



Preparing for a Strategic Shift on U.S. Policy Toward Egypt

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Introduction and summary

The United States has adopted a cautious and often unclear policy in reaction to the past year's tumultuous events in Egypt. This stance is due to the complicated nature of Egypt's ongoing political transition and the shifting nature of regional power dynamics in the Middle East. President Barack Obama and his administration have understood that the key centers of power inside of the country and the regional actors that attempt to support and shape trends in the country are driving the events on the ground.

But the current U.S. posture on Egypt is not sustainable in the long term; it represents a temporary “hold pattern” in a policy approach. Since 2011, this stance has essentially been trapped in the same path of longstanding U.S. policy toward Egypt since the early 1980s. Since the ouster of former Egyptian President Mohamed Morsi, U.S. policy has been caught in self-imposed suspended animation—the slowing of normal policy processes without a complete rupture in ties. The decisions this summer and fall to temporarily delay some forms of military assistance have only forestalled making decisions about the broader relationship.

This U.S. position on Egypt comes at a time of considerable disorder and tension across the region, with a civil war raging in Syria, the unresolved Arab-Israeli conflict, ongoing uncertainty about Iran's nuclear program, and enduring threats from terrorist networks in many countries. The U.S. government shutdown in October and the Obama administration's tentative stance on Egypt have contributed to growing pessimism about the role of the United States in Egypt and the broader region.

Inside Egypt, people of all walks of life continue to experience considerable turmoil and uncertainty. A heavy burden—one that is unlikely to be addressed satisfactorily—rests upon the shoulders of the country's leaders. The government, private sector, civil society, and the media all have a responsibility to create a more inclusive, pluralistic, and stable political transition than the country has experi-

enced since the fall of former President Hosni Mubarak in 2011. This political foundation is necessary to jumpstart economic growth.

The multiple centers of power that have emerged in Egypt since 2011 have competed for institutional and factional advantage and control.¹ The new political disorder is not adequately responding to three interlocking crises that continue to plague Egypt: political polarization characterized by ultra-nationalism on one side—bordering on militarism and xenophobia at times—and deepening rejectionism and denial among the Muslim Brotherhood and their supporters on the other side; economic stagnation driven by poor economic management, which contributes to high unemployment; and insecurity and continued terrorist attacks. These trends have produced an environment that is not beneficial to the Egyptian people and are contributing dramatically to the fraying of the country’s social fabric. It has also made Egypt a less reliable partner for the United States and other countries seeking to remain engaged in the region.

The remedy to this situation ultimately must begin with the Egyptian people and their leaders. Even though the United States paused some of its military assistance and several countries in the region, including Saudi Arabia, the United Arab Emirates, or UAE, and Kuwait, have moved in with increased assistance,² these moves will in no way be decisive if Egypt’s leaders do not finally seize the opportunity to put an end to internal polarization, continued violence, and economic stagnation.

One of the most troubling features of Egypt’s transition since 2011 has been the emptiness of the political debate and the lack of concrete ideas to solve the country’s mounting problems. The jockeying for power in the successive phases of Egypt’s transition since 2011 is disconnected with the concerns of ordinary Egyptians—particularly the overriding economic concerns. Egypt remains locked in a battle of elites over attempts to redefine the country’s national identity and purpose. Meanwhile, governance of the country and provision of services to citizens have deteriorated, reflecting the country’s lack of leadership and minimal levels of consensus. Each center of power in Egypt that has emerged with the upper hand at various phases of the political transition has overreached. Without clearer leadership that fosters more inclusive politics and straightforward answers to the country’s economic, security, and social problems, Egypt will continue to drift without a coherent national consensus of how to produce a governing agenda.

In the United States, the policy debate on Egypt is often unfortunately reduced to a choice between continuing longstanding U.S. policies unchanged or abruptly cutting aid to Cairo altogether.³ The Obama administration split the difference between these polar opposites with unclear results. This move has delivered an opaque message to Egypt and the region. The current U.S. posture seems to give tacit assent to Egypt's military-led transitional authorities' current attempt to impose stability through a combination of repression with limited gestures at inclusiveness. This model does not seem sustainable; stability imposed by repression cannot be assured and may not be conducive in supporting Egyptian interests—or, for that matter, those of the United States—in the long run. It is not likely to produce the sort of sustainable security that helps spark economic growth and jobs, which is the ultimate challenge in a country where massive demographic, economic, and social problems are mounting.

The strategic rationale and context for U.S.-Egyptian bilateral ties have fundamentally changed. For decades since the peace treaty between Israel and Egypt, the United States and Egypt worked together to advance regional security interests. During the last decade of the Cold War, Egypt was one partner in the broader U.S. effort to contain and check Soviet influence. Three decades later, the situation has completely changed; the Soviet Union no longer exists, and the Middle East has become a region filled with intense competition for influence among countries in the region with wealthier and better organized countries seeking to influence outcomes of political battles in more divided countries with less resources. This new strategic environment lends itself to policies that are muddled and lacking in clarity—which the U.S. policy has exhibited to date. This approach may be pragmatic in the short run, but it is ultimately damaging to U.S. influence, interests, and values. The changed strategic context requires the United States to develop a new policy approach.

