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DISCUSSION PAPER SERIES

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ABSTRACT

The 'Despotic Leviathan' and Its Financial Architecture: How IMF Conditionalities Deepen Inequality

This paper examines how IMF policies contribute to the inequality in MENA, and to a Middle-Income Trap (MIT). Developing a theory expanding Acemoglu and Robinson's "Narrow Corridor" framework, it shows how IMF conditions align domestic elite incentives with creditor interests through a principal-agent lens. Using 2020-2025 data, its analysis reveals IMF monetary policies create rent-seeking structures that institutionalize inequality and suppress growth. The paper identifies an "engineered r>g dynamic" as a quantifiable signature of this extraction, empirically verified in Egypt. It establishes a causal link between financial/monetary policy (interest rates, debt compounding) and the "Despotic Leviathan" state formation.

JEL Classification: O11, O43, P16, F33

Keywords: state capture, IMF conditionality, inequality, domestic debt, political economy, Middle-Income Trap, Egypt

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I. Introduction: The MENA Paradox of Inequality and Stagnation

Many countries reached a middle-income status, but they experience economic stagnation and severe inequality. The Middle-Income Trap (MIT) occurs when nations are unable to progress to high-income status due to structural and institutional challenges (Glawe & Wagner, 2016). Graduating to high-income country (HIC) status is a rare event; between 1990 and 2021, only 34 economies made this transition, many of which were small, oil-based, or had unique historical starting points, underscoring the difficulty of the challenge facing the MENA nations (Alvaredo, Assouad, & Piketty, 2017). This paper addresses this middle-income trap, and in doing so, makes the case that the failure to achieve equitable and sustainable growth is not primarily a technical economic problem, but a deep-seated governance crisis. This crisis, characterized by a profound imbalance of power between the State and Society, creates a political economy of elite capture. Within this context, orthodox macroeconomic stabilization programs, such as those promoted by the International Monetary Fund (IMF), are not neutral; they are a form of global financial architecture that enables and legitimizes elite capture, ultimately deepening inequality and hindering development.

Conventional explanations for the MIT advanced by institutions like the World Bank (2024) and the IMF focus on supply-side failures. This narrative suggests that middle-income countries get stuck because they fail to transition from a growth model based on factor accumulation (cheap labor, technology catch-up) to one based on innovation and productivity gains. The proposed solutions, therefore, center on supply-side government actions to improve investment, technological infusion, and innovation. While these factors are not irrelevant, we posit that such an explanation is critically incomplete. **The paper's hypothesis** and alternative narrative are that the MIT in MENA is a symptom of a profound internal governance crisis of elite capture and institutionalized rent-seeking over the productive sector that is reinforced by an IMF financial architecture through its conditionalities. Furthermore, the paper challenges the IMF's orthodox narrative by arguing that the IMF's stabilization policies are far from being neutral technical solutions. However, they function as a political methodology that systematically redistributes wealth upwards and entrenches the power of a narrow elite. In doing so, create a financial architecture of extraction that locks the country in the very trap they purport to solve.

To conceptualize this governance crisis, this paper employs and expands the "Narrow Corridor" framework developed by Acemoglu & Robinson (2019). Their framework in governance and development explains the historical, internal political evolution of states. They theorize that liberty and sustained, inclusive prosperity emerge only when a balance is struck between the power of the state and the power of society, creating a "Shackled Leviathan." However, a nation with a profound imbalance of power between the state and society exists outside this corridor. Most MENA states exist far outside this corridor, and many operate as "Despotic Leviathans," where the power of the state vastly exceeds that of society. In this system, the state prioritizes extracting wealth for a narrow elite over providing public goods or promoting widespread development, resulting in limited prosperity, significant inequities, low growth, extractive institutions, and elite capture that characterize those regimes (Acemoglu & Robinson, 2019).

While this framework helps understand the nature of the state, **our literature review** in the Theoretical Framework section highlights its limitations. A&R describes 'Despotic Leviathan' as a self-sustaining system and fails to account for how modern external actors actively construct and reinforce these political structures. Also, it ignores the fact that a government is not homogenous but made up of different actors with their agencies interacting and competing, and their dynamics shape public policy. Building on those known critics of the theory, the theoretical framework section of the paper introduces and expands A&R's narrow corridor framework to investigate the cause of the Middle-Income Trap (MIT) and the role of the IMF as external actors in creating a financial architecture that empowers and sustains a "**Despotic Leviathan**". We argue that in the modern global system, the 'Despotic Leviathan' is not merely self-sustaining; it is actively empowered by global financial architecture, with the IMF as a key agent. In the third section, we apply the Expanded Framework to the IMF Financial Architecture in Egypt. The paper helps to understand how the IMF's financial architecture incentivizes and gives a political cover to reinforce elite capture, inequality, and stagnation using data from Egypt. In that section, the paper moves from this high-level theory to a detailed empirical analysis of the specific mechanisms at play.

