‘Old’ Approaches to the Environment in the ‘New’ Foreign Aid of the Millennium Challenge Corporation: The Importance of Property Rights

Isaac Post
Competitive Enterprise Institute

The Millennium Challenge Corporation is a foreign aid initiative that was conceived with the view that economic growth is the essential ingredient for eliminating poverty in developing countries. Unlike previous foreign aid programs, the MCC encourages this process by limiting aid to a country that demonstrates a commitment to good governance, economic freedom and investments in its people. But the MCC’s interpretation of environmental issues echoes the thinking of the “old” foreign aid from which it was supposed to differ.

New economic research regarding the relationship between economic growth and the environment, and the role of institutions in economic development underscores the inadequate foundation upon which this interpretation lies. It is suggested that the MCC’s concerns can be met with a focus on private property rights, as their recognition allows for the rational balancing of trade-offs that is essential for wise environmental stewardship.

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In January 2004, President George W. Bush signed the Millennium Challenge Act (MCA) into law. The Act created a new government corporation, the Millennium Challenge Corporation (MCC), that would be responsible for allocating foreign development assistance grants (“foreign aid”). But unlike previous foreign aid programs, to be eligible for MCC grants, a candidate country would have to demonstrate a commitment to (a) just and democratic governance, (b) economic freedom, and (c) investments in its people, particularly women and children. While such an emphasis on institutions and economic freedom was a significant departure from conventional thinking on foreign aid, it was not a complete departure: the MCA’s references to the environment maintained a link to the conventional view. This fact encouraged the MCC to launch a search for a specific environmental indicator in early 2005.¹

This paper has two main purposes. First, it will challenge the assumption that such an indicator is meaningful and useful by re-assessing the relationship between the health of the environment and the promotion of economic growth and poverty reduction, the latter being the explicit purpose of the MCA. Second, this paper will argue that, within the context of economic development, the conventional emphasis of an environmental indicator on environmental inputs and outputs is misplaced: the focus should be on economic institutions, especially property rights.

This paper is divided into three sections. In the first part, I explain the origins of the MCC and why it represents a break with traditional foreign aid, except for its incorporation of environmental issues. In the second part, I explore the relationship

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¹ In this context, an indicator is simply a measurement – a statistic – that indicates the economic, political, social or environmental condition of a country. For example, a well-known indicator of a country’s standard of living is Gross Domestic Product per person. As of this writing, the results of the MCC’s search for an environmental indicator are not complete.
between the environment, economic growth and poverty reduction and examine why the use of an environmental indicator, as viewed by the MCC, is problematic. In the third part, I argue that property rights and a focus on economic institutions, generally, are a more useful indicator for foreign aid programs, like the MCC, that seek to encourage both economic growth and a healthy environment.

The “New” Foreign Aid of the Millennium Challenge Corporation

Standing alongside U2 lead singer Bono in March 2002, President Bush announced the formation of a “new compact for global development, defined by new accountability.” As he explained it:

Countries that live by these three broad standards—ruling justly, investing in their people, and encouraging economic freedom—will receive more aid from America. And, more importantly, over time, they will really no longer need it, because nations with sound laws and policies will attract more foreign investment…earn more trade revenues…and find that all these sources of capital will be invested more effectively and productively to create more jobs for their people.

Heeding the president’s call, Congress passed the Millennium Challenge Act of 2003. The Act created a new government corporation, the Millennium Challenge Corporation (MCC), to be responsible for granting the development aid. The MCC selected 16 quantifiable indicators to determine how well a candidate country’s policy

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2 The emphasis on private sector economic growth as the key to reducing poverty is even stronger in the MCC’s Background Paper on Implementing the Millennium Challenge Account: http://www.mcc.gov/about_us/key_documents/MCA_BackgroundPaper_FactSheet.pdf

3 The legislation is available at http://www.mcc.gov/about_us/key_documents/MCA_Legislation.pdf
environment reflected the three broad criteria, using data from respected, established sources (see Figure 1).

