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Will 'Opportunity Zones' Work? We May Never Know. Here's Why.

As America grapples with widening inequality and deepening political polarization, a group of wonks in Washington is quietly embarking on a new national experiment to rehabilitate the country's most distressed regions. Tucked into the 2017 Republican tax law, Opportunity Zones, as the program is called, offer huge tax incentives for financiers who invest in downtrodden communities.

The promising idea has one potentially huge flaw, however: As the Treasury Department finalizes the program's rules in preparation for its launch in 2019, researchers and economists are increasingly worried that the agency is leaving out critical requirements to track the law's effects—and as a result, we may never know if Opportunity Zones actually work.

The new law has attracted attention in policy circles because it's the most specific thing the Trump administration has done to help "left behind" areas, and could cost more than $1 billion a year, at least initially.

But it's far from a sure thing. Earlier versions of the idea have been tried, with an unproven track record. The Opportunity Zones provision was originally drafted with a requirement for the Treasury Department to provide detailed information on the distressed regions and the impact of investments, but that dropped out when the tax bill was finalized. And when the Treasury Department released its proposed rules for the program last month, it didn't require investors to disclose much detailed information.

Without better reporting requirements in this version, critics say, it's hard to know if the law will have any effect besides saving investors money and draining federal tax revenues.

"There's never going to be a really rigorous evaluation of this program," said Tim Bartik, an economist at the Upjohn Institute. "There will always be questions."

Federal programs often pass Congress without any evidence they work, in part because it's so difficult to collect data on the impact of broad policies. But Opportunity Zones are a trackable scheme, operating in the data-rich field of finance, where investments and returns are all carefully measured by the financial players involved. It appears, however, they won't need to report those results to Washington.

"The regulations, as they are right now, don't include any of the data fields we were hoping for," said Nick Fritz, an official at the Sorenson Impact Center at the University of Utah, which focuses on improving the social impact of investing. Fritz is optimistic about Opportunity Zones but worries that the lack of data will make it hard to know whether the program actually succeeds.

Tax incentives for investing in distressed areas first gained traction in the 1980s, when they were pushed by NFL-player-turned-congressman Jack Kemp as a free-market solution to regional poverty. They were expanded during the Clinton administration, which liked to back ideas that were politically centrist and didn't sound like "welfare."

But despite billions of dollars targeted toward communities—through both direct spending and the tax code—policymakers know little about the results. In numerous studies over the years, some have found small positive gains, others small negative ones. Two major studies, conducted by the Government Accountability Office in 2006 and 2010, concluded that there simply wasn't enough data to evaluate.

As a result, many economists are skeptical that Opportunity Zones will do what they promise, helping lift up impoverished areas. Instead, they argue, money will be funneled to areas that are on the cusp of a development boom and don't need the extra help. Since the zones were designated by state governments—which could designate up to 25 percent of their low-income communities as Opportunity Zones—they also worry that political considerations and lobbying efforts influenced the states' selection process.

"The places that got picked got picked for a reason, and the ones that got passed over got passed over for a reason," said Adam Looney, a senior fellow at the Brookings Institution who has been closely tracking Opportunity Zones. That initial design choice, he said, will make it difficult to fairly compare the results of the program without deeper information on the areas that actually received the investments.

The program is built on the fact that investors nationwide are sitting on $6 trillion in unrealized capital gains—money that they've made in the stock market and other investments but haven't put to new use because doing so would trigger a tax payment. The new law will allow investors to defer those taxes by rolling that money into "Opportunity Funds," new vehicles that invest primarily in distressed areas. If they hold that investment for 10 years, any new returns are tax-free. (They do eventually have to pay taxes on the deferred capital gains.)

Supporters believe the law will result in a flood of new investor money into those areas. But it comes at a cost to the government: The Joint Committee on Taxation projects that the tax break will cost $7.7 billion during the first five years, falling to $1.6 billion over a decade as investors pay their deferred capital gains.