Since 2011, the United States has stumbled through with tactical adjustments in policy, which has not advanced U.S. interests and values. Since Morsi's ouster, the Obama administration has signaled its disapproval with the political transition and the lack of a clear governing plan and, most importantly, with the trajectory of events and the heavy-handed repression following Morsi's removal by cutting some forms of U.S. military assistance and cooperation. This mildly coercive and punitive approach has achieved few tangible results and sent a confused message to Egypt and the region.

The events of the past two and a half years make it clear that autopilot will not achieve U.S. policy objectives for a stable, prosperous, and free Egypt. U.S. policymakers should take this opportunity to evaluate and prepare two major options: a much larger and more positive incentive track and a more serious coercive track. Policymakers should also seek to make U.S. policy more flexible and able to respond to future contingencies.

Plan 1: Offer a new bilateral partnership with positive incentives

The United States should make it clear that it is willing to progressively reengage Egypt if the country moves toward more effective governance, including democratic political pluralism, and develops an economic plan that could create inclusive growth and jobs. The United States has currently made clear what its core priorities are in Egypt: fighting terrorist networks and advancing regional security interests, including maintaining the peace treaty with Israel.

If Egypt takes serious steps to build a more inclusive and stable foundation, then the United States should work with European partners and others in the region to present a new offer for reengagement. The United States should seek to expand the foundations for the relationship by offering more meaningful cooperation with Egypt than it has since 2011. This new partnership would have three key components.

Expand economic ties aimed at boosting economic growth and integrating Egypt into the global economy

This means offering the potential of an even larger incentive package for boosting economic growth in Egypt than was previously presented in the G-8 Deauville Partnership and the corresponding Middle East and North Africa Transition Fund. Over the past decade, the United States has made announcements of a range of initiatives aimed at expanding economic ties, investment, and trade, but the follow through and implementation has lagged. If Egypt's leaders produce a viable plan for a more cohesive political system and a clearer economic plan, then the United States should use Egypt as a test case for expanded tools in cooperation with other countries, international agencies, and financial institutions to spark economic growth and job creation in Egypt. It could offer the possibility of a positive incentive in the form of expanded trade, perhaps even in the future con-

text of the current discussion on creating the Transatlantic Free Trade Agreement between the United States and European Union. It could also entail new efforts to build commercial ties, expanded educational exchanges, and a new bilateral arrangement on wheat exports.

Focus diplomatic efforts on countries already making major investments in Egypt's transition

Given the increased activity and engagement of actors in the region—notably, the investments made by Saudi Arabia, the UAE, and Kuwait—the United States should work to make sure these efforts are coordinated to the longer-term purpose of building a new foundation for Egypt to succeed in its political transition and craft a new economic plan. This will require difficult diplomacy; many regional actors do not recognize the dangers of the polarized politics in Egypt, and in the current regional environment, some of these countries are operating at cross purposes with U.S. policy on other key priorities, such as Syria, Iran, and the Arab-Israeli conflict. The lack of national consensus in Egypt's politics will likely make it difficult for the government to implement necessary economic reforms that reduce debt and reform subsidies.

Reform U.S. security assistance to Egypt

The United States is currently holding the delivery of many weapons systems. If Egypt moves in the right direction on political and economic reforms, the United States should use this current pause as an opportunity to reopen the dialogue about fundamentally reforming U.S.-Egypt security cooperation to move beyond the limited focus on supplying sophisticated military hardware and toward more emphasis on fundamental security sector reforms, including police reforms to advance the rule of law. Depending on future appropriations, a focus on security sector reform might require some rebalancing of foreign military financing, or FME, and authorization to shift a portion of funding into police development and training programs.

Plan 2: Prepare for the worst contingencies

Given the political polarization inside Egypt, outlining a more positive set of incentives for change may not succeed. If Egypt remains mired in internal conflict

and unable to produce a plan for governing and growing the economy, the United States needs to be prepared to fundamentally rewrite its regional security strategy to account for a less reliable partner in Egypt. This might entail cutting the large assistance package entirely and exploring other partnerships in the region and options for maintaining America's regional security footprint without some of the current benefits of expedited overflight approvals and access to the Suez Canal.

Alternative contingency planning should also factor in the potential for partial progress toward transitional goals. This could entail the continued suspension of portions of the security assistance program while other items, such as counterterrorism and border security assistance, might continue along with targeted forms of economic assistance. Such alternative planning would also be an appropriate reflection of the fact that progress toward democratization will be incremental and time consuming. Egypt is not—and has not been—on the brink of consolidating a democratization process. While no near-term process can be realistically expected to be fully inclusive, incremental progress is certainly possible. As opposed to foreclosing any future possibility of democratization, the key for the near term is to take concrete steps that restore a democratizing and inclusive process.

As part of a contingency planning process, the United States should also undertake a thorough review of the core objectives of the security assistance program and its relationship to democratization.

Clearly, the first plan is preferable to the alternative of downgrading ties with Egypt. The United States could continue to avoid a strategic shift in its policy described above and seek instead to muddle through in reaction to events in the coming year in Egypt, but this approach has not served to advance U.S. interests and values.

The 2013 crisis in Egypt's political, security, and economic transitions

Over the past year, Egypt's political, security, and economic situation has deteriorated, contributing to a deeply rooted identity crisis in the country's orientation and outlook. Since 2011, political polarization has impeded successive Egyptian governments from crafting a coherent economic plan to deal with the government's mounting debt, to reform budget-crushing energy subsidies, and to attract investment that produces inclusive economic growth and jobs. At the same time, the security situation has worsened in many parts of Egypt and is threatening to undermine broader regional stability.

