

INTERVIEWER: Today is May 3rd, 2010. I am Karen Arenson. We are talking this afternoon with professor James Poterba, the Mitsui professor of economics at MIT, whose specialty is taxes and how they affect people in companies, and the decisions they make. He officially joined the MIT economics department in 1983 and served as its associate department head and department head for 13 years. Two years ago, in an appointment applauded by economists on the right and the left he was named president and chief executive of the National Bureau of Economic Research, a high profile organization with more than 1000 research associates at colleges and universities across North America. It is also the arbiter of when the United States enters and leaves recessions. Jim, thanks for talking with us today. Let's talk about taxes.

Most people run away from the subject, you seem to run toward it. What attracts you?

POTERBA: You know, I think taxes are a place where if you are interested in economics and the effect of incentives on the behavior of people and on firms, if you've also got a willingness to dig into some details and find it interesting to learn about institutional rules and structures it's an ideal place for someone with that joint interest to apply their tools. And I've in fact, found taxes interesting for a long time. I think it actually goes back-- if my memory serves-- to my freshman year in high school when I was on my high school debate team. The debate subject for the year, this was at a time in the early 1970s when revenue sharing was an active topic of discussion when a lot of states and localities were struggling, not completely unfamiliar today, was something like resolve that the federal government should finance primary and secondary education in the United States. And there was discussion then of should we have a national value added tax? Should the federal government use the income tax to finance what's usually a property or sales tax financed expenditure in most US localities? So I learned something about taxes then and I liked it, and have been following that interest in one way or another, more or less, ever since.

INTERVIEWER: As a debater you were probably expected to be ready to take both sides of that argument, but did you have a favorite between the two?

POTERBA: Ninth grade is long enough ago that I'm not sure whether I felt affirmative or negative was easier in those days. But you're right, and I think that the fact that then as now there were always arguments plus and minus for any tax that you could think of, and that these were not simple, easy recommendations. But rather, one can lay out a menu of here's what you could do. Here are the positives and here are the negatives associated with that. I've actually always found that very attractive. I'm not someone who's very much given to making strong policy prescriptions, but I like the analytical part that lies behind the policy so that one can try as an economist to help the politicians or the decision-makers to understand the consequences of different choices and then leave it to the process to decide.

INTERVIEWER: Do you recall whether other students, your teammates or your opponents really got into this topic too? Or whether some of them were put off by--

POTERBA: My vague recollection is that most people thought this was a pretty dry and dull topic. And that I was probably a little bit at the enthusiastic extreme relative to the set of people who were, as ninth graders, learning about value added taxes.

INTERVIEWER: Did you have any sense then, ah-ha, this is going to be my life's work?

POTERBA: I don't think so. I learned at that stage and throughout the rest of my high school debating career because we often tackled questions that had a lot of economics in them. I think that back in my senior year in high school the topic was something about the allocation of scarce world resources, and that of course is really front and center to thinking about how economists might sort of play a role. It wasn't really until I got to college that I was drawn into economics as more than a side light. In fact, when I came to college I thought that I would be a scientist of some sort, probably a chemist or a chemical engineer. Although I didn't come to MIT as an undergraduate, I do remember my MIT undergraduate admissions interview. Because when the interviewer said, do you have any questions about MIT? I think the only thing I asked was, does Paul Samuelson teach undergraduate economics courses? And the interviewer parried the question in just the right way and said, well I think he probably teaches some more advanced courses, typically.

But I must have been interested enough in economics to be thinking about it at that point as a sort of rising senior in high school. But it was really when I got to college and wanted to continue to be involved in debate that my debate coach basically said well, you know these science courses, with all these labs, it's very hard for you to travel a lot and participate in debate activities if you take a lot of chemistry and physics and biology. So at that point in my freshman year, I said, well I better sign on for economics and math doesn't have labs, so I'll take some of that. And some other courses that sort of turned out to be fitting in with that broad interest. At that point I really was drawn into realizing what economic analysis could do at the sort of more substantive and deeper analytical level. I really started to find it very interesting. So at that point there was no looking back.

INTERVIEWER: When you were in high school and you started looking at the tax issues do you remember whether you talked to your parents about their taxes or said, let me look at a tax return. Or I'll help you fill it out?

POTERBA: There must be something in the genes about taxes because my father, who is about to turn 90 still does his own income tax return with pencil and paper. A task that I find amazingly daunting. I certainly am helped by some computer programs in doing my taxes. But I don't think we had family discussions about tax issues. I'm pretty sure that I didn't know much about our household finances until well beyond my move out of the house to go to college.

INTERVIEWER: What's your general view of the American system of taxation now?

POTERBA: It could certainly be made better. And I think we are unfortunately held hostage by a political process that puts a lot of special interest influence into the making of tax policy. You know, the broad prescription that most economists and I would offer for raising revenue is to try to find as broad a tax base as one can. And then to raise revenue on that base with as low a set of rates as you can manage, subject to carrying out whatever redistributive objectives the society chooses to have. So a simple flat tax on everybody's income at the same rate doesn't seem like it's the way to go because one would like to do some redistributive activity and to help those who are less fortunate.

At the same time, the very high marginal tax rates that one saw during the 70s and 80s in countries like Scandinavia-- even to some degree in the United States-- I think there's been a sense that those very high rates create a lot of distortions. They encourage people to find ways to avoid taxes, to evade taxes, whether legally or illegally. And they may discourage productive activity in the economy. So somehow, in trying to navigate between those two poles is the challenge. And what we have at the moment is an income based tax system, but one that has a large number of special deductions and exemptions for various activities, many of which I think are rather difficult to justify on clear analytical or policy grounds. And I think that the way I would like to see us go, at least initially, we have a huge revenue hole in the US that needs to be filled going forward. And what I think the first step should be is to try to do some base broadening and reign in some of those deductions, see if we can collect sufficient additional revenue there. I suspect we need higher rates as well, and it'll be less painful to raise the rates if the base is broader so that we don't exacerbate some of these distortions. But it's going to be a very interesting decade for people interested in tax policy because the projections at this point going forward from 2010 suggest that we have a long-term deficiency in our revenue capacities relative to the set of expenditure programs we have in place. And there's going to be enormous interest, I think, in figuring out how we tackle those problems.

INTERVIEWER: Are you seeing any kind of increased interest, either among undergraduate or graduate students? Or even among some of your professional colleagues?

POTERBA: I think you can see it most easily in the many academic economists who I interact with. And even within the narrow field of what we call public finance, the people who study tax issues. For a decade or a decade and a half there has been growing interest within the academic study of government in the economy. In understanding various expenditure programs, looking at medical care insurance, looking at social security. Taxes, in part because they were relatively low by historical standards, had attracted less interest I would say, for a while. The last 18 months when the US embarked on a historic stimulus program in peacetime, and when suddenly the long-term forecast that had always been there saying, the US is going to need more revenue when the baby boomers retire. Those projections were always 15, then 10, then 8 years away and what happened in 2008 when the federal government undertook a vast array of new spending programs was that the projections which had said relatively modest budget deficits followed by an increase-- sunny followed by showers and clouds late tonight and tomorrow became cloudy followed by severe thunderstorms by evening. And people suddenly realized we've got to think much harder about the fiscal dynamic that we are engaged in. So I've seen much more discussion focusing on budget deficits, on the effect of government stimulus programs, on how to think about raising taxes, and I expect that's the beginning of what's going to be a snowballing effect as people think about that going forward.

INTERVIEWER: Are there any countries whose tax systems you particularly admire? Who do it the way you're describing?

POTERBA: They're few and far between to be honest. And the problems that arise from the political economy of making tax policy in the US are hardly unique. There are though a few examples where you can find situations where tax rates have been raised or the base has been broadened in a striking way. New Zealand adopted a value added tax at one point, about a decade ago. And in most countries in Europe where there's a value added tax it's a form of a sales tax basically. So usually there's a question of which goods will be taxed under the value added tax? And just as in the US states there's always a question of which goods will bear sales tax? Should food, should restaurant meals, should education, should medical care be taxed under the sales tax? The same question comes up with the value added tax.

New Zealand managed to do something very different from virtually all the other countries where most of the countries leave about half of the consumption that's done out of the value added tax base. New Zealand actually got not just to 100 percent, but actually taxes more consumption than appears to show up in the government's national accounts. I think they were just committed to the proposition that we are going to allow no exclusions. Once you've got some religion that that's going to be the principle that's going to guide you, if you can sort of really stay with it and beat back all of the special pleading for special deals, that can get you to a place that leads to a somewhat more efficient tax system.

Even in the US there is some evidence of hope that goes back to 1986. Because in '86 we had a significant tax reform that commanded bipartisan support. Bill Bradley for example, a democratic senator from New Jersey, was a large proponent of doing something to reform the tax system. President Reagan at the same time was eager to see something happen. The congress basically came together and did something that was pretty painful, in that they cut back on a number of special deals that were in the tax code for various industries and various interest groups. They lowered rates at that time and managed to basically keep the total revenue, not quite constant, but within hailing distance of constant. And the fact that that happened 25 years ago, I take some hope from because I think it does at least raise the possibility that when there's real sense that we need to urgently do something on the tax code the US system can actually get it done, but it's going to be a challenge.

INTERVIEWER: President Reagan actually had two rounds in major tax changes, right? He'd done one in '81 or '82--

POTERBA: That's right. And in fact, the '81 tax cut was a tax cut. It was much less of a reform of structure as opposed to take all the rates down. And then it became very clear shortly after the '81 cut that we'd gone too far and that we were running deficits. And in '82 and '83 and '84 there were tax bills that tried to lean against that wind and collect more revenue. But I think it was partly a sense through all that process that the whole system just needed to be overhauled. And that's what led to reductions in top rates for example, from 50 to 28 in the '86 bill. At the same time that we did other things, for example, we taxed capital gains more than we had before, we changed some of the depreciation rules for businesses. We did a lot of different things that added up to a sort of simplification of the tax system. Since then there has been a gradual chipping away at the sort of steps that were taken in '86. The tax codes become more complicated, we've done a lot of social engineering through the tax system, and those are all things that I think they may all have justifications for them, but one needs to take a sort of top to bottom look at those issues.

INTERVIEWER: Do taxes really distort behavior? If you look across the landscape, what do you see?

POTERBA: I think there are two ways to answer or to think about that. The part that is easiest to address is that when taxpayers-- whether they are firms or they're individuals-- see a chance to reduce their tax liability without too much reconfiguring of what their real decision-making looks like, they run for it. I'll give you two examples. One is in the 1986 reform when the capital gains rate was going to be going up, taxpayers could tell that they were facing a lower tax rate in 1986 than they were going to face in 1987 or beyond. You look back at the history of realized capital gains in the US in say, 1983 through 1986, it was \$90 billion, \$102 billion, \$105 billion, \$370 billion, \$90 billion, \$72 billion. So basically there was a clear move to just move all of the capital gain realizations forward through time and take advantage of those low rates. The same thing happened in 1992.