II. Theoretical framework

Acemoglu and Robinson's book *The Narrow Corridor: States, Societies, and the Fate of Liberty* offers (A&R) a historical framework to explain why liberty and inclusive prosperity flourish in some nations while others remain in oppression, anarchy, or stagnation. The A&R framework categorizes political orders into three types based on the balance of power between state and society. The first is the "**Despotic Leviathan**". It is described as a state when the government wields excessive power over society, operating without constraints or accountability. It primarily benefits a narrow elite, often resulting in limited and unequal economic growth. While a **Despotic Leviathan** can impose order and may even generate periods of economic growth, this prosperity is inherently limited and unequally shared, creating a political economy of elite capture. Many states in the Middle East and North Africa, including Egypt, exemplify this model, as reflected in low scores on the V-Dem Institute (2024) Liberal Democracy Index. The second type is called the "**Absent Leviathan"**, which occurs when societal power overwhelms a weak state. In that state, the society has fragmented norms or local factions, leading to anarchy and social disorder, as seen in Lebanon, Yemen, and Syria. The lack of state capacity results in limited societal arrangements for cooperation, which hinders progress. The ideal type, the **Shackled Leviathan**, represents a balanced state-society dynamic within the 'Narrow Corridor.' A 'Shackled Leviathan' emerges when these two forces are in relative balance, creating a state that is powerful enough to provide public services and enforce laws but is simultaneously constrained by and accountable to an organized and mobilized society. It is within this corridor that liberty and broad-based prosperity are most likely to flourish.

A. The 'Narrow Corridor' and the Nature of the MENA State.

Data from the V-Dem (Varieties of Democracy) Institute (2024) quantitatively demonstrates that the vast majority of MENA states operate as 'Despotic Leviathans'. On a scale from 0 to 1, the V-Dem Liberal Democracy Index for 2024 places Saudi Arabia in the lowest decile (0.000-0.099). Egypt, alongside Oman, Yemen, the UAE, Syria, and Iran, falls into the next-worst decile (0.100-0.199). Even countries with some democratic features, like Jordan, Kuwait, and Turkey, score poorly (0.200-0.299). Within the region, only Israel is rated as a "flawed democracy", and its democracy is confined to the Jewish population. It does not extend to the Arab original residents of Palestine (which makes it practically an 'apartheid' state, now genocidal). These low scores reflect the profound weakness of societal power—the absence of free media, independent civil society, and meaningful political competition—relative to the coercive and administrative power of the state.

This imbalance has direct economic consequences. Evidence suggests that democracy is conducive to higher quality, more equitable growth. Countries that democratize tend to experience long-term growth improvements of up to 20% (Acemoglu, Naidu, Restrepo, & Robinson, 2018). This is partly because citizens pressure accountable governments to increase public spending on human capital—namely education and health—which they finance through higher and more progressive taxation. The 'Shackled Leviathan' is thus compelled to invest in its people, creating a virtuous cycle of human development and inclusive growth. The 'Despotic Leviathan', facing no such pressure, is free to pursue a path of extraction, leading to the limited and inequitable prosperity that characterizes the MENA region.

B. Despotic Leviathan, Rentierism, Weak Institutions, and Elite Capture.

The extractive logic of the 'Despotic Leviathan' in MENA is operationalized through the institutional framework of the rentier state. A rentier economy relies on substantial external rents—unearned income derived from sources such as oil and gas revenues, geopolitical aid, or worker remittances—rather than on a productive, industrialized domestic base. Several countries in the region, including Egypt, Algeria, Iraq, and the Gulf states, are archetypal rentier states.

Rentierism itself is not inherently problematic. A country like Norway has used its oil wealth to build a robust welfare state and make long-term investments for its citizens. The critical difference lies in the quality of institutions. In the MENA context, rentierism is not complemented by inclusive institutions that ensure the broad-based redistribution of these rents. Instead, the resources are typically captured and controlled by hereditary rulers or unaccountable political leaders and their partners in the private sector. This creates a system where the primary economic activity is not production or innovation, but rent-seeking: maneuvering for privileged access to state-controlled resources. This dynamic institutionalizes clientelism and corruption, as access to wealth and opportunity is determined by political connections rather than market competition.

This political-economic model produces a distinct set of structural features. First, the state has little incentive to develop a robust and progressive tax system. With access to "easy" money from rents, there is no need to engage in the complex process of bargaining with society to extract tax revenue. This process historically led to demands for representation and accountability in Europe ("no taxation without representation"). Consequently, tax-to-GDP ratios in the region are exceptionally low: just 2% in Iraq, 12.5% in Egypt, and 15% in Lebanon, compared to 25-35% in European welfare states. If we compare groups (sample averages) of oil-rich sample average (9 countries): 3.98% tax/GDP with nNon-oil sample average (8 countries): 14.78% tax/GDP the World Bank Open Data base shows the contrast. In representative sample oil-exporting MENA countries collect far less tax revenue relative to GDP (roughly ~4% on average) than non-oil peers (~15%). This pattern is well-documented in IMF/WB/OWID sources: oil rents are typically recorded outside the “tax” series (royalties/dividends are non-tax revenue), and many oil exporters rely on those non-tax receipts instead of broad-based taxation.

Second, with a weak tax base and a focus on elite benefits, public spending on social protection and services is minimal. Formal social protection systems cover only 30-40% of the population, and some states fail to provide even basic services, such as reliable electricity or water. Finally, the system encourages capital flight, as elites siphon their share of the rents into offshore accounts, further depriving the domestic economy of investment, and a hallmark of that system is extreme inequality.

