
U.S. House of Representatives
Committee on International Relations
Subcommittee on the Middle East and South Asia
“The Revolution in Egypt: Turning Point?”
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The uprising that toppled President Hosni Mubarak was an incredible achievement for Egyptians. Under Mubarak, Egypt was a key regional ally of Washington, a reliable peace partner for Israel, and an island of stability in a turbulent Middle East. But Mubarak was also an authoritarian, whose ruling party presided over an increasingly repressive state apparatus at home. With Mubarak gone, Egyptians have a chance to chart their own course. And over the past year and a half, they have been doing so via unprecedented political contestation. Sixteen months after the revolt, however, it's not clear that Egypt is headed for either democracy or stability.

This week's elections promised to be the culmination of a prolonged period of instability. Instead of signaling the onset of normalcy, however, the apparent election of Muslim Brotherhood's Freedom and Justice Party (FJP) candidate Mohammed Morsi touched off a renewed round of instability in the state. Two Constitutional Court decisions issued only days before the presidential elections threatened to derail the voting. The first ruled that one candidate—former Prime Minister Ahmed Shafiq—would be allowed to compete, notwithstanding a law that banned former regime officials from participating. The same day, the court also disqualified one-third of the seats elected by party list during the winter parliamentary elections, a decision that led to the dissolution of the four-month old parliament.

Meanwhile, with parliament dissolved, the Supreme Council of the Armed Forces or SCAF has assumed legislative powers, and has announced that it would appoint the Constitutional drafting committee, a body that had previously been selected by the now-dissolved Islamist-controlled parliament. Already, this new body is inserting language ensuring the military remains unaccountable to civilians. Taken together, these steps have been understood by many Egyptians as a soft coup, safeguarding the continued dominant political position of military. In the process, the legitimacy of Egypt's leadership and formally respected institutions—in particular the judiciary—have been undermined.

Revolutions are messy, but the last year and a half in Egypt has been particularly erratic. And the political volatility is sure to continue. The SCAF has announced that it will return to the barracks on June 30, but this will not represent an end to the military's role in and above Egyptian politics. Indeed, the Muslim Brotherhood's control of the executive (if confirmed)—and, most likely, the next legislature—puts the Islamists on a collision course with the military. Egypt's Islamists are already refusing to recognize the court decision dismissing parliament. At the same time, the SCAF's monopolization of Constitution-writing is sure to make the process contentious. Making matters worse, security in the Sinai and throughout much of Egypt continues to deteriorate.

Economic Morass

Egypt today faces enormous challenges. Notwithstanding the ongoing democracy deficit, perhaps foremost among Egypt's ongoing difficulties is the economy. The economy has long been a source of dissatisfaction for Egyptians, a problem often summarized by the now-axiomatic World Bank statistic that some 40 percent of Egyptians survive on less than two dollars a day. In recent years, though, the combination of low wages, high under-employment, and inflating prices of commodities contributed to an acute sense of desperation. To wit, in an April 2011 International Republican Institute poll, 64 percent of Egyptians identified “low living standard/lack of jobs” as the key factor influencing their decision to support or participate in the uprising.

Since the revolt, the Egyptian economy has degenerated to the point of crisis. Foreign reserves have plummeted from \$36 billion in February 2011 to less than \$15 billion, capital has fled, foreign direct investment has dried up, inflation is taking hold, and tourism—a sector that traditionally sustained about 11 percent of the economy—has been reduced to a fraction of its pre-2011 levels. Not surprisingly, not only have rates of poverty and unemployment increased, frustrations have spiked among the vast majority of Egyptians who expected their household finances to improve in 2011. The dour mood is reflected in popular polling. In March 2012, 88

percent of those polled said they were pessimistic about Egypt's economic prospects—an astounding increase from 11 percent just a month earlier.¹

Short on cash and with precious few sources of revenue, Cairo is borrowing from domestic banks at interest rates in excess of 15 percent to help cover its \$23 billion budget deficit. It also borrowed \$1 billion from the Egyptian military. To fill the gap, the Government is also issuing its own bonds, including notes sold in April due in 2040 providing a return of 8.3 percent.² In an effort to stem capital flight and declines in the market, earlier this month Prime Minister Ganzouri banned local brokerage firms handling securities from dealing with foreign equity outside of Egypt. The purpose of the ban, as the chief economic analyst at the leading Egyptian daily *Al Masry al Youm* observed, was to “close the door to funds moving abroad.”³

In May, the Minister of Finance Mumtaz Saad predicted that elections would be “the beginning of national economic recovery.”⁴ Notwithstanding the minister's optimism, however, it's not clear when, how, or if the situation will improve. Much will depend on the trajectory of Egyptian politics. No doubt, ongoing protests will undermine efforts to return to economic normalcy. So too will continued clashes between state security forces and the civilian opposition.