When President Clinton had been elected it was clear the tax rates were likely to go higher. Wall Street firms that typically pay bonuses early in January accelerated those bonuses and paid them in December of 1992. That effect even then, prior to the rapid growth of Wall Street over the last decade and a half, even then that move of bonuses from January to December is enough so that the national income accounts for the US show a special adjustment factor in labor income because things moved across the year. Those are both examples of short-term re-timing. You see similar things with people giving to charity. If they know their tax rates are going to change from one year to the next they try to make the gift in the year with the higher tax rate. The harder question is whether if you change the tax structure substantially and you leave it in place and don't fiddle with it for awhile, whether moving from one system to another leads to substantial changes in behavior.

My sense is that that's harder to tell just because we have fewer examples in which the tax system has stably moved from one place to another. But I do think that people's willingness to exert lots of effort to take on risky propositions and see whether they can create businesses or create new occupations, I think that is probably sensitive to the after tax rewards that they could earn. That when the tax rates are really high, the days when you might face of 70 percent tax rate on your labor income if you were really successful-- I think that did probably have a dampening effect on how much people were willing to work in those stages.

INTERVIEWER: There's been widespread use of taxes that are not only aimed at trying to change behavior-- I mean, sometimes explicitly so-- as well as to raise revenue, like the so-called sin taxes on products like cigarettes or alcohol. Have those been affected or--

POTERBA: Absolutely. There's no doubt if you look at situations where say the cigarette tax has been increased by a state that spending on cigarettes declines or the consumption of cigarettes declines and we know that-- again, stay with cigarettes, we know that young smokers tend to be more sensitive to the price per pack than older smokers. So that what you typically see is that when you jack up the price significantly with a tax that leads some people to not start smoking, and that may have of course, some important public health benefits. But the cigarette tax example is a good one for showing how the short run and the long run can look different. I think there's very little controversy that in the long run if the cigarette tax is higher that there will be fewer smokers and that smokers who do smoke will smoke less. However if you look at the short run movements around the time when the cigarette taxes go up, take for example, California, which I think increased their cigarette tax by \$0.50 or \$1.00 a pack in the late 1980s.

In the month before the tax increase took effect cigarettes were flying off the shelves in California supermarkets and other venues. And in the month after the tax took effect cigarette sales fell precipitously. So if an economist without the knowledge of how the complexities of behavior might work out were to go and look at, right before and right after the tax increase, you'd conclude that this paradoxical result, cigarette sales fell right after the taxes went up as you would expect them to. But very, very sharply. And what you found was that this kind of hoarding behavior exacerbated the effect of the tax. Made it look much larger in the very short run than it was in the longer haul. That's part and parcel of why I found the analysis of taxes interesting. Because it's not something where there's a very simple, one size fits all analytical strategy. You need to think about these interesting institutional details, like the fact that cigarettes are storable and that some California smokers were filling their garages with cartons of cigarettes.

INTERVIEWER: They don't get stale after a while.

POTERBA: Staleness I don't know, but they do burn. And one of the concerns with the hoarding behavior was that people would be putting lots of flammable stuff in their garages and I think there was a slight increase in the reported rates of home fires and things like that.

INTERVIEWER: They weren't talking about the hearth?

POTERBA: That's right.

INTERVIEWER: Let's go back to your childhood. You talked about tripping over taxes in ninth grade, but where were you raised and what were you like as a child?

POTERBA: Well, I lived on Long Island. I still have a Long Island accent, I think, even though I moved when I was in seventh grade. But I lived in Long Island and I lived in eastern Pennsylvania in Bucks County when I was in high school. I don't think I had much the markings of economics at that stage. As a high school student I was-- as I said I was interested in math and computers and science. I don't think I quite realized yet that economics had some analytical and mathematical components that might actually link up with those interests. I had a paper route. I was on my debate team. I was tapped to run the student store in our middle school or lower high school, which I remembered was a very early introduction to what it was like to try to run a business. To try to prevent the big kids from jumping over the wall and stealing the candy out of the store was always a challenge for the little nerdier kids who were thought to be in charge of the store and keeping the books.

INTERVIEWER: Did you figure out a way?

POTERBA: We tried to make them our friends. That was our best strategy, but we never resorted to bribery, which would be the other option. Those are the sort of things that I remember being involved in. A number of economists who I've talked about their-- what drew them into economics-- I think the root of thinking that science and math would be a career and then discovering in college that economics has some elements like that. That amongst the social sciences it turns out to be a relatively quantitative one. That there is a route for using some of those tools, but that also mixes in the kind of interesting public policy elements that people might find fascinating. I don't think my experience is all that atypical in terms of the way I was drawn into economics.

INTERVIEWER: But if it weren't for the debate you might have gone to all the science labs and turned into a biologist?

POTERBA: I think that's right. I mean I absolutely think that small nudges can be very important in the way things play out. And my high school had a ninth grade economics course that I remember and it was relatively introductory. So I think we discussed how prisoners of war traded cigarettes in POW camps in the Second World War. I remember we did something on an Indian tribe called the Kwakiutls that had particular tribal customs for how they traded and decided what was produced. It turned out that my high school economics teacher in ninth grade was the roommate of the high school debate coach and the way in which the debate team did its recruiting was that the two of them would talk and they would try to find out who might seem interested in this. So literally my launch into doing debate and probably doing economics was back in ninth grade when my teacher came in and said, you're going to go and try out for the novice debate team this afternoon. And I dutifully did it and I've always been very grateful for the fact. That moment was a watershed moment in shifting the things I was doing.

INTERVIEWER: Did you know any economists growing up? What did your parents do?

POTERBA: My dad was an accountant, my mom was a school teacher, and neither of them quite knew what academics was about until well after my joining the faculty at MIT when they would ask, are you teaching this semester? And I would say yes. They would say, how much? And I would say, well six hours a week. They would look back mystified and say what do you do with the rest of the week? So the whole academic enterprise and the notion of research and teaching going hand in hand and working with graduate students and things like that. It took a long time for that to work its way into the fabric of my household.

INTERVIEWER: Well, but one was in education and the other was in numbers, and you do both.

POTERBA: That's right. And in fact, if you look back, at some level this fuses the two things together.

INTERVIEWER: How did you decide where to go to college and you talked a little about what to study, but--

POTERBA: I'll be honest. I faced a very tough choice between MIT and Harvard. I really thought that MIT had an astonishing-- although, I didn't know much about economics besides Paul Samuelson being here, I knew that MIT was great at all of the science things that I was interested in. Most of my debate friends-- and I had a national group of friends who I would sort of compete against-- the ones of those who I knew who were thinking about this choice were by and large leaning toward Harvard. And since I thought I wanted to do debating in college and MIT's debate team didn't have quite as much depth as the Harvard debate team I decided well, I'll head off in that direction.

It turned out that the MIT/Harvard connection continued to play out because while I was debating my freshman and then my sophomore year in college there was an MIT debate team coached by an economics graduate student at Harvard by the name of Larry Summers. Larry was working on his dissertation at Harvard while spending time at MIT, which had been his undergraduate school, working with their debate team. He'd been a very successful college debater at MIT. Bringing some economic analysis in fact, at a very high level into the collegiate debate circuit.

And it was the Thanksgiving weekend or thereabouts in my sophomore year and Larry and I were both at a debate tournament at Wake Forest in North Carolina. And we went for a walk during one of the breaks and Larry said, you know, I'm thinking about hiring a research assistant, and I was wondering if you'd like to think about doing that? And I said, well, I just really don't know that I'd have time to do it given the demanding travel and work schedule that our debate team imposes. And we had a conversation and he said well maybe you want to think about whether you prefer to do research assistant work than do debate. And that was really a monumental decision for me to have to think through. But once the idea had been floated and the appeal of being able to do more than be a consumer of the research that other people had been doing-- instead of using that research to try to build arguments one way or the other, but the notion of being a producer of some of that research had a certain appeal. And it took me about two months of noodling over this offer before I finally decided right after the New Year in my sophomore year in college that I'd actually switch over and I'd leave the debate team. I'd signed on for this research assistant activity.

Again, I was living under this charmed star because the first two economists I worked for were Kim Clark who was a Harvard graduate student at that point, but went on to be a very successful professor at the Harvard Business School, the dean at the Harvard Business School, and Larry Summers. And it'd be hard to think of a better way to jump into this field than by working for a duo like that.

INTERVIEWER: Do you remember what kinds of projects you did for them and what they wanted you to do?

POTERBA: Oh, vividly. The first thing I did was I collected data-- this is pre the era of online downloadable data, remember. Kim was doing some work on the productivity of the cement industry in the US and the role of labor inputs in the productivity of cement factories. Cement's a very capital intensive industry, so collecting detailed data on the cement firms and their plants was on key part of his research. So I was identifying and copying data on the capital stock that the workers used in cement factories. These are places that have kilns that produce cement for all across the US I was creating that and typing it into punch cards so we could do statistical analysis.

And then Larry and Kim collaborated on work, which even today has been very influential in economics. We were studying the role of labor market transitions, movements between employment and unemployment out of labor force, and the way things like unemployment insurance and other public programs affected those transitions. I had as I mentioned, been interested in computer programming and I'd done a fair amount of computer work. So I was writing computer code for them that was basically doing data analysis with information that we'd received from the Bureau of Labor Statistics and Labor Department on some of these labor market flows and transitions. We were also trying to simulate the effect of different public policy programs. And for example, I remember we had-- one of the issues always was, at what point would a worker who had become unemployed just give up if they hadn't found a job. After 6 months or 9 months or 12 months? When would they finally say I'm throwing in the towel that I'm just getting out of the labor force? And I remember programming something called the indomitable worker.

The indomitable worker was somebody who would never throw it in, who would basically just keep searching and searching and searching. We were interested in trying to understand how long in the worst case scenario-- if you were really committed to finding a job how long could it take you to finally get employment? And how that varied over the course of the business cycle and with different state unemployment insurance programs and things like that. The fact that today, 30 odd years later, I can still remember some of the things that we worked on at that point. And it speaks to just how exciting a time it was and how exciting a team it was to be working on as we worked on these various issues.

INTERVIEWER: And you had begun to take the economics sequence in your freshman year?