The MENA region's inequality is concerning, with the top 10% of income earners capturing 64% of total income between 1990 and 2016, according to the World Inequality Lab (2025). This figure stands in sharp contrast to the 37% share held by the top decile in Western Europe, placing MENA in the same bracket as notoriously unequal regions and countries, such as Brazil and South Africa (Alvaredo et al., 2017). This concentration of income and wealth is linked to conventional explanations for the MIT, often advanced by institutions like the World Bank, which focus on supply-side failures. This World Bank (2024) narrative suggests that middle-income countries get stuck because they fail to transition from a growth model based on factor accumulation (cheap labor, technology catch-up) to one based on innovation and productivity gains. The proposed solutions, therefore, center on supply-side government actions to improve investment, technological infusion, and innovation, according to the report. While these factors are not irrelevant, we posit that such an explanation is critically incomplete. It overlooks the more fundamental constraints on the demand side, which are themselves a direct consequence of the region's political economy. An alternative narrative, which we advance here, suggests that the MIT is a function of demand-side failures, rooted in extreme inequality that suppresses broad-based consumption, and that this inequality is a symptom of a profound governance crisis. The persistence of such extreme inequality is not an accident of economics; it is a product of politics.

C. Externally Reinforced Despotic Leviathan

The literature review has highlighted several limitations of the A&R framework, as it ignores the role of external forces in shaping societies. Also, it ignores the fact that a government is not homogenous but made up of different actors with their agencies interacting and competing, and their dynamics shape public policy. *Dixit (2020)* contends that the binary concepts of "state" and "society" are analytical constructs that need to be unpacked. In his critique, he stated that "state" itself is **composed of multiple agencies and actors with competing** interests; this internal complexity is central to our upcoming analysis. Furthermore, the theory offers less predictive power regarding the specific triggers or conditions that cause a society to enter, exit, or remain within the corridor. While A&R's focus is on long-run endogenous evolution, we argue that in the modern era, no state develops in a vacuum. A&R framework neglects international relations, geopolitics, and colonialism in shaping domestic state-society dynamics. In a review by Khan (2023) in the *South Asia Journal, it was* correctly pointed out that the A&R framework does not consider the role of interference in poor countries' political systems. The author highlighted the fact that many developing nations are in debt cycles and have lost their freedom to the IMF or World Bank.

Building on those known critics of the theory, the paper augments and expands Acemoglu, D., & Robinson (A&R)'s narrow corridor framework to investigate the cause of the Middle-Income Trap (MIT) and the role of the IMF as an external actor in empowering and sustaining a "Despotic Leviathan" that is characterized by elite capture, low growth and inequality. This paper introduces a theory of external reinforcement. We argue that in the contemporary global system, the 'Despotic Leviathan' is not merely self-sustaining; it is actively empowered by global financial architecture, with the IMF as a key agent. We theorize the IMF not as a mere influencer, but as a primary architect of a financial system that entrenches the despotic state's power. This is not an unintended consequence; it is the direct result of explicit IMF conditionalities that make rent-seeking activities more profitable while simultaneously dismantling alternative economic channels.

The exact mechanism through which this architecture operates is the central banks' interest rates, domestic public debt, and the classical misalignments of incentive structures known in the **Agency Problem**. Central bank interest rate decisions in the presence of large domestic debt have considerable internal distributional consequences. When a central bank adjusts its policy rate in the presence of large domestic public debt, it creates a fiscal transfer between the rent-seeking creditors' class on one side and the taxpayer and the productive public sector on the other. Making the changes in interest rates creates sizable internal transfers and generates substantial interest income for a segment of the population. In that context, the IMF's conditionalities on monetary policy provide some domestic agents of the state with powerful incentives to serve a narrow creditor class and themselves over their citizens. Financial institutions, hedge funds, and banks directly benefit from domestic public debt dynamics as their KPI soar during high interest rates. Some of those influential domestic economic and financial practitioners are also consultants to and part of state actors ('agents') with powerful incentives to serve a narrow creditor class and themselves over their citizens ('principals'), thus formalizing and institutionalizing elite capture. **We provide a quantifiable signature for this rent-seeking incentive structure ($r>g$)**. We demonstrate that the IMF-mandated system is built on a logic where the return on capital is structurally engineered to be greater than the return on growth ($r > g$).

The financial architecture engineered by the IMF derives its influence not only from its technical design but also from the ideological framework surrounding its implementation. By presenting policies that lead to radical distributional consequences as neutral and objective, the IMF's interventions exemplify what sociologist James Ferguson (1994) called the anti-politics machine. The IMF serves the purpose of reframing the contentious fiscal public policy question of who shoulders the burdens of economic adjustment into superficially technical monetary policy dilemmas that necessitate expert intervention. In doing so, it insulates these critical issues from public scrutiny and debate. We suggest that the 'Agency Problem' identified within our analysis serves as the pivotal mechanism within this complex machine. This dynamic exploits the front of technocracy to enhance the bureaucratic capacity of some state actors to extract resources, while simultaneously legitimizing the political-economic arrangements that sustain what can be described as the Despotic Leviathan. The following section shows precisely how the interaction between the IMF as an external actor and domestic political systems is co-opted to serve elite interests in capturing the state.

III. Applying the Expanded Framework to the IMF Financial Architecture in Egypt

The IMF's financial architecture is empowering the 'Despotic Leviathan' by institutionalizing rent-seeking (r > g) and actively preventing the emergence of the inclusive, productive institutions necessary for innovation-led growth. **In doing so, the IMF is aligning the incentive structures of the** domestic coalition of policymakers and financial elites **with the domestic** creditor class**, which has** a vested interest in maintaining the low-growth, high-extraction status quo. **The extraction process is done through domestic public debt.** This locks the country into a political trap, making the economic transition to a high-income status politically impossible. The 'Despotic Leviathan is thus the direct economic consequence of this externally reinforced political equilibrium.

A. The IMF Blueprint for Extraction In Egypt.

The IMF creates rent-seeking architecture through specific, binding monetary policy conditions in Egypt. The period from 2020 to 2025, marked by the IMF's programs and several external inflationary shocks, offers a compelling case study of these dynamics in action. The augmented Despotic Leviathan framework provides the lens through which to analyze the effects of the IMF monetary policy conditions in Egypt.