The Egyptian bourse has been particularly jittery since the revolt. After losing half its value in 2011, the stock market rebounded in early 2012. Since then, however, political shocks have left the bourse shaking. When the Muslim Brotherhood reversed its decision and announced this past April that it would run a candidate for president, for example, the EGX 30 stock index dropped almost four percent. On June 18th, the market constricted another 3.4 percent, a twenty percent dive from its post-revolt peak in March.

Egypt's young demographic and growing consumer class remain attractive to investors. Indeed, just last year, Procter & Gamble built a \$1.5 billion diaper factory outside of Cairo. Still, foreign direct investment will not return to Egypt so quickly, particularly given the likelihood of a devaluation of the Egyptian pound. Another concern for foreign investors will be the economic policies of post-Mubarak Egypt.

Free Market Future?

There appears to be broad consensus among Egypt's political (and military) leadership that the country should continue along the path of free market economics. In the current populist political environment, however—given that the clarion cry of the revolt was “social justice”—free market capitalism may be a tough sell. Indeed, despite a doubling of per capita GDP from \$3,000 in 1998 to \$6,000 in 2009, economic reform is negatively viewed by most Egyptians.

Starting in 2004, the Mubarak regime introduced a series of economic reforms which resulted in impressive economic growth. In 2007, Egypt posted real gross domestic product (GDP) growth of 7.1 percent; 7.2 percent in 2008; and a 4.7 percent rate of GDP growth in 2009. Compared to previous years, growth in 2009 seems low. Yet given that this growth occurred at the low point of the global economic downturn, the number was remarkable.

Impressive numbers aside, the vast majority of Egyptians did not benefit much from the reforms. At least in part, the problem was that the benefits of economic expansion failed to trickle down to the poor while Mubarak regime associates profited richly from the new rules and the privatization process. As a result of this dynamic, Egyptians today largely associate the era of economic reform with corruption and crony capitalism.

¹ Maryam Badr Eddin, “Al Maalumat: Inkhifad thiqa al mustahlik al Masri khilal Maris binisba 2.1%,” *Al Yawm al Saba*, April 11, 2012.

² Muhammed Ahmed Al Sadani, “Irtifa al 'aaid al sandat al dolarat bisabab taakir qurud sunduq al naqd,” *Al Masry al Yawm*, April 12, 2012.

³ Amir Haidar, “Al Ganzuri, youthir ta'amal sharikat al samsara fil isham al ijnabi,” *Al Masry al Youm*, June 4, 2012.

⁴ Mohsin Abdl Raziq, “Wazir al maliya: Al Mashad al intikhabi bidaya lita'fi al iqtisad,” *Al Masry al Youm*, May 24, 2012.

Notwithstanding, Egypt's Islamists—both the Muslim Brotherhood and Salafist parties—have said they are committed to free-market economics and have issued economic programs that largely adhere to this model. (A notable exception is some support for trade protectionism). Muslim Brotherhood officials have visited Egypt's bourse and declared support for the institution, and the organization's former deputy supreme guide and one-time presidential candidate Khairat al-Shater is an unabashed entrepreneur and millionaire. As Brotherhood member and businessman Hassan Malik told the Egyptian daily *Al Masry al Youm* in October 2011, Mubarak-era economic policies were “moving in the right direction.” The problem, he said, was that they “were marred by rampant corruption and cronyism.”

While these sentiments may be reassuring, it's unclear if they'll be sufficient. Al-Shater, for example, has suggested that there will be “social constraints” on the private sector in an “Islamic system” of government favored by the Brotherhood. And Morsi has issued a number of problematic populist and expensive campaign promises, including forgiving the debts of all Egyptian farmers and providing raises of 400 percent to Egyptian soldiers.

Perennial Economic Challenges

Regardless of who heads the new Government, prevailing populist politics in Egypt will complicate the implementation of sound reform-minded economic policies. Even if Egypt's next Government pursues good policies, however, perennial challenges remain—chief among them endemic unemployment. Egypt needs 6 percent annual GDP growth just to provide enough jobs for the 650,000 Egyptians that enter the job market every year. This past year, growth only reached 2.5 percent, and is forecast to drop to under 2 percent in 2012.