Egypt's political transition and the ongoing struggle for power

Today's Egyptian politics face rampant political polarization, a crisis of legitimacy, and the breakdown of formal politics. The blame for this is shared: The current situation is the accumulated result of the repressive legacy of Egypt's post-colonial authoritarian rule, the misrule of the Supreme Council of the Armed Forces, or SCAF, and since 2011, the poor leadership of Mohamed Morsi and the Muslim Brotherhood. None of these actors have helped the country come together under a clear plan to govern the country. The lack of political pluralism, inclusion, and respect for rule of law and basic human rights displayed since 2011 has undermined the already weak foundations for stability and economic prosperity in Egypt.

A fundamental lack of trust pervades Egyptian political life, and politics itself is often devoid of substance. Average Egyptians do not trust political leaders to deliver on promises of economic betterment or political reform. Egyptian political leaders do not trust one another; neither the military nor the judiciary fully trust political leaders; and the Muslim Brotherhood trusts no one outside its own organization. This general atmosphere feeds off the inability or unwillingness of any of Egypt's political actors to formulate a broad and concrete vision that accommodates the broad spectrum of Egyptian society. It also undermines support for electoral politics and democratization.

Starting in the summer of 2012, the nearly one-year rule of the Muslim Brotherhood was particularly damaging to the country. Rather than laying the foundations for a functional and inclusive political order, Morsi and the Brotherhood chose “factional gain, zero-sum politics, and populist demagoguery.”⁴ Most prominent among the Brotherhood’s mistakes was Morsi’s November 2012 constitutional declaration, which gave him sweeping and dictatorial powers that he used to force the adoption of a constitution drafted by an Islamist-dominated assembly.⁵ Beyond its substantive impact, this ill-conceived gambit destroyed the possibility of even minimal levels of trust among political rivals and irrevocably turned a segment of Morsi’s former—and reluctant—supporters against his rule. This unexpected move came atop restrictive laws governing labor and nongovernmental organizations and a crackdown on freedom of expression via the increased application of laws against blasphemy and “insulting the president.”⁶

The Muslim Brotherhood’s concerted effort to seek hegemony over Egyptian politics, coupled with these serial failures, created a broad-based popular backlash that culminated in the massive protests against Morsi’s rule on June 30, 2013, crippling Morsi’s leadership and enabling the military to overthrow him on July 3. Those protests included not only reformists and revolutionaries from the original movement that propelled forward the uprising of January 25, 2011, but also those seeking to restore the former regime and apolitical citizens who came to the streets for the first time, spurred by increased economic desperation and deteriorating security. Crucially, support for Morsi ebbed with some of his more hardline Islamist allies among the Salafis, depressing their turnout in counter Islamist-led demonstrations.⁷ This meant that on June 30, Morsi and the Muslim Brotherhood faced an enlarged and emboldened opposition, albeit an incoherent amalgam of groups with often-divergent political goals and agendas.

Since the coup, Egypt’s military-backed transitional government has conducted a broad and often violent crackdown on the Muslim Brotherhood, killing hundreds and fostering the emergence of an ultra-nationalist political environment.⁸ The crackdown has also revived fears of militancy, sectarianism, and radicalization among segments of the Islamist current and created conditions that might produce and enable protracted, low-level insurgency throughout the country.

The post-coup transitional government suffers from the same deficits in polarization, legitimacy, and functional formal politics as those of the Muslim Brotherhood-led Morsi government. Where the Brotherhood alienated virtually every other faction in Egyptian political life with its actions in power, the tran-

sitional government and the security establishment that backs it have deepened this polarization with its wide and bloody crackdown on the Brotherhood and its Islamist allies.⁹ While the overthrow of Morsi himself appears to have considerable popular support, no government installed by the military will possess sufficient long-term legitimacy to rule a country as large and fractious as Egypt. To address this incipient legitimacy deficit, Egypt's current rulers have indulged a campaign of ultra-nationalism—including virulent anti-American propaganda—in the media,¹⁰ further inflaming the country's politics and endangering U.S.-Egypt ties.

Four steps in the next phase of Egypt's political transition

On July 3, 2013, the general command of the Egyptian armed forces ousted former President Mohamed Morsi, suspended the 2012 Egyptian Constitution, and appointed Adly Mansour—the chief justice of the Supreme Constitutional Court—as interim president.¹¹ On July 8, President Mansour announced a constitutional declaration with 33 articles outlining the contours of the next phase of the political transition after the military's removal and arrest of Morsi.¹² This transition has four basic steps:

Formation of committees to draft a new constitution: President Mansour's constitutional declaration stated that within 28 days, the president must form a legal committee of 10 judges and legal experts to amend the suspended 2012 constitution.¹³ This committee drafted a broad set of constitutional amendments. Article 29 of the constitutional declaration stated that the legal committee would present its recommendations to another committee of 50 members representing various segments of Egyptian society, including the military, civil-society groups, labor unions, al-Azhar University, and the Coptic Church.¹⁴ The work of the constitutional committee should have been completed by the end of October, but it has been delayed.

