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Strengthening Economic Freedom:

Natural Resource Indicators and Economic Growth

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EXECUTIVE SUMMARY

Created in 2003 to rise above the failed programs that have characterized sixty years of American foreign aid, the Millennium Challenge Corporation (MCC) conditions aid upon recipients enacting institutional changes and policies that support poverty reduction through economic growth. MCC proposes expanding the criteria it uses to judge such policies to include "natural resource management." This decision will affect the long-term viability and direction of MCC.

One proposed indicator, the Natural Resource Management Index (NRMI), violates MCC's legislative mandate and threatens to derail MCC's focus on economic growth, rendering MCC ineffective. NRMI is plagued by poor data quality, arbitrary criteria, massive compliance costs, and lack of any causal connection to economic growth. Moreover, NRMI confuses causes and effects of growth, focusing on Washington-created procedures rather than country-driven outcomes. MCC should remain focused on economic growth and not adopt the NRMI indicator.

MCC's other proposed indicator, the Land Rights and Access Index (LRAI), provides a much better measure of effective natural resource management as it relates to economic freedom and growth. LRAI creates incentives for candidate countries to avoid the natural resources curse and encourages effective long-term natural resource management through secure property rights rather than command-and-control mechanisms. LRAI is an appropriate measure of natural resource management, and MCC is within its mandate to adopt it as an "economic freedom" indicator.

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INTRODUCTION

In just four years, the Millennium Challenge Corporation[1] has gone from a bold, untested concept to one of the main hopes of American foreign aid. Through investing in MCC, policy makers have demonstrated a desire to move beyond policies that have frequently done more harm than good to a model that focuses on establishing the context for sustainable economic growth.

Since its inception, MCC has embraced concepts essential to understanding the context for growth: most significantly, the idea that institutions provide the framework for development. Among these institutions, the security of property rights is paramount, as secure property rights enable the engines of growth—entrepreneurship and trade—to operate.

The reason that MCC shows promise where other development programs have failed is its acknowledgement that incentives matter. To this end, MCC has been effective at incentivizing developing countries to adopt pro-growth policies that encourage indigenous solutions to poverty. Indeed, these incentives are the most important part of MCC's work: while the effects of the projects undertaken by compact countries are still unknown, the positive effects of MCC's incentives—the so-called "MCC effect"—have already been empirically observed.[2]

Thus far, MCC has identified 16 indicators across the three categories outlined in section 607 of the Millennium Challenge Act of 2003 ("the Act")—ruling justly, economic freedom, and investing in people. For the most part, these indicators have been prudently selected, and they encourage policies that are actionable by recipient countries, quick to show results, are outcome-oriented rather than prescriptive, and are known to encourage economic growth.

The intent of President Bush and MCC's framers in Congress in creating MCC was to make aid conditional solely on pro-growth institutional changes and not on factors outside its purview,

[1] The Millennium Challenge Corporation (MCC) is the government agency charged with administering the Millennium Challenge Account (MCA). For simplicity, we refer to the account and its administering corporation as MCC throughout.

[2] For empirical work on the MCC effect, see Doug Johnson and Tristan Zajonc, "Can Foreign Aid Create an Incentive for Good Governance? Evidence from the Millennium Challenge Corporation" (working paper, SSRN, April 2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=896293.

especially those covered by other agencies and programs. While so far the intent of the program has been respected by and large, the risk of teetering towards narrow goals instead of broad economic growth presents a threat to MCC's unique ability to produce results.

In 2005 MCC indicated a desire to expand the number of indicators. This choice represented a critical decision point—one that will have consequences for the long-term viability and direction of MCC. The latest report on the criteria and methodology on eligibility for MCC assistance reveals that MCC has made both good and potentially damaging choices at this decision point. If MCC is to continue to effectively produce results, it must closely follow its mandate.

Unfortunately, the current search for a natural resource management indicator shows signs of severe mission creep which augurs poorly for MCC. The Yale/Columbia Natural Resource Management Index (NRMI), in particular, is flawed and counterproductive to economic growth. Indeed, it seeks to use MCC in a manner that is out of line with its mission and the carefully delineated legislative mandate for natural resource management. NRMI would impose specific burdens on the poor resulting in the retarding of growth rather than its promotion.