1. The Blueprint for Extraction

Table 1: IMF Blueprint for Extraction in Egypt

IMF Monetary Conditions	**Stated Orthodox Goal**	**Actual Purpose in Rent-Seeking Architecture**
Extreme Interest Rate Hikes	Tame inflation.	1. Compounding domestic public debt. 2. Borrowing is expensive for productive businesses. 3. Engineer a massive regressive redistribution of income.
Removal of CBE Lending Initiatives	End market distortions.	1. Deliberately cut off affordable credit to the industrial and agricultural sectors, weakening the productive economy. 2. Borrowing is expensive for productive businesses.
Rapid Currency Devaluation	Boost exports.	1. Erode the wealth of the population while protecting the dollar-denominated assets of the elite. 2. Devaluation of domestic productive businesses and their assets. 3. Facilitate foreign companies' productive businesses. 4. Facilitate local elite capture of public productive assets.

IMF (2022; 2024) If the analytical logic of how column 3 outcomes ensue due to column 1 actions is not spelt out in the paper, this table may work against our argument!

With the IMF advocating for long-term high interest rates, it pushes local capital towards non-productive, rent-seeking activities such as real estate speculation or capturing returns from government debt—activities that offer high returns to the wealthy but generate little employment or sustainable growth. The aggregate results of the high interest rates in Egypt are the compounding of domestic debt, shifting the intermediation process from the productive sectors toward interest income for the wealthy segment of the population. In contrast, the productive industry struggles to access capital or refinance its loans. The empirical evidence presented in the next section demonstrates how a set of seemingly neutral, technocratic policy conditionalities, when applied in the Egyptian context, functioned as a powerful engine for compounding domestic debt, engineering a massive regressive redistribution of income, and entrenching a dynamic where returns to capital (r) far outstrip economic growth (g) in which the paper estimates cumulative factor of r and g to be 3.48 and 2.65, which institutionalize rent-seeking behavior and facilitate the capture of public resources by a local elite.

Income distribution is done through two primary channels. **The first** was a radical regressive tax system in which almost all government revenues were redistributed to the local beneficiaries of domestic debt. **Second**, the banking system, which includes savings deposits and time deposits in local currency, compensates only a fraction of the population for inflationary events. **On aggregate**, this has led to a situation where fixed income growth has exceeded **economic growth (r > g) over the last five years**. This leads to an r>g dynamic do we explain in the paper that the outcome of a r>g dynamic in the long run will be fiscally catastrophic? But we cant because the time horizon of the data is 5 yrs (20-25), or v short, where returns on capital far outpace economic growth; furthermore, it facilitated a radical local elite capture of public resources. The paper further estimates that, based on FY 24/25**, a one percent interest rate on domestic public debt costs the public far more than the planned revenue from privatization and the sale** of public assets for that year.

2. The Proof: A Nation's Wealth Diverted

Table 2: Domestic Interest Payment and Public Services in Egypt

In Billions Of Egyptian Pounds	**Jun. 21**	**Jun. 22**	**Jun. 23**	**Jun. 24**	**Jun. 25***
Total revenue:**	1108.6	1347.2	1563.9	2142.1	2625.2
Tax Revenues**	833.9	991.4	1258.6	1529.9	2021.9
Domestic Debt Of The Budget Sector***	**4,591**	**5,399**	**7,119**	**8,727**	**-**
Interest: Domestic	518	528	825	1674	2146
Subsidies: Food	83	98	118	135	150
Nominal GDP	6,663	7,843	9,545	13,862	17,673
Interest Domestic / Tax	**62%**	**53%**	**66%**	**109%**	**106%**
Interest Domestic / Nominal GDP	**8%**	**7%**	**9%**	**12%**	**12%**

*IMF projection (IMF, 2024, pp. 30 -33); ratios are author calculations.
** Egyptian Ministry of Finance MOF, (2024)
***MOF (2025, p. 4)

The Central Bank of Egypt (CBE) initiated its current interest rate tightening cycle in March 2022, raising the rate by a cumulative 19 percentage points to reach an all-time high of 27.75%. As of July 2025, interest rates stand at 24.5%, with headline inflation hovering around 14% for the past three months, resulting in real interest rates exceeding 10%. As the above table shows, the most immediate consequence of the high-interest-rate policy was the explosive growth of Egypt's domestic debt (from 6 to 12% of GDP in a matter of 4 years, with interest cost share in total revenues rising from 62% to 106%). Our analysis indicates that the primary problem does not reside on the revenue side, particularly as Egypt has maintained **a primary budget surplus since 2018**. Instead, the crisis stems significantly from the IMF's conditionalities imposed on the Central Bank of Egypt. The compounding of domestic debt over the last five years has been driven almost entirely by the mechanical process of interest compounding on existing debt. If permitted to continue, this situation will itself require yet another IMF loan, with even stronger conditionalities.

Despite the government consistently achieving a primary budget surplus (meaning tax revenues exceeded non-interest spending) since 2018, the stock of domestic inherited debt held by the budget sector more than doubled in just four years as a direct consequence of the IMF's advocated monetary policy. According to the Egyptian Ministry of Finance (MOF, 2025, p. 4), the Domestic debt stock ballooned from 3.9 trillion Egyptian pounds (LE) in June 2020 to 8.7 trillion LE by June 2024. This 4.7 trillion LE increase was not driven by new government spending on public services or investment, but almost entirely by the mechanical process of interest compounding on existing debt. The dynamic became self-perpetuating: the government had to issue new debt at high interest rates simply to pay interest on its old debt. By the 2023/24 fiscal year, the feedback loop was so severe that the estimated interest payment on domestic debt exceeded the total tax revenue. The interest payments are compounded, becoming a significant part of nominal GDP and flooding the financial system with liquidity and interest income for the elite.