Given the disagreements over the potential for the program, experts on both sides agree that good data is essential. The original bill, introduced by Sens. Tim Scott (R-S.C.) and Cory Booker (D-N.J.) in February 2017, required Treasury to submit an annual report to Congress, starting five years after enactment, with detailed information about how the tax incentive was affecting Opportunity Zones, including which communities and projects actually received investment.

That section was dropped from the bill when it was inserted into the GOP tax package, however, because the Republican Congress passed the tax law through budget reconciliation—a process that, by Congress' rules, can include reforms that only affect taxes or spending. The reporting requirement fell outside that boundary.

That's left Treasury with broad authority to collect information about the program—or not. The agency's initial proposal and an accompanying proposed IRS form require Opportunity Funds to provide basic information, such as the name of the fund, and aggregate investment numbers. Those numbers are used to prove to the IRS that investors are actually investing their money in Opportunity Zones, but they don't provide the granular, transaction-level data that would show which specific tracts and types of projects received money. The omission has left even supporters concerned that limited data will make it harder to grow political support for the program.

"It's the crux of really realizing the power and potential of this incredibly exciting bill," said Tracy Palandjian, CEO of Social Finance. "Without an intentional framework about how to think about how

to measure the payment over time … we're going to be back to the old tales that these things are ineffective."

Not everyone is so concerned. John Lettieri, president of the Economic Innovation Group, a leading proponent of the program, dismissed the skeptics' concerns that states designated less-needy tracts for investment. He pointed to recent research from the Urban Institute, which found just 3 percent of the selected areas were experiencing substantial socioeconomic improvement. As a result, he said, researchers will be able to analyze the program's impact, even without the additional data.

Lettieri agreed that additional reporting requirements would be helpful and was optimistic that they would be added in the future. But he added that the agency had to craft such requirements so they don't impose a heavy burden on investors or, worse, require them to turn over proprietary information.

"You want to avoid implicitly restricting or inhibiting the very things the incentive was designed to do," Lettieri said, adding, "[The] right balance needs to be struck."

A spokesperson for the Treasury Department said the agency hasn't written off the idea and is "considering whether the initiative could benefit from a more robust data collection effort in future tax years."

"We believe we can spend some time to get this right and still have enough data to analyze its effectiveness," said the spokesperson. "Our current focus is on ensuring that the tax incentives of [Opportunity] Zones best serve communities and benefit investors."

If the Treasury Department does add new requirements going forward, it won't be a huge surprise. The agency had a tight timeline for drafting rules and launching the program, forcing it to prioritize some elements of the rollout over others. If reporting requirements are added, researchers will breathe a sigh of relief. Given the long-term nature of the investments—the tax benefits rise substantially as investors hold their investments for longer—a retrospective requirement could be enough to answer their questions about whether it works.

But, said Fritz, the researcher at Sorenson Impact, the real challenge with later reporting is the effectiveness of the funds themselves. The longer Treasury takes to collect and analyze data, the less investors will know about what types of projects have the greatest impact on low-income communities. "This limits the ability of municipalities and funds to learn from others' best practices and make sound, impactful investments," Fritz added.

Even with the best economic data, debates over the effectiveness of public policies are never settled. Despite decades of evidence on minimum wage increases, for instance, researchers are still sharply divided on its impact. In other words, experts suggested, even if Treasury imposes significant reporting requirements on Opportunity Funds, disagreements over such place-based policies will continue—but that's not a reason to not collect the data at all.

"Will we be able to evaluate the efficacy of this tax expenditure and, in particular, who it's benefiting?" said Laurel Blatchford, president of Enterprise Community Partners and a former senior official at the Department of Housing and Urban Development. "There's a lot of excitement and a lot of questions."

THE AGENDA

By DANNY VINIK

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Danny Vinik is a student at the Georgetown University Law Center and former assistant editor of The Agenda. He can be reached @DannyVinik and dvinik2@gmail.com.

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