COMMENTS

"TAX INCENTIVES FOR INVESTING IN LOW-INCOME COMMUNITIES: HAS THE NEW MARKET TAX CREDIT LED TO INCREASED INVESTMENT IN TARGETED COMMUNITIES?" BY TAMI GURLEY-CALVEZ, THOMAS J. GILBERT, DONALD J. MARPLES, KATHERINE HARPER, AND KEVIN DALY

Byron Lutz, Federal Reserve Board

"Tax incentives for investing in Low-Income Communities: Has the New Market Tax Credit Led to Increased Investment in Targeted Communities?" by Tami Gurley-Calvez, Thomas Gilbert, Donald Marples, Katherine Harper and Kevin Daly addresses a topic of considerable importance: how to spur the revitalization of economically blighted communities. The authors deserve credit for adopting a novel approach to studying the impact of the New Market Tax Credit (NMTC) and for the tremendous amount of effort clearly required to obtain and clean the data used in the paper. The work is also valuable because programs like the NMTC have been relatively understudied.

The NMTC program provides a tax credit to individuals who make investments in impoverished, low-income communities. In order to measure the impact of this tax credit, the paper draws on the methodology developed in the IRA and 401(k) literature. This methodology compares the wealth of IRA/401(k) participants and nonparticipants to determine if these programs increase total net saving. In the current paper, the wealth of NMTC investors is compared to non-investors. The results of the paper suggest that the NMTC increases investment in low-income areas and does so by increasing saving (i.e., decreasing the consumption of NMTC investors).

While the use of the 401(k) literature methodology to assess the impact of the NMTC is novel and quite interesting, a potential problem exists with the application of the methodology in this context. IRA and 401(k)s are targeted at individuals and unambiguously provide an incentive to increase savings. The NMTC is not targeted at individuals, instead it is targeted at a specific investment. The market price of this investment should reflect its tax-preferred status. The pre-tax expected return on the investment should be lower than that of a non-tax-preferred investment carrying a similar level of risk. The after-tax, risk-adjusted rate of return on the NMTC investment should be roughly equal to other, non-tax-preferred, investments. Given the financial sophistication surrounding NMTC investments (e.g., a secondary market for these assets exists), this assumption appears quite plausible.

The NMTC should increase investment in low-income communities. It is less clear, based on the above assumption concerning the after-tax rate of return on NMTC investments, that a particular individual who happens to make an NMTC investment is induced to increase his overall level of savings (i.e., the introduction of a new asset with a return equal to previously available investments does not provide an incentive to increase savings). There could be an economy-wide, general equilibrium effect of the NMTC program which increases the return to all savings and thereby increases savings economy wide. This seems unlikely given the size of the program. More fundamentally, it is not clear that this effect would express itself solely through the savings of the individuals who happen to make a NMTC investment. It would strengthen the paper to address this potential concern with using the 401(k) methodology in the NMTC setting.

The authors employ two econometric techniques to compare the wealth of NMTC participants and nonparticipants – a fixed-effect (FE) estimator and a matching estimator. The FE estimator relies on the comparison of a treatment group (NMTC participants) and a control group (nonparticipants). In an empirical setting such as this, it is important that the treatment and control group be comparable in the pretreatment period. Unfortunately, as is fully acknowledged by the authors, participants and nonparticipants are not very comparable in 2000, the year prior to the introduction of the NMTC; in particular the control group has only about 1/3 the wealth of the treatment group.

In situations in which the treatment and control group are dissimilar, a useful approach is to employ

a matching estimator to balance the covariates between the treatment and control group. It is therefore quite advantageous that the paper uses a propensity score matching estimator in addition to the FE estimates. Additionally, the matching estimator produces point estimates which are smaller, and more plausible, than the FE estimates. I would argue that these estimates should be strongly preferred to the FE estimates.

A useful extension to the matching approach would be to employ the semi-parametric matching estimator developed by Abadie (2005). A treatment and control group strategy, like the one employed here, is most convincing when it can be shown that the treatment and control group are not only similar in the pretreatment period, but are also trending in a similar fashion in the pre-period.

The Abadie estimator, which involves a relatively straightforward re-weighting of the control group such that it matches the treatment group along observable dimensions, allows for the plotting of the trend in the treatment and control groups. Use of this technique would lend added credibility to the paper's estimates.

In conclusion, the paper is an ambitious effort to understand the impact of the NMTC. Given the persistence of economically blighted communities, this is an important effort.

Reference

Abadie, Alberto. Semiparametric Difference-in-Differences Estimators. *Review of Economic Studies* 72 (January 2005): 1-19.