Subsidies are also a significant drag on the economy. Energy and food subsidies—a relic of Nasserist socialism of the 1950s—comprise \$24 billion of Egypt's \$105 billion budget this year. In the 1970s, then-President Anwar Sadat tried to phase out some of these subsidies, a move that resulted in widespread riots. The Mubarak government had likewise pledged as part of its economic reform initiative to phase out fuel and electricity subsidies by 2014, but had accomplished little by the time he was deposed.

The new Egyptian Government budget includes a 27 percent reduction in fuel subsidies. It's a positive first step, especially given that 90 percent of this assistance goes to the top 20 percent of Egyptian households—a subsidy that International Monetary Fund (IMF) Middle East and Central Asia Department director Masood Ahmed says targets the rich. Reform of the food assistance, however, in particular the \$2.7 billion to subsidize bread, is not likely to occur anytime soon. Egyptians have come to depend on government food subsidy, especially for wheat products. Today the state is the world's top wheat importer, bringing in about 7 million tons per year to feed the import-dependent state. Egypt's insolvency makes payment for the subsidies increasingly difficult.

Global increases in the food prices combined with rising local unemployment, and a lower value for the Egyptian pound could prove a volatile combination. Back in May 2011, Maj. Gen. Mahmoud Nasr of the SCAF held a press conference in Cairo, in which he said the poverty rate could reach 70 percent, inspiring a “revolution of the hungry.”

The Security Problem

To a great extent, an improved economy and prospects for a more stable Egypt are dependent on the re-establishment of security. The immediate aftermath of the revolt saw a significant deterioration in security in Egypt, including a series of widely reported prison escapes and a surge in violent crime, including car-jackings, armed robberies, and kidnappings. A series of factors have contributed to the deterioration, not the least of which has been that security forces have lost personnel, capacity, and motivation since the uprising. An influx of weapons from Libya hasn't helped, either. Despite Mubarak's resignation and promises to reform the police and state security services, the security situation has failed to improve. The spike in crime drove much of the appeal for Ahmed Shafiq in the presidential contest. He was, essentially, the law-and-order candidate.

The most conspicuous manifestation of the security deficit is in the Sinai, where armed groups claiming allegiance to the ideology and agenda of Al Qaida are becoming increasingly active. These groups are largely believed to have been responsible for the 14 attacks on the natural gas pipeline between Egypt and Israel and Jordan in the Sinai. Lately, Bedouin tribesmen have also become a threat, kidnapping tourists and harassing the Multinational Force and Observers (MFO). On 29 July 2011, hundreds of Bedouin shouting Islamic slogans exchanged fire with security services and attacked the El-Arish police station in northern Sinai, killing three civilians and two security officers. In March 2012, a group of armed tribesmen surrounded the MFO camp at El Gorah for eight days, demanding the release of Bedouin imprisoned nearly a decade earlier for terrorist bombings. More recently, on June 11, 2012, a group of unidentified assailants ambushed police and military along the El-Arish ring road.

Operations by Gaza-based terrorists against Israel emanating from the Sinai are also on the rise, with once-infrequent cross-border rocket strikes and cross-border attacks becoming a routine occurrence. Earlier this week on June 18, terrorists entered Israel from the Sinai and detonated a road-side bomb, killing one Israeli civilian. In August 2011, the Popular Resistance Committees (PRC), a Palestinian organization, launched a cross-border raid on Israel from Egypt that killed eight Israelis, including two soldiers. Making matters worse, while in pursuit of the attackers in August 2011, Israeli forces killed six Egyptian soldiers, a development that sparked a bilateral crisis.

It's difficult to discern whether the Egyptian military is incapable or just unwilling to secure the Sinai. Both scenarios are troubling. Insecurity in the Sinai is unlikely to be contained to the peninsula indefinitely: Egypt has a troubling history of terrorism in the Nile Valley targeting westerners, Coptic Christians, and the state alike. And should Israeli-Egyptian ties further deteriorate, border incidents will become more difficult to manage. Still firmly in control in August 2011, the SCAF was able to ignore popular demands to expel the Israeli ambassador from Cairo and prevent Israeli ships from transiting the Suez Canal. If and when the SCAF returns to the barracks, however, a similar situation might be handled in a less productive way. As it happened, the State was barely able to secure Israeli diplomats in Cairo, who were almost lynched by an angry mob.

