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A bend in the river

Many of my economist colleagues think that foreign aid in any form is a bad idea. I don't agree - except when it comes to so-called strategic aid, ie aid that is given explicitly to buy the allegiance of the recipient country government for some strategic cause of the donor's. Egypt is the world's single-biggest recipient of strategic aid (unless we count Israel), that it gets for being nice to Israel. It is a sizeable amount: in 2010 it amounted, according to one calculation, to \$20 for every child under five in sub-Saharan Africa, the poorest region in the world. Egypt is one of the richer countries in Africa, with a per capita GDP slightly less than twice that of India's.

That money, well spent, could have done a lot for Egypt too, of course. Did it? Well this is one of those questions that can never be taken entirely beyond the realm of pure speculation because who knows what would have happened to Egypt had that money not showed up. What we know is that GDP growth did not go up after 1979 when the aid flows started, not only relative to the 1970s - when the Egyptian economy was booming thanks to the oil boom and the jobs it created in the Gulf for Egyptian immigrants - but also compared to the 1960s. That is still not hard proof that the aid did not help since other things also changed in 1979 - oil prices went up sharply again, which should have helped Egypt, but the world economy also went into recession - but clearly there is no evidence of an aid-fed growth miracle.

My suspicion deepens when I hear what experts seem to be saying about what ails the Egyptian economy - the word oligarchy comes up a lot in particular. A smallish number of wealthy families, along with their friends (and family) in the government and the military, seem to have a finger in every pie in the country. This was how things had always been in Egypt - Nasser spoke out against it in the 1950s - but the inflow of aid money almost surely did not help. Most of it went to the military and the paramilitary forces in order to buy their support. That meant a lot of new contracts with little oversight (most countries, including the US, have a lot of trouble with regulating military contracts). Moreover, the donor stayed away from asking too many questions about where the money went lest it offended its friends in government.

It is said military contracts are the main reason how Mubarak's family fortune got to be many billions of dollars, and no doubt he was not the only beneficiary. The money also paid for a lot of jobs. In particular there were many jobs in the armed forces - Egypt, with a 80 million people, has a million people in the armed forces - which served the dual purpose of buying support and helping to intimidate potential dissenters. All of this made sure that there was never (before the last few weeks) too much questioning of the right of the elites to hold on to the many economic goodies that they had usurped.

This view of what happened in Egypt is admittedly speculative, but it fits well with what happened in another US strategic ally, and one that we in India know much better. Coincidentally, the big jump in US munificence to Pakistan, like in Egypt, was also in 1979, prompted in this case by the Soviet invasion of Afghanistan. A part of the money went to the armed forces, a part for the training of Islamic militias to fight the Soviets and a part for buying political support for President Zia's unelected regime. Later, when it turned out that the Islamic militias were the problem rather than the solution, there was more money for the army and more money to buy the support of whoever happened to be in power. Pakistan has historically had an oligarchy (Mahbub ul Haq, the famous Pakistani economist, used to refer to the '20 families' who control Pakistan), which has now expanded to include the army: It is said that the armed forces in Pakistan own everything from banks to bakeries and that the total revenues on these assets may be as much as 10% of the GDP.

This means that any push towards really democratising the political system (or the economy) has a set of powerful enemies, who worry that this would end up making them face scrutiny or competition (or both). It is no wonder that Pakistan never seems to be able to get a stable genuinely popular government (though democratic pretenders are tolerated as long as they are sufficiently corrupt that they would have no incentive to genuinely reform the system).

Egypt now has a rare chance to break out of all this and to create a genuinely democratic society and economy. For that to happen many things will have to go right: in particular, the US will need to show a great deal of forbearance. It will be tempted to use Egypt's dependence on US aid as a threat ('play ball with Israel or else') but that can only backfire. No real democrat in the current middle-eastern political climate can survive the taint of being bullied (or bought) by the US. Therefore, any such push by the US will only serve to make the establishment more reluctant to compromise with the democrats (because they fear the loss of the US gravy train) and at the same time empower the anti-US constituency among the democrats. The aid needs to be given as a genuine gift, from one democratic people to another, help for building a real democracy.

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