Constitutional referendum: Article 30 of the July constitutional declaration states that after a final text is adopted, the president will put the amendments to a public referendum.¹⁵ Strict adherence to the roadmap would require a referendum around the end of November, but the dates have slipped. The interim authorities, however, seem intent on meeting the basic procedural requirements of the roadmap and have accorded procedural fidelity a great degree of importance.

Parliamentary elections: The constitutional declaration states that the president would open the door for parliamentary elec-

tions within 15 days of passage of a newly amended constitution and complete these elections no more than two months later.¹⁶ According to the declaration, this should happen sometime in late January or early February. This timeline, however, does not account for the possibility that amendments may be voted down or for potential logistical issues related to the time it takes to actually hold the referendum. Even if parliamentary elections commence on or around the time anticipated by the constitutional decree, they could be held over stages lasting several months. Ultimately, the new cabinet must issue an elections law before any elections can take place.

Presidential elections: According to the current roadmap, presidential elections will be called within one week after the first session of the new parliament is sworn in.¹⁷ Since parliamentary elections may involve runoffs or other procedural problems, there does not seem to be a clear guideline for when presidential elections will take place. They may start in late February or early March 2014, and the actual election may be pushed back even further.

This ambitious timeline for the next phase of the transition faces many challenges. First, the crackdown and banning of the Muslim Brotherhood has raised significant questions about political legitimacy and the inclusiveness of the process. The 50-person constitutional committee has only one Islamist representative, a marked shift from last year.¹⁸ Second, the overall environment in Egypt has not fostered a spirit of openness and debate; ongoing violence has claimed hundreds of lives, government authorities have arrested hundreds of members of the Muslim Brotherhood and other dissident voices, and the transitional government has taken steps to restrict basic freedoms of expression and assembly.¹⁹

The various actions of the Muslim Brotherhood, the Egyptian military, and other political factions only scratch the surface of the country's political problems. Egyptians do not yet have firm political affiliations or allegiances; the Brotherhood dominated Egypt's transitional elections, yet less than a year after Morsi's inauguration, millions took to the streets to express their disapproval of his rule and, in many cases, demand his ouster. Above all, this fluidity and shallowness of political loyalties indicate an embryonic political environment and, more worryingly, may also indicate a lack of confidence in electoral politics to deliver results, either on the concrete economic issues that average Egyptians face or the reformist impulses that motivated the overthrow of Mubarak in 2011. Indeed, the very instability associated with the failed post-Mubarak transition and the turbulent period of Muslim Brotherhood ascendancy likely increased the willingness of many Egyptians to accept the military's repressive measures.

The Muslim Brotherhood has refused to accept the fact of Morsi's ouster and those leaders who remain free, both inside and outside Egypt, have proclaimed their intentions to lead a campaign of civil and peaceful resistance.²⁰ In light of recent violence, however, the Brotherhood has neither the moral authority to convincingly undertake such steps or the formal control to ensure that continued mobilization does not lead to further violence. As opposed to increasing sympathy with their plight, open-ended protest tactics will likely foster more violence and sour the public mood further. Regardless of the Muslim Brotherhood's actual role in the violence, it will be associated with such violence in the minds of large sectors of the Egyptian public. Instigation and mobilization against the state will likely continue to provide space for more militant actors to act in violent ways.

Internal instability and the return of terrorist insurgencies

Since the chaos that surrounded the overthrow of former President Hosni Mubarak in February 2011, security in Egypt has deteriorated steadily across the board, and popular perceptions of instability have increased exponentially. Threats to basic law and order, the growth of criminality, the availability of advanced weapons, and increasing lawlessness and violence in the Sinai Peninsula have all materialized over the past two and a half years. The prospect of a return to the assassinations and insurgent tactics employed by violent terrorist groups in their low-level insurgency of the 1990s remains a very real possibility. The accumulated experiences of transnational militancy, including that of some Egyptian foreign fighters and jihadists who have returned to Egypt, and the ease with which information, know-how, and capacity

can be relayed, suggest that the rudimentary tactics of that decade might be eclipsed by more sophisticated forms of terrorism such as suicide attacks, more advanced car bombs, and incendiary explosive devices.

Crime

Crime has skyrocketed since Mubarak's overthrow with homicides rising from 774 in 2010 to 2,144 in 2012.²¹ Armed robbery and home invasions have also dramatically increased, and automotive theft has increased by a factor of four from 4,973 in 2010 to 21,166 in 2012.²² Egypt has become a major transit hub for arms trafficking, as weapons from Libya flow through Egypt to militants in the Sinai and Gaza Strip. As the final report of the U.N. Security Council's Panel of Experts on Libya's arms put it, "the flows of military materiel in the country present a threat to its internal security, in particular given materiel acquisition by armed groups in the Sinai area."²³

The Sinai in particular has seen a marked deterioration in security over the past two years. Militants have killed dozens of Egyptian security force personnel, particularly in two large ambushes in August 2012 and August 2013 that killed 16 soldiers and 25 police, respectively.²⁴ In the recent past, previous campaigns in Sinai have largely remained a matter of rhetoric with little impact on the ground. More recently, however, Egypt's military has responded severely to violent unrest in the Sinai, launching major military operations and air strikes against militants, raising fears of heavy-handed and indiscriminate tactics. Violence has escalated sharply since Morsi's overthrow with almost 100 police officers and soldiers killed in militant attacks.²⁵ Militants have also attempted to attack ships transiting the Suez Canal though unsuccessfully thus far.²⁶

