Financial Times BeyondBrics Blog: Guest post: is Egypt committing economic suicide?

By Dalibor Rohac

How does one save an economy on the brink of bankruptcy? In Egypt, the answer seems to be a stimulus plan. Egypt's finance minister, Ahmed Galal, announced that starting in January the government will increase the planned stimulus package by 25 per cent to a total of $4.36bn.

All of this is happening at a time when the country's budget deficit is at 14 per cent of GDP, and the growth in public debt – currently at 87.5 per cent of GDP – is out of control.

The new stimulus plan is to be financed largely through short term borrowing from the Gulf countries – Saudi Arabia, Kuwait, and United Arab Emirates – which all pledged support to Egypt's government following the ousting of President Mohamed Morsi in July 2013. Reliance on this form of aid is precarious not only because of its temporary nature but also because the Gulf countries hardly have reputations as reliable donors.

Somewhat perplexingly, Galal is by no means oblivious to the magnitude of the country's fiscal problem. A graduate of Boston University, he worked at the World Bank for 18 years and authored several prominent academic publications about the problems of emerging economies, and most prominently the Arab world. He is thus the last person in Egypt who could be seen as ignorant of the perils that the rising debt represents. Indeed, he said recently that he "worried sick about the budget deficit" – and for a good reason.

Galal's gamble is that the spending increase – most of it allocated towards public investment, with a minor part used for salary raises in the public sector – will help Egypt's economy grow out of its current problems. With high rates of economic growth – such as the 7 per cent annually that Egypt enjoyed before the end of Mubarak's rule – the soaring public debt would certainly become more manageable. More importantly, stronger economic growth would mean more jobs for Egypt's masses of unemployed young people – many of whom were the moving force behind the events of the Arab Spring.

Yet this gamble is unlikely to work. Increasing public spending at a time when the deficit-to-GDP ratio is nearing triple digits would be seen as an extremely risky strategy, even for a country afflicted by just a temporary economic recession. In 2009 or 2010, as a debt crisis was raging on eurozone's periphery, nobody was suggesting – not even Paul Krugman – that the Greek government should have been spending more.

Egypt's rates of economic growth before 2011 had to do with the liberalising reforms undertaken in the final years of Mubarak's rule, in an period marked by rampant cronyism and corruption. The privatisation of state-owned enterprises, for example, was widely seen as unfair, done with the purpose of enriching a handful of Mubarak's friends. Simultaneously, though, wasteful consumer subsidies were being reduced, budget deficit brought progressively under control, and there were some sizeable improvements in the country's institutional environment. Between 2006 and 2011, the country moved from 141st place on World Bank's Doing Business ranking to 94th place.

For all their flaws, it is unfortunate that after the Arab Spring, many of these reforms have been stalled or reversed altogether. The country's current military leadership displays little interest in pursuing an agenda of economic liberalisation.

Without such reforms, it is fanciful to expect stronger economic growth. Egypt's economic problems are not cyclical and cannot be solved by more spending or by looser monetary policy. They are a combination of numerous structural problems – wasteful spending, populist overregulation, weak rule of law – and rampant uncertainty about the future direction of economic policy and indeed of the country's political system.

Galal must know all of this and yet he is willing to play along and pile more public debt on the shoulders of a nation that is, for most practical purposes, insolvent. That only shows how mistaken were those who thought that the technocratic government of Hazem El-Beblawi (also a PhD economist) would be a significant improvement over the shambolic rule of Morsi's men. But more importantly, Galal's big gamble pushes Egypt further down the road of economic ruin, with repercussions that will be felt throughout the region.