

# Egypt Macro Flash

## US military assistance: An economic red herring

- The violent crackdown by the military backed interim government on pro-Morsi supporters in Egypt over the past week has led to an unprecedented clamour amongst politicians in Washington to suspend the \$1.3 billion in annual US military assistance to the Egyptian army. This is leading many to conclude that Egypt's frail economy may soon be dealt a further blow with the suspension of critical aid flows. In our view, this is unlikely to be the case, and the suspension of US military aid to Egypt is likely to have almost no impact on the fundamental economic outlook.
- The argument that a suspension of US military aid will have a significant impact on the Egyptian economy pre-supposes that 1. Money is paid by the US government to the Egyptian government or military, and 2. That this money constitutes an element of Egyptian domestic demand through the procurement of goods and services by the government/military in the domestic economy. Both these assumptions are wrong.
- Egypt receives around \$1.3 annually in military assistance under the US State Department's Foreign Military Financing (FMF) programme. This is a US foreign policy tool that promotes US interests by providing the US leverage and ensuring co-operation from foreign governments on a range of military and national security issues, and also by 'increasing demand for U.S. systems' and therefore contributing '...to a strong U.S. defense industrial base' and securing 'more jobs for American workers' (<http://www.state.gov/t/pm/ppa/sat/>).
- In reality, under the FMF programme, the US provides grants to foreign governments to procure US military equipment, services and training. No cash is transferred to the foreign government, no procurement occurs within the foreign economy. FMF is effectively a credit note to spend in the US military 'shop'.
- The impact of the suspension of FMF assistance to the Egyptian military would therefore be a halt in payments by the FMF programme from accounts within the US to military suppliers within the US. There would also be a halt in transfer of military equipment and services to the Egyptian government. In our view, there would be no adverse balance of payments or budgetary implications, nor any impact on domestic demand in Egypt.
- We also give little weight to arguments that a suspension in aid signals a permanent loss of US support to Egypt. Egypt remains of vital strategic interest to the US, in our view, and any withdrawal of support due to the current violence is likely to be short-lived. Whether relations between Egypt and the US will recover as quickly is another matter, particularly as the void left by any withdrawal of US assistance could potentially be filled by the willing and able Gulf states.

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