Deterioration in the Sinai Peninsula

The deterioration of security in the Sinai raises the specter of destabilizing cross-border activity and potential Israeli retaliation. Since Mubarak's overthrow, there have been at least three attacks in which militants from the Sinai physically crossed the Egypt-Israel border to attack Israel.²⁷ The most deadly and consequential thus far was the August 2011 cross-border attack that left eight Israelis and five Egyptians dead and created a severe diplomatic crisis between the two countries.²⁸ Moreover, militants have repeatedly fired rockets on Israel from the Sinai, most

recently in August.²⁹ Israeli intelligence estimated that Sinai militants carried out 11 attacks in 2012.³⁰ The situation in the Sinai is such that Israel's Shin Bet intelligence agency has formed a new unit to prevent attacks from the 15 jihadist groups that it estimates are operating in the Sinai.³¹

In addition to potential regional destabilization, continued deterioration of security in the Sinai will provide an important tool for the mobilization of domestic Egyptian and international jihadist organizations. Insecurity in the Sinai provides these organizations with an attractive and largely ungoverned space to organize and mobilize outside the reach of state security services. Its geographic location also provides a platform to launch attacks on Israel and international trade through the Suez Canal, opening wider militant recruitment possibilities than a fight directed solely against the Egyptian state. While Syria's civil war remains the primary destination for jihadists, porous borders and prolonged instability and conflict in Egypt and the Sinai could also prove to be a magnet for foreign fighters.

Moreover, the violent crackdown on the Muslim Brotherhood, its allies, and its sympathizers, which left hundreds dead, threatens to splinter and fragment Islamist groups, possibly leading to some radical groups' reversion to violence and the formation of new and more militant successors. Pro-Morsi sympathizers' sectarian reprisals against Coptic Christians across the country³² reveal the inability of the Brotherhood to control the dynamics of protest and violence, particularly after months of incitement and with much of its leadership currently under arrest.

Egypt's continued economic freefall

The political and security crises outlined above have worsened a weak economic situation in Egypt, and the continued lack of strong economic growth and employment opportunities in Egypt will likely further impede attempts to move forward in the political transition and deal with the security situation. Egypt is, for now, trapped in a vicious cycle that requires the current leaders to deal with mounting security and economic challenges at a time of political polarization and weak political legitimacy for the formal institutions of government.

Egypt's troubled economy

The Egyptian economy has been largely neglected over the past two and a half years, allowing macroeconomic crises to fester and delaying much-needed structural reforms to kickstart economic growth. Both the interim SCAF government and the recently toppled Morsi government appeared more interested in buying social peace or fighting out political battles than articulating a coherent economic vision for the nation. As a result, Egypt's economy has fallen several steps behind its already precarious position before the 2011 revolution to unseat President Mubarak. Luckily, the Egyptian economy has managed to muddle through its escalating problems and prevented a complete economic collapse, thanks largely to billions of dollars of foreign aid from friendly governments in the Gulf.

The military-backed government led by President Mansour and Prime Minister Hazem Beblawi faces a daunting economic challenge but is constrained in its ability to address these challenges by the deeply fractured and potentially violent political landscape in Egypt.

Balance of payments crisis: Egypt's foreign-exchange reserves declined from \$35 billion in 2010 to just \$13.4 billion in April 2013, enough for less than two and a half months of imports.³³ Egypt's reserves have rebounded to a slightly more manageable \$18.6 billion as of November, thanks to the billions of dollars in cash aid from Gulf states following the July coup.³⁴

Growing budget deficit: The government's budget deficit has grown to \$34.8 billion, or 13.8 percent of gross domestic product, or GDP, up from \$24.2 billion the previous year due to weak GDP growth, lower-than-expected tax and non-tax revenue, the increasing size of the public sector under the Morsi government, and the

government's reliance on higher-cost, short-term treasury bills and bonds to finance its debt.³⁵

Weak GDP growth: Egypt's GDP grew by 2.3 percent in fiscal year 2012, a slight increase from the previous year, largely due to an expansion of public consumption, while investment and net exports have contracted.³⁶ Private consumption growth continues to decline, exacerbating the imbalance between the public and private sectors.³⁷

Declining currency value: The value of the Egyptian pound has declined 21 percent since its peak in January 2010, down to 6.89 LE to \$1 USD.³⁸ Many economists still believe the pound is priced far above its true market value, creating the potential for continued exchange-rate volatility.

Expensive subsidies: The depreciation of the pound has made it more expensive for the country to buy fuel and wheat, making it more expensive for the Egyptian government to maintain its already oversized and inefficient subsidy program.³⁹ The cost of fuel subsidies has increased 54 percent since last year and accounts for 20 percent of total government expenditures alone.⁴⁰

Continued high unemployment: The unemployment rate in Egypt rose to more than 13 percent in June and has remained at more than 10 percent since the 2011 revolution.⁴¹ Three quarters of unemployed Egyptians are between the ages of 15 and 29.⁴² The inability to create enough jobs to keep up with population growth will only become more difficult as Egypt's population is expected to increase by 40 percent to 123 million people by 2050.⁴³

According to the International Monetary Fund, or IMF, Egypt's foreign currency reserves have declined from more than \$35 billion in January 2011 to less than \$14.5 billion in June 2013.⁴⁴ This position has improved slightly to \$19 billion with the temporary relief provided by regional support.⁴⁵ This past summer after Morsi's overthrow, Saudi Arabia, the United Arab Emirates, and Kuwait pledged

\$12 billion in aid to Egypt, and Saudi Arabia and the UAE have already deposited \$7 billion of this aid in Egypt's central bank.⁴⁶ While the influx of Gulf aid eases the immediate cash shortage crisis, it is unclear how the Egyptian government plans on leveraging this lifeline to put its economy on a stable path forward or if the Gulf countries will need to continue sending billions of dollars to Egypt to keep the economy afloat.

