDSTEIN: Regulatory.

KRISTOL: Yeah.

FELDSTEIN: Regulatory.

KRISTOL: So how big a burden is that, do you think, really?

FELDSTEIN: It's very hard to know. I mean, you know, as an economist, I can talk about the taxes and I've got a measure of them and what it does to the cost of capital and all that.

On regulation, though, you do hear from every kind of business how, what a burden it is. And how they spend their time and staff and all that trying to figure out what the regulations are because they don't want to get caught in violation, and figuring out how to cope with these regulations. And so, cutting back on some of the regulations that have been put in place I think will, undoubtedly, be a plus in terms of economic growth, and that we won't be doing damage if we do that in a smart way. I'll just put it that way.

So you don't throw away Dodd-Frank, but you make changes in Dodd-Frank that remove some of the regulatory burdens on the financial sector; you make changes in the Clean Air Act that don't cause terrible pollution of our environment, but again, remove lots of the detailed controls that we now have in place.

KRISTOL: If you were back as chairman of the CEA, how much would you be telling the president to worry about the debt? I mean, $20 trillion seems like a lot.

FELDSTEIN: A lot. A lot. Yeah, a lot. I mean, that was part of my theme then. It was part of Mr. Reagan's theme before he came to the White House. And in the end, by the time he left, at the end of the eight years, the cost of servicing the debt, the deficit – no, not the cost of servicing the debt; the deficit excluding the cost of servicing the debt – so the deficit, so-called "primary deficit" that excludes the interest rates, was back to where it was when he came in. People don't recognize that.

KRISTOL: So we managed to do a big defense buildup and –

FELDSTEIN: Big defense buildup.

KRISTOL: Not cut entitlements much at all.

FELDSTEIN: Not cut entitlements much.

KRISTOL: Reduce the rate of growth, I guess, of Social Security so yeah.

FELDSTEIN: But that didn't really take effect during his eight years. So, it was a – I think the ability of the Reagan administration to change the Social Security rules gradually, over time, has paid off in terms of the size of the deficit now. Although, as life expectancy has continued to increase, you're running harder to just stand still. So we need to go back to that subject.

KRISTOL: Yeah. Talk – I'm just – I hadn't really planned to think about that, talk about that, but what about the – you were there, right? I think you were chairman of the council in the Reagan and Tip O'Neill negotiations?

FELDSTEIN: Yes. Right.

KRISTOL: And you were very much involved.

FELDSTEIN: Yes. That happened in '83.

KRISTOL: It seems like people cite that as sort the last case studies of an actual bipartisan deal that, you know.

FELDSTEIN: Well, the ’86 Tax Act was a – that came a little later, but we had been working on those issues. And that was also done with the Democrats controlling the House. And so it’s pretty amazing, pretty amazing.
KRISTOL: And lessons from that, having had a real ringside seat—and not just a seat but being a participant?

FELDSTEIN: So that brought down the top rate. The ’86 Tax Reform Act brought – it was just about personal taxes, unlike what’s being debated now, which is mostly about corporate taxes. That brought down, the ’86 Act brought down the top rate from 50 percent to 28 percent. That’s pretty amazing when you think about that.

It meant that you got to keep twice as much of your after-tax income than you did before. So, it didn’t last. And, of course, there was a give-up in order to get it. There was a base broadening, taxing more things, getting rid of some of the artificial-accounting gimmicks so that on an income class by income class, income bracket by income bracket, there was no reduction in taxes. But there was a reduction in the marginal tax rates, the tax rates on incremental income, and that changed incentives.

And so that was a very good thing to do. So, we got it down to 28 percent.

And then George H. W. Bush was persuaded that in order to get a spending cut deal, he should allow the 28 to go to 31. Politically, a terrible mistake, because he had run on the “Read my lips: no new taxes,” and he pushed the tax rate up by this little bit.

Then, when Clinton came in, he said, well, we’ve got a budget deficit. It’s a serious problem. We’ll take that 31 up to 36, an extra 5 percent. But, for high-income individuals, we’ll put a 10 percent extra tax on it. So, the 36 became 39.6. And that’s where we are—except that Obama, as part of the Obamacare, pushed it up to 44.

So, what’s the lesson? That you can get a temporary reduction by giving up certain structural features. So that’s going to make it hard to sell, going forward.

KRISTOL: And the lesson for you for the sort of political side, the leadership side, I think, you know, seeing you’ve been involved in it yourself? I mean, anything a young person going to Washington should take from those two episodes, ’83 or ’86—especially ’83, where you were right there?

FELDSTEIN: Well, ’83 was a great example of doing something that needed to be done but that would phase in very, very slowly. Until a couple years ago it hadn’t fully phased in. So, phasing in very slowly by gradually increasing the age at which people got full benefits.

