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How aid helped turn Egypt into a disaster

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Senators John McCain and Lindsey Graham might be personae non gratae in Egypt but their call to stop US aid to the Egypt is fully justified. The story of Egypt displays all the pathologies commonly described the critics of foreign aid: waste, unintended consequences and the emergence of a culture of dependence and policy inertia.

This should not come as a surprise given that the aid – coming from the US, Europe or from the Gulf – has not been motivated by economic reasons but rather by the political importance of Egypt as the most populous Arab country.

A part of the aid was directed at the promotion of human rights and good governance. In retrospect, much of it seems like a waste of money. Between 2007 and 2013, Egypt received €1bn from the EU, making it one of the largest recipients of European aid. According to the European Court of Auditors, the aid – half of which was simply given to Egypt's Treasury as direct budget support – did nothing to foster good governance, human rights, or fight corruption. Similarly, in 2009, US Office of Inspector General concluded that the continued American support to Egyptian NGOs had essentially no positive effect on civil society because of the oppressiveness of Mubrarak's regime.

But waste is a relatively minor problem compared to the corrosive effect that continued aid has had on the Egyptian political and economic landscape. Since Egypt's independence, the US has provided Egypt with some $70bn in aid, most of it going to the country's military. Egypt's Armed Forces are the largest on the African continent and control a large fraction of the economy, between 15 and 40 per cent of GDP, according to some estimates. The military runs hotels, resorts, and numerous manufacturing businesses producing anything from kitchen appliances to olive oil and bottled water.

The aftermath of the coup makes it very difficult to claim, as some did in the past, that the military is a benign force – or that the west has any leverage over it. Instead, the bloated, opaque, and powerful organisation is now the single biggest obstacle to Egypt's transition to a representative form of government.

But it gets worse. The aid that has come after the Arab Spring – particularly from Qatar – likely deterred the government from tackling the country's soaring budget deficit. During his year in power, Qatar gave Mohamed Morsi's government $7bn in aid while pledging to purchase government bonds and invest $18bn in the country over the next five years. The inflow of aid made it possible for Morsi to increase the number of government jobs and increase spending on subsidies without facing the immediate risk of government insolvency.

The new government put in place by the military is adopting the same strategy. "We will seek to pump more new funds into the economy and not follow austerity measures," says Ahmed Galal, Egypt’s new finance minister – notwithstanding the budget deficit which reached 11.8 per cent of the GDP in the first 11 months of the fiscal year 2012-13.

That is bad economics – Egypt’s economic problems are not cyclical and can’t be addressed by a financial stimulus. They are structural and long-term in nature. The Egyptian economy will not get better unless the government brings public spending under control by cutting subsidies, reducing the bloated government bureaucracy, and dismantling the myriad of unnecessary barriers to economic activity.

In any case, the blasé attitude of Egyptian officials to economic reforms has been made possible by the massive inflow of aid and short-term loans from the Gulf following the removal of Morsi, which boosted the country’s foreign exchange reserves to the highest levels since 2011. The United Arab Emirates sent $3bn, followed by $2bn from Saudi Arabia. Meanwhile, Kuwait announced a $4bn aid package to the country.

The inflow of aid allows the government to kick the can down the road. But that does no good to the Egyptians – particularly not to the 25 per cent living below the poverty line of $440 annually. Egypt can expect a rude awakening when the financial spigot from the Gulf and the west is turned off. Unfortunately, it appears that it will only take a full-blown balance of payment crisis to force Egyptian policy makers to seriously address the economic problems plaguing their country.