MCC's mandate is to provide assistance to countries whose policies improve economic freedom. Well defined and enforced land access rights increase economic freedom and provide strong institutional incentives for the good management of natural resources. If MCC fails to adhere to its mandate, it will become just another agency involved in development that replicates the work—and the poor results—of others.

A. Reflecting on Four Years of MCC

The Millennium Challenge Account was created in 2003 by policy makers who saw real potential to go beyond the post-World War II Bretton Woods framework that dominated the development community for almost sixty years. Now in its fourth year, the Millennium Challenge Corporation has a number of successes of which it should be proud.

MCC has thus far identified in the three categories outlined in section 607 of the Millennium Challenge Act of 2003—ruling justly, economic freedom, and investing in people—16 indicators that it uses to measure candidate countries' commitments to growth. Indicators for the first two categories have been well chosen, although the selection process for "investing in people" indicators has proven more cumbersome. These wise choices have already borne results by providing clear targets of institutional change for countries competing for access to MCC funds.

To date, MCC has seen some real and substantial results from its efforts. Although it has signed nine compacts granting over $2.1 billion in aid,[3] the real results have been seen in the incentivizing work done by the indicators. For example, in 2005, 43 countries worldwide made it easier to start a business, and "more reforms took place in Africa than ever before."[4] This is compared to only two countries in Africa that made it easier to start a business in 2004.[5] According to *Doing Business in 2007*, "three MCA-eligible countries [were] among the 10 most aggressive reformers of the past year: Georgia; Ghana; and Tanzania."[6]

Because the indicators have been highly effective in creating incentives, MCC must choose new indicators carefully and provide clear analyses of proposed indicators.

In 2005, MCC sought input from the academic community, public and private sector practitioners, and NGOs in "finding a better measure of a country's demonstrated commitment to '. . . economic policies that promote . . . the sustainable management of natural resources.'"[7] After sifting through many proposals, two have been chosen to garner additional comments and testing. We present here a critical evaluation of the choices made and initiated in FY2007 criteria and methodology report.

B. Key Concepts of MCC

The key way in which MCC fundamentally differs from other government aid programs is that MCC aims to address the cause of poverty rather than bandage over its effects. Although it is a simple concept, government aid organizations have never provided aid conditional on pro-growth institutional change effectively.[8]

[3] Millennium Challenge Corporation, "Budget Justification 2007," http://www.mcc.gov/about_us/key_documents/FY07_Budget_Justification.pdf.
[4] World Bank and International Finance Corporation, *Doing Business in 2007: How to Reform* (Washington, DC: World Bank Group, 2006). The "Doing Business" website is located at http://www.doingbusiness.org.
[5] Ibid.
[6] Millennium Challenge Corporation, "Annual Report of International Finance Corporation Highlights Reform Incentives Created by Millennium Challenge Corporation" (press release, September 23, 2006), http://www.mcc.gov/public_affairs/press_releases/pr_090606_IFC.shtml. In other copies of this press release, Armenia was added as a fourth country. However, Armenia and MCC have already signed a compact, so Armenia is technically not an "eligible country."
[7] Millennium Challenge Corporation, "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2007" (September 8, 2006), http://www.mcc.gov/about_us/congressional_reports/FY07_Criteria_Methodology.pdf.
[8] Although the idea of conditionality has been tried before by various international institutions, MCC has devised a new way to make aid conditional by incentivizing micro-institutional change. In this sense, it is novel and holds new promise.

It is worth recalling why economic growth is important and how it occurs. At its core, economic growth occurs when factor productivity increases; that is, when entrepreneurs find new ways to more cheaply combine resources to make things that people value. The fruits of this innovation are the goods and services that allow people to live longer, healthier, and better lives. In the long run, economic growth rolls back the frontier of poverty.

The gains from entrepreneurial activity cannot be sustained without extended trading activities. As the realm of exchanges grows, entrepreneurs can take better advantage of a greater division of labor and knowledge and increase the size of their investments. As trade expands, more and more poor people can experience the improved living standards, longer and healthier lives, and the comforts that a rich country's residents take for granted.[9]

Moreover, economic growth creates a virtuous cycle by reducing strife, instability, and social stratification. As economist Benjamin Friedman argues, "Economic growth . . . fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy."[10]

But this growth must occur endogenously within the cultural and political institutions of a country. In the words of William Easterly: "Markets everywhere emerge in an unplanned, spontaneous way, adapting to local traditions and circumstances, and not through reforms designed by outsiders. The free market depends on the bottom-up emergence of complex institutions and social norms that are difficult for outsiders to understand, much less change."[11]

Every country that has grown prosperous has followed a recipe of economic freedom, security of property, trade, and fiscal restraint. To the extent that MCC's indicators identify and reward national policies that promote these policies, MCC promotes economic growth. But if its indicators force countries to sacrifice economic growth in the name of narrow interests, it fails.