So that was a very good thing to do. And we should go back and do it again because, since ’83, life expectancy for somebody in their mid-sixties has gone up by another three years. So, they pushed it up from 65 to 67, and now, that has been more than undone by the improvements in health care and healthy living.

KRISTOL: And Reagan’s performance there, I mean lessons for future –

FELDSTEIN: Well, he was just great at doing that. I mean he was just – the fact that he was able to negotiate that with Tip O’Neill. I remember once – it must have been around a budget time, and O’Neill and a few of the Democratic Leadership came to the Oval Office. And since the issue was a tax and economic issue, I was there.

And O'Neill said, "Oh, that's terrible, Mr. President. We can't, you know, we can't live with any of that," and so on. Then they went away, and then Jim Baker, who was – I think he must have been Chief of Staff at the time, said, "They're ready to deal."

KRISTOL: Yeah.

FELDSTEIN: So, you know, as a neophyte, a guy who had been on the job for a matter of months, it seemed to me this was an explosive, "No, no, we're not doing anything." But a savvy politician like Jim could read in the – whether it was the body language or the words – that yes, he had to make those noises; even though it was private, even though it was, you know, just in the Oval Office, he had to make those noises. But then, they could sit down and start dealing.

KRISTOL: You mentioned passing, that of course, the tax rates, marginal rates impact on incentives, that was not always part of, I mean, the mainstream economic thinking?

FELDSTEIN: Right.

KRISTOL: I mean that's a pretty big change, right?

FELDSTEIN: Right. I think it's hard to believe anybody would dispute that.

KRISTOL: I know. When you said it, it seemed sort of commonsensical, but –

FELDSTEIN: Right. Right.

KRISTOL: But that [inaudible].

FELDSTEIN: That's right. No, no. People do what they do. They get up in the morning and they go to work and they work hard, and it's the American way. And taxes don't move the one way or the other.

KRISTOL: Was that a case where actual, you know, intellectual work led to policy changes? Or was it more of being mugged by reality and just –

FELDSTEIN: Well, I think it was both. I think there was a lot of empirical work which showed the sensitivity, and then subsequent to the '86 Act, that was such a wonderful experiment because you had this big move, and the IRS produces anonymized tax return data that researchers like myself can study and say, "Well, what happened?"

You could follow the same individuals before and after the '86 change, and you can see what a substantial increase in their taxable income occurred. Not just that they worked harder, but that they took more of their compensation in cash. They took more of their compensation in taxable form rather than fringe benefits and they took fewer deductions for all of the wonderful deductible things.

So yes, I think we learned a lot. We had learned a certain amount before. When I first started teaching public finance, the technical literature and economics sort of downplayed the impact of this. But then, over time – particularly in the financial area, how people change, capital gains – all of that began to change. And so, the government now has what they call "dynamic scoring," which they take into account the behavior. That was very, very controversial.

KRISTOL: Yeah. It seems the problem is less not knowing things today and more of not having the political will or courage to do certain things.

FELDSTEIN: Well, we'll see what happens in the tax [inaudible].

KRISTOL: That will be interesting.

FELDSTEIN: I think that will be interesting.

KRISTOL: But you mentioned I mean President Reagan and I guess so you got there in ’82 I guess.

FELDSTEIN: Eighty-two, year.

KRISTOL: But Paul Volcker, so we were ready, we were coming out a little bit of the recession or were we still in the ’81, ’82 recession?

FELDSTEIN: We were still very much in the recession in the summer of ’82 when I arrived.

KRISTOL: And do you agree that – I always thought Reagan gets so much credit as he’s known for obviously the Cold War and for the tax cuts. But I think sticking – hanging tough in ’81, ’82 with the Fed chairman Paul Volcker –

FELDSTEIN: Right.

KRISTOL: As we really went through the ringer in a pretty tough recession.

FELDSTEIN: So Volcker had been appointed by Carter. He went to Carter at one point and said, “We’re looking at 10 percent, 12 percent inflation. We’ve got to do something about it. It could cause a recession.” Carter said, “Go for it.” And Volcker did, and it caused the recession. And that was the end of Carter’s presidency. He lost the election.

And Reagan, when he came in, said, you know, this recession isn’t my fault. It’s their fault. It was the last guy’s, and they allowed this economy to get way off track, to have this high inflation, and so I backed Mr. Volcker in doing this. And that did it. And we had enormously high inflation, but as the – and enormously high interest rates. But if you – they did daily tracking polls, and so you could see as the inflation numbers came down, the president’s popularity went up.

KRISTOL: So he was able to stand by Volcker despite –

FELDSTEIN: Right.

