The Targeting of Place-Based Policies: The New Markets Tax Credit Versus Opportunity Zones*

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Abstract

A necessary condition for a successful place-based policy is that it targets the right places, typically defined by policymakers as places with less economic development and worse resident well-being. The United States currently has two major place-based tax policies in operation—the New Markets Tax Credit, an allocated tax incentive program with investments chosen by government-approved entities, and Opportunity Zones, an open-ended tax incentive with investments chosen by private investors. Using an array of data sources, we compare the targeting of investment in these two place-based policies along a comprehensive set of dimensions: economic development, economic well-being, and social well-being. We then draw lessons from places that have received investment from both, just one, or neither program to inform which type of policy best targets certain areas and which areas have been left out altogether. Our results inform the design of future place-based policies that seek to target the most distressed areas across various dimensions.

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1 Introduction

Large and growing disparities across areas in the United States (Ganong and Shoag 2017), together with research showing that place matters for long run outcomes of their residents (Chetty et al. 2016; Chyn 2018), have motivated renewed attention on place-based policies that target distressed areas (Austin et al. 2018). The two largest and currently ongoing federal tax policies are the New Markets Tax Credit (NMTC) and Opportunity Zones (OZs). The NMTC was enacted in 2000. The U.S. Department of the Treasury allocates tax credits to Community Development Entities (CDEs) which are in turn provided to private investors in return for capital to invest in low income communities. The amount of tax credits is limited each year which effectively caps the amount of investment made under the program. OZs were implemented in 2018. Taxpayers with recently realized capital gains can invest in Qualified Opportunity Funds (QOFs) that in turn can invest in low income census tracts designated by state governors as OZs. Investors are allowed to defer capital gains tax on their original investment, and any capital gains on the OZ investment itself is completely forgiven if held for at least 10 years. There is no limit on the amount of OZ investment each year in aggregate or to particular OZs.

NMTC and OZs represent two distinct approaches to place-based tax policies: The NMTC centralizes power with the U.S. Department of Treasury, which is empowered to approve specific CDEs that direct investments into low-income communities. The OZ policy delegates ultimate authority to private investors who can invest unlimited amounts in any area, so long as it was approved as an OZ. The distinctly different approaches of these policies, along with the fact that they have been in effect simultaneously since 2018, provides a unique opportunity to evaluate how a more intentional, government-centered approach compares to a more decentralized, market-driven approach when it comes to one of the

most important metrics of a place-based policy—whether it targets distressed areas (see, for example, Neumark and Simpson 2015 for a discussion of the rationales for place-based policies).

The targeting of these two distinct policy approaches offers important lessons for the future design of place-based policies. For example, a common critique of OZs is that it provides too much discretion to private investors who may simply invest in the least needy areas where the return on investment is expected to be highest (e.g., Theodos et al. 2023). How OZs compare to an established tax-based policy that exerts more control can help answer that question. We present some preliminary evidence in Figure 1 that both OZs and NMTC target their investment in similar deciles of census tracts ranked by median income, despite the significant differences in the implementation of these two place-based policies. For example, 28.0 percent of OZ investment is in the lowest decile of census tract median income while 29.5 percent of NMTC investment is in this same decile. The top two deciles receive about 5.6 percent of OZ investment and 4.1 percent of NMTC investment. While OZ investment is mildly shifted towards higher income deciles, it is rather striking how broadly similar these two policies target lower income census tracts.

Of course, this general figure is likely masks heterogeneity within deciles and we plan to investigate this further in our project. In addition, examining which areas receive investment from both, only one, or neither program can inform how policies should be designed to best cover the most distressed areas. Certain types of distressed areas that receive investment from just one program may suggest that a mix of approaches are needed to promote full coverage. If there are certain types of areas that receive no investment from either program, this could suggest that altogether different approaches are needed for those areas, potentially interventions that extend beyond tax-based investment incentives.