Finally, in order to promote pro-growth policies, MCC must clearly separate the causes of growth from its effects. Environmental protection, improved health outcomes, and quality education are the effects of growth, not its causes. Instead, a productive institutional environment for trade and entrepreneurship is the cause of growth.

[9] See Peter T. Bauer, *From Subsistence to Exchange* (Princeton, NJ: Princeton University Press, 2000). On the role of entrepreneurship, see Israel Kirzner and Frederic Sautet, *The Nature and Role of Entrepreneurship in Markets: Implications for Policy*, Mercatus Policy Series, Policy Primer No. 4 (Arlington, VA: Mercatus Center at George Mason University, 2006), http://www.mercatus.org/Publications/pubID.2492/pub_detail.asp.
[10] Benjamin M. Friedman, *The Moral Consequences of Economic Growth* (New York: Knopf, 2005), 4.
[11] William Easterly, *The White Man's Burden* (New York: Penguin Press, 2006), 61.

Confusing the effect with its cause is likely to achieve neither. MCC is tasked with the narrow mission of promoting the growth from which the effects will follow. As a result, MCC must maintain a laser focus on the causes of growth and not try to artificially stimulate its effects.

C. The Two Proposed Indicators

C1. What is the legislation intended to achieve?

Any discussion of a proposed natural resource management indicator must take place squarely within the context of the legislative authority granted to MCC. MCC's mandate on natural resources stems from section 607(b)(2), which specifies that candidate countries should have demonstrated a commitment to "economic freedom, including a demonstrated commitment to economic policies that . . . promote private sector growth and the sustainable management of natural resources."[12]

Within this context, the purpose is clearly to encourage private-sector growth based on actual growth of productivity while ensuring that Gross Domestic Product (GDP) growth is not simply an artifact of unsustainable plunder of natural resources. Within the context of economic freedom, a natural resource indicator would check a government's desire to control (and eventually overexploit) its natural resources.[13]

Unsustainable economic growth—that which is based solely on resource extraction and depletion—must not be confused with the sustainable economic growth flowing from entrepreneurship flourishing within a supporting institutional framework.

Having discussed the legislative mandate for a natural resource indicator and how such an indicator relates to MCC's mission, we consider the specifics of the suggested indicators.

C2. The Yale/Columbia Natural Resource Management Indicator

The Natural Resource Management Index (NRMI), the first of the two proposed natural resource management indicators, is the joint work of Columbia University's Center for International Earth Science Information Network (CIESIN) and the Yale Center for

[12] Millennium Challenge Act of 2003, Pub. L. 108-199, Division D, Title VI,
http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:h2673enr.txt.pdf.

[13] A detailed discussion of the connection between government-controlled natural resources and poverty and underdevelopment is presented in Frederic Sautet, Brian Hooks, and Daniel M. Rothschild, "The Challenge Ahead: Maintaining a Focus on Incentives to Enable Development" (Mercatus Center public interest comment filed with the Millennium Challenge Corporation, October 2005),
http://www.mcc.gov/countries/selection/comment/FY06/Mercatus_Center_Comment_FY06.PDF.

Environmental Law and Policy (YCLEP). It consists of four sub-indicators covering biome protection, access to sanitation, access to water, and non-infant child mortality.

C2-1. Eco-region protection in NRMI

The eco-region sub-indicator is part of a larger twelve-indicator Environmental Protection Index (EPI) crafted by CIESIN and YCLEP. In order to measure wildlife and biodiversity protection, it measures whether or not candidate countries have formally protected at least ten percent of all biomes within their borders.

As discussed at length in a comment filed last year,[14] environmental protection is a consequence and not a cause of economic growth: as countries get richer, people devote more resources to environmental protection. In the language of economics, environmental protection is a "superior good," something to which people devote an increasing proportion of their disposable income as it increases.