POTERBA: My freshman economics teacher was a second year Harvard graduate student named Jane Katz who had just come from the University of Chicago where she'd been an undergraduate. She had been steeped in the exciting price theory, economics as a lens of understanding all kinds of human behavior, that we associate with Gary Becker and Milton Friedman and others like that. Then of course I was studying this in Cambridge, in a place where there was a lot of interest in how to design policies that might be able to affect the macroeconomy. People like Larry Summers, Marty Feldstein was Larry Summers' thesis adviser as a graduate student, and I subsequently worked for Marty as an undergraduate.

I remember seeing Bob Solow from MIT come and speak to the Undergraduate Economics Club my freshman year. Bob had written a paper called, "Up and Down the Phillips Curve with Gun and Camera." The Phillips curve is a relationship between unemployment and inflation. I thought anyone who could be a professional economist write a paper with a title like that, which I just loved, was really neat and I remember seeing Bob who then was probably about my age now come and just talk to the undergraduates. It seemed like what he was doing was really interesting and exciting. A variety of these things fit together in sort of creating a clear sense of economics as an exciting place to go.

INTERVIEWER: And this was late 70s, mid 70s?

POTERBA: Bob Solow came to visit sometime around January 1977. My working with Larry Summers began in early 1978. Economics was more in the national news then than it was probably any time until the last couple of years. Because we were coming out of stagflation. There was a sense, there was a malaise in the economy. People were trying to figure out what you could do to get things back on the roaring path that we'd been on in the 1960s. And I'm sure that that played some role in drawing me into this.

INTERVIEWER: But wasn't it a period where we weren't really coming out. We didn't really come out until the early 80s and that economics were kind of in disfavor? I mean, were you conscious of that?

POTERBA: I don't think that part quite connected, but I think I knew that the economy was creating problems for the society. But I think that beyond that I wasn't yet far enough along to understand that at the more rarefied levels that economics was going through a wrenching transition as the policies which it seemed to work so well during the 1960s were suddenly coming under much more active attack by various wings within the economics profession. And there was skepticism in places like Washington and other national capitals as to whether economics had much to offer in solving these problems.

INTERVIEWER: Did URPE, the radical economists, have much of a foothold in your--

POTERBA: Not much. And it may say something that my introductory economics teacher was a Chicago trained person who would be very much the other end of the spectrum from the radical political economists and whatever. Those issues never really much came on to the radar screen.

INTERVIEWER: Sam Bowles was in the department then or not really?

POTERBA: Sam Bowles was certainly around. I'm not sure exactly when Sam Bowles was at Harvard, but he was-- in the Harvard economics department. Sam Bowles is someone who I don't think I've ever met, but I know by his work. He was someone who had done a lot of work on the mathematical microeconomics. He'd actually taught some of the introductory graduate courses at Harvard, I believe, in that area. And I certainly had a book of problems that he'd worked and shared with graduate students, and I used at various points as a late stage undergraduate. But he was also a leader of those arguing that neoclassical economics may have missed some of the important insights here. That part I don't think I ever connected with particularly much.

INTERVIEWER: So you managed to do all this research work after all the hours of debating and you still came out with amazing grades. You were summa cum laude, Phi Beta Kappa. Did you go in with that as a goal of yours and did you feel pressure to achieve it at some point? Or did you do it effortlessly?

POTERBA: I think to be perfectly honest I remember a lot more about the research assistant work than I do about the sort of worry about grades and things. But I think the truth be told, by the time I was through my sophomore year I had gotten a really clear sense of how much fun research could be. And at that point I tried to configure my classes and other things in such a way that I was picking up the tools that I needed along the way to be able to pursue what was then becoming clearly a professional interest in economics. But I'm trying to figure the right way to say-- I shied away from what might have been the most difficult and demanding undergraduate general education courses on the grounds that I really wanted to be able to spend my time hanging around with the economist graduate students, and doing research work. So I for example, took linear algebra courses and things like that, that I knew were going to come in handy. I took an advanced statistics course that my graduate student friends said was a good thing to go and study. In retrospect, it's a little hard for me know.

INTERVIEWER: They worked on challenging, they just weren't broadening I guess.

POTERBA: Those were hard courses and they were courses that I knew I had to work hard in and I did well in, but I didn't take courses that I might have taken with a broader focus in the sciences or in some of the humanities that were known to be difficult and really demanding courses, but where people came out and said, I learned so much in that course. It was great though because I was spending my time learning in the research carrel where I was typing data in and running programs.

INTERVIEWER: So speaking of incentives and distortions and behavior, it sounds like there was a bit of that there. Had there been a couple of pass/fail courses might you have taken one or two? Are there courses you look back that you're sorry you didn't take now?

POTERBA: I do remember taking a pass/fail history course that I was particularly interested in, and I do remember the professor calling me in afterwards and saying, you got an A minus in the course, aren't you disappointed you took it pass/fail. And I do remember a little bit of cognitive dissonance surrounding that. The more scary experience was the second semester of my senior year, there was a course in numerical analysis. Basically, how to use applied mathematical techniques in various kind of computer solution problems of things that could be handy in economics. And I'd signed up for this course, it was a graduate level course in the applied math department. And it was taught in a very big lecture hall, but there was a very small group of students-- there were only five of us in the beginning. But the professor, who was terrific would come and write and we'd go up and down on all the blackboards of the room. And not too long after we got started, by around President's Day weekend, two of the students stopped coming. And at some point, a few weeks after that I turned to the other two and I said, well, I guess it's just the three of us. And they said, oh no, we're just auditors. We're not taking this course. And I said, well, why not? And they said, well he's well known to have a C median and we didn't want to take this course for credit.

So there I was as a second semester senior, needing this course to graduate, and locked in to getting through this thing. So what I do remember quite vividly is spending the last six weeks of my senior year when most of my contemporaries were on the banks of the Charles or exploring Boston and going on various kinds of field trips doing a lot of learning numerical analysis and applied linear algebra. It was a great experience. It was a fantastic thing. Since I was the only one in the course for a grade we somehow turned the final evaluation into a research presentation or project that I did in the professor's office. And it was fantastic. I still remember Professor Anderson. It was a great learning experience. But that's one that if I've been doing it over, I might not have locked into my second semester of senior year.

INTERVIEWER: What did you do after college?

POTERBA: Well, again I followed a path that I don't think I put a whole lot of thought into *ex ante*. I applied for the various international scholarships that people apply for and I was fortunate enough to win a Marshall Scholarship to go to England. And I asked my undergraduate thesis adviser, who was Marty Feldstein where he would recommend I go if I were going to England. And he actually had done his doctoral work at Nuffield College at Oxford. So he said, well, I think the answer is Nuffield College at Oxford. So I packed my bags and headed off to England for what I thought would be two years. I'd in fact planned to come to graduate school here at MIT in economics and I'd been accepted. Oh, actually no, I hadn't been accepted. I'd applied. And I sent in an application, but I then-- I don't know, maybe I failed to withdraw it or something, but I remember getting a call from Robert Bishop who was then the chair of the MIT Admissions Committee saying, what's up with you? We have an application or we have you on a list of NSF grant recipients, but we don't have an application.

That's what it was. I'd applied for a fellowship, but never applied to MIT because I had gotten the Marshall in December and the deadline for applying for graduate fellowships was before the Marshall notification, but the deadline to apply to graduate school was later. So I never applied to MIT, but it seemed like I won a fellowship to come to graduate school. They were very concerned they lost my folder. So I got this call and I said, well I'm going to England for two years, but fear not. I'm planning to go do a Master's and I'll come back and come to graduate school when I'm done.

So I went to England and there was a wonderful collection of people who I encountered. I interacted with Mervyn King, who was very interested in taxes and public policy. Even though Mervyn was based in Birmingham, not Oxford, I was able to commute on the train to London and meet with him there. John Fleming, who was a friend of Marty Feldstein's and was then an economic adviser to the Bank of England, was based at Nuffield College at Oxford and we got to know each other quite well. And he was a key force in helping to point me toward dissertation topics. Terrence Gorman, who actually been Marty Feldstein's thesis adviser was now-- 25 years later-- still around and I was actually able to do some classes and some lectures with him. Jim Mirrlees, who was an eminent public finance economist was in Oxford at that stage. David Hendry was an econometrician who came to Oxford.

So it was all a very exciting time, and I did the Master's coursework. I turned in a Master's thesis and at that point there were some three year graduate fellowships in England that were running. And there was some pressure, I've always thought, to demonstrate that one could do a graduate degree, get a PhD in three years at that stage. So when I turned in the Master's thesis the examiner said, you know, if you wanted to stay for a third year we could probably give you a PhD. Well that was a complete new development because I really hadn't been planning on that. I had thought I would come back to the US I was a little reluctant to stay for a third year because my girlfriend, who has now been my wife for 27 years, Nancy Rose, who's also a member of the economics faculty here at MIT, was at that point a first year graduate student at MIT.

We had met at freshman registration in college. We'd gone out at various stages during college and having been two years on the other side of the Atlantic-- even though I'd come back and been in the US in the summers, it was clear that things were wearing a little thin by that stage. So I was very eager to come back to the US and in particular to come back to Cambridge and MIT.

Again, I was living under the right star. It turned out that an MIT assistant professor, who had been teaching an undergraduates statistics course at MIT was wooed away by the justice department at that stage, Marilyn Simon was her name, and she unexpectedly left the department. So MIT was looking for somebody to come and serve as an instructor in the fall of 1982 as a statistics teacher. And Jim Mirrlees, who I'd been working with at Oxford, was a good friend of Peter Diamond here at MIT; they'd written a lot of papers together and they were close collaborators. So somehow or another, I got a call from Cary Brown, who was the long-time chairman of the MIT economics department, offering me a princely sum of \$10 thousand if I'd be willing to come and teach this undergraduate statistics course in the fall of 1982. Of course, this was like Brer Rabbit being asked to be thrown into the briar patch. I couldn't think of anything better to do. And Oxford was happy to let me take a term off at that point while still moving ahead with the progress toward my dissertation. So I came to MIT in July of 1982.

I set up shop as an instructor and, at the same time it just so happened that MIT's then empirical data-oriented tax person, Larry Summers, had decided to take a job at Harvard. So there was an opening on the faculty, not just for a statistics instructor, but for somebody who might be a more permanent fixture. It was a little stressful because I knew that that job was there, the faculty knew that I was on the premises and that I might well fit that bill. Unlike when today's graduate students go to interview for a job at an institution, they fly in in the morning, they run through a day long gauntlet of interviews, they give a seminar at the end of the day, they have a nice dinner with some of the faculty, they head back to the airport the next morning and they're gone, however, my experience was sort of stretched out over three months and involved various people coming along and saying, hey how about we go have coffee. Let's talk about what you're working on, whatever.