Moreover, we also consider the possibility that NMTC investment was altered in response to the creation of OZs. Figure 2 shows the amount of NMTC investment from 2010 through 2021 divided into two groups of census tracts—those that were eventually selected as OZs and those that were eligible but not selected. While purely suggestive at this point, the figure shows that after passage of the Tax Cuts and Jobs Act (TCJA), investment in selected tracts begins to diverge from that in eligible but not selected tracts. This is consistent with the idea that different place-based policies may tend to target similar census tracts despite the vast differences in their implementation. It is these sorts of observational descriptions that we plan to investigate further in our analysis. More precisely, we ask whether the typical census tract targeted for NMTC investment changes after the introduction of OZs. Did census tracts that were selected as OZs become more or less likely to be awarded NMTC projects? Understanding the complementarity or substitutability of these two programs is important for better understanding how best to promote development in distressed areas.

2 Background

The New Markets Tax Credit (NMTC) program is a federal initiative designed to stimulate economic development and investment in low-income communities across the United States. Established by Congress in 2000 as part of the Community Renewal Tax Relief Act, the NMTC program aims to attract private capital to areas with limited access to financing, thereby promoting the revitalization of distressed neighborhoods (Congressional Research Service 2022). The program is administered by the Community Development Financial Institutions (CDFI) Fund in the U.S. Department of the Treasury and provides tax credits to investors who make qualified equity investments in designated Community Development

Entities (CDEs). These CDEs, in turn, deploy the invested capital to support businesses and real estate projects in economically disadvantaged areas.

Opportunity Zones (OZs) were enacted in 2018 as part of the Tax Cuts and Jobs Act with a similar goal of encouraging economic development and promoting resident wellbeing in low-income communities (Bernstein and Hassett 2015). The same census tracts that are eligible for the NMTC were also made eligible to be OZs, of which state governors selected about 25 percent for OZ designation.[1] The fact that the NMTC and OZs share the same eligibility criteria ensures that investment for neither program will flow to the approximately half of census tracts that are not eligible due to higher median incomes and lower poverty rates. But the allocation of investment within these eligible tracts will depend more heavily on decisions by Treasury and CDEs in the case of the NMTC, and by state governors and private investors in the case of OZs (see for example Frank et al. 2022 who document political factors in OZ designations by governors).

3 Data

Our data include actual investment from the NMTC and OZs by census tract, and an array of area characteristics to evaluate the targeting of each program.

Investment data for the NMTC are publicly available from the CDFI Fund of the U.S. Treasury. This dataset contains the amount of tax credits and total investment in each project, and the specific census tract in which the investment was made. NMTC investment data are available from 2003, soon after the program began, to 2021. Investment data for

[1] An additional group of census tracts were also potentially eligible under OZ rules—those census tracts that are contiguous to a designated tract and with median income no more than 125% of the designated tract to which it is contiguous. The designated contiguous tracts comprise about 2 percent of designated OZs.

OZs are proprietary as they are assembled from confidential tax data filed by Qualified Opportunity Funds (QOFs) (see Coyne and Johnson 2023). From these tax forms we have the total amount of dollars invested in each census tract.[2]

We evaluate the targeting of NMTC and OZ investment along three general dimensions: economic development, the economic wellbeing of residents, and the social wellbeing of residents. We do so using an array of data sources, at the census tract and county level.

One important dimension for targeting is economic development. Both the NMTC and OZs are intended to promote economic development through increased investment, and so it is important to determine whether investment is flowing to areas with lower levels of investment. We rely primarily on data from Real Capital Analytics, which contains the universe of commercial and multi-family housing real estate transactions in the United States, for transaction of $2.5 million or above (for a description of these data see Corinth and Feldman 2023).

Another important dimension is the economic wellbeing of residents. We rely on the American Community Survey which provides census tract level estimates of median income, poverty, home values, and labor market indicators, as well as demographic variables like race/ethnicity, and age, based on a 5-year pooled sample. We also use data from Opportunity Insights, based on the universe of tax records in the United States, that reflect economic mobility of each census tract, indicating the extent to which children from poor backgrounds have higher incomes when reaching adulthood (Chetty et al. 2018).

