Box 7-6: Former CEA Chairman Martin Feldstein (1982 – 1984)

I became Chairman of President Ronald Reagan's Council of Economic Advisers in the summer of 1982. I served for two years, the maximum time allowed by Harvard's policy of leave for government service. Acting as CEA chairman provided a crash course in a wide range of economic issues, including exchange rates, financial regulation and emerging market deficits, as well as an education in how the political process works inside the administration and with Congress.

Ronald Reagan made his economic goals very clear: lowering the rate of inflation, reducing the government's share of gross domestic product (GDP) while increasing defense spending, lowering tax rates, and reducing government regulation. Although he left it to others to work out the details, he made these things happen because of his skills in speaking to the American public and his ability to compromise in working with the Congress. He succeeded in achieving his goals, although never to the extent that he wanted. Government spending fell from 21.6 percent of GDP in 1981 to 20.5 percent in 1989, while the defense share rose from 5.0 percent to 5.5 percent, taxes fell from 19.1 percent of GDP to 17.8 percent, and the fiscal deficit excluding interest on the national debt (the primary balance) fell from 0.3 percent to minus 0.3 percent.

Although the Democrats had an overwhelming majority in the House of Representatives for the entire eight years of the Reagan presidency, the President achieved major tax reform (a revenue-neutral reduction of the top personal tax rate from 50 percent to 28 percent), a major reform of Social Security (raising the future age for full benefits from 65 to 67), and a free trade agreement with Canada.

The Federal Reserve under Chairman Paul Volcker (who had been appointed by President Jimmy Carter and later reappointed by President Reagan) achieved a rapid fall in inflation from 12.5 percent in 1980 to 3.8 percent in 1982 and 1983. This disinflation involved double-digit interest rates and a sharp economic downturn. One of my challenges as CEA chairman was to defend the Federal Reserve's actions against critics both inside and outside the administration.

The overall budget deficit increased sharply from 2.5 percent of GDP in 1981 to 5.9 percent of GDP in 1983. The 25-percent cut in personal tax rates that was enacted in 1981 was not expected to result in such a large deficit increase because, with tax brackets not indexed to inflation before 1986, it was projected that the high inflation that prevailed before the tax cuts would raise taxable incomes to offset the cut in tax rates. The unexpectedly rapid fall in inflation reduced the offsetting tax revenue. Although some of the rise in the fiscal deficit was also due to the recession that began in 1981, a net increase in the structural deficit remained. I joined forces with Budget Director David Stockman to argue that revenue increases as well as spending cuts were needed to shrink that structural deficit. Although the political side of the White House criticized me for this position, President Reagan made no objections and did support annual revenue-raising changes in corporate taxation while sticking with his promise not to raise taxes on “hard-working families struggling to make ends meet.”

Although there were very good economists in several different cabinet departments, I realized that they each had two roles. In addition to advising the cabinet member who was the head of their department, they had to represent their department’s position at interdepartmental meetings. I therefore found myself debating with these economists at meetings while suspecting that they were presenting their department’s positions rather than their professional judgments. Perhaps they didn’t mind losing some of those debates.

In my meetings with economic officials of other countries, I came to appreciate the unique role of the Council. As CEA chairman, I reported directly to the President and presented my own views in testimony to Congress. In contrast, the senior economic officials in other countries were often political figures rather than professional economists, or were economists who reported only privately to a minister of finance.

The team at the CEA is also unusual in being academics serving for only one or two years (except for the very valuable long-term statistical staff). This meant having very high quality people who brought up-to-date professional thinking, but who had to learn quickly the details of policy issues. William Poole and William Niskanen were already members of the CEA when I arrived and continued to work with me during my two years. The people I recruited as members of the staff included Democrats as well as Republicans, chosen for their analytic abilities, including Larry Summers, Paul Krugman, John Cochrane and Jeff Frankel, as well as younger economists Ken Froot, Larry Lindsey, Greg Mankiw and Katherine Utgoff, and others whose political affiliations I did not know. Although the White House personnel office was surprised when they eventually discovered some of their political affiliations, there was no attempt to change these appointments or limit what I did in my second-year appointments.

One of the many pleasures in working with President Reagan was his positive and optimistic attitude. It no doubt made it possible for him to work successfully with both Republicans and Democrats in Congress. But it sometimes made it difficult for me to convince him of the need to adopt certain policy changes. I recall one occasion after I had just had one of my Oval Office meetings with the President in which I said that it would be very risky not to make a particular policy change. The President asked whether continuing with the current policy was sure to create a problem. I said that I couldn't be certain of that but that the current policy would have a very low probability of success. I thought that my argument would have persuaded a typical prudent corporate CEO to make the change that I was suggesting. But the President decided not to do so.

As I left the Oval Office I realized that the President's optimism and his willingness to take a long shot on policy was not an accident but was based on his own life history. He started as a radio sports announcer but was soon a major movie star in Hollywood. When his movie career came to an end, he eventually went on to become a popular California governor. He later ran for the nomination as Republican candidate for the presidency but was defeated. But the next time around he won the nomination, was elected overwhelmingly, and was reelected four years later with an even larger margin. And there I was, after his long string of improbable successes, trying to persuade him not to do something because it was unlikely to happen.