Well fortunately, by around the end of November the word came that the faculty had voted to extend an assistant professor offer. And at that point they said, you know, we understand if you'd like to explore other options, but with my girlfriend, Nancy, on the premises and MIT being the incredible department it was, the need to look elsewhere just didn't even strike me as worth doing. So I more or less accepted on the spot. That left me with the task of finishing my graduate work in Oxford. And speaking to the careful reading of institutional detail, I learned that the requirements of graduate study at Oxford were that you needed to be-- each term you needed to be within hearing distance of Tom Tower's bell at Christ Church for 42 nights during the term. So I returned for 42 nights during the winter term and for another 42 nights during the spring term, and defended my dissertation at the end of that time, returned to MIT as an assistant professor and at that point realized that to be honest, the great thing about studying at Oxford had been that there was more emphasis on starting your research very early on. Some people could get a doctorate in England at that time without taking any courses. If you produced a body of research that would do it.

So the faculty treated even the first year graduate students almost as co-equals. You know, tell us about your research, I'll tell you about mine. That was a fantastic thing to be dropped into as a 21-year-old or 22-year-old. And the good side was I got started on research right away. The downside was that I didn't take as many courses as I would have taken if I was here in the US going through a standard graduate program. So when I came back as an instructor and then as an assistant professor one of the things I did was I enrolled in or at least audited a number of the graduate courses. So it is a sort of unusual experience my first year as an assistant professor. I would be teaching the graduate public finance course and then sitting next to some of my students when we were taking the econometrics course and things like that. But it was a really terrific blend of different educational experiences that all worked out very well.

INTERVIEWER: And you had also taken a number of graduate courses when you were an undergraduate.

POTERBA: I had. I'd taken a course that Marty Feldstein and Dick Musgrave taught at Harvard on graduate public finance, which was a great experience. And I'd taken some graduate econometrics courses there. And I interacted enough with some of the graduate students that I knew something about what was going on. The other thing that was very fortunate was that my primary supervisor at Oxford, David Beg, who is now a dean of the business school at Imperial College-- basically I had this experience of David had just come back from MIT. So he had the problem sets and other things that he had studied with. So that gave me this chance to basically dive in and kind of do a lot of the problem set type work that was being used at MIT at that point. So I was kind of like a long- distance learner in the MIT graduate program.

INTERVIEWER: What was your dissertation about and how did you choose that topic?

POTERBA: It was about taxes. And in particular it was about business taxes and the tax treatment of dividends. This was something where it turned out to be fortunate to have gone to the UK because there's a longstanding question in tax policy of whether or not taxing dividends-- would investors receive them? It's really just like taxing the company on its profits. Or whether the investors somehow treat the taxes on dividends differently than company level taxes would be treated. The US, up to that point hadn't had a lot of big reforms of our dividend tax regime that would give you lots of opportunities to study how firms and investors responded. But the UK had gone through two full cycles of shifting to a situation where dividends were taxed lightly and then returning to taxing them heavily. Once in 1965 and again in 1973, when there were shifts from the liberals to the conservatives in power. The result was that there was a rich opportunity to study the effective dividend policy, effective taxes on dividend policy in the UK.

And that was a subject, it turned out, that Mervyn King had been interested in and had written a book about a few years before my arrival, so I basically was able to use some of the econometric tools that I had brought with me, enhanced by some things I was learning at Oxford, to study how dividend taxation affected the amount of dividends that firms paid out, how it affected the investment decisions that they made, and to really try to shed some light on some of these questions that surrounded the role of dividend taxes in the corporate sphere. So that turned out to be a good reason to have studied in the UK and that research took advantage of the institutional niceties that were present in the UK. That work came in handy when a decade and a half later the US went through some changes in our dividend policies-- in our dividend tax policies. And the evidence of the UK was often pointed to as one thing that could help us to learn about what would happen as we thought about cutting dividend taxes in 2003.

INTERVIEWER: What was it like to be in a department, the one at MIT that was so small after being in one at Harvard, even as a student that was so much larger?

POTERBA: You know, I think that my experience at Harvard didn't quite-- sort of the largeness of the Harvard department, the very big undergraduate major had not been something that really colored my experience there very much because I met a lot of the graduate students and I kind of quickly made friends with people who, while they might still be graduate students, were well on their way to being the leading lights of the next generation on economics, and that was really exciting. And I had a lot of access to Marty Feldstein who supervised my undergraduate thesis and I worked for through my junior and senior years. That said, coming to MIT in the early 1980s was just an extraordinary experience because it was just at the moment when the generation of scholars who had built the post war MIT economics department was reaching traditional retirement age. And they didn't retire, they didn't retire from economics, but they did retire officially from the faculty.

So during the first few years that I was an assistant professor, Cary Brown, Evsey Domar, and Paul Samuelson all went through the official retirement process. And in each of those cases we had a big departmental party and we celebrated their contributions, and we had reminiscences from many of their contemporaries about what it had been like in the early post-war era. The MIT economics department-- many people think it was just created after World War II by Paul Samuelson and that's a complete misapprehension. The MIT economics department is much older, and MIT was actually the first college to institute a required economics course in the United States. That was done in the 1880s when President Walker was here at MIT.

Francis Amasa Walker was one of the leading lights of economics in the second half of the 19th century in the United States. He was a very distinguished political economist who was teaching at the Sheffield School of Science at Yale when he was recruited by Francis Barton Rogers, the founder of MIT, to come and serve as MIT's third president. He directed the 1870 and the 1880 censuses. He was a decorated brigadier general, a veteran of the Civil War. He was this incredible fellow. And when he came to MIT, amongst other things he said, I'm going to be teaching my political economy course. He introduced that as a required course, and MIT from that time had a political economy department, which flew under various administrative flags over the course of its next 60 or 70 years. But that taught a largely service- based curriculum for the engineers and the scientists to learn about industrial economics and political economy. I look back at some of the exams from the Walker era and from the later eras and they actually-- there are questions on them that even today you could just transplant and offer to current undergraduates or even graduate students. What is the appropriate level of the tariff? What is the consequence of Chinese monetary policy for understanding world trade patterns? And those are questions that are there highlight the way in which this field has focused on many topics that just keep cycling around.

There were some other highlights in that period, pre World War II. Davis R. Dewey for example, after whom our library here at MIT is named, was a founding editor of the American Economic Review and he edited the AER for nearly 25 years. And Walker was the founding president of the American Economic Association. So MIT has this very long connection with economics. But it wasn't until 1940 when Paul Samuelson joined the faculty here at MIT. He'd been recruited in part by a fellow named Rupert Maclaurin. Rupert Maclaurin was the son of MIT's sixth president-- President Maclaurin.

And Maclaurin had a vision for moving MIT's economics activities from the undergraduate activity to a more research- oriented and more graduate- focused mode. The year Paul Samuelson arrived MIT introduced a Master's program. The next year they ramped up to have a PhD program. Their first graduate student was Laurie Klein. Laurie Klein went on to a very distinguished career at the University of Pennsylvania, amongst other places. Won the Nobel Prize. They could have stopped after one and said the average quality is great, but they didn't.

But it was really right after World War II and during the war various things were transformed around MIT as elsewhere. Paul Samuelson worked at the MIT Radiation Lab on several mechanism designed for radar during that period. And taught some courses in the math department while the mathematicians were off doing other things.

So it wasn't until 1945, 1946 when the returning service people were thinking about graduate school in many cases. that MIT began to really ramp up and to add faculty in economics. And that's when people like Bob Bishop and Cary Brown, Morris Adelman, then a few years later, Bob Solow, in 1949 joined the faculty. Charlie Kindleberger, Evsey Domar -- this group basically, from a very small start that handful of faculty members created a new graduate program and partly because they didn't have to work from the old graduate program that they were reforming, they were able to create something that was very different than what had gone before.

Although MIT was not alone in having faculty members who thought about mathematical approaches to economics, MIT was able to create a graduate curriculum that broke out of the prior mold and was able to become much more rigorous and much more formal from the start. And it wasn't long before the word got out that something special was happening in Kendall Square and there was a place that was teaching economics that looked more contemporary. And if you were a really promising graduate student this was where you wanted to come to learn about that stuff. And over the course of the 1950s the MIT economics department just expanded; it became an incredible magnet for the NSF funded graduate students in economics. And by the early 60s it really had established itself as certainly, if not the premier place to do graduate study, one of the one or two or three top departments in which to study. The presence of that post-war faculty group was critical to making that all happen. Of course, Bob Solow and Paul Samuelson were especially significant in this. And then Franco Modigliani, the third MIT faculty Nobel laureate in economics joined the mix in 1962 and continued this push.

What was neat for me was that coming in without much MIT background in the early 1980s I got to listen to this-- free education as each of them would stand up at the others' retirement parties and reminisce on the fun experiences that they'd had in the early 50s and the 60s as they sort of trained these vintage economics graduate classes. We have one group of graduate students, the 1966 graduating class, with two Nobel laureates in it: Joe Stiglitz and George Akerlof. They had an incredible time running and building this graduate program and they were deeply, deeply proud of what had happened.

What was exciting for me was to learn about that history, but also to watch what was basically the hand-off of that legacy to the next generation, which was then a group that consisted of many people who had been trained here at MIT and then returned to be faculty members. So Peter Diamond, Peter Temin, Stan Fisher, joined with people like Rudy Dornbusch, Frank Fisher, Jerry Hausman who had come from Oxford, from Nuffield College as well. That was a core part of the group that was moving the PhD program forward.

And for me to be able to watch that process playing out-- someone in 1982, if you'd asked to take a bet, would MIT economics be a premier economics department 25 years later? I think you could very reasonably have thought that that was a bit of a long shot. You might have said it was an incredibly successful post war experience. They had a collection of faculty that liked to be here, but going forward they're not going to have that special sauce anymore. And they'll just become one of the pack. And what was really surprising is that it didn't happen. That MIT remained at the forefront for the next 25 years. And in fact, it was the way MIT was training graduate students even then in the 80s that was increasingly copied by other institutions. And that the rivalry to MIT came from places that were copycats. And in some cases they did what we did better, and we had to learn from them over time. But the generation that followed the post war new guard did a great job of moving the department forward. And you know, now as we talk in 2010, we're seeing the beginnings of yet another transition.

Just this last weekend Peter Diamond was celebrated for his contributions as he retired from our department. And we've now seen a shift to yet another generation. Again, that includes a mix of MIT trained and non MIT folks, but it's very exciting to see the vibrancy at an institution like this, which just propels it forward. The topics change, the foci of interest change, but there's something in the water that has enabled MIT economics to remain at the peak of the activity.