By inventing a mandate for environmental protection in the selection process, MCC exceeds its authority. What's worse, in so doing, it threatens to act against its mission to pursue economic growth and poverty alleviation as environmental protection does not lead to economic growth and poverty alleviation. If MCC remains true to its mission, however, environmental protection will likely result as economic growth yields increased environmental protection.

NRMI's sub-indicator of eco-region protection, then, fails as an economically sound and mission-relevant criterion on which to judge candidate countries. This indicator is not related to a country's commitment to economic freedom and does not even attempt to address MCC's core mandate—poverty alleviation through economic growth. In effect, it asks countries to achieve the outcomes of development before development occurs.

This indicator also establishes a dangerous precedent: it is the first indicator that, in essence, writes national policy for candidate countries. A key MCC goal is local policy ownership and allowing countries to find indigenous routes to better outcomes. Policy ownership by recipient countries is a tenet of MCC, because policies designed by their owners work better than policies designed in Washington.

Besides these fatal flaws, there are several additional problems with this indicator. First, this indicator raises the larger problem of measuring *activities*, not *outcomes*. Even if increased biodiversity were a legitimate outcome of MCC—an idea for which there is no legislative or economic authority—MCC admits that this indicator "does not measure the effectiveness" of habitat

[14] Sautet, Hooks, and Rothschild (2005).

protection and biodiversity programs.[15] This is in no small part because the sub-indicator examines only *de jure* land policies, not the *de facto* on the ground reality.

Second, NRMI has poor data quality. As even its creators admit, "The EPI should be seen as a pilot index because a number of serious data gaps and methodological questions remain open. Data gaps relate to both the lack of available information on important environmental policy issues and serious shortcomings in the quality, geographical coverage, or timeliness of the available data."[16] Moreover, "[D]ata are often not measured widely enough or with a sufficient degree of methodological consistency to be useful within the context of a broad analysis." This lack of data is likely to produce biased and inaccurate results. Additionally, it violates MCC's own policy that indicators should "utilize objective and high-quality data" and "have broad country-coverage and [be] comparable across countries."[17]

Third, the selected criteria also appear to be arbitrary. For instance, there is no explanation of how the ten percent goal for protection came to be. The sub-indicator does not give candidate countries the chance to consider trade-offs to development and the alternative uses of protected biomes. Without each country performing an analysis of tradeoffs, the biomes indicator would be micromanaging a very important decision that each country should make itself. Moreover, according to CIESIN's own data, the United States and 24 of the 25 European Union countries do not meet the ten percent goal.[18] It is neither logical nor fair to expect developing countries to dictate tighter management of the environment than the world's wealthiest nations.

One need not stretch to imagine the trade-offs this indicator could entail: for countries with less than ten percent protection, the policy interventions necessary to meet this indicator may involve driving people off their land, violating the property rights of landowners, splitting up communities, or making decisions about what should be protected in ways that benefit politically favored ethnic or tribal groups. In other words, complying with this indicator may create substantial disruption and hardship.

[15] "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2007," 2-3.
[16] Yale Center for Environmental Law and Policy and Center for International Earth Science Information Network, *Pilot 2006 Environmental Performance Index* (New Haven, 2006), 280, http://www.yale.edu/epi/2006EPI_Report_Full.pdf.
[17] Millennium Challenge Corporation, "Millennium Challenge Account–Indicator Descriptions," http://www.mcc.gov/countries/selection/Extended_Descriptions_Selection_Criteria.pdf.
[18] *Pilot 2006 Environmental Performance Index*, 92-93.

Thus, given the uncertainty of the benefits it is particularly troublesome.

Overall, this sub-indicator would require people who are barely able to feed their families to invest in a public good for which they do not have the income. Environmental conservation is a worthy goal, but it cannot be done and should not be attempted by government fiat. Rather, environmental improvements result from economic growth. Because this sub-indicator will not yield the intended outcome, MCC would be irresponsible in accepting it as a criterion for country selection.

C2-2. Confusing Cause with Effect in NRMI

While well-intentioned and noble in sentiment, the other three sub-indicators in NRMI—access to sanitation, access to water, and non-infant child mortality—also confuse the causes and effects of economic growth. It is because these are desirable goals that we want economic growth—not the other way around.

Reduced non-infant child mortality is a noble goal, but again, it is the result of economic growth, not its cause. As the Center for Global Development correctly points out, "the child mortality index is an output, not a policy that government can change."[19] Countries can no more flip a switch and instantly lower child mortality rates than they can wish environmental quality into existence.

