

# Policy Evaluation with Interactive Fixed Effects

(Joint work with Marc Chan)

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## Abstract:

We develop an alternative estimator for policy evaluation in the presence of interactive fixed effects. It extends Pesaran (2006)'s two-stage procedure to a difference-in-differences-type program evaluation framework, and extracts principal components from the control group to form factor proxies. Consistency and asymptotic distributions are derived under stationary factors, as well as nonstationary factors with any integration order. Simulation exercises demonstrate excellent performance of our estimator relative to existing methods. We present empirical results from microeconomic and macroeconomic applications. We find that our estimator generates the most robust treatment effect estimates, and our weights for control group units deliver strong economic interpretation regarding the nature of the underlying factors.