Finding one: **Public Revenue is hijacked.** During the five fiscal years, the high interest rates have radically redistributed the nation's income from productive sectors and taxpayers to the privileged segment of society at a rate ranging from 7% to 12% of GDP. The scale of this transfer is breathtaking. For the 2024/25 fiscal year, projected interest payments on domestic debt (estimated by the IMF at 2.146 trillion LE) are set to exceed the total projected tax revenues for the entire country (2.021 trillion LE). **In essence,** more than 100% of the income collected by the state from its citizens and businesses in two fiscal years is immediately transferred to domestic bondholders in a radically regressive system. **Finding two: Growth is Captured by Rent-Seekers.** According to the data from the table, by Jun 2025, 50 percent of the county's nominal growth in **five fiscal years** will have been directed towards **residents** who benefit from domestic public debt dynamics. This is the definition of regressive **financial architecture**, where the combined spending on public sector wages, food subsidies, and social insurance transfers is dwarfed by the passive income flowing to holders of financial assets.

All this **institutionalizes rent-seeking behavior and facilitates the radical capture of public resources by a local elite.** The resulting **financial architecture** is aggressively redistributing Egypt's wealth upwards, creating an asset bubble that distorts the demand for real estate, making it a speculative asset outside the means of median income earners, and significantly increasing the ratio of the banking sector's local currency credit for consumption relative to credit for business.

While the IMF's official communications emphasize the scaling up of social support, the analysis of Egypt's fiscal accounts in the table above reveals a profound disparity in resource allocation and the social cost of this policy. For the 2024/25 fiscal year, projected interest payments on domestic debt (2.146 trillion LE) are more than fourteen times the budget for food subsidies (150 billion LE). This demonstrates that the scale of the upward redistribution of wealth to domestic creditors systematically dwarfs the scale of social mitigation efforts, rendering them marginal in comparison. Furthermore, a marginal change in the interest rate has severe effects on the budget; a one-percentage-point increase in rates on the domestic debt stock at the beginning of fiscal year 24/25 would cost the public an estimated 87 billion LE. To put this in perspective, this single percentage point costs more than the entire planned revenue from privatization for the 2024/25 fiscal year (67 billion LE). Also, it is equivalent to 68% of the budget for the General Authority for Supply Commodities (GASC), which manages food subsidies for people experiencing poverty (MOF, 2024; IMF, 2024)

The incentive structure is geared entirely towards rent-seeking rather than growth, and the productive sector is crowded out. The high interest rates in Egypt shifted the money creation process from productive sectors toward disposable income for the wealthy segment of the population. The financial system as of June 2024 creates more liquidity for passive rent-seekers (an estimated 2.35 trillion LE in annual interest income) than the entire outstanding stock of credit to the private business sector (1.87 trillion LE) (CBE, 2024).[2] The total interest income channels in local currency increased as a percentage of the entire economy credit for the private sector, reaching 125.81%. More money is being created toward fixed income than the total credit for the private business sector in local currency. The cumulative effect of high Interest rates is an increase in disposable income at the expense

[2] On Jun. 2024, the income generated from public debt was projected to be 1.51 trillion LE. Additionally, at the same time, savings deposits in local currency, categorized as M2 stock, amounted to around 5.6 trillion LE, with an assumed interest rate of 12%. As a result, the minimum interest income from both public debt and savings deposits in local currency is expected to total approximately 2.35 trillion LE.

of the productive sector.

The IMF's claim that its program will "unlock Egypt's growth potential" and allow the private sector to become the "primary engine of growth" is directly contradicted by the paper's findings.But no data on pvt inv or total inv to GDP is presented over time! It is fundamentally tilting the entire economic landscape away from productive investment and towards passive rent-seeking. This is the definition of a regressive system, where the combined spending on public sector wages, food subsidies, and social insurance transfers is dwarfed by the passive income flowing to holders of financial assets. Institutionalize rent-seeking behavior and facilitate the radical capture of public resources by a local elite.