KRISTOL: – a rough –

FELDSTEIN: Right.

KRISTOL: – year and [inaudible].

FELDSTEIN: Right. Right. It wasn’t his problem. He inherited it, and Volcker was doing the right thing. And he never criticized Volcker.

KRISTOL: Yeah, that’s –

FELDSTEIN: Don Regan, the treasury secretary at the time, almost never passed up an opportunity to criticize the Fed, because one of his senior officials was always picking on – [unintelligible] was always picking on the Fed and Don would – who didn’t know very much about economics or financial markets, even though he’d been the head of Merrill Lynch, that they – but the president never did.

KRISTOL: I mean, that seems like a contrast with the last bunch of years. You were saying earlier that the Fed, both under Bush and under Obama, kept the rates low; I suppose, probably because they genuinely were worried, at times, about a crash.

FELDSTEIN: Right.

KRISTOL: I mean after ’09, after ’08, but also just because it’s politically easier, I guess, not to be the tough guy, right?

FELDSTEIN: Yeah.

KRISTOL: But Volcker, that’s an impressive – is that story like – do people appreciate that enough? Somehow it seems to me –

FELDSTEIN: Well, they do – they –

KRISTOL: Maybe in the economics world, maybe. Maybe not in the broader world.

FELDSTEIN: So, they do and they don’t. They do and they don’t. So, when the Fed celebrated its hundredth anniversary, a little while ago, Paul Volcker came to Cambridge to a summer meeting of the National Bureau of Economic Research. It brings together a few hundred people.

KRISTOL: Which you ran for many years.

FELDSTEIN: Which I ran for 30 years. But I got to interview Paul on that occasion, when he came up. And one of the things I said to him was, “Well, it must have been difficult to persuade your colleagues on the Open Market Committee to raise interest rates to these enormously high levels.” Well, “We didn’t raise interest rates. The market raised interest rates.” So all we did was to change some of the reserve requirement rules.

So, the Fed doesn’t want its fingerprints on tough policies. Of course, he did it. Everybody knew it at the time. He led an intellectual change. It wasn’t just changing interest rates; it was persuading them that that’s what was needed to reverse the inflation. Because, you know, until then, the typical rhetoric was about so-called “cost push inflation”: it’s unions, it’s import prices, it’s who knows what. But it’s not our fault, at the Fed.

And so, and the Fed had also made the mistake, until Volcker got there, of not making a distinction between actual interest rates and real interest rates. In other words, not adjusting for inflation. So, as inflation picked up, they raised interest rates a little bit, and they said, “you see, we’re tightening.”

But if you looked at inflation at the same time, you’d say that those interest rates in real terms – meaning the interest rate minus the inflation rate – were actually going down. So, the Fed was just not doing what it needed to do. And there were a few academics, a few people at the Fed who were explaining all that, and then finally, when things were just running off the rails with double digit inflation, Paul said “[We’ve] got to do this.”

KRISTOL: Yeah, it’s impressive, you know.

FELDSTEIN: It is.

KRISTOL: He deserves more attention than he gets.

FELDSTEIN: Yeah, right. No, no, no. He certainly did.

KRISTOL: Let me ask you one – I'll let you go here in a minute, a few minutes, but it's always interesting to ask people who have achieved high office in government sort of how they got there. Young people always look up and they think there's some smooth path up to being chairman of the Council of Economic Advisers or whatever. I'm just curious, how did you happen to become – President Reagan picked up the phone one day and said, "Hey, you're teaching up there at Harvard. Why don't you come to Washington for a year or two?"

FELDSTEIN: Not quite. I had been doing policy-related research. I had been writing papers about taxes. I had been testifying occasionally, to Congress, about these issues. But I was not at all involved in – with Reagan. When George –

KRISTOL: Had you been in government before? I can't remember.

FELDSTEIN: No, I had never been in government.

KRISTOL: So you really had no –

FELDSTEIN: Nothing. Nothing.

KRISTOL: That's unusual.

FELDSTEIN: Right. Right. Good pure academic. So, when George H. W. Bush started to think about running for president, one of my –

KRISTOL: So this is 1978, '79.

FELDSTEIN: Something like that, yeah. So, one of my close friends in Congress called up and said, you know, "There's this smart guy who we know from the Ways and Means Committee who's now gone off to Texas, but he's thinking about running, and we're going to have a meeting in Kennebunkport; it's close to you. Do you want to come up and join the discussion?"

I'd never done anything like that. That seemed like a good thing to do. So I went up and I met George H. W., and he ran and I had lots of conversations with him. And then at some point, he lost the nomination to Reagan and so he dropped – so I dropped out of that whole thing and went back to doing what I do.