Moreover, as others have noted,[20] the data used in the sanitation, water access, and child mortality sub-indicators are updated very infrequently—the most recent data are from 2002—which violates MCC's definition of good indicators.

But more importantly, these sub-indicators do not measure the "economic freedom" category in which the natural resource mandate resides. If MCC wishes to place the sub-indicators in the "investing in people" category, it should take a closer look at the statutory requirements for inclusion in that category.

C2-3. Legislative Intent and NRMI

The hunt for a natural resource indicator began by searching for an indicator to quantify an aspect of the "economic freedom" category. However, NRMI taken as a whole does not meet the criteria established under the Millennium Challenge Act of 2003 for inclusion as a country selection indicator. Indeed, by suggesting that it be included in the "investing in people" category, MCC tacitly admits this. However, Congress was explicit about what is acceptable for MCC to consider in that category as well, and it is dubious

[19] Steve Radelet, Sarah Rose, and Sheila Herring, *Adding Natural Resource Indicators: An Opportunity to Strengthen the MCA Eligibility Process* (Washington, DC: Center for Global Development, 2006), 4, http://www.cgdev.org/files/10103_file_MCCnatural_resource.pdf.

[20] See, inter alia, Radelet, Rose, and Herring (2006), 4.

at best to assume that NRMI would meet those requirements upon a detailed analysis.

This is neither a trivial question nor a simple matter of organization. What has occurred is a classic example of a program straying from its legislative intent—which, as we discuss previously, risks rendering MCC ineffective and thus irrelevant.

MCC began the indicator search process in 2005 with a simple question: what indicator might measure the sustainable management of natural resources? By the time it developed an answer, it had changed the question—to one about a country's investment in sanitation and biome protection. This is just the kind of mission creep that MCC must avoid.

Straying this far from the intent of Congress threatens MCC's long-term viability and America's commitment to growth-based poverty reduction. The gravity of adopting an indicator that is so far afield from MCC's mission is difficult to understate.[21]

C3. The Land Access Indicator

In contrast to the NRMI, the Land Rights and Access Index (LRAI), based on sub-indicators developed by the International Fund for Agricultural Development (IFAD) and the International Finance Corporation (IFC), proves to be a much more growth-relevant means of tracking natural resource management. This measure would provide a much better indicator of effective natural resource management as it relates to economic freedom and encouraging economic growth as mandated by MCC's mission.

By selecting this indicator, MCC would recognize that effective land titling mechanisms and well-functioning markets in land are important means to enable economic freedom and stimulate entrepreneurship, which are the necessary conditions to create the incentives that allow conservation of natural resources. As we note in our introduction, the Act recognizes that economic growth occurs best in an environment of secure property rights and the institutions that support these rights.[22]

One of the key benefits of LRAI is that its sub-indicators are quickly actionable; candidate countries can implement policy changes in a matter of weeks or months that will bear fruit quickly. This meets MCC's goal that indicators

[21] See Sautet, Hooks, and Rothschild (2005) for a detailed legislative history.

[22] On property rights, see Karol Boudreaux, *The Role of Property Rights as an Institution: Implications for Development Policy*, Mercatus Policy Series, Policy Primer No. 2 (Arlington, VA: The Mercatus Center at George Mason University, 2005), http://www.mercatus.org/Publications/pubID.2211/pub_detail.asp. On institutions and growth more broadly, see Daron Acemoglu, Simon Johnson, and James Robinson, "Institutions as the Fundamental Cause of Long-Run Growth" (working paper 10481, NBER, May 2004), http://papers.nber.org/papers/w10481.pdf.

"measure factors that governments can influence within a two to three year horizon."[23] Perhaps more importantly, LRAI identifies outcomes that candidate countries can address through a number of different policy interventions, thereby truly owning the policies. This allows for *de jure* changes that are more likely to align with *de facto* social norms and informal institutions, which is a crucial factor in encouraging successful public policy.[24]

While LRAI is a vastly preferable indicator to NRMI, it is not without its faults. Gaps in the data need to be filled before the indicator meets the legislative criteria for selection. Because of this, the indicator should remain on watch for another year before MCC uses it to select compact countries.

We turn now to specific analysis of the sub-indicators dealing with urban and rural issues.