3. The Engine of the Architecture: The Agency Problem in Practice

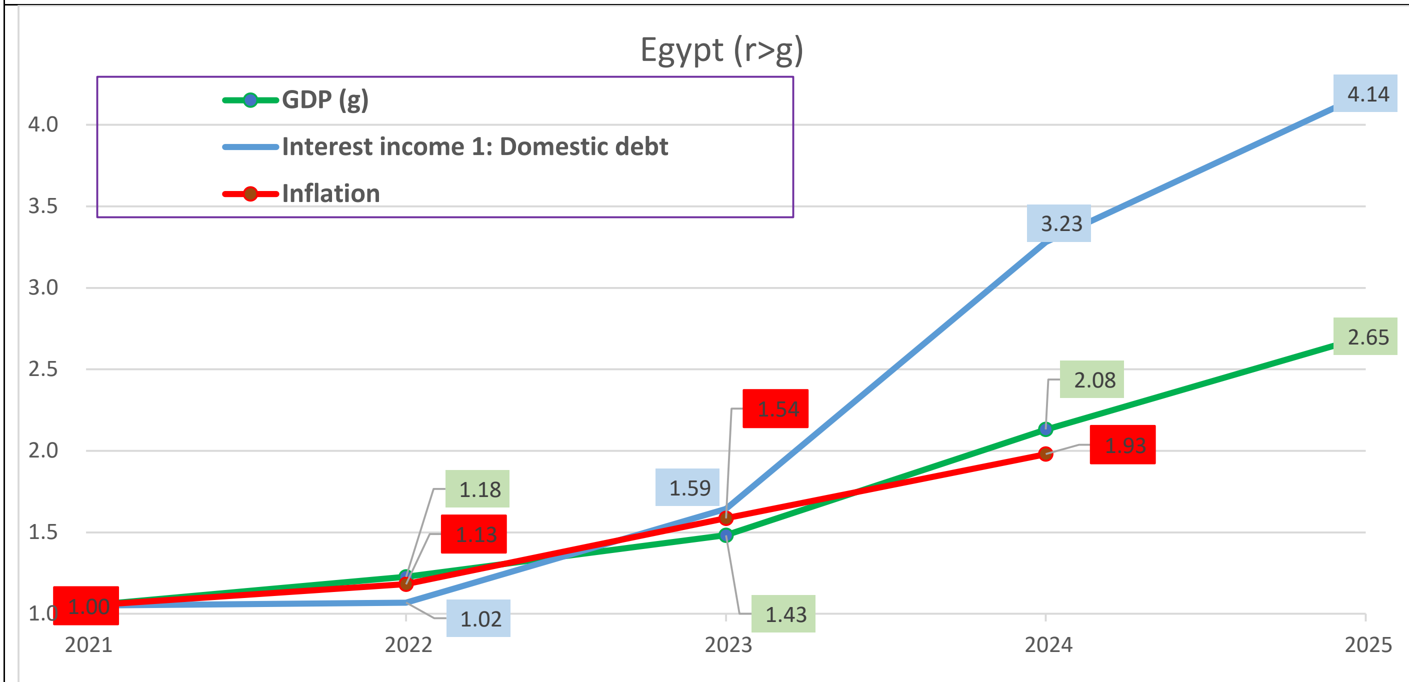
This process described before amounts to a radical and deeply regressive redistribution of the nation's resources. The state's fiscal apparatus has been transformed into a mechanism for transferring income from the broad base of taxpayers and the productive economy to the small, privileged segment of society that holds government debt.

The IMF's high-interest-rate regime directly aligns the personal financial incentives of domestic 'agents' (bankers, ifund managers, state-adjacent financial practitioners) with the rent-seeking system. The ncentives of those financial practitioners and influencers on the Central bank reaction functions are skewed. Their performance metrics (profits and bonuses) benefit from the interest and domestic debt dynamics. Their associated companies and their bonuses are tied to capturing the risk-free high yields from government debt, not to productive lending. The financial sector's profitability becomes decoupled from the health of the real economy. The core activity of financial intermediation for development suffers. The Productive Sector is Crowded Out, and the incentive structure is directed entirely towards rent-seeking rather than growth. This is proven by simply estimating from the CBE banking survey loan statistics. The Egyptian banking sector now creates more liquidity for passive rent-seekers (an estimated 2.35 trillion LE in annual interest income) than the entire outstanding stock of credit to the private business sector (1.87 trillion LE). The massive liquidity injected into the hands of a narrow elite, combined with a lack of productive investment opportunities, fuels speculative asset bubbles, particularly in real estate, further widening the wealth gap.

4. The r > g Dynamic in Action

The consequence of this policy of regressive redistribution is the entrenchment of a dynamic where the rate of return on capital (r) is significantly and persistently higher than the rate of economic growth (g). This r>g inequality, analyzed by Piketty & Goldhammer (2014), is a powerful driver of widening wealth concentration. In Egypt, this is not an abstract trend but a direct, engineered outcome of the IMF's advocated monetary policy.

Chart 1: The rate of return on capital (r) exceeds economic growth (g) (r>g).



Compiled data from the IMF (2024), MOF (2025), CBE (2024), and authors' estimations. Inflation, nominal GDP—both actual and projected—along with domestic interest payments and estimates of local currency time and savings deposits, is compiled to calculate the indexed estimated value. This approach facilitates the visualization of the inequality process in Egypt by allowing for the calculation of the cumulative rate of return for selected indicators.

The above chart illustrates and quantifies the Egyptian r > g dynamics with stark clarity. Between June 2021 and a projection for June 2025, while the Egyptian economy (nominal GDP) is expected to grow by a cumulative factor of 2.65, the total income flowing to domestic fixed-income channels is projected to grow by a factor of 4.14. The returns on passive financial wealth are growing substantially faster than the real economy that is supposed to support it. This has created a situation where, by June 2025, an estimated 50% of the country's entire nominal GDP growth over the preceding five-year period will have been directed to the resident beneficiaries of domestic public debt.

This financialization of the economy comes at the direct expense of productive investment. The same high interest rates that generate massive returns for bondholders make credit prohibitively expensive for private businesses. As a result, credit to the productive sector has stagnated. In a devastating indicator of this trend, by 2024, our estimation for the total amount of money being created annually to service domestic interest income (2.35 trillion LE) surpassed the entire stock of outstanding credit to the private business sector in local currency (1.87 trillion LE) (CBE, 2024).