INTERVIEWER: Two of the factors that seem to foster some of that might have been both the smallness of the group, but also the collegiality. I remember in the 60s that there used to be a lunch table of economists in the faculty club and they sat and talked to each other. You know, the Samuelson, Solow, and all the young-- did that still happen in the 80s, and does it still happen now?

POTERBA: When I arrived in the fall of 1982 the lunch table was still there. And it could accommodate about 12 or 13, maybe 14 if you really squeezed. And there was a mad dash at noon to the faculty club to get one of those spots at the table because if you didn't make it to the big round table then you were going to be at the sort of alternative table, which is a little square one with just a few people next door. And it was incredibly exciting because the level of discourse was high. It was daunting and frightening to be honest to go and be involved in that, but you could just see how they all had fun being together, and that was very special. And in fact, the department of the 60s and 70s was unbelievably intertwined. Not only did they have lunch together most days, but there was a big contingent that lived in Concord, Massachusetts. They carpoled together. There was a carpool with four or five faculty members that drove in every day. So faculty meetings weren't terribly exciting because they sorted everything out on the way in the car.

As people got busier, as research became somewhat more specialized, the every day of the week, one big lunch table basically broke down. As people got healthier and they didn't eat big lunches in the middle of the day in their faculty clubs anymore. Today, 25 years later we still have a once a week lunch with our faculty where we have incredibly high participation rates. People get together, many of the faculty actually spend some other lunches with their students listening to them make presentations. We've developed a model of thesis advising for the graduate students where the students present early stage work, and we hear-- many faculty will come and offer comments at those lunches. So there's still a lot of collegiality here. To be honest, as in many settings, I believe that there has been a decline in away from the office interactions. You know, the frequent dinner parties that were planned on the back of the non-working spouses that are just too difficult to pull off and we don't quite see as much of that anymore. But there is still a lot of back and forth between the faculty. And Paul Samuelson used to say that he liked to claim that we may not be the best department, but we are the happiest. And I think we were both the best and the happiest for quite a long time. But the happiness and the enthusiasm of the faculty certainly still remains.

INTERVIEWER: Are there other things that make the economics department at MIT special or unusual?

POTERBA: I think there are. One of them is historical in part. It's a combination of a focus on analytical rigor-- math-- and policy in the sense that Paul Samuelson used to say that he thought it was very natural that formal, analytical economics would arise at a place like MIT in the post war years because so much of MIT was quantitative and the intellectual milieu around MIT embraced and celebrated the capacity to formalize and to measure things. So that bringing mathematical tools to economics is he and some of his contemporaries did, was a very natural thing to happen here. But what was always striking about the MIT economics of that era was that it didn't just do mathematical tools and analytical excitement for its own sake because that generation of economists-- and their students who have led the department subsequently-- were always very interested in public policy questions. They were as comfortable talking about what the right size of the tax cut in the early 1960s in the Kennedy administration as they were debating fine points of turnpike theorems in mathematics and how they might apply to some economic model. That really put a lasting impression on what MIT economics was.

That it was basically the use of rigorous and well grounded analytical methods, but in the pursuit of the higher calling of making the world a better place. You can see the same thing happening again, you know there's been a remarkable revolution in development economics, the study of third world countries, in the last decade. And MIT has played a very important role in that. We have a group that centered on an organization called the Jameel Poverty Action Laboratory that is really pushing the frontiers of using econometric tools to evaluate how programs that are designed to help education or sanitation or health in the third world-- how those things really work. Well, I think of that as very much the same spirit as what was driving the post war gang. In a sense that it's using the statistical and the analytical and the formal tools that have been developed in economic science, but taking them to the real world and saying, how can we actually use those tools to make things better? In this case, on the ground, in developing countries, and with interventions like providing the right kind of incentives for teachers to come to the schools or figuring out whether one health intervention or another has a higher return. And then encouraging the aid agencies to push in the direction of the higher return option. Those are all the kinds of things that are happening and I think they really wind back to the very same kind of focus.

INTERVIEWER: What about the undergraduate economics focus, how much is there? It's a small number of majors and a very big service department or?

POTERBA: The actual majors at MIT in economics are outnumbered by the graduate students. So that creates a very unusual sort of inverted character to the department. I think that's always been special because a place where the graduate program is as important as the undergraduate program, is not found any place else. But for an undergraduate taking economics at MIT it's an extraordinary experience. Not doing anything that we do. In some sense it's all through what they do or what they bring. Because MIT's undergraduates all know calculus, they all can do math. And economics is a field where you can labor and you can huff and you can puff until you blow the house down to try to explain with graphs and with tables and with charts how a lot of the basic principles of microeconomics work. But if you can just stand up on the board and tell somebody that I'm going to write down this equation and I'm going to take a derivative here and I'm going to put an equal sign in the mix, it just it's all so much easier. And the result has been that, at least historically, we've been able to teach the undergraduate program at MIT at a level that can sweep away a lot of really burdensome work at the front end, and just show people right away where the heart of the issue is. They get it. They enjoy it because they see this is an application of the tools that they've learned in other courses around MIT. And then we're able to move along quickly to essentially sort of teach at a higher level than many of the other undergraduate programs in other colleges.

Now what's happened in many other institutions is that there's been a sort of tracking in some sense of undergraduate economics. For students who are interested in going onto graduate school in economics, the departments have begun to offer a math-based microeconomics course-- a math-based macro course, and then some advanced topics courses, which will build on that. Or they encourage the students to start taking graduate courses as undergraduates. At MIT our intermediate level courses have always been at a more quantitative level. So they provided a very good background for the students as they thought about what their-- if they thought about going onto graduate school. So I think that the MIT undergraduate economics major is just a gem of a program. And it's had a very successful history of training students who've gone onto a variety of different roles as professional economists or as policymakers in areas that use economics.

INTERVIEWER: Do many students end up doing the undergraduates doing research-- the UROP program? Is that much of a factor in your department?

POTERBA: Yes, they do. And I think that UROP is actually something else that makes our department very special because MIT puts a lot of emphasis on UROP. There's a-- pressure would be the wrong word, but there's an enthusiasm for getting students, undergraduate students involved in research and that enthusiasm carries over through our department in such a way that I think the undergraduate majors and even those who are just doing a few courses in economics, they discover in the community that it's a good idea to work with faculty on research projects. The other thing turns out, economics lends itself to projects that undergraduates can get involved in.

I describe my own experience in copying data on cement plants from one column onto punch cards. We don't do that anymore. But we can download the data on many interesting topics from government surveys and from various websites, and there's a lot of opportunity for statistical analysis with those data. And once our undergraduates have taken the undergraduate econometrics courses that we offer they're well positioned to start to do some of that work. I found a number of undergraduate UROP workers to be terrific assistants in research. Some of my colleagues have a flotilla of undergraduates who are employed and moving on in various projects. And I think it's by and large been a very good experience for the undergraduates as well as a very rewarding one for the faculty.

INTERVIEWER: Do many of them get hooked on economics the way you did?

POTERBA: I think so. I know that one of my earliest UROPs, a fellow named, Bill Gentry, is now a professor at Williams College here in Massachusetts. He worked with me when he was a sophomore or junior. Went onto get an economics PhD at Princeton and is today one of the editors of the national tax journal. So I think I probably had a little bit of a long-term influence on the things that he was interested in.

INTERVIEWER: How would the life of a professor in the economics department compare to other universities? Do you have to teach any more or less? Do you get paid more or less? Do you find that you're susceptible to raiding, for whatever reasons by other universities?

POTERBA: The trials and tribulations of the academic labor market. MIT has and does expect the faculty to be more involved in the teaching program than at least some of our leading competitors. We take our teaching seriously and I think that it's not a written set of rules. Although, I think our teaching loads are somewhat higher than many of our leading competitors. But there is a sense that-- sort of an unwritten set of rules that if you were shirking your teaching responsibilities that would not be good. And I think that frankly the faculty members who have decided-- some of my former colleagues and some who've never come because they had the opportunity, but chose not to-- I think if you decide that you don't want to spend as much time engaged in the teaching process as MIT may demand, you have many opportunities to move elsewhere. And people sometimes do or they don't come to MIT in the first place.

And what's interesting is that MIT has not been very successful historically in recruiting senior professors from other universities to move to MIT. There are just a handful. Bengt Holstrom came from Yale to MIT in the early 1990s. Rob Townsend moved as a full tenured professor a couple of years ago from University of Chicago. And we've had some other successes at the tenured level, but typically at just at the moment of tenure or a couple of years later. We typically have a lot of trouble getting people who are well established, senior scholars to move. Some of that I think may be that when they simply look and compare what the burdens would be at MIT and what they are at their home Institution they decide it looks better to stay home. We've never had a policy of offering superlative salaries to try to lure people from other schools and I'm sure that contributes to what I've just described in terms of our success rate. But on the other hand, we do pretty well at retaining people who've been here.

MIT is well known as a great place to be an assistant professor. We're much more successful at recruiting the very top prospects in the assistant professor market than we are in the senior faculty market. And many of those folks get here, they discover that it's not burdensome to teach the graduate students, they're terrific. And they often become your collaborators, your lifelong friends, your co-authors through many decades even after they leave MIT, and that's a lot of fun. And we consequently do quite well at holding onto people who've been here as assistant professors who have learned the MIT way and decide that even in the face of offers outside, which may offer lower teaching burdens or higher salaries, they're willing to stay. It's a slightly fragile equilibrium because it depends on the great graduate students being here because they want to work with the faculty, the faculty who want to stay here to work with the terrific students who we recruit, and for as long as I've been here we've been biting our nails about whether this equilibrium can continue to go forward. But at least so far, it's been working pretty well.

INTERVIEWER: The economics department also seems to promote and tenure very quickly. It seems to have done this for 30 or 40 years that I'm familiar with it and apparently still does. More so, I think than other departments within MIT and then comparable departments outside of MIT.

POTERBA: I don't think we're unusual as an economics department, but I suspect we are unusual by comparison to many other departments across other fields. And this just seems to be the workings of the labor market for academic economists. That perhaps because we're a relatively small field, perhaps because the set of skills that people reveal in the first few years after graduate school in writing clever, important papers, perhaps because-- maybe this is just hubris-- that we think we can identify someone who's going to be a real star going forward. There has been some, you can call it unraveling or you could call it jumping the gun or whatever. But there's been some move toward very early tenured offers to people who may be only four or five years out of graduate school. I think that's an unusual thing by comparison to many other disciplines, but in the last decade or decade and a half it's happened surprisingly frequently in economics. It's happened surprisingly often to our faculty because they've been in great demand from other institutions. The result has been that when it seemed appropriate to us we've matched the market and we've taken those early steps.