<table>
<thead>
<tr>
<th>Category</th>
<th>Indicator</th>
<th>Source</th>
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<tr>
<td>Ruling Justly</td>
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<td>Political Rights</td>
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<td>Rule of Law</td>
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<td>Government Effectiveness</td>
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<td>Voice and Accountability</td>
<td>World Bank Institute</td>
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<td>Economic Freedom</td>
<td>Days to Start a Business</td>
<td>World Bank Institute</td>
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<td></td>
<td>Cost of Starting a Business</td>
<td>World Bank Group</td>
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<td>Fiscal Policy</td>
<td>National Governments/IMF</td>
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<td>World Bank Group</td>
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<td>Regulatory Quality</td>
<td>Heritage Foundation</td>
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<td></td>
<td></td>
<td>Index of Economic Freedom</td>
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<tr>
<td>Investing in People</td>
<td>Public Expenditures on Health as % of GDP</td>
<td>National Governments</td>
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<td>Immunization Rates: DPT3 and Measles</td>
<td>World Health Organization</td>
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<td>Public Primary Education Spending as % of GDP</td>
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<td></td>
<td>Girls Primary Education Completion Rate</td>
<td>World Bank/UNESCO</td>
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Figure 1:

MCC Indicators for Establishing Aid Eligibility  
(Source: www.mcc.gov)

To be a candidate for aid, countries must (a) be a “lower” or “lower middle” income country and not be on the list of countries that are prohibited from receiving U.S. foreign aid; (b) “perform above the median (in relation to its peers) on at least half of the indicators in each of the three policy categories”; and (c) submit a ‘Compact Proposal’

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4 See the list of 69 low-income and 29 lower-middle income countries that are MCC candidate countries for Fiscal Year 2006 [http://www.mcc.gov/countries/candidate/FY06_candidate_report.pdf](http://www.mcc.gov/countries/candidate/FY06_candidate_report.pdf)

5 See the MCC’s report on the criteria and methodology for country eligibility [http://www.mcc.gov/about_us/congressional_reports/FY06_Criteria_Methodology.pdf](http://www.mcc.gov/about_us/congressional_reports/FY06_Criteria_Methodology.pdf)
that identifies how they will spend the aid money. In addition, the MCC emphasizes the importance of “country ownership” of a compact. This is the idea that policymakers in developing countries—as opposed to MCC staff or U.S. government bureaucrats—should be the ones to set priorities regarding what programs to finance with an MCC grant.

As of this writing, 23 countries are eligible to submit compact proposals to the MCC. Of these, the MCC has signed compacts—formal agreements to give foreign aid grants—with eight countries for more than $1.5 billion over a multi-year period.

<table>
<thead>
<tr>
<th>Date Signed</th>
<th>Country</th>
<th>Amount (millions U.S. $)</th>
<th>Time Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2005</td>
<td>Madagascar</td>
<td>110</td>
<td>4 years</td>
</tr>
<tr>
<td>June 2005</td>
<td>Honduras</td>
<td>215</td>
<td>5 years</td>
</tr>
<tr>
<td>July 2005</td>
<td>Cape Verde</td>
<td>110</td>
<td>5 years</td>
</tr>
<tr>
<td>July 2005</td>
<td>Nicaragua</td>
<td>175</td>
<td>5 years</td>
</tr>
<tr>
<td>September 2005</td>
<td>Georgia</td>
<td>295.3</td>
<td>5 years</td>
</tr>
<tr>
<td>February 2006</td>
<td>Benin</td>
<td>307</td>
<td>5 years</td>
</tr>
<tr>
<td>March 2006</td>
<td>Vanuatu</td>
<td>65.69</td>
<td>5 years</td>
</tr>
<tr>
<td>March 2006</td>
<td>Armenia</td>
<td>235.65</td>
<td>5 years</td>
</tr>
</tbody>
</table>

Figure 2: Signed MCC Compacts
(Source: www.mcc.gov)

Thus far, the critical response to the MCC’s work has been mixed, with healthy skepticism being the dominant sentiment. For example, Rieffel and Fox (2005) argue that the MCC “has been less political and therefore better positioned to allocate funding

Note that countries must perform above the median of its peers on the corruption indicator and have an annual inflation rate of less than 15 per cent.