US Policy Implications

Muslim Brotherhood officials had pledged another "more violent" revolution if Shafiq had been elected, so Morsi's apparent win may at least temporarily forestall a clash with the military.⁵ Still, the victory was not decisive, and it's safe to say that few will be truly happy with Morsi's victory. As the disqualified Islamist erstwhile presidential candidate Abdel Monem Aboul Fattouh pointed out while endorsing Morsi on the eve of the election, the choice was between "bad and worse."

It's unclear how the Muslim Brotherhood and the Salafists will perform when elections are eventually held for the new parliament. Some Egyptian analysts like Mahmoud Salem, who is better known by his blogging moniker "Sandmonkey," say Islamist popularity has been on the decline in recent months based on broken promises, few legislative accomplishments, and a rising fear of theocracy. At the same time, it appears likely that the Muslim Brotherhood will be challenged on the right by the Salafists, their chief political and ideological rivals, a development that could push the Brothers to take an even more militant line. Before the parliament was dissolved, this dynamic was already playing out.

The biggest competition in the coming months, however, is likely to be between the Muslim Brotherhood and its allies, and the SCAF, a struggle that may involve mass protests, further destabilizing Egypt.

Although the military via extremely friendly constitutional amendments may have the upper hand for the immediate future, for Washington the election of Morsi is a clarifying moment. Depending on what powers the president retains, Morsi may have an opportunity to impact the policy agenda via the selection of a cabinet.

⁵ Almost certainly, if Shafiq is somehow declared the victor on Thursday June 21, mass demonstrations will ensue.

While this would not immediately impact Egypt's foreign relations, the peace agreement with Israel, or strategic ties to the US, populist and/or Islamist policies that impact women, political pluralism, and religious tolerance could complicate bilateral relations with Washington. Calls by senior Muslim Brotherhood officials and leading FJP boosters for the re-establishment of the caliphate and the liberation of Jerusalem will do little to help, either.

Egypt's economic policies could also impact the relationship, especially given the Administration's pledge—articulated on March 3 by State Department spokeswoman Victoria Nuland—that the US was “committed to ensuring Egypt's economic and financial stability.” While the prospect of Egypt as a failed state is unappealing, it's not exactly clear what the administration's commitment entails -- or whether the obligation will endure implementation of illiberal and repressive legislation in Cairo.

Washington and the international community should encourage Egypt to commit to economic reform and to lay out a clear vision of where the economy is headed. The US can also continue to emphasize to Egypt and its Islamist-led Government the inverse relationship between radicalism and foreign direct investment. At the most basic level, however, Egypt is going to have to help itself. Already, the Salafis and MB have opposed Japanese loan to expand the Metro System in Cairo, which Islamists consider as *ribh*, or interest, and prohibited by Islam. The Salafis are also opposed to the \$3 billion IMF loan. Will the Muslim Brotherhood be able to withstand the pressure?

For the foreseeable future, even if the military returns to the barracks, it will remain the key power center in Egyptian politics. For many Egyptians, this status quo is undemocratic and unacceptable, falling well short of the goals of the revolt. This dynamic alone is sure to contribute to an ongoing tense environment in Egypt, perpetuating the instability of the past 16 months. The absence of a parliament and a president with limited powers will likewise diffuse authority, making it difficult for Washington to work with civilian leaders in Cairo on issues of mutual interest.

Continued military preeminence in Cairo may in the short term guarantee some longstanding US strategic interests in Egypt—priority canal access, over-flights, counterterrorism cooperation, and the maintenance of the peace treaty with Israel-- but it is an inherently volatile situation. The opposition, Islamist and liberal alike, is likely to employ anti-US populist politics as a cudgel against the military, and, should the military crackdown and re-institute draconian measures, it will further stress bilateral relations.

Sixteen months on, the transition in Egypt is not over. Indeed, it is just beginning. With limited leverage, Washington has to pick its spots with both the military and the Islamist leadership. The *sine qua non* for maintaining the substantial US aid package to Egypt is the continuity of the core elements of the strategic partnership. While the instinct may be to lower the standard for other, less pressing issues, Washington should in fact take the opposite tack. If democracy in Egypt is to take root, Cairo should be held to a high standard in this coming period in terms of human rights, religious freedoms, political pluralism, and women's rights. Egypt, with 83 million people, is too big and too important to fail. But a return to authoritarianism—either religious or secular—would also be a failure, dashing Egyptian's aspirations and undermining US interests in the region.