So I know that when I was department head-- communicating the personnel cases that our department had to other department heads in the School of Humanities and Social Sciences, there were often some raised eyebrows on the date of PhD and the level of promotion that I was coming in to argue for. But in every case the school and the other departments recognized that this was just a constraint that we faced in terms of our labor market.

INTERVIEWER: Where does the economics department fit within MIT and even within its school? And has that changed much in the time you've been here?

POTERBA: Many outsiders think that economics just doesn't fit naturally at MIT at all. They're kind of surprised. They scratch their heads to find out that we have an economics department at all. Because MIT certainly has as its marquee message that it's an Institution that promotes science and engineering education. The good news is that once you're here you discover that economics fits very well within the broader MIT fabric in a couple of different ways.

First, I think there is a recognition of economics at the highest levels of MIT, as well as throughout some of the other departments in places where people are interested in practical problem-solving and in going from their science or their engineering to an application. Whether it's commercialization of a technology or it's offering guidance on regulatory or legislative issues. What should you do to deal with climate policy or pollution policy? How should you think about interventions in the third world to build infrastructure? What should be the appropriate intervention in financial markets? Our colleagues in the Sloan school would think about those kind of questions. That all links back in various ways to economics-- it may not be the focus, but there's an important element of it. So what I have found exciting to observe and in some cases to participate in, is the cross department pollination of some of these questions. In groups like the Center for Energy and Environmental Policy or the linkages that build between say, civil engineers and economists as they think about problems together. Those are places where the fact that the economists are able to access the knowledge and the detailed understanding of the technology can be tremendously helpful.

I saw a presentation just earlier today about a student who's studying how one can abate nitrogen oxides emitted from power plants. Well, if you're a graduate student in economics studying that question at MIT, you walk three buildings over and you find somebody who actually can design the technology for doing that, and that can be very helpful.

The other place that we fit very naturally I think is as part of the focus on management education in the Sloan school. The Sloan school was in the forefront, along with economics department, of some of the very important developments in financial economics. Paul Samuelson, Bob Merton when he was here on the faculty, Franco Modigliani, other Sloan faculty like Stew Myers, Fischer Black and Myron Scholes were both here for a while when they were working on their option pricing formula. The economics department and the finance department of the Sloan School more generally have collaborated very successfully over time. When one thinks about what's the role of economics at MIT, it's important to recognize that some of that role is enhanced by the fact that MIT has a world class business school and that we fit very naturally in some of the research interests of the economists and allied fields there.

INTERVIEWER: And how comfortable is the fit within the school that also has the arts and humanities in it? It's, I guess, political science and economics are the two social sciences.

POTERBA: The biggest challenge or the biggest source of heterogeneity is kind of some of these labor market things. The job market for academic economists, even in a down turn in the economy, is pretty strong. Whereas some of the other more humanistic fields don't have the blessing and the luxury of that kind of a situation. So I think there's a little bit of a culture shock in communicating across some of those departments, and communicating how different economics as an academic labor market can be from what they're accustomed to. But I certainly found in my time as department head sitting on school council that the other department heads were fascinated to learn about what economists did. And I was fascinated to hear about some of the things that went on in their subject.

INTERVIEWER: Theater arts and--

POTERBA: Yeah, I've used for example-- I remember a promotion case that came through about someone in history of science who was looking at how different kinds of teaching strategies in physics diffused across different departments. And I have repeatedly sent students to look up that research work because they're interested in technology diffusion or how management practices diffuse. Seems to me that there's a lot of complementary that one could often find in surprising places.

INTERVIEWER: A big issue in recent years with the plunge in the markets that the financial markets has been a question of university endowments. How well funded in terms of endowment is the economics department and how do you think about it?

POTERBA: Well now, finally in your probing you've found something where there's a genuine weakness. Which is that our economics department is less well funded than most of our major competitors. That is a challenge for us. It's become more of a challenge, frankly, in the last few years. And we see this at two levels. One is the ability to compete for faculty and we've never been super successful, but we are always nervous about that margin. The bigger problem lately has been competing for top graduate students. And we still we do extremely well in attracting top students. We are seeing more situations in the last couple of years where students are saying my fellowship offer at another school is more generous. My teaching burdens as a graduate student will be less onerous and I'll have more time to do my research, so I think I'm going to go elsewhere. It's an MIT wide challenge to find enough funding for the pool of graduate students.

Economics is different from the much of MIT in this regard than in many of the other aspects of how the disciplines work because our faculty don't raise money that will then be used to support graduate students when they come to our department. Our students are either supported by fellowships that they win in some competitive market outside, National Science Foundation graduate student fellowships, fellowships from their home country, their central bank, things like that, or they're funded by MIT fellowship offers from a limited endowment that we have that provides money for our graduate students. We are only able to fund a little less than half of our incoming graduate class. The other universities that have top tier economics departments tend to be the large, very prestigious, universities like Harvard, Princeton, Yale, Stanford, Chicago. And they also tend to have large endowments in many cases. So we often find ourselves competing against other departments, which can fund not just half but all of their incoming students. And at the moment to be perfectly honest, this is a challenge we're wrestling with, and we're trying to identify some strategies that will enable us to deepen our base of funding support there.

INTERVIEWER: How much would it cost to fund the other half--

POTERBA: To do the other half, I mean, roughly speaking it costs about \$60 thousand a year to fund a student. And we would have to fund them for a couple of years. To simply fund the first two years of graduate school for another 10 students a year-- let's say 12 students a year would be around \$700 thousand in each of the classes. It's about one and a half million dollars there. That would mean at current payout rates from an endowment, which are probably around 4 percent or something like that, you'd multiply by about 25. So you need something of your \$35 million. The other place that we're seeing some slippage is in how much the students are expected to teach. The current MIT model is you come and we fund you for the first two years, and then you are a teaching assistant for the next three. That's becoming a little bit more anachronistic amazingly enough. And students at many other departments are just having research time after their first two years. So to fund that would be another very substantial lump sum. At least at the moment the economics department does not have an obvious source of financial resources at that level. But that's something we've got to look at.

INTERVIEWER: Are economics departments elsewhere having trouble then in terms of teaching their undergraduates? In other words, if Harvard has 800 undergraduates a year taking first year econ and then they turn to the law school and Boston University to come in and teach their undergraduates, don't they get some push back on that?

POTERBA: On this very issue I've been polling some of my colleagues at other universities to learn a bit about what's going on. My impression is that in some places the big principles of economics courses are staffed not by economics PhD students, but by business school students or law students who've had undergraduate economics majors. And that may be a workable, alternative model. It's never been our model here at MIT, and in some ways I hope we don't have to explore that. But it may be what we have to look at.

INTERVIEWER: How much fundraising have you had to do for the department? When you were department head did that begin to eat up half or three quarters of your time?

POTERBA: Well, our department historically has not done a lot of dedicated fundraising. That's not to say that we haven't received some very generous gifts from our alumni, but we haven't really had a campaign to do that. When I became department head in 2006 we knew for reasons like the need for fellowship support and because we wanted to try to endow some professorial positions that it was really time for us to try to raise some funds on our own. And we had some members of our visiting committee-- at MIT visiting committees come every other year. They're composed of distinguished graduates at the department, and other friends of the department who can provide input to the president on how things are going in the department. But they're also a very good resource for the department in terms of advice. And several members of our visiting committee had said, you know, it's time for you folks in the department to step up and actually do some fundraising yourself.

So when I became department head we agreed that we would try to do a \$15 million campaign for the department. I did some traveling, and a fair amount of talking to people about that. It didn't consume half my time by any means, but we went to a wonderful dinner that Pedro Aspe, one of our graduates in Mexico City hosted for MIT economists who were in Mexico. We had a great event in San Francisco that George Shultz, who's an MIT economics PhD graduate, hosted for Silicon Valley and San Francisco folks. We started to communicate to the group that funding the economics department should be a thing they considered and that was a priority for us.

The result was very successful. We reached the \$15 million target even though the financial markets were starting to slide before we got to the finish line. And we then even went beyond that and managed to raise a professorship in honor of Bob Solow around his 85th birthday, which was great. I will confess that I actually found the process of talking to the alumni about this very interesting and very enjoyable. Because one of the great things about our department is that we have a set of alumni who have gone off to do a remarkable range of really interesting and exciting things. And prior to being department head, prior to doing some of this outreach I was in pretty good touch with many of our graduates who had stayed in academia. The PhD graduates who had gone on to teach at various colleges and universities or who are researchers at the IMF or the Federal Reserve Board-- they are all people who were part of the normal beat that economists who were here in the department would see. We would see them at annual conventions or at research meetings.

Who I hadn't seen very much of were the undergraduates I taught or those who my predecessors had taught who had gone off to careers on Wall Street or in other fields. And I hadn't seen very much of our graduates who had done a PhD who had gone off to non- research oriented careers. And it's been really fun to get to see what some of them are doing because in many cases they are doing absolutely fascinating things that use their economic tools, their economic analysis. Give you one example that jumps to mind is Gary Loveman, who is the CEO of Harrah's Casinos. Gary got a PhD in economics, taught at the Harvard Business School for a while. His career then took him to working as an executive at Harrah's and he now is the chief executive.

Well, we've had him come here, talk on campus several times to both the undergraduate and the graduate students about how he has used the tools of economic analysis to think about not just the industry of casinos and other recreational pursuits, but to think about how to build loyalty programs for his consumers who come to the various establishments. And we had fascinating discussions about how economic methodology and tools can be applied there. That's something you miss out on if you just go to the annual meetings of the American Economic Association and talk to people at the MIT cocktail party there. So it's been fun and I think we have a great base of alumni who will over the long haul be incredibly supportive of this department.

INTERVIEWER: You seemed to have moved into administrative roles pretty quickly, not just in junior high school with the store, but you were tapped as associate director of the department and associate director of the Public Economics Research Program at the National Bureau of Economic Research. Then as department head here, and then most recently as president and CEO of the National Bureau of Economic Research. So do you have an administrative or leadership gene? Do you have principles of management that you follow?

POTERBA: To be perfectly honest, this has all happened a little bit by surprise and by accident. But if I look back, the history certainly reads the way you've just described it. One of the things I think I am reasonably good at is trying to pay attention to some of the details that one needs to keep on top of for these kind of administrative roles. And to be honest, the different things I've done are somewhat distinct in that the associate department head role, which I played here at MIT for a number of years-- it's really an internal role where you're doing things like preparing promotion cases, you're trying to find a way to describe the work of your colleagues in a way that will be intelligible to the members of a school council that don't have a lot of economics background. Or helping to plan retirement events where we want to bring alumni back the campus to celebrate someone. So a lot of that actually involves doing economics, but just doing it in a slightly different way than otherwise. Department head is different.