6 For an example, see the proposal put forward by Cape Verde. (http://virtualcapeverde.net/news2/modules/Downloads/docs/mcaproposal.doc)

7 For example, regarding Mongolia’s eligibility for aid, the MCC explains that “technical assistance from the U.S. Government for priority identification or proposal development in the early stages could interfere with country ownership and will generally be discouraged.” (http://www.mca.mn/eng/country.php)

based on objective criteria” (6). At the same time, they caution that “the current MCC Compacts are too similar to conventional aid activities to be classified as the bold new approach that was originally advertised” (4). Schaefer (2006) emphasizes the failure of past foreign aid programs, especially in Africa, but also points out that the MCC compacts with Cape Verde and Madagascar both encourage private investment through programs targeting land and water management, in the former, and the financial system and land-titling, in the latter. In the popular press, the strongest criticism of the MCC has come from Rolling Stone magazine. Kurlantzick (2006) accuses the MCC of: not having a big enough staff, not hiring “aid experts”, not working more closely with other aid agencies, being dominated by a “pro-business orientation” and, most significantly, not giving away enough money. In short, Kurlantzick thinks the MCC ought to abandon its new approach to foreign aid and embrace all of the features of the old.

But is the MCC really a “new” type of foreign aid organization after all? First, as Easterly (2002) points out, not only does the idea of selectivity in foreign aid go back decades, but so, too, does the idea of country ownership of development as well as the focus on alleviating poverty. Second, regarding the effectiveness of foreign aid, Boone (1995) found that foreign aid given out between 1971 and 1990 not only did not increase investment but instead increased consumption, which “did not benefit the poor” (27). Third, the evidence on which the idea of the MCA is based is itself questionable. Easterly (2003) argues that the media, politicians, and the World Bank, among others, mischaracterized an earlier academic study by Burnside Dollar (2000) which had found that, “aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies but has little effect in the presence of poor policies.” It was
this study, of course, which suggested the plausibility of the Millennium Challenge idea. Easterly goes on to point out that (a) the empirical basis for this “new” foreign aid is highly dependent upon how one defines, for instance, “good policies”; (b) a sound theoretical basis for thinking that foreign aid can increase economic growth is still lacking; and (c) aid agencies around the world continue to ignore evidence that development aid is not contributing to economic growth. Thus it is easy to understand why Vasquez (2003) concludes that the “new aid enthusiasm…is not justified”.

At the same time, however, there have been many different objectives for foreign aid, besides the alleviation of poverty, in the past. For instance, foreign aid has often been viewed as an instrument of foreign policy. Alesina and Dollar (2000) find much evidence to support this view in their examination of foreign aid intent over the period 1970 to 1994.

Factors such as colonial past and voting patterns in the United Nations explain more of the distribution of [bilateral] aid than the political institutions or economic policy of recipients. Most striking here is that a non-democratic former colony gets about twice as much aid as a democratic non-colony. The third-party data which the MCC uses to establish country eligibility—especially the emphasis on low corruption—is an attempt to deal with this issue. Moreover, many of the institutional failings of foreign aid discussed by Easterly (2002)—including a large bureaucracy or a belief that the greater the amount of aid given the better—are the same characteristics Kurlantzick (2006) criticizes the MCC for not displaying.

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9 In fact, the United States Agency for International Development (USAID) frames the foreign aid debate as “Foreign Aid in the National Interest” (USAID, 2002).
What is unique about the Millennium Challenge experiment is the idea that it can spur the growth of key institutions in developing countries that are preconditions for long-term economic growth and therefore the alleviation of poverty. The promise of aid acts as an incentive to political leaders in developing countries to focus on the specific, policy-related, indicators measuring the extent of the rule of law, economic freedom and human capital (investments in people) in their countries. Former MCC CEO Paul Applegarth referred to this incentive-to-reform effect as the “MCC effect”. But even this welcome innovation to foreign aid thinking is put at risk through the MCC’s interpretation of environmental issues.