C3-1. Rural Issues: Land Access

Fundamentally, LRAI creates incentives against government depredation of natural resources while avoiding the pitfalls of NRMI detailed above. In the process, it creates incentives for long-term environmental protection. The greatest strength of this sub-indicator is that it would lead to desirable results through creating proper incentives that would achieve the goals NRMI seeks to impose through command-and-control means.[25] By measuring land access and the ability of rural dwellers to make effective local choices about land use, LRAI checks government policies that tend toward the "natural resources curse," and it empowers both the public and private sectors to address critical needs of conservation, sanitation, clean water access, and childhood mortality problems.[26]

Unlike NRMI, which focuses on the effects of development, the land access sub-indicator reflects the causes of development. Indeed, as MCC correctly argues, "Secure land tenure is a critical component of sustainable natural resource management because those who lack clear ownership or use rights to their land are less likely to make long-term investments in land productivity and more likely to make short-term decisions with negative environmental impacts such as deforestation."[27]

[23] "Millennium Challenge Account—Indicator Descriptions."
[24] See Sautet, Hooks, and Rothschild (2005).
[25] On how property rights lead to environmental protection, see Karol Boudreaux, *Community-based Natural Resource Management and Poverty Alleviation in Namibia: A Case Study for Enterprise Africa!*, Mercatus Policy Series, forthcoming.
[26] See Edella Schlager and Elinor Ostrom, "Property Rights Regimes and Natural Resources," *Land Economics* 68, no. 3 (August 1992): 249-62; Gershon Feder and David Feeny, "Land Tenure and Property Rights: Theory and Implications for Development Policy," *World Bank Economic Review* 5, no. 1 (1991): 135-53.
[27] "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2007," 5.

By identifying the pertinent incentives, MCC identifies the best way to encourage stewardship of the environment, not fall prey to the natural resources curse.[28] Encouraging developing countries to promote the long-run incentives commensurate with secure land title will do more in the long run to promote conservation and species diversity than the best-intentioned policies imposed from abroad.

By replacing a prescriptive indicator with one focusing on the necessary institutions, MCC will better serve the cause of sustainable natural resource management. Such an incentive structure makes environmental protection possible because, in the face of long-term incentives to conserve natural resources, ecological protection can be a growth-enhancing activity rather than a growth-retarding one. Additionally, as explained above, entrepreneurship and trade within the right institutional context are the main factors of development. Land access rights are essential to that process because entrepreneurship and trade depend upon them.[29]

Finally, it is important that indicators not look merely at the *de jure* institutional environment but the *de facto* one as well. A significant body of economic and legal research indicates that these two environments are frequently quite different, which allows outsiders to confuse the laws on the books with the reality on the ground. It is unclear whether LRAI distinguishes between *de jure* and *de facto* reforms. However, the policy of employing "actual performance assessments by the respective country teams, consisting of the country programme manager and the regional economist"[30] suggests a commitment to measure *de facto* realities. This speaks favorably for IFAD and suggests that the land access sub-indicator is a particularly strong measurement tool.

C3-2. Urban Issues: Days and Cost to Register Title

Like the land access sub-indicator, these items are easily actionable by recipient country governments and can show quick results in countries committed to economic freedom and economic opportunity. Much like the "days to start a business" and other widely-touted MCC economic freedom indicators, the days and

[28] The natural resources curse is discussed in Sautet, Hooks, and Rothschild (2005), 15. See also Peter Heller and Sanjeev Gupta, "Challenges in Expanding Development Assistance" (IMF Policy Discussion Paper PDP/02/5, 2002); Jeffrey Sachs and Andrew Warner, "Natural Resource Abundance and Economic Growth" (working paper 5398, NBER, December 1995), http://www.nber.org/papers/w5398.pdf.
[29] Ganesh Shivakoti, George Varughese, Elinor Ostrom, Ashutosh Shukla, and Ganesh Thapa (eds.), *People and Participation in Sustainable Development: Understanding the Dynamics of Natural Resource Systems* (Bloomington: Workshop in Political Theory and Policy Analysis, Indiana University, 1997).
[30] International Fund for Agricultural Development, *2004 Progress Report on the Implementation of the Performance-Based Allocation System* (Rome: IFAD, 2005), http://www.ifad.org/gbdocs/gc/28/e/GC-28-L-9.pdf.

cost to register title sub-indicators get to the root, through outcomes-based tools, of the barriers that can stifle entrepreneurship and economic growth.