The transitional government has not resumed long-stalled negotiations with the IMF over a \$4.8 billion loan conditioned on subsidy cuts and other economic reforms.⁴⁷ Unemployment remains rampant with an official 13.3 percent rate prior to Morsi's overthrow.⁴⁸ Egypt's vital tourism industry—which employs 2.83 million Egyptians and generated 11.3 percent of Egypt's GDP in 2011—has been negatively affected by chronic post-Mubarak political unrest.⁴⁹ The political stalemate has also delayed reform of Egypt's unsustainable and inefficient food and fuel subsidies, which interim Prime Minister Hazem El-Beblawi claimed consumed a quarter of Egypt's budget.⁵⁰

Given the level of popular excessive nationalism and xenophobia encouraged by post-coup nationalist propaganda and the unpopularity of subsidy reform, continued slow-rolling of the IMF loan proposal is likely inevitable. Much-needed systemic economic reforms would inevitably entail some level of social dislocation. As such, undertaking these reforms in a practicable fashion will require broad-based political buy-in, which is unlikely in the near to medium term.

Conclusion: Preparing a new foundation for U.S.-Egypt ties

These intertwined crises and the volatile situation in Egypt and the region makes it clear that U.S. policy toward Egypt must change. It also demonstrates that the oft-recommended alternative of cutting off all U.S. aid to Cairo will not serve American interests nor will it help Egypt resolve its severe problems. Current policy discussions around a coercive U.S.-Egypt policy revolve primarily on cutting or eliminating the \$1.5 billion in annual aid provided to Cairo by the United States, most of which is now temporarily suspended.⁵¹ Blunt conditionality, which is the primary leverage provided by current discussions about cutting aid, remains a problematic approach to changing the U.S.-Egypt relationship.

The United States should pragmatically and gradually rewrite the terms of its relationship with Egypt, protecting its security concerns while placing an increased emphasis on values and economic progress. Washington and Cairo must work together to lay a new and more constructive foundation for U.S.-Egypt relations. If the United States and Egypt fail in this endeavor and Egypt is unable to establish a sustainable civilian-led democratic transition, then this important bilateral relationship will no longer be sustainable.

The events of the past two and a half years make it clear that autopilot will not achieve U.S. policy objectives for a stable, prosperous, and free Egypt. U.S. policymakers should take this opportunity to evaluate and prepare two major options: a much larger and incremental positive incentive track and a more serious coercive track. Policymakers should also seek to make U.S. policy more flexible and able to respond to future contingencies.

U.S. policy moves on Egypt since the military takeover

Egypt was supposed to receive \$1.23 billion in FMF funding and \$241 million in Economic Support Funds, or ESF, in FY 2013, which ended in September.⁵² The events of this summer prompted an administration review of all assistance to Egypt. By the time this review began, the United States had already disbursed \$650 million in FY 2013 FMF to Egypt, while none of the \$241 million in FY 2013 ESF money has been disbursed.⁵³

July 2013 **Coup designation not made and delivery of fighter jets and tanks delayed:** According to Section 7008 of the Consolidated Appropriations Act, the U.S. government is prohibited from giving military aid to any country whose elected head of state has been deposed by a coup d'état. In an effort to maintain maximum flexibility in its policy, the Obama administration declines to identify the situation in Egypt as a "coup;" it is currently operating in a manner such that official actions are in compliance with U.S. law. This posture is intended to signal American displeasure with the coup in Egypt without rupturing relations.

In July, the administration informs Congress that it is putting the delivery of the F-16 fighter jets and M1A1 tanks "under review."⁵⁴ The F-16s impacted by the delayed delivery are part of a deal the United States and Egypt reached in 2009 for the delivery of 20 F-16 C/D fighters in 2013. The first batch of aircraft was delivered in January, with delivery for the rest originally scheduled for this summer and late this year.⁵⁵

August 2013 **Joint military exercises suspended:** President Obama announces the cancellation of "Bright Star," the U.S.-Egypt biannual joint military exercises scheduled for September.⁵⁶

October 2013 **Deliveries of other weapons systems delayed and other forms of assistance such as a cash transfer and loan guarantees held up:** After further review, the United States announces an indefinite delay in the delivery of Apache helicopters, M1 tanks, and Harpoon missiles.⁵⁷

In addition, a proposed \$260 million cash transfer offered to Egypt's previous government for debt relief and general expenses continues to be suspended; this money was conditional on the Morsi government's agreement to the International Monetary Fund's economic reforms.⁵⁸

The \$300 million of loan guarantees expected in FY 2014 is withheld.⁵⁹

What aid remains

Funding for security assistance for Egyptian counterterrorism programs and efforts to protect Egypt's borders continues for the time being. It also includes the provision of spare parts and support for U.S.-origin weapons systems already delivered and fund military education and training.⁶⁰ U.S. Agency for International Development, or USAID, funding for certain types of education, health care, and business-development programs designed to improve the lives of the Egyptians, not to directly benefit the Egyptian government, also remains in place. Without some form of legislative action to provide flexibility or relief in the next several months, FMF and security assistance would grind to a complete halt.