The “Old” Environmental Approach

The environment makes two appearances in the MCA. First, it prohibits funding of “any project that is likely to cause significant environmental, health, or safety hazard.” To flesh out this prohibition, the MCC wrote a set of Environmental Guidelines. But in contrast to MCC letterhead—where ‘Reducing Poverty Through Growth’ is the slogan—the guidelines “recognize that the pursuit of sustainable economic growth and a healthy environment are necessarily related” (emphasis added). Second, a country will only be eligible for project funding if the MCC determines that the country “has demonstrated a commitment to economic freedom, including a demonstrated commitment to economic

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policies that...promote private sector growth and the sustainable management of natural resources” (emphasis added).

This emphasis on ‘sustainable’ growth/management for environmental issues is both significant and worrying. It is significant because it is a reference to the concept of ‘sustainable development’, a doctrine that has underpinned much of the ‘old’ foreign aid programs from which the MCC was supposed to differ. It is worrisome because ‘sustainable development’, as it is generally understood, contradicts the purpose of the MCA, namely, to promote economic growth and the elimination of extreme poverty.

Discussions of ‘sustainable development’ usually begin with the well-known definition of the Brundtland Report followed by examples of the concept’s incorporation into international and national policy documents. But this approach does not offer a substantive understanding of what ‘sustainable development’ is really about. For that, one must look back to the Brundtland Report’s intellectual forerunner: the 1972 Club of Rome publication The Limits to Growth. This was a report on “five major trends of global concern – accelerating industrialization, rapid population growth, widespread malnutrition, depletion of nonrenewable resources, and a deteriorating environment.” The Limits to Growth concluded that:

if the present growth trends . . . continue unchanged, the limits to growth on this planet will be reached sometime within the next one hundred years.”

But “it is possible to alter these growth trends and to establish a condition of ecological and economic stability that is sustainable far into the future. . . Indeed

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12 Development that “meets the needs of the present without compromising the ability of future generations to meet their own needs” (WCED, 1987: 24)
there would be little point even in discussing such fundamental changes in the functioning of modern society if we felt that the present pattern of unrestricted growth were sustainable into the future. All the evidence available to us, however, suggests that of the three alternatives—unrestricted growth, a self-imposed limitation to growth, or a nature-imposed limitation to growth—only the last two are actually possible. [emphasis added]

Thus, according to the Club of Rome, there is a conflict between “unrestricted” economic growth and the Earth’s limited natural resources. In order to avoid the harsh consequences of running up against these natural “limits to growth”, humanity must impose artificial limits to growth upon itself, creating “a condition of ecological and economic stability”: sustainable growth. The assumption that economic growth is at odds with the environment is therefore implicit whenever reference is made to ‘sustainable growth/development/management/etc.’; something that is not clear from the Brundtland definition.14

In contrast, and notwithstanding environmental issues, the MCA was conceived with the view that economic growth is the essential ingredient for eliminating poverty. As President Bush stated in his speech that launched the MCA idea:

The advances of free markets and trade and democracy and rule of law have brought prosperity to an ever-widening circle of people in this world…Yet in many nations…poverty is broad and seemingly inescapable…Yet many of the old models of economic development assistance are outdated… The needs of the

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14 Sustainable development is, of course, a ubiquitous phrase that occupies a vaulting position within the world of economic development. For a few examples, consider World Bank (1992), Weaver, Rock & Kusterer (1997) and Kula (1998) among many others. The phrase has become so ingrained in the culture that even when it is severely criticized it is still retained. See Victor (2006).
developing world demand a new approach…This new vision looks beyond arbitrary inputs from the rich, and demands tangible outcomes for the poor.”