5. The Endgame: State Capture and the Locked-in Political Trap

This financial architecture leads to a vicious cycle of state capture. *The financial system is now creating more liquidity for passive rent-seekers than it is for the country's entrepreneurs and industries combined. This is a recipe for de-industrialization and long-term economic stagnation, locking the country firmly in the Middle-Income Trap.* The IMF architecture of high-interest rate policies creates a powerful rentier class that benefits enormously from the status quo it created. This new elite uses its wealth to ensure policymakers (the "agents") continue the policies that guarantee their high returns. The "Despotic Leviathan" is reinforced as the state, now financially beholden to this domestic creditor class, and has no incentive to be accountable to its citizens. The country is now trapped by a political structure where a segment of the ruling coalition has a direct financial stake in maintaining the extractivism, preventing the emergence of a productive, competitive economy, and the Despotic Leviathan is locked.

B. The Failure of Inflation Control

The central justification for the IMF's high-interest-rate prescription is to control inflation. The conventional theory holds that by raising rates, central banks incentivize saving over spending, thus reducing aggregate demand and cooling price pressures. However, this logic is refuted in the Egyptian context, arguing that beyond a certain point, the policy becomes counterproductive and inflationary.

The primary reason is that the policy overlooks the substantial liquidity injected into the financial system through interest income channels. Yes and No. Why? Because the beneficiary class will easily do one of two things with the windfall gain in money they are making: invest it in real estate (hence the New Cairo shell housing/office space arises) or capital flight abroad (if capital controls exist). Do cap controls exist? Pl explain. Second, is it possible to demonstrate either or both empirically? The analysis conservatively estimates that the cumulative interest paid on domestic debt during the tightening cycle has injected 5.173 trillion LE into the financial system. This amount represents 50% of the increase in nominal GDP. It is more than three times the amount of cash circulating outside the banking sector as of September 2024, or over double the narrow money supply (M1). In addition, high interest rates on bank deposits generate further income for the wealthy. According to the CBE's (2024) statistical bulletin, time and savings deposits in local currency (M2) totaled 5.616 trillion as of October 2024. An effective rate of 13.5% on that stock of savings deposits would inject another 758 billion LE annually directly into the demand deposit accounts of the affluent. It is puzzling that a policy that injects trillions of LE of disposable income into the hands of the segment of the population with the highest propensity to consume luxury goods and assets is considered "contractionary." This policy effectively converts an external inflationary shock into a domestic demand shock, fueling inflation in assets like real estate and concentrating asset ownership further. But are u presenting actual inflation data to suggest that IMF induced action is ‘inflationary’? it may possibly only inflate real estate prices and costs. And also increase capital flight to safe havens!

IV. Discussion: Egypt As 'Despotic Leviathan's' And The IMF Financial Architecture.

The empirical evidence from Egypt presents a series of outcomes that appear puzzling or counterproductive when viewed through the lens of conventional macroeconomic theory. Domestic debt explodes despite fiscal prudence; inequality deepens in the name of stability; and a policy designed to fight inflation ends up fueling it. Where is the evidence for fueling ?? These puzzles, however, resolve themselves when the analysis shifts from a purely technical to a political-economic perspective. The Egyptian case study ceases to be a story of policy failure. It becomes a clear illustration of policy success in achieving the structurally embedded goals of a 'Despotic Leviathan' state. The IMF-advised policies, while presented in the universal language of technocracy, are perfectly tailored to the political-economic logic of elite capture.

The core argument of this paper, to reiterate, is that the IMF, through its orthodoxy, incentivized and legitimized the state's inherent tendency toward extraction. The 'Despotic Leviathan', as described in the theoretical framework, is a system organized around the benefit of a narrow elite, not the public good. The financial architecture created by the IMF's conditionalities serves this purpose with remarkable efficiency. The quantified $r > g$ dynamic, which shows returns on financial capital massively outpacing the growth of the real economy, is the precise financial signature of the rentier-state elite capture mechanism. It represents rent-seeking behavior that has been institutionalized into the very heart of the country's monetary policy, transforming the central bank from a potential agent of development into a machine for upward wealth redistribution.

From this perspective, the 'puzzling' failure of the policies to control inflation is reinterpreted. While inflation control may have been the stated goal, massive wealth redistribution was the *actual, structural outcome*. The policy proved highly effective at its unstated objective of enriching a small, powerful segment of society. The transfer of over 5 trillion LE (50% of GDP growth) to domestic debt holders is not an unfortunate side effect; it is the central event. This outcome aligns perfectly with the objectives of a 'Despotic Leviathan', which prioritizes the welfare of its elite constituents over the stability and well-being of the general population. The international legitimacy conferred by the IMF provides convenient cover for this institutionalized rent-seeking behavior in a society. The dismantling of the state's developmental capacity is central to this case study. The IMF's push to eliminate the CBE's subsidized lending was not just a technical adjustment but a move with significant structural consequences. These programs, despite their flaws, enabled the state to direct capital for industrial policy and economic development. Their removal undermined the state's developmental role, leaving only rent-seeking financial channels available.

This creates a fundamental and irreconcilable contradiction between the two forms of stability. The IMF framework prioritizes financial stability, defined narrowly as the ability to attract and retain volatile foreign portfolio inflows ("hot money") to manage the balance of payments. To achieve this, the state is compelled to maintain extremely high interest rates. But u don’t show that inflation did happen! This para is a non starter for this reason.However, these same high rates make credit prohibitively expensive for the domestic industry, stifling productive investment and preventing the creation of quality jobs, thus undermining developmental stability and long-term growth. The framework forces a choice, and the 'Despotic Leviathan' State, structured around elite benefit, will rationally and consistently choose the path that serves its core constituency. It will choose the high-interest-rate regime that generates massive, risk-free returns for financial asset holders, even if it hollows out the country's long-term productive capacity. For a 'Despotic Leviathan', the interests of financial elites will always trump the nation's developmental needs. This process reinforces itself by creating a strong domestic group of financial beneficiaries invested in the high-interest-rate, low-growth status quo, making a shift to a more productive economic model increasingly difficult. The IMF framework, therefore, acts to incentivize and institutionalize rent-seeking behavior.