Recent action by Congress

Several members of Congress have proposed legislation to condition U.S. assistance to Egypt on progress toward democratic reforms and counterterrorism actions; these measures have not yet passed to become law.⁶¹ In October, Sen. Lindsey Graham (R-SC) blocked a \$60 million transfer to support the Egyptian-American Enterprise Fund until he sees "Egypt moving toward democracy."⁶²

Offer the potential for a new bilateral partnership with positive incentives

If Egypt's competing centers of power manage to move forward and begin constructing an inclusive political order, the United States should be ready to work with the European Union and willing Gulf Cooperation Council, or GCC, states to mount a more coordinated effort to help Egypt's troubled economy. There are two primary obstacles facing this track: the poor prognosis for the building of an inclusive political order in Egypt itself and the willingness of some GCC states to provide a blank check to Egypt with primary regard for their own political inter-

ests but with less focus on helping Egypt construct a new, inclusive political order. There is little the United States can do to improve the former, but a stronger effort can and should be made with the latter.

Expand economic ties aimed at boosting economic growth and integrating Egypt into the global economy

The United States should make it clear that it is willing to reengage Egypt if the country moves toward more political pluralism and develops an economic plan to create inclusive growth and jobs. This means offering the potential of an even larger incentive package for reform than was previously presented in the G-8 Deauville Partnership. It could also offer the possibility of a positive incentive in the form of expanded trade, perhaps even in the future context of the current discussion on creating the Transatlantic Free Trade Agreement between the United States and European Union. Over the past decade, the United States has made announcements of a range of initiatives aimed at expanding economic ties, investment, and trade, but the follow through and implementation has lagged. If Egypt's leaders produce a viable plan for a more cohesive political system and a clearer economic plan, the United States should use Egypt as a test case for expanded tools in cooperation with other countries and international agencies to spark economic growth and job creation in Egypt. It could also entail new efforts to build commercial ties, expanded educational exchanges, and a new bilateral arrangement on wheat exports.

Work with regional actors and international powers to craft a more meaningful multilateral framework to support Egypt's transition

Given the increased activity and engagement of actors in the region—including the notable investments made by Saudi Arabia, the United Arab Emirates, and Kuwait—the United States should work to make sure these efforts are coordinated to the longer-term purpose of building a new foundation for Egypt to succeed in its political transition and craft a new economic plan. This will require difficult diplomacy; many regional actors do not recognize the dangers of polarized politics in Egypt to their own interests.

Regional powers have aggressively pursued their own political interests in Egypt without reference to a broader and more coherent strategy. Qatar and Turkey supported the Muslim Brotherhood-led government, while Saudi Arabia and the United Arab Emirates opposed it.⁶³ While both sides have invested enormous sums in their preferred outcome, their competition for influence has made it difficult to manage change in Egypt and lowered the return on their substantial investments there.

Saudi Arabian and other Gulf states' efforts to secure their recent gains in Egypt will continue. The broader question is whether regional tensions arising from competition for influence in Egypt will spill over into wider regional dynamics, such as Saudi-Turkish strains that are hampering cooperation in Syria.⁶⁴ The largesse of these Gulf countries and the scope of Egypt's economic crisis also pointedly raises the issue of sustainability regarding future financial support.

A more coordinated approach that discourages negative, zero-sum behavior by relevant regional and international powers is needed. As the example of regional powers attempting to buy influence with Egypt shows, there are multiple potential modalities for foreign engagement in Egypt. While the prospects for a more coordinated and coherent diplomatic approach remain limited, multilateral diplomacy will remain an essential tool. Disengagement will only deepen the clearly negative outcomes that the regional competition for influence in Egypt has produced thus far.

Implement fundamental reforms in U.S. security assistance to Egypt

Currently, United States is temporarily holding the delivery of many weapons systems. If Egypt moves in the right direction on political and economic reforms, the United States should use this current pause as an opportunity to reopen the dialogue about fundamentally reforming U.S.-Egypt security cooperation to move beyond the focus on supplying sophisticated military hardware and toward more emphasis on fundamental security sector reforms, including police reforms, to advance rule of law. The United States should also explore the possibility of addressing unfulfilled Egyptian procurement priorities, mindful of regional military balance of power considerations.

U.S. security interests in Egypt should focus more clearly and sharply on the emerging threats from terrorist networks in the Sinai and North Africa. The attack against the U.S. diplomatic facility in Benghazi, the French-led campaign against jihadists in Mali, and the sharp increase in militant activity in the Sinai all point to the dangers these networks pose to U.S. allies and partners in Europe, North Africa, and the Middle East. With the Egypt-Israel peace treaty likely to remain secure, Islamist terrorism presents the most significant challenge to security in Egypt and the broader region.