Finally, the World Bank (2005) puts it more simply in its 2004 Annual Review of Development Effectiveness: “Economic growth generally leads to poverty reduction” and this fact is “well established.”

However, this has not stopped the MCC from leaning toward the ‘limits to growth’ assumption rather than the ‘growth to reduce poverty’ assumption as it has interpreted the MCA legislation. The MCC read the phrase ‘private sector growth and the sustainable management of natural resources’ to mean that they were required to identify—and use—an indicator that would uniquely measure ‘the sustainable management of natural resources’. Instead, the MCC ought to have interpreted the MCA’s, and its legislative proponent’s, linkage of growth and sustainable management as a rejection of the ‘limits to growth’ assumption.

This can best be seen through the MCC’s public search for a specific “natural resources” indicator. Initially, the MCC decided to use a combination of four indicators to gauge natural resource management, including (i) the percentage of land of a country dedicated to the protection and maintenance of biological diversity; (ii) the change in forest cover as an average annual percentage from 1990 to 2000; (iii) performance in implementing the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES); (iv) the percent of the urban and rural population with access to improved sanitation. This led to a day-long public conference, hosted by the

Brookings Institution, to explore alternative indicators. Some of the indicators that were discussed at this event include: (i) the Environmental Sustainability Index; (ii) Adjusted Net Savings; (iii) Green National Accounts; and (iv) the Country Policies and Institutional Assessment of the World Bank.

All of these indicators, however, are rooted in the ‘limits to growth’ assumption of sustainable development. More specifically, they take ‘sustainability’ to mean ‘preservation’. Bartelmus (1999) explains that in ‘Green National Accounts, “monetary valuation of costs and benefits from economic activities is replaced - at the borderline - by social evaluation of feasible development” (17). This, he explains, is supposed to help “operationalize” the “elusive” concept of sustainable development.

Regarding the MCC’s initial natural resources indicators, the percentage change in forest cover, for example, is certainly a simpler concept to understand, but is just as useless in practice. As the U.S. Department of Agriculture points out, “since 1630, about 286 million acres of forest land [in the United States] have been converted to other uses—mainly agricultural”, with the majority of this conversion taking place in the 1800s (USDA Forest Service, 2004). Thus during the very period when the U.S. was developing into the dynamic, wealthy economy it is today, the U.S. was engaging in the supposedly unsustainable management of its natural resources.

Nigel Purvis, a Brookings Institution scholar, was the moderator of the ‘natural resources indicator’ conference. Two years prior to this conference, Purvis (2003)

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17 Full transcript of the event can be found at [http://www.brookings.edu/fp/events/20050624.htm](http://www.brookings.edu/fp/events/20050624.htm)
18 [http://www.yale.edu/esi/](http://www.yale.edu/esi/)
20 See Bartelmus (1999)
questioned the MCA’s focus on economic growth and poverty reduction and argued that, in fact, the environment has “a great deal” to do with reducing poverty, a sentiment that was echoed in Brainard et al. (2003). Unfortunately, this view was also grounded in the ‘limits to growth’ assumption:

Unless managed carefully, the path to wealth pursued by poor countries can bring about fundamental, irreversible, and unwise environmental change…Some environmental problems, moreover, are accentuated by consumption patterns ordinarily associated with economic development. (Purvis, 2003: 3)

Thus in both Purvis’ comments and in the construction of the various natural resources indicators above, there is a shift in perspective away from alleviating poverty in developing countries and towards restricting the growth in developed countries. Yet, unlike past Marxist theories of development\textsuperscript{22}, there is not even a causal mechanism that links consumption in the developed world to the poverty of the developing world. Instead, there is merely the pervasive assumption of “limits to growth”. Thus, the MCC’s interpretation of environmental issues contradicts its mission to alleviate poverty through encouraging economic growth.

