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THE MCC AT FIVE: CONTINUING TOWARD A GROWTH-BASED POVERTY REDUCTION POLICY

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Introduction and Overview

After only five years of existence, the Millennium Challenge Corporation (MCC) has inspired new thinking about western governments' approaches to international aid. By focusing on the policies and institutions that provide the framework for growth-based development through entrepreneurship and trade, the MCC's poverty reduction model promises to be one of the most sustainable and successful government-based development programs.

Critically, the MCC has remained focused on its sole mission: to promote international development through economic growth. Although it has not always remained completely faithful to its mission, the indicators it uses to select candidate countries have broadly stuck to their legislative mandates and in most cases demonstrate a clear, causal link to economic growth and poverty reduction. Maintaining focus on this narrow mission and avoiding becoming another catch-all international aid bureaucracy is vital to the MCC's long-term success.

[1] This is a Public Interest Comment from the Mercatus Center's Global Prosperity Initiative submitted in response to the "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2008." It does not represent an official position of George Mason University.

The indicator selection process has been no simple task. A wide array of organizations with different interests have suggested the inclusion of divergent indicators that are frequently irrelevant to—or even at odds with—growth-based poverty reduction. While some policies and institutions that support growth are relatively easy to measure, such as the days and cost to start a business, others such as access to land and security of title are much more complex and do not lend themselves to easy quantitative measurement. The MCC is to be commended for taking a careful approach in selecting the Land Rights and Access Index (LRAI) and avoiding the temptation to include simplistic, misleading measures of complex questions.

Placement and Combination of Current Indicators

We argued strenuously last year against the inclusion of the Natural Resources Management Indicator (NRMI) in the MCC's selection criteria on the grounds that it:

- confuses the causes and effects of economic growth;
- ignores local knowledge and institutions;
- would impose significant hardships;
- contains data of poor quality by the MCC's own standards;
- may create incentives that work against rather than for economic growth; and
- reflects a dangerous mission creep away from the MCC's legislatively authorized purpose.

Simultaneously, we argued that the LRAI better reflects the MCC's mission by directly measuring an important institutional question related to economic freedom and growth.

Because it measures an important aspect of economic freedom, we applaud the MCC's decision to include the LRAI in the "Economic Freedom" category, although would prefer the indicator to remain advisory until data quality issues are resolved. We agree that the NRMI does not belong in the "Economic Freedom" category since there is no relationship between this indicator and economic freedom. It is preferable to place it in the "Investing in People" category, which deals with health and education policies, although we reiterate our concern that the indicator does not measure any meaningful pro-growth investment in people or follow the intent of Section 607(b)(3) of the Millennium Challenge Act.

The "Days to Start a Business" and "Cost to Start a Business" indicators can, we believe, be effectively combined into a single index, as they effectively measure similar phenomena and have already enjoyed substantial successes in promoting pro-growth policies by candidate and potential candidate countries. The MCC might consider adding a third element to this index to measure the costs of exiting a business, as these have impacts similar to barriers to entry.[2] The MCC should take appropriate steps to counsel countries to maintain a focus on policy reforms that promote entrepreneurship broadly.

[2] The MCC may wish to refer to the business closing data in World Bank's *Doing Business 2008*.

Education Indicators

The MCC deserves plaudits for the careful approach it is taking in the FY2008 indicator selection process. Rather than adopting education indicators that do not meet the MCC's own criteria for quality, the organization does itself a great favor by demonstrating a reserved approach and carefully considering how any potential indicator is both:

1) an indicator of educational *outputs* rather than *inputs*, and
2) directly "policy linked … [to] factors that governments can influence within a two- to three-year horizon."[3]

Given the difficulty that wealthy western countries have had with measuring educational progress and attaining improved outcomes despite significant effort and cost, we are somewhat skeptical that developing countries can achieve this seemingly elusive goal. Attempts to ascertain educational quality even across county and state lines in the United States have proved remarkably expensive, and have yielded problematic data.

The problem is further complicated in the international context because educational needs are deeply embedded in cultural, social, and economic norms and realities that are specific to places and times. That is, there is no universal definition as to what constitutes a quality education. Therefore, finding an indicator that is "comparable across countries" and enjoys "broad country coverage" may be impossible.

Indicators which seek to measure "the extent to which government inputs are being translated into improved educational quality and learning outcomes" are likely to miss the impact that private education has on overall educational outcomes. For example, where there are strong teacher unions, using teachers' salaries as an "input" may reflect the demand from the teachers' unions to be paid above market wages, not the quality of education. In some circumstances, deregulating private schools—or even acknowledging their existence, which some governments do not—may be the action most conducive to improving educational outcomes.

Because most poor countries do not have a well-developed infrastructure for public education, resources dedicated to public education are often wasted. As recent research shows, entrepreneurs in the private sector frequently offer innovative solutions to the demand for education.[4] Therefore, while we remain skeptical about the relevance of including an additional educational indicator in the MCC's selection criteria, we strongly urge any further investigation into this subject to include privately provided education as well as public educational programs, noting that educational entrepreneurs, like other entrepreneurs, are critical to growth and innovation. Such an investigation could also measure the regulation of private-sector education

[3] Millennium Challenge Corporation, "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance in Fiscal Year 2008," (September 2007).

[4] See, inter alia: James Tooley and Pauline Dixon, "Private schooling for low-income families: A census and comparative survey in East Delhi, India," *International Journal of Educational Development* 27, 2 (2007): 205–19; James Tooley, "Educating Amaretch: Private schools for the poor and the new frontier for investors," *Economic Affairs* 27, 2 (2007): 37–43.

and whether candidate countries acknowledge and allow private educational institutions to operate.

Moreover, educational quality is seldom improved by quick fixes by policy makers but, as with the improvement of any good or service, is the result of experimentation and learning over a longer term. The MCC rightly stresses the importance of indicators being policy linked and actionable over a two- to three-year time horizon, and any educational quality indicator adopted by the MCC should be certain to adhere to this.

The process for selecting new indicators can be controversial and challenging, given that many of the things that are most important to growth-based poverty reduction are also the most difficult to measure. The MCC should be applauded for taking a cautious approach with respect to adding an additional educational indicator.

Conclusion

Over the coming years, the MCC will undoubtedly face pressure from various interests to meet narrow agendas that may have little to do with, or even be counterproductive to encouraging economic growth.

In order to prove to policymakers and the general public that its model is unique and it can achieve results where other programs and agencies have failed, the MCC must retain its sharp focus on growth-based poverty reduction. To this end, indicators must create incentives for and reward countries that bolster the policies and institutions that promote real economic growth led by entrepreneurship and trade.

Especially critical is proving that the “MCC effect” is indeed real. For this reason, indicators must be policy linked and actionable on a short time frame. The days and cost to start a business indicators are excellent examples of this, and future indicators must also be immediately actionable by candidate country governments. This will encourage an “MCC effect” in candidate countries, which will bear fruits even before compacts are drafted, and it will prove to Congress and the public that the MCC is capable of achieving results. At the same time, the MCC must encourage candidate countries to make deeper reforms that translate into actual improvements, cognizant of the gap that often exists between laws on the books and the reality on the ground.

As we wrote last year, the MCC is entering a critical phase of its development and needs to prove its potential. For this reason, indicators must continue to focus on the policies that promote economic growth and are quickly actionable by developing country governments. Through these indicators and the incentives they create, the MCC has a very good chance to prove how incentives matter in foreign aid and that growth-based poverty reduction works.