Department head there's a lot of just making sure the trains are running on time and representing the department at the Institute level and at school level functions in ways that make you a conduit between the higher levels at MIT and the department and your colleagues. And I only did that job for a little over two years. I think that it's hard to steer very much in that short period of time.

There are issues like, how should the undergraduate program be structured? How should we think about these funding issues for graduate students that we've talked about? What are the departments' long-term priorities and can you have an influence on what your colleagues think about those questions by sort of your leverages as department head? And yet again, the NBER is yet another role because there to be sure there's a fair amount of administration in just running a large research organization with now close to 1,100 affiliates and-- in part, the NBER is a very flat structure in the sense that there are 19 research programs that correspond broadly to fields within economics. Like monetary economics and labor studies and public economics, but in many cases the researchers in those programs will feel that they've got a question about, can they embark upon a particular project? Can they come visit the NBER's offices here in Cambridge? And those questions come right to me. While that is administration it does keep me in contact with a large swath of the economics profession. And one of the parts I enjoy the most, to be honest, is we publish about a thousand working papers a year. And the NBER-- well, backtrack for a second. The NBER is a nonprofit, nonpartisan research organization. It was created as a consortium of universities.

So MIT, for example, is one of 12 universities that are represented on the NBER board of directors. Paul Samuelson was the first MIT representative. Bob Solow was a director of the NBER for a while. Frank Fisher is our current director. But the universities plus organizations that are interested in economics, the American Economic Association, the American Agricultural Economics Association, the Canadian Economics Association, all are represented on the NBER board. And the NBER carries out research. The original mission was to not just do research that would be relevant for economic policy, but to provide a sort of stamp of authenticity that would say this is work that was not carried out by somebody with an axe to grind in some place. But rather, a disinterested group of researchers have done this analysis and here's what they found. We have a prohibition about making policy recommendations in NBER publications. And it turns out what is and isn't a policy recommendation is a little hard to judge sometimes. So I actually read the abstracts and some part of the papers, nearly all of these one 1,000 working papers that come along.

INTERVIEWER: That's three a day.

POTERBA: At three a day, which sounds-- you can either view that as yikes! What a burden. On the other hand it means that when some new and exciting paper comes along, I have some idea of what the findings are and it is certainly-- the NBER job has broadened my knowledge base substantially beyond the fields of tax policy and financial economics that I had historically worked in. One of the other tasks is to figure out which papers will be identified for a write up in our sort of more mass market publications?

I find really interesting to try to think through, you know, which of these papers will people find interesting? Which one should we try to commission someone to profile? That's a fun part of the job. So it is administration, it's clearly different from the old days when I got to sit in my own office, thinking about my own research papers and sort of working away on these with my research assistants. But it does have a connection-- at least I tell myself it's still got a pretty substantial connection to economic research.

INTERVIEWER: So you've been in this post two years now?

POTERBA: Just about two years.

INTERVIEWER: Have you seen other fields of economics or paths of inquiry that are tempting to you where you say hmm..., if I had some time I'd really like to explore that even though it's not what I've been in the past so much?

POTERBA: Yes, there are. For example, I'll give you two illustrations of that. One is quite technically in data demanding, the others in fact, just is historically interesting. One of the new working groups that we started on my watch at the NBER is in the area of market design. Susan Athey, a professor at Harvard and Parag Pathak, one of my colleagues here at MIT have headed up this working group. It's concerned with things like auctions that are done by eBay or the way Google chooses to price the ads on its site and on its web pages. There's just an extraordinarily amount of interesting and exciting economics going on that's connected up with the information revolution, and the transformation in the knowledge that third party providers can have about you and your interests. You know, I think it's just remarkable that I can go on to a website like Amazon.com and I can look for one book on something and suddenly it will tell me that here are four more that I might like to be interested in. And in fact, I find myself a surprising fraction of the time deciding that yes, I am interested in one of those other things. So I think there's an incredible amount of exciting work that draws on backgrounds in industrial organization and in economic theory, as well as some data analytic tools that I-- you know, some of them are frankly things I don't quite have. But I've been very interested in that area.

The other thing I've been really intrigued to discover is the very interesting work that economic historians do on questions that often have incredibly close bearing on issues that we confront today. I'll give you two illustrations from economic history. I recently heard my colleague Steve Ross talk about the financial crisis at a gathering of MIT alumni. He started by saying that while many people have looked for parallels to the recent financial crisis in the Great Depression that some argue that the closer parallel is the 1873 panic. In 1873, in Central Europe there was a new competitor which was undercutting the prices of both farm products and manufactured goods, shipping them across an ocean in new, fast steamships. And of course, it was United States which-- the American heartland had been opened by the railroad and the farms were more productive than those in Eastern Europe and Central Europe. The manufacturing efficiency in the US was unparalleled, and suddenly the banks in capitals like Vienna and Warsaw and Prague discovered that loans that they had extended to farms and to manufacturing enterprises on the assumption they would have profits galore, for years to go-- they're vanishing because they couldn't compete with the new American producers. This caused a banking crisis.

The banks could never tell who was on the hook to whom for what and they stopped lending to each other and it sounded remarkably like the 2008 experience in the US but it was playing out in the European capitals during the 1870s. Well, I just thought that was an incredibly interesting insight that one could try to learn from those sorts of things. Similarly, looking at housing policies in the US I've learned from some of my economic historian colleagues at the NBER, that the experience of the 1920s and 1930s is similar. There was a huge bubble during the 1920s with lots of housing construction. If you look at places like Manhattan the rise of building multi-tenant buildings was in the late 1920s. Prior to that you built the Chrysler Building or the General Motors Building. But the notion that you build a building and then you would lease it out to several different buyers was a speculative innovation that enabled you to build more buildings and bigger buildings and faster. And that led to an overbuilding cycle, which then came crashing back down.

Similarly, some of the things that happened in the housing market more generally. And we see the policies that were introduced. The FHA, and things like that that were trying to help bolster the housing market of the 1930s. So this is something where I had never really spent much time learning about this, but as I see these working papers cross my desk, as I attend meetings that are in fields that are not primarily my own specialization, it's been really interesting to learn about all these things.

INTERVIEWER: Does your being head of the NBER create special opportunities for MIT and its students? Faculty?

POTERBA: I don't think particularly. And in fact, I would say I bend over backwards to try to make sure that in my NBER role - while I am an MIT faculty member, I am responsible to the border economics community. So I try very hard to neither advantage nor disadvantage MIT in my dealings there. One thing that I think has benefited MIT students and faculty enormously about the NBER, but this is not specific to me, is that the NBER, which was founded in New York in the 1920s, opened a Cambridge office in Technology Square in the late 1960s that was under John Meyer who was a Harvard professor who was then the president of the NBER. Marty Feldstein, who became president of the NBER in 1977 closed the Technology Square office, but opened an office in Harvard Square which is the principal headquarters today of the NBER.

The majority of our meetings take place here in Cambridge, we gather the research community together. There are opportunities for students to engage in research projects there. And a number of MIT students are supported as pre doctoral or post doctoral fellows there. But the big thing is just that there's this enormous research community that comes together here in Cambridge. And during the summer, for example, the NBER sponsors something called the NBER Summer Institute. Last year we had 1,840 economists participate in that meeting, which was held in various places here in Cambridge -- The Royal Sonesta Hotel, the NBER offices at Harvard Square, the Hotel Marlowe were the three principal foci.

If you're here in Cambridge, it's a great opportunity to hear some of the presentations and whereas, if you're someplace else you have to make a long trek to be involved in those meetings. I think that has generated positive externalities for both MIT and for Harvard here in Cambridge.

INTERVIEWER: Despite your managerial hats you also seem to be very prolific, how do you manage that?

POTERBA: Well, I will confess that my research productivity has taken a hit since I took on the NBER job. I'm a little bit living on the past experiences. And it's been harder than I-- while I was department head I was able to still manage to move some research forward and start new projects. That has been harder in the last two years, but I consider it a major challenge for me to make sure that I can still do some of that going forward. The advice I've gotten from many people over the years and that I've tried to follow is to do a bit of compartmentalization and to say, well, for a couple of hours now I'm going to try not to check e-mail. I don't normally succeed. In fact, most of the time I fail. But occasionally I do succeed, and the other thing is it's also a lot easier to do research when you're in an environment where there are other people doing it and who are really excited about it. The kind of research that I've done-- I've collaborated with a lot of people. I've worked with many of my students over the years to write papers together. It's not sort of lone wolf research where I've gone off and closed the door to the tower and worked away in isolation for years and come back and said, here's the magnum opus. It's more work which involves doing things that collecting data, learning about institutions, writing about the inset of effects of those things. And when you've got a very excited graduate student and research assistant, or collaborator, or a recent MIT graduate who's eager to get tenure somewhere saying come on Jim, we've got to write that paper, that turns out to be a very good prod to keep things working along. I found that to be very helpful.

INTERVIEWER: The NBER has grown very rapidly I think. I'm not sure when the growth happened, but it's much larger than it used to be. What explains that?

POTERBA: Well, there's a couple of different things. And you can measure it in different ways. The biggest thing that's happened in terms of the volume of research that's carried out at the NBER, which has nearly doubled over five or six years. That depends on the availability of funding. The NBER has a small pool of assets that it's accumulated, but a lot of the research is funded by government grants. The National Institute of Aging has been very interested in economics for the last decade and a half, two decades. And the NIA is part of the National Institute of Health, which has a large research budget. The National Science Foundation has been the traditional funder of economics research. And to be honest, it's a much smaller pool of resources. So one thing that's happened is the NIA has gotten interested in the economics of health, the economics of retirement saving, labor market activity over the life course, what people do after they're retired, how housing fits into peoples life planning. There's a whole behavioral economics and how that could help us understand the factors that make them more or less likely to experience senescence or health issues in retirement.

There's been just a burgeoning field of research focused on the issues associated with the life course and aging and health issues. Researchers like the NBER typical team that's involved in applied research, that has a certain willingness to roll up their sleeves and learn about the institutional details-- they've been very well positioned to participate in that research activity. There's been an external shift in some sense in demand for research of just the kind that NBER researchers are good at delivering. And that has caused a ramping up of some of the research activity around the NBER. I think the other thing is that empirical applied economics has just gone through a renaissance as the fields become more specialized, the example on the auctions and the online stuff is a good one to look at.