The third dimension is the social wellbeing of residents. We rely on county-level data on suicides and drug overdose deaths from the Centers on Disease Control and Prevention, WONDER database. We also use a county-level social capital index from Opportunity

[2]For this proposal we use data from Form 8996 for tax years 2019-2020, for the paper we will use Form 8996 data for tax years 2019-2022.

Insights. Their social capital index leverages data from Facebook to measure social connectedness across socioeconomic lines in a given area (Chetty et al. 2022).

4 Methodology

There are two parts to our approach. First, we measure the targeting of NMTC and OZs compared to one another. Second, we analyze the areas that received investment from both, just one, or neither program to draw lessons about the coverage of each program and their gaps.

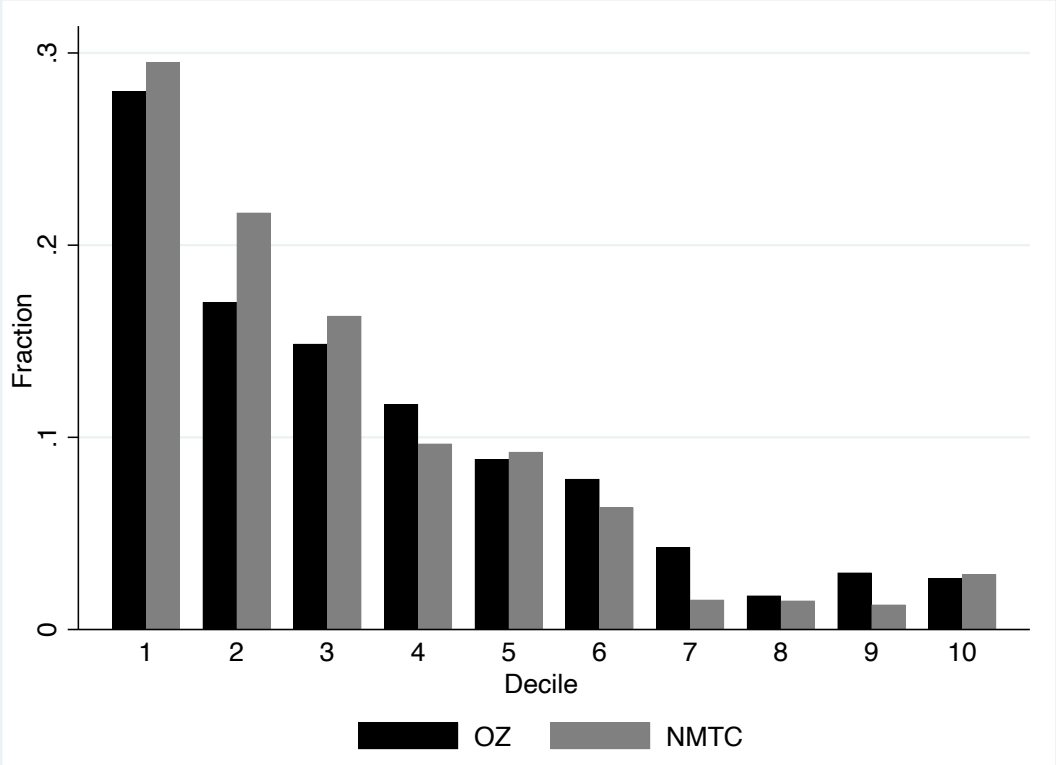
We measure the targeting of OZ and NMTC investment across each individual targeting variable. For most analyses, we restrict our sample to census tracts that are low-income communities (poverty rate of at least 20% or median income below 80% of metropolitan area median), because the NMTC and OZs were restricted to these areas. We also consider targeting across multiple targeting variables simultaneously, determining whether each program targeted areas that tended to be distressed across multiple dimensions or just one.