Nevertheless, the debate over the natural resources indicator demonstrates the need to examine more deeply how the environment is related to economic growth and poverty alleviation. Perhaps the best starting point is a paper by Grossman and Krueger (1995) titled “Economic Growth and the Environment”, which examines the empirical relationship between per capita GDP and various measures of environmental quality. They found “little evidence that environmental quality deteriorates steadily with economic growth”. Instead, they found that economic growth “brings an initial phase of

\textsuperscript{22} See Frank (1967)
deterioration followed by a subsequent phase of improvement”, with the turning point being “before a country reaches a per capita income of $8000”. This empirical relationship is known as an Environmental Kuznets Curve (EKC)\textsuperscript{23} and resembles an inverted U (Fig. 3).

![Environmental Kuznets Curve](image)

**Figure 3:**
Environmental Kuznets Curve

Since Grossman and Krueger\textsuperscript{24}, the study of the EKC has exploded, with some economists finding much supportive evidence (Shafik and Bandyopadhyay, 1992; Panayotou, 1997; Goklany, 2002; Panayotou, 2003) and others finding little or none (Borghesi, 1999; Perman and Stern, 2003). But the significance of this research is clear to the preceding argument: it contradicts the idea that as countries become wealthier, they will do “permanent” damage to their environment.

\textsuperscript{23} Referring to Simon Kuznets, a development economist who postulated that income inequality first worsens, then improves, as a country develops; giving an inverted U-shape between inequality (y-axis) and economic development or income (x-axis).

It is important, however, to emphasize that this is an empirical relationship. There is no argument, or theory, that explains why environmental quality starts to improve with income beyond a certain point. Yandle et al (2004) discuss this very point at length. They argue that this relationship is consistent with the growth, in developing countries, of institutions, specifically property rights. With poor institutions and un-enforced property rights (or no property rights), the increased demand on natural resources by a growing economy does result in worsening environmental quality. But as institutions improve, and property rights are recognized and protected, individuals begin to rationally respond to a new set of incentives in which the wasting of resources is no longer costless. Owners have a stake in wisely managing their property, whether their purpose is to sell it, loan it, invest it or conserve it. Let us first consider the importance of institutions, generally, to economic development, then to the role of property rights, more specifically.

Institutions, Economic Development and Property Rights

As recently as 1994, the study of institutions and economic development was characterized as “primitive and still growing” (Williamson, 1994: 172). Yet perhaps the most significant aspect of the MCA is its focus on the role of institutions in economic development. To understand why this change has occurred, consider the following diagram:
From this, it is very clear that there is a strong, positive relationship between the strength of the rule of law in a country and the standard of living of its people.

The study of institutions and its application to economic development is part of a larger field in economics known as the New Institutional Economics (NIE). This is important because the NIE helps bridge the gap between the idea of market failure, that forms the basis for calls for government environmental regulation, and critics of foreign aid, who point toward the importance of economic freedom (Vasquez, 2003). In other words, the NIE fits in between “those who underscore the role of the state and those who advocate the primacy of the market” (Bates, 1995: 36). This is due to the economic role of “transactions costs”.

In his celebrated article, economist Ronald Coase (1960) argued that economic reasoning often failed to take into account the costs of actually carrying out market
transactions. These include the money and time it takes “to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on” (Coase, 1960: 15). He goes on to criticize the standard remedies for dealing with such costs, including direct compensation from one party to another, taxes and regulation. He concludes by suggesting that a better way to incorporate these transactions costs into economic decisions is by viewing a “factor of production” – land, equipment, buildings, labor – not as a mere “physical entity”, but as a “right to carry out a circumscribed list of actions” (i.e. a property right) (Coase, 1960: 43-44).