V. Conclusion and Policy Implications for Emerging Markets

This paper demonstrates that the persistent challenges of inequality and economic stagnation are fundamentally rooted in politics. The case of Egypt under an IMF program from 2020 to 2025 provides a stark, quantitative illustration of a broader regional dynamic. It validates a governance-centric theory of the Middle-Income Trap by showing how orthodox stabilization programs, when applied to a 'Despotic Leviathan' State, do not simply fail in their stated objectives; they succeed in achieving the unstated goal of accelerating elite capture. The resulting financial architecture, characterized by compounding domestic debt and a severe $r > g$ dynamic, entrenches the very inequality that suppresses broad-based demand and blocks the path to sustainable development.

The analysis compels a conclusion that moves beyond a mere technical critique of the policy mix. The problem, we argue, is not simply that the interest rate was set too high or that the wrong economic model was used. The problem is that the entire policy paradigm is misaligned with the developmental needs of emerging markets operating within political contexts of extreme power imbalances. As long as the primary objective is to create an environment attractive to volatile international capital, and as long as elite interests capture the state itself, any macroeconomic program risks being co-opted by an extractive logic, producing the perverse and destabilizing outcomes witnessed in Egypt.

The regressive outcomes of these conditionalities are not unique to Egypt. A striking parallel can be drawn with the crisis in Greece, where similar austerity and stabilization programs were implemented while shielding the bondholders from losses. Eichengreen (2021, p. 195) notes in his analysis of public debt that the IMF-led program in Greece led to profound violations of societal fairness norms, triggering a subsequent political backlash. As a consequence, the IMF (2019) finally acknowledged the importance of protecting people experiencing poverty for the political sustainability of its policies. The Egyptian experience echoes Greek precedent in that the program violates fairness norms. It also suggests that the IMF did not learn from the experience, pointing out that the systemic issue is that the IMF program design fails to account for, and indeed exacerbates, deep-seated social and economic inequalities, regardless of regional context.

What we see here is a pattern: across cases, regressive impacts with consumption-based taxes, subsidy removals, and inflation disproportionately burden people with low incomes. Similarly, winners, including exporters, elites, and financial sectors, often benefit from currency devaluations or market liberalization. Moreover, political risk with social unrest and government instability often follows IMF-backed austerity programs, with some gendered effects too (women may face disproportionate burdens due to cuts in public sector employment and services).

Therefore, a genuine path forward requires a paradigm shift in policymaking for emerging markets, one rooted in a different political-economic logic that prioritizes strengthening societal power and building state capacity for development, not just extraction. Drawing from the international evidence on successful development and inequality reduction, a new agenda should be built on three pillars :

1. **Reclaiming the Central Bank Role for Development:** Our finding that total interest income in local currency rose to exceed the total credit to the private sector's credit in the banking sector during an external shock highlighted the importance of our first recommendation. The mandate of central banks in developing nations must be broadened beyond a narrow focus on inflation targeting, especially during external supply shocks that drive inflation. This involves exploring unconventional monetary policies, including the expansion of central banks' balance sheets and subsidized credit initiatives to channel finance toward productive sectors, SMEs, and green technologies. **This means reversing the very policies the IMF imposed on Egypt, which dismantled the CBE's capacity for industrial policy.**

2. **Pursuing Fiscal Justice:** Our finding that interest payments on domestic debt are projected to exceed 100% of tax revenues (Table 2) underscores the urgency of this recommendation that the rentier state's elite capture through domestic public debt needs to be directly addressed. This entails building state fiscal capacity through progressive taxation on wealth, income, and property, with the revenue aimed at strengthening public spending in universal health, quality education, and comprehensive social protection systems. This not only directly reduces inequality and builds human capital but also strengthens the social contract between the state and its citizens.

3. **Addressing the agency problem:** For public or quasi-public institutions, KPIs must be isolated and decoupled from any profits generated through public debt, particularly in the case of public banks. The same principle applies to high-level government consultants; they should not receive bonuses originating from that source.

4. **Establishing an independent Fiscal Council:** A key element in ensuring fiscal sustainability and fairness is the presence of strong, independent institutions. The severe r>g dynamic documented in our analysis (Chart 2), which funnels 50% of GDP growth to creditors, demonstrates the need for strong institutions that independently assess the macro policies from a justice perspective. Therefore, a critical step would be the establishment of an independent Fiscal Council in developing economies. Such a body would provide transparent, non-partisan analysis of budget policy and monitor debt dynamics, acting as a crucial check on policies that prioritize short-term financial stabilization over long-term fiscal health and equitable development. This would help insulate fiscal policy from the extractive logic of the 'Despotic Leviathan'. Also, it pushes back and highlights when foreign institutions like the IMF implement regressive fiscal

measures through central banks' operations.

These policies aim to rebalance power between the State and Society, seeking to establish a 'Shackled Leviathan' where the state is capable and accountable. Without a deliberate effort to move toward the 'Narrow Corridor', developing economies like Egypt will remain vulnerable. Any macroeconomic reform program risks being captured by the 'Despotic Leviathan', perpetuating inequality, stagnation, and instability.

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