We next evaluate the coverage of the NMTC and OZs. We determine the census tracts benefiting from both programs, just one program, or neither program. Specifically, we form a 2x2 matrix with cells based on whether each census tract received investment from each program, and we provide summary statistics of the census tract in each cell. This allows us to determine the characteristics of areas that are conducive to investment from one program or the other, and the characteristics of tracts that receive no investment from either program. Pertinent characteristics include the various dimensions of economic development and resident wellbeing, as well as geography (i.e., states, urban vs. rural), and demographics such as race/ethnicity and age of residents. As part of this analysis, we will seek to determine

whether OZ designation and investment has crowded out NMTC investment, by assessing whether NMTC has declined in OZs relative to eligible but not selected census tracts since 2018 when the OZ policy was enacted.

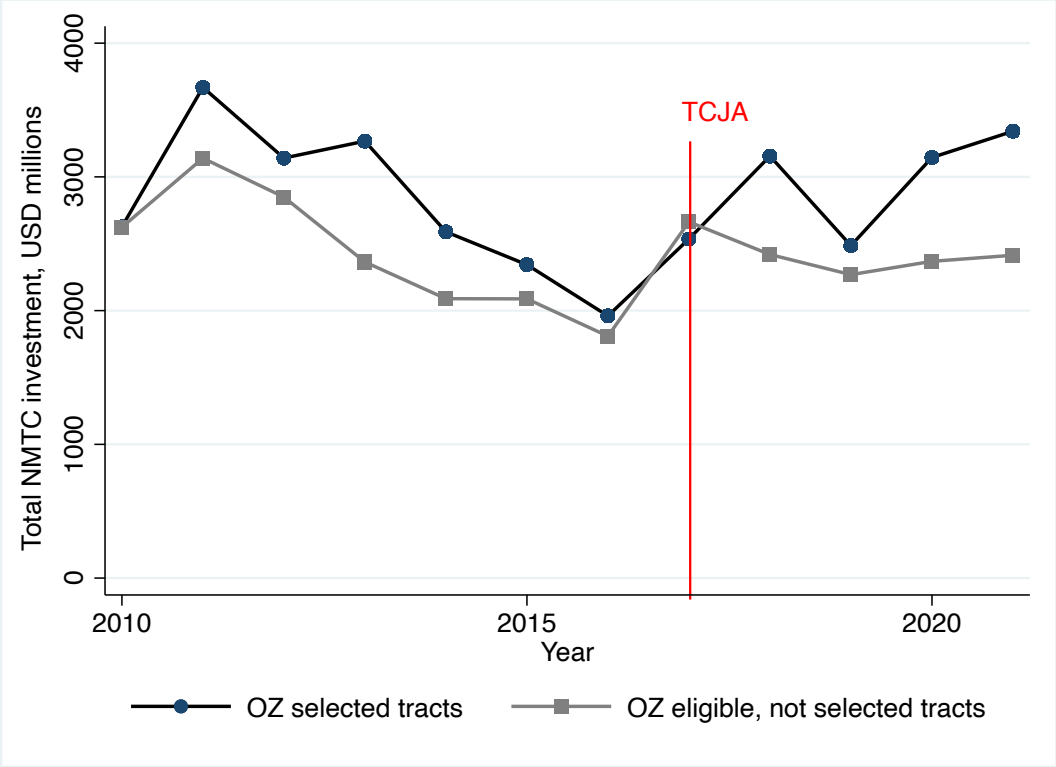
Finally, we aim to draw lessons for medium to longer run development by looking at outcomes based upon the extent of how these two programs overlap and the likely pockets of still neglected distressed areas within the United States that are served by neither program.

Figure 1: Share of total Opportunity Zone and New Markets Tax Credit investment by census tract level median income, 2018–2020



Source: Community Development Financial Institutions Fund New Markets Tax Credit Public Data Release File, 2003–2021; Internal Revenue Service Form 8996; American Community Survey; Authors' calculations.

Figure 2: New Markets Tax Credit investment by Opportunity Zone eligibility and selection, 2010–2021



Source: Community Development Financial Institutions Fund New Markets Tax Credit Public Data Release File, 2003–2021; American Community Survey; United States Department of the Treasury; Authors' calculations.
Note: Vertical red line indicates enactment of the Tax Cuts and Jobs Act, which enacted Opportunity Zones.

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