And then one day – so Reagan won, and a man named Murray Weidenbaum, who had been in the Treasury, was appointed as CEA chair. And then Murray, after two years, decided he'd had enough. And the next thing I knew, I got a call, not from the president but from the *Wall Street Journal*, saying, "You're on the short list for this CEA thing. What do you think?"

And I said, "Well, that comes as a surprise to me. Who else is on the short list?" And the guy I talked to said, "Well, I think you're the *only one* on the short list." So the next thing I knew, I did get a call to come down and meet the president.

KRISTOL: That's unusual that that would be your first job in government. And what surprised you? I mean what was, what would you tell someone who's not been in government if they were about to go to Washington for the first time?

FELDSTEIN: Well, when I – a few years earlier, when Gerald Ford was president, I got a call from his chief of staff saying they would like me to come and be a member of the council; not chairman, but be a member. And I think I didn't think about it very long.

I was hard at work doing stuff that I thought was important and that I wanted to get done. And so, I said, "Well, I'm very flattered, but thanks but no thanks." And the chief of staff said, "Well, you'll regret this." And that was the end of that conversation. So no, I'd had no experience. And that's unusual.

KRISTOL: Yeah.

FELDSTEIN: I think most people who have – well, I'm not so sure about that. If you think about some of the recent CEA chairs, I think –

KRISTOL: Maybe not.

FELDSTEIN: Yeah. I think –

KRISTOL: A lot of them seem to have spent one year maybe, though, you know –

FELDSTEIN: On the staff.

KRISTOL: – on the staff first.

FELDSTEIN: Right, yeah. So, Greg was on the staff as a very junior person when I was chairman, Greg Mankiw, and then went back as chairman.

I can't remember whether Glenn Hubbard had been there or not. So ,I don't have any great advice about how to, you know –

KRISTOL: Were there any, you know, surprises when you got there?

FELDSTEIN: When I got there? Well, I think one of the things that surprised me was what a small stage army it was. You saw the same 12 people all the time. And, in a sense, how apolitical it was.

I mean, the discussions were about substance. The discussions were about substance. And that's not to say that they happened in a political vacuum, but that they were not, "Well, how many votes, who's this, who's going to do that." It was, "Well, what is it we're trying to achieve here, and then can we sell it?"

KRISTOL: Well, that's good.

FELDSTEIN: Yeah.

KRISTOL: It's encouraging.

FELDSTEIN: Yeah. Right. Yeah.

KRISTOL: And on that encouragement, but generally, just one final thing. I mean, so it seems to me you're – I don't know. You're a combination of worried about the policies and sort of encouraged about the underlying capabilities of the country. Is that a fair way to say it?

FELDSTEIN: I'm worried about the financial-market fragility, about the mispriced assets, and people in the financial sector are incented to go along rather than to bet against. Because if the market goes up another two percent and they bet against it, they lost two percent and their competition gained two percent, then they're in trouble. So, they don't want to do that.

And that was true, that was true back in '06 and '07 when I would talk to people in the financial sector and say, you know, "Aren't you worried? Don't things look overpriced?" And they'd say, "Yes." And I'd say, "Why don't you bet against it, reduce your investments, short this or that?" And they'd say, "You don't understand. If I do that, the money leaves and goes across the street."

So they're incented to keep taking risks. It's not their money. It's not their money. They're managing, you know, your money, my money, the insurance companies' money and so on. And if it doesn't work out, well, they're experienced professionals—they may even lose their job, but they'll find another job.

KRISTOL: That sounds like that problem is –

FELDSTEIN: It doesn't go away.

KRISTOL: A Fed problem, though, in some respects.

FELDSTEIN: Well, the Fed could pursue policy –

KRISTOL: I mean the interest rate being low is sort of a key precondition, you might say, for this problem.

FELDSTEIN: Absolutely. Absolutely. And, you know, if we're all lucky, it will all go away quietly. They will gradually raise rates. But of course, the *they* is a totally new Fed. So we're going to have a new chairman and a vice chairman, new two vice chairmen, and a whole new cast of governors within 12 months.

KRISTOL: And it's funny, all the talk in Washington about the tax bill and the health care bill, this, that, other personalities, this is something that's not talked about much.

FELDSTEIN: Right, and it's overwhelming. You know, if there's a financial problem, the question is how does this inexperienced new team, how are they going to handle it? And what kind of folks is the president going to choose for those things? So, that's going to be very interesting to watch.

KRISTOL: I hope he calls you up and gets your advice, but that's a good note to end on, something that people haven't thought enough about, probably. Marty, thanks so much for taking the time to be with us.

FELDSTEIN: Good to be with you. It was fun having this conversation.

KRISTOL: I enjoyed it too. And thank you for joining us on CONVERSATIONS.

[END]