The relationship between Coase’s emphasis on internalizing transactions costs through property rights and concern for the environment is made more explicit by Demsetz in his classic 1967 article, which is worth quoting at length:

If a single person owns land, he will attempt to maximize its present value by taking into account alternative future time streams of benefits and costs and selecting that one which he believes will maximize the present value of his privately-owned land rights. We all know that this means that he will attempt to take into account the supply and demand conditions that he thinks will exist after his death….In effect, an owner of a private right to use land acts as a broker whose wealth depends on how well he takes into account the competing claims of the present and the future….The resulting private ownership of land will internalize many of the external costs associated with communal ownership, for now an owner, by virtue of his power to exclude others, can generally count on
realizing the rewards associated with husbanding the game and increasing the
fertility of his land. This concentration of benefits and costs on owners creates
incentives to utilize resources more efficiently. (Demsetz, 1967: 355-356)

Like Coase, Demsetz, too, is concerned with how to incorporate all the costs of an
economic action into an individual’s economic decision. By focusing on the
management of land resources, however, Demsetz, is arguing that a system of private
property rights achieves this goal by creating an incentive for owners to consider (a) both
their long-term and short-term needs; and (b) the costs that would be imposed if in
pursuit of the latter, they compromise the former (and vice versa).

But merely having title to a piece of property is not enough. Property rights must
also be respected and if not, then enforced. This is where the rule of law becomes
crucial. Having a sophisticated judicial system that is free from corruption is essential to
not only establishing and enforcing property rights, but also to establishing a climate with
the stable expectations, trust and commitment that lower transactions costs, thereby
creating room for investment, entrepreneurship and economic growth.  

Economists have conducted many empirical studies examining how property
rights, and institutions more broadly, affect economic growth. Scully (1988) compared
countries’ economic growth rates of per capita income with measures of political, civil
and economic freedom over the period 1960 to 1980. Scully used country rankings of
political and economic freedom from Gastil (1982) and comparable measures of per
capita income from Summers and Heston (1984). Scully found that “the average growth
rate in societies in which these freedoms [political, civil and economic] are restricted is
one-third of that of free societies” (Scully, 1988: 658). Unfortunately, Scully’s study

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25 For more on economic institutions and corruption, see (Lambsdorff, Taube & Shramm, 2005)
does not address the causal mechanism – the incentive created by the property right to
invest in one’s property and reap the profit – by which property rights contribute to
economic prosperity.

Besley (1995) investigates the causal link between property rights and investment
incentives by using empirical evidence from two regions of Ghana: Wassa in the west
and Anloga in the southeast. In Wassa, a cocoa growing region, Besley focuses on the
decision by farmers to plant trees. He concludes that “the findings for tree planting in
Wassa found investments significantly related to land rights. Moreover, this is robust to
attempts to control for farmer heterogeneity and instrumenting for land rights.” (Besley,
1995: 926). In Anloga, “farmers specialize in growing shallots (a small type of onion on
very small plots of land” (905). For this part of the study, Besley focuses on transfer
rights, “rights to sell, rent, bequeath, pledge, mortgage and gift” one’s land (905). He
concludes that “the rights variables have a positive and significant effect on the
probability of investing” (927) but cautions that “rights should properly be regarded as
something that farmers affect, not as exogenously given conditions, which reinforces the
importance of studying the determinants of rights, effective and nominal, and not just
their consequences” (931).

Seth Norton (1998a) uses property rights data to investigate the impact of
property rights on people’s welfare. To measure welfare or human well-being across
countries, Norton uses the United Nations’ Human Development Index (HDI) and
Human Poverty Index (HPI), a measure of “the most deprived people in the community”
(United Nations in Norton, 1998a). Norton finds that “there is compelling evidence that
strong property rights significantly reduce the deprivation of the world’s most
impoverished people and there is some evidence that weak property rights increase the deprivation of those people” (Norton, 1998a: 239).

Norton (1998b) looks at the relationship between property rights, economic growth—not income levels—and measures of environmental quality. He finds “that in countries where property rights are well protected, much higher percentages of the people have access to safe drinking water and sewage treatment. Norton proposes that well-defined and protected property rights lead to increased economic growth, which in turn leads to better environmental quality” (Brown & Shaw, 1999).