Any future revamped security assistance program to Egypt should be structured to create more flexibility to allow for modulation in U.S. aid to Egypt without creating ruptures. This might require revisiting the issue of cash-flow financing for U.S. military assistance to Egypt, which allows Egypt to enter into forward contracts that are independent of yearly appropriations. Egypt is currently the only country other than Israel to be afforded this treatment. In addition to allowing future flexibility, moving away from cash-flow financing in and of itself will be a clear signal of U.S. displeasure to the interim Egyptian authorities and military.

When assessing political progress in Egypt, the United States should move beyond crude procedural benchmarks and should make qualitative judgments as to the overall process of democratization. Fidelity to an electoral schedule is only one facet of the democratization process, and elections should not be the sole criterion by which the United States chooses to reengage fully with Egypt. Such a determination should also include assessments regarding key issues related to the broader atmosphere for democratization, including freedom of association, assembly, and speech; religious freedom; civil-military relations; and treatment of nongovernmental organizations. This suggests that any benchmarking process going forward, whether undertaken by the administration or Congress, should be incremental. For instance, the legislative agenda of the current cabinet can serve as an indicator of democratic progress in Egypt.

A proposed protest law will have a direct impact on personal freedoms and participatory politics before a constitution is passed or elections are held. The current government is unencumbered by an elected legislature and has an opportunity to demonstrate its seriousness by working with civil society to deliver democracy advancing laws. A decision to reengage with Egypt in a phased fashion would also reflect a more realistic judgment about the likely pace of change. Democratization will not happen quickly, despite the potential of meeting near-term electoral benchmarks.

While returning to the status quo ante is impossible in the coming months, a process of reintegrating excluded Islamist actors and pulling back from heavy-handed repression can begin. Furthermore, judgments regarding future democratization should be based on the opportunity for all political actors to compete fully and fairly, as opposed to a simple requirement of participation, which requires assent of both the authorities and excluded actors. Any benchmarks regarding inclusivity should avoid endowing specific political groups with the power to essentially veto fulfillment of benchmarks and should instead focus on the opportunity and ability to participate.

With the United States needing legislative action to forestall the possibility of an abrupt stop to foreign military funding and economic assistance, the Obama administration should engage more closely with Congress in coordinating a response to these developments and ensuring that any potential legislative relief offers a practicable pathway for incremental reengagement with Egypt.

Prepare for the worst contingencies

Outlining a more positive set of incentives for reform may not succeed in Egypt, given the political polarization inside the country. If Egypt remains mired in internal conflict and unable to produce a plan for governing and growing the economy, the United States needs to be prepared to fundamentally rewrite its regional security strategy to account for Egypt becoming a less reliable partner. This means exploring other partnerships in the region and options for maintaining America's regional security footprint without some of the current benefits of expedited overflight approvals, access to the Suez Canal, intelligence sharing, and counterterrorism cooperation.

To have any impact, a coercive track must move beyond the question of U.S. aid to Egypt and address the broader U.S.-Egypt strategic equation. The current relationship gives the United States a number of tangible benefits: overflight rights for the U.S. military, expedited passage through the Suez Canal for U.S. warships, and cooperation against Islamist extremist groups. Any coercive track that aims to have an actual impact on Egyptian calculations and the U.S.-Egypt relationship must include a broader and more complete strategic shift in U.S. regional security strategy that is less dependent on these tangible benefits. The possibility of turning in this direction requires rigorous contingency planning.

Signaling, whether publicly or privately, that this type of contingency planning is underway could in and of itself be another useful step to indicate that the United States is committed to thoughtfully engaging with a wide array of future policy options. The U.S. military could undertake this contingency planning process in response to requests by either the executive branch or Congress.

The future of the Egypt-Israel peace treaty is an oft-discussed element in maintaining the current U.S.-Egypt relationship. But the importance of the current U.S.-Egypt relationship to the maintenance of peace between Cairo and Jerusalem is likely overstated. Egypt does not maintain the peace treaty with Israel because it receives American aid; it maintains the peace treaty because it is in Egypt's own national interests to do so. Paradoxically, reconfiguring the U.S.-Egypt strategic relationship may increase the durability of the treaty and Egypt-Israel cooperation as Egyptians are forced to confront the reality that peace with Israel is a function of their own country's interests and not simply those of the United States.

This approach, however, is unlikely to change either the motivations of the Egyptian security establishment—the presumed target of any aid cuts—or the dynamics of the U.S.-Egypt relationship. To have any impact, a coercive track must move beyond the question of U.S. aid to Egypt and address the broader issue of U.S. regional strategy and capabilities.

Regardless of its policy toward and relationship with Egypt, the United States should plan for the worst: an unstable Egypt beset by a low-level nationwide insurgency, persistent and broad-based terrorism, or, in an unlikely worst-case scenario, civil war. U.S. policymakers should not be wholly unprepared if Egypt's political, security, and economic situation deteriorates completely. While there is likely little that the United States can do to prevent such deterioration, it should consider the impact of a highly unstable Egypt and the possibility of fundamental shifts in the bilateral relationship and prepare accordingly.

Finally, assuming continuation of the current trajectory, the United States should explore other coercive steps before making major decisions about aid to Egypt or the broader U.S.-Egypt strategic relationship. These steps may factor into the Egyptian government's calculus while creating time and space for further diplomatic engagement. Such steps could include delays in the delivery of equipment and spare parts, directing—in consultation with other shareholders—the IMF to limit its engagement with Egypt or taking a page from the European Union's playbook and suspending export licenses for goods that could be employed in domestic repression.

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