Indeed, it could be argued that these sub-indicators are the other side of the coin of the business and entrepreneurship indicators found in the economic freedom category. As with the business and entrepreneurship indicators, the title registration sub-indicators could very likely benefit from the "MCC effect" and see median times and costs fall sharply within a short amount of time of their incorporation into MCC decision-making matrix. For urban communities, the benefits of this would be enormous.

The International Finance Corporation recognizes the importance of the *de facto* in their data collection process instead of just focusing on the *de jure* arrangements. The data are collected through "local experts, including lawyers, business consultants, accountants, government officials, and other professionals routinely administering or advising on legal and regulatory requirements" through several rounds of interaction.[31]

Because they are quickly actionable, focused on *de facto* realities, and closely tied to economic freedom, these sub-indicators are some of the most promising innovations of the last two years.

D. Looking Forward

The FY2007 criteria and methodology report fails to address a standard suggested in the public comment last year.[32] We again suggest that MCC and Congress should ask a simple question of any proposed indicator: how does this indicator help us to know more about a country's commitments to economic freedom? Unfortunately, the answer with NRMI appears to be: it does not.

This is a critical time for MCC both politically and institutionally. While MCC has been given substantial leeway in its first four years, policy makers and the public at large would be right to grow increasingly skeptical in the future. MCC must remain accountable, mission-focused, and have real results to show if it is going to continue to exist.

Because of this, MCC must remain true to its mission and strictly adhere to it its role in the American development program—and to policy solutions that actually work. As President Bush stated in 2003, "The goal of the Millennium Challenge Account initiative is to reduce poverty by significantly increasing economic growth in recipient countries . . . . "[33] MCC is not a generalist

[31] *Doing Business in 2007*, 61.

[32] Sautet, Hooks, and Rothschild (2005).

[33] Transmission letter from President Bush to the Congress proposing MCA and MCC, *Congressional Record* (March 6, 2003): S 3329.

aid agency, but one with a narrow mission and clear measures of accountability. This is its strength and something to be guarded dearly by those entrusted with the new organization's formative years.

To this end, MCC must continue to embrace three key concepts:

1. **Institutions are vital to growth.** If we have learned nothing else from fifty years of failure in development policy, we have learned that prosperous and free societies come from strong and effective indigenous institutions that support economic freedom, property rights, and peace.[34]

2. **The only path to development is an indigenous one.** Development is something a country must do, not something that must be done to it. The United States and other developed countries can offer assistance and incentives to promote grassroots poverty alleviation, but we cannot lead the effort. Because of the importance of local knowledge and institutions, policies that underlie economic growth must have the support of the institutions and the people in candidate countries and cannot be imported from abroad.

3. **Entrepreneurship and trade are the keys to economic growth.** People must be given the possibility to bet on the future using the resources they own and to reap the fruit of their bets. It is only through the development of entrepreneurial activity and the expansion of trading that economic growth and poverty alleviation takes place.

If MCC remains true to these three points and keeps its mission sharp and focused, it retains the potential to be a transformation in government-based international economic development. But if it wanders from its mandate and its mission becomes dull and broad, it will end up in the historical dustbin of failed ideas. And the world's poor will be worse off for it.

We conclude with two specific recommendations for the new indicators proposed by MCC.

1. MCC should abandon the Natural Resource Management Index (NRMI) for its failure to separate the causes from effects of economic growth, its command-and-control mechanism that ignores local knowledge and institutions, the hardships that compliance with it would impose, and its poor data quality. This indicator may serve the desires of certain narrow interests but would likely retard rather than encourage economic growth. Moreover, NRMI has no basis in

[34] See Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990).

legislation and would reflect a substantial and dangerous mission creep if adopted.

2. MCC should adopt the Land Rights and Access Index (LRAI) and place it in the economic freedom category because it reflects the true mission of MCC and addresses that part of the legislative mandate. However, it should only be advisory until the data quality is improved and then be revisited next year. Because LRAI furthers economic freedom, it also enhances growth and development.

In order to maintain its credibility and potential for success, MCC must aggressively focus on its mission of alleviating poverty through promoting economic growth. MCC must continue to be guided by sound economic principles and its legislative mandate. At this critical time, MCC must prove that it can do just that.

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