Yandle and Morriss (2001) expand on the link between property rights and environmental quality, arguing that:

> to obtain efficiency in environmental management, economic agents must be allowed to truck and barter as they juggle access to and use of environmental resources…The degree to which property rights can be alienated determines the wealth creation potential for the resource in question. The limits of efficiency are found when defined and defended environmental rights can be completely alienated. (144-145).

Thus, the efficient management of environmental resources is dependent upon the recognition and enforcement of property rights.

However, the importance of property rights both for development as well for managing natural resources has not gone unchallenged. Ellsworth (2002) claims that the difficulty of measuring property rights has caused economists to “oversimplify” and rely on “vague correlations”(10). She also presents a caricature of the NIE and its concern with property rights. In the end, what upsets Ellsworth the most is the idea of
“commoditizing” nature. As she sees it, there are certain “values of nature” - including a
stable “place in the world”, “landscape beauty”, or “religious or cultural values associated
with a particular place” – that cannot, and should not, be thought of in terms of economic
value. But she is unwilling to recognize that economic value is of a different kind from
the social values of everyday language: the simple fact of resource scarcity—that
people’s requirement for resources exceed their availability—creates economic value
(Menger, 1994). If the fundamental issue is alleviating poverty in the developing world,
then—and especially in the absence of any theory to suggest otherwise—the
preoccupation with the economic, environmental or moral conduct of the developed
world is misplaced. And if one is concerned with “sustainability”, then one should not
confuse it with “preservation”:

…a sustainable path for the economy is thus not necessarily one that conserves
every single thing or any single thing. It is one that replaces whatever it takes
from its inherited natural and produced environment, its material and intellectual
endowment. What matters is not the particular form that the replacement takes,
but only its capacity to produce the things that posterity will enjoy. Those
depletions and investment decisions are the proper focus (Solow, 1992: 15).

The institution of private property rights is what allows for those “depletion and
investment decisions” to be made rationally. It transforms the vague hope of ‘sustainable
development’ into a working method for the efficient (i.e. not wasteful but sustainable)
management and use of all resources. Indeed, “private property is the only institutional
arrangement that leaves the faculty of reason intact, in a way that is conducive to
productive and moral outcomes.” (Bethell, 2004, 34) Thus, the MCC’s environmental
concerns can be met by a focusing on the extent and protection of private property rights in developing countries.

**Conclusion**

The MCC is an experiment in encouraging the growth of institutions in developing countries that are conducive to economic growth and the reduction of poverty. Its significance lies much less in debates over the amount of aid given than in its attempt to further “incentivize” institutional reform in developing countries. The mechanism through which this occurs is a country’s response to the MCC’s indicators that measure good governance, economic freedom, and investments in people: the so-called “MCC effect”. To better judge the extent of this effect, perhaps it would be wise to limit the existence of the MCC to 10 or 15 years. That way it would be possible to determine if the MCC effect was powerful enough to institutionalize “good” policies leading to sustained growth and poverty reduction. At the same time—and combined with the five year duration of MCC grants—this might limit the incentive for countries to become dependent on the aid and to not continue with their economic reforms. But in promoting this “new” approach to foreign aid, the MCC is also an acknowledgement of the failure of the “old” foreign aid programs. The latter should, therefore, be shut down, so that the U.S. can concentrate on the MCC.

At the same time, the MCC’s approach to environmental issues echoes the “old” foreign aid thinking based on the ‘limits to growth’ assumption of the “sustainable development” literature. Yet, research into the relationship between income and the environment—the Environmental Kuznets Curve—questions this claim and helps keep
the focus on economic growth in developing countries rather than the alleged failings of the developed world. In addition, the institution of private property rights allows for the rational balancing of trade-offs that must be made whenever an economic decision—that is, a decision involving the use or exchange of a scarce resource—is made. This is important not only for the wise management of natural resources, but also in terms of laying the foundations for private enterprise, the functioning of a free market and long-term economic growth. Research in the New Institutional Economics combined with many empirical studies over the past decade offers strong support for this view.
References