Where there wasn't anything before there's just sprung up dozens of researchers who are focusing on these topics. Fortunately the NBER has had the resources to be able to welcome those researchers in. You know our process for bringing new researchers on-- and as I said, we have more than 1,100 there. The process is that every January I write to the existing members of the NBER family and I ask them to nominate their younger colleagues, others who they think are not members who would be suitable, and this is all very decentralized. It goes out to the 19 directors of the programs convene a review panel, typically, and they come back to me with some nominations, and then we-- assuming the numbers aren't too big we try to move on into being part of the NBER group. The NBER, all of these people have other appointments. Virtually nobody is just an NBER person. So we're really a loose confederation of researchers based at colleges and universities throughout North America who come together for these meetings and who periodically participate in joint research undertakings where the whole can be greater than the sum of the parts.

INTERVIEWER: You mentioned something about setting up a new division to study something, was that in the last two years and was that the first one in some period or did they get created every year or two? How does that work?

POTERBA: The NBER is organized into these 19 core programs, which as I said, tend to match up pretty well with fields in which you would take graduate courses in a graduate department like MIT's. In addition we have these working groups and working groups tend to be somewhat more elastic. They can pop up, they can be closed. And they are more opportunistic in terms of whatever the research might be. And they span an amazing range we have one on the economics of national security, we have one on China, we have one on networking and market design, we have one on urbanization. So they can have a lot more narrow focus and more desire to bring in a specialized group of researchers.

I think one of the most fun parts of the NBER job is trying to think through, where should we plant a new research working group. The less fun part is trying to figure out where has one outlived its usefulness and where do we want to prune it back? But those are things that we do. And people will sometimes come to me with suggestions for working groups. We've just launched in the last year-- I mean, two years ago, right after I started I felt that this market design area was just so obviously in need of some activity that was just an easy start to launch that. But we've launched one on innovation policy in the economy that focuses on how the process of patenting and technological progress takes place, and how policy incentives might matter for some of those issues. And there are other proposals that have come to me as suggestions. And the other time we've closed down a couple of other working groups that seemed as though they had sort of been created, they had done what was natural.

One of them in fact, was in the area of international trade in organizations. And the question that I was thinking about was a lot of trade across countries happens within firms. The same company imports and exports to two different divisions. Well that raises a whole host of questions that organizational economists who think about which divisions of a firm does what are good at thinking about. So a group a few years ago said to Marty Feldstein, we think it might make sense to convene a few meetings on this subject. And Pol Antras, who's one of our former students, he's now a professor at Harvard was the director of that working group. He came to me last summer and said, you know, Jim, I think we've kind of accomplished what we've set out to do. And I said, you're telling me you'd like me to close you're working group down? He said, I think that's what I'm telling you. So I agreed that that was something we could do and we sort of folded its tent and moved on.

INTERVIEWER: And you didn't need a vote of the members or a vote of the Executive Committee, if there is one?

POTERBA: No, we're not a democracy for this purpose.

INTERVIEWER: Has the field of public finance changed much since you entered it?

POTERBA: Well, that's interesting. Yes. Public finance has gone through a number of swings over time that I think sort of track the subject matter and the interesting questions that have attracted attention within the tax policy area. Around the time I was getting interested in economics of tax, so this would be as an undergraduate I would say, public finance was just beginning a revolution of looking at data. Looking at micro data on households, micro data on firms, and trying to study how tax policy affected their behavior. Marty Feldstein had been a key pioneer in that. The field was moving from a largely theoretical study of what should a tax system look like, or what was the right level of public spending to provide. Cost benefit analysis had been a big issue prior to this new empirical embrace of let's study behavior. It was perfectly aligned with the availability of large new data sets from the government and the rise of computer technologies that made it possible to analyze those with statistical tools.

So I rode that wave in the early days, along with many of the people who I got to know as an undergraduate and as a graduate student. Then I think we got to a stage where the opportunities were just low-hanging fruit by saying, let's study the behavior with respect to charitable giving or let's study labor supply. It started to run out. The interesting, more recent revolution has been toward finding richer and in some cases, off the beaten track databases to try to study these questions. Not always in the US and in many European countries for example, where the privacy restrictions on access to government records are somewhat looser. We find the research frontier moving back faster. In Denmark or in Sweden, for example, where you can find out people's asset holdings, people's labor supply, and other things.

The other place where there's been a big step is toward doing experiments. Economists have historically taken the data that's come to them. We're now seeing folks who go out and will actually run either randomized trials where they'll tell some taxpayers they are going to be audited and tell others nothing and see whether there's a difference in the ex post truthfulness. The federal government doesn't do things like this, but sometimes state governments are willing to perform experiments like that. Sometimes you can try to educate taxpayers about the tax system. Maybe working in tandem with some private tax preparers-- H&R Block has been involved in a number of research studies with economists along those lines. And sometimes you're literally doing experiments. A group in Berkeley did a project where they posted the tax on a good along with the price of the good in a supermarket, and then tried to see whether when the tax was listed there right next to the good that tended to discourage people from buying those goods. And lo and behold it did. It's a little hard to tell what we make of that finding, but there are facts like that that are emerging.

INTERVIEWER: The short run, long run--

POTERBA: Short run, long run kinds of issues. Exactly. **INTERVIEWER:** What are some of the things that we understand now that are different from what you were taught when you were a student? Is there anything that's really reversed or that's been a huge surprise?

POTERBA:

I think there's been a much clearer delineation of the difference between short- run and long- run responses to the tax system than we knew about when I started in this business. The recognition that there's a lot of high- frequency adjustment around tax changes and that you have to be very careful with your statistical procedures to tease that out and not let that contaminate your inferences about the longer- term. I think that's one place that's been a very central finding that's pretty important. The other place I would say is that there's a greater recognition that a simple neoclassical model of optimizing taxpayers, optimizing households may not fully characterize people's behavior. That there seems to be some role for some behavioral elements, some psychology, some other things that enter into this. That the social milieu in which you make decisions about your own behaviors, your savings decisions, your labor supply decisions-- if the tax system changes and you say, you know, I'm going to ignore it. I'm just going to keep doing what I do. And a lot of other people at my workplace say the same thing, I may just end up ignoring it too.

Whereas, if you come in and say, can you believe how much they changed my taxes by? I'm going to stop working. I may think, I should probably do that too. So I think we're discovering that there are lots of kinds of social interactions that are important. The one fascinating thing about doing public finance research and studying taxes is that they're always there. We've got taxes with us always. And there is no end to ingenuity of what the revenue authorities dream up as ways to collect revenue. And it creates a constant source of new opportunities to think about this.

So in the environmental context for example, the carbon tax is an exciting new thing to worry about. The possibility of using new sort of smart metering devices to charge for electricity or water, things like that could all be examples to think about where public finance is marching forward to some pretty interesting new opportunities.

INTERVIEWER:

We've been reading the headlines about Greece having such major financial problems right now, and there was an interesting story a couple days ago about the different cultural reactions to taxes. This particular story on the front page of the *Times* referred to some village with 30,000 rich people in it where apparently they asked, do you have a swimming pool and only 300 people declared that they did. And then they looked at an aerial photograph and I saw thousands of them. And this was the seg into the people there take taxes rather cavalierly. Are you getting any SOS's from the European community or Greece to come help then think about taxation?

POTERBA: Absolutely. There are two things and we may need to close on this because I'm going to have to get back to a seminar. But there are two things that have actually happened as a result of a recent experience in Greece. One is that questions about fiscal policy and long-term deficits and raising revenues have come back to the floor as an issue that macroeconomists have spent a lot of time on that, but public finance economists had largely focused on the microeconomics of taxation. No more. We now understand that we need to link arms with the macro people who know about this and everybody needs to be thinking about these questions. But I think it also highlights the differences across countries in the nature of the revenue structure, and how important things like different responses to opportunities for tax evasion might be, understanding what one can do to improve the enforcement and the administration of the tax code. It's often not the scintillating stuff of a new mathematical model, but it can be really important. I think that economists are now playing a part in helping to understand what can make the systems work better. Doing experiments about administration that are exciting because of the research on what works administratively, not because they're interested in just knowing that if you keep the store open-- the revenue authority open until 9:00 at night more people will show up and pay their taxes. But because we can now do controlled trials where in some villages we keep the revenue authority opened late and others not. And then we discover, does that really matter for how people pay or how they perceive the tax system? Those are the kinds of questions that are out there on the horizon.

INTERVIEWER: As a final note I wonder if you could tell us about the NBER role in determining recessions beginnings and end. And also, how involved you are in that, if at all.

POTERBA: Yeah, so the NBER-- beginning around 1960 the US commerce department concluded that it did not like the political heat that went along with deciding when the economy was in recession and recovery. And the NBER had been, from its origin, doing work that had tracked the fluctuations in the economy. So the NBER was naturally positioned to take on this task. And the commerce department, without a whole lot of fanfare just began publishing the NBER's chronology of recessions and recoveries. And that made the NBER de facto the official dater of the US business cycle. The NBER group continued to work along on this topic. The formal structure that we have today was created in the late 1970s when we created a Business Cycle Dating Committee, which has had a various number of members. It's chaired by professor Robert Hall at Stanford, who's an MIT alum and the director of our economic fluctuations program at the NBER. But that group stays in constant contact looking at new releases on the economy. The job of this group is to determine when the economy reaches a peak and when it reaches a trough. So it's really a matter of dating upflows and downflows in economic activity. We don't define depressions. People often ask, what's a depression. We don't do it. We do recessions and we do recoveries. And we often do it with a lag because we're very interested in trying to hit that peak and trough on target so that we don't have data revised or new information that arises, so that we have to revise the date that we offered.

Many people find that absolutely infuriating because they'll say, the economy's doing well or badly at the moment, why haven't you made an announcement? And we often have to say it's because we're waiting until we're sure when things happen. The NBER's definition of a recession is not as simple as two quarters of economic decline in GDP. We say it's a broad based decline in economic activity spread throughout the economy. And consequently, we look at a number of different indicators: GDP, industrial production, employment. We might look at some sales data and it's really a process of debate and discussion amongst the committee members without a hard and fast formula that we use for this purpose. It is clear though that amongst the various things the NBER does, making pronouncements about the starting point and the ending points for economic downturns is certainly the highest visibility of the activities we're engaged in.

INTERVIEWER: And do you get involved in that committee?

POTERBA: I sit on the committee of the Business Cycle Dating Committee as a member, but as you can imagine this is not an area that I spent a lot of time studying prior to taking on this role. At this point, I'm still more of a learner than a strong voice for one view or another.

INTERVIEWER: In this digital age have we gotten any better at determining these things?

POTERBA: I think there's more information available, but it doesn't always point with a single message in terms of the direction things are moving. So I'm not sure that it's gotten any easier over time.

INTERVIEWER: And can you tell us where the economy's headed now?

POTERBA: Where we're headed? I can't. I can tell you where we've been.

INTERVIEWER: Thank you very much.

POTERBA: Thank you. This was fun.