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*Strategic Directions for the United States International
Development Finance Corporation (DFC)*

LEAD AUTHOR
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A Report of the CSIS PROJECT ON PROSPERITY AND DEVELOPMENT

CSIS | CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES

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Context

Although a relatively small country in terms of population, Tunisia is strategically located at the intersection of Europe, Africa, and the Middle East, which enables it to connect large markets and people (Table 1). Tunisia is the only country in the Arab world considered to be “free” in the democratic sense and is considered by many to be a beacon of hope in a neighborhood that has not always been amenable to democracy.¹ Since the fall of the dictatorial Zine Ben Ali regime in 2011, Tunisia has indeed made significant progress politically; however, commensurate economic progress has been elusive.² High levels of inflation, youth unemployment, erratic and uneven economic growth, and pervasive corruption remain key challenges.³ The lack of economic progress has reached a critical point where some have started to question the merits of democratic governance.

Young people played an important role in the pro-democracy protests against the former dictator, but many of those invigorated by revolution are still unemployed and are increasingly losing faith in the democracy they helped deliver. Young people are also more susceptible to violent extremism and more likely to attempt emigration.^{4,5} A lack of economic opportunities has fueled outward migration and has led to “brain drain,” whereby Tunisia’s best and brightest—talent often compared to the best in the world—seek opportunities in France, Italy, and elsewhere.⁶ Since 2011, approximately 150,000 Tunisians have migrated in search of better economic opportunities.⁷ Skilled workers have

1. “Freedom in the World 2019 Map,” Freedom House, <https://freedomhouse.org/report/freedom-world/freedom-world-2019/map>.

2. The Economist, “The other victim,” Economist, July 2, 2015, <https://www.economist.com/middle-east-and-africa/2015/07/02/the-other-victim>.

3. International Monetary Fund Middle East and Central Asia Dept., *Tunisia : Fourth Review Under the Extended Fund Facility Arrangement and Request for Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Tunisia* (Washington, DC: IMF, 2018), <https://www.imf.org/en/Publications/CR/Issues/2018/10/08/Tunisia-Fourth-Review-Under-the-Extended-Fund-Facility-Arrangement-and-Request-for-46285>.

4. Evelyn Rupert, “A data-driven approach to preventing violent extremism in Tunisia,” Creative Associates International, October 18, 2018, <https://www.creativeassociatesinternational.com/stories/a-data-driven-approach-to-preventing-violent-extremism-in-tunisia/>.

5. REACH and Mercy Corps, *Tunisia, country of emigration and return: Migration dynamics since 2011* (REACH and Mercy Corps, 2018), https://reliefweb.int/sites/reliefweb.int/files/resources/reach_tun_report_tunisian_country_of_emigration_and_return_december_2018.pdf.

6. Iman Zayat, “Exodus of highly skilled labour could cripple Tunisia’s development prospects,” *Arab Weekly*, November 19, 2017, <https://thearabweekly.com/exodus-highly-skilled-labour-could-cripple-tunisias-development-prospects>.

7. “World Population Prospects 2019,” United Nations Department of Economic and Social Affairs, <https://population.un.org/wpp/DataQuery/>.

struggled to find jobs in Tunisia, and many of them have risked their lives to emigrate to Europe.⁸ Youth unemployment is particularly high at 34.8 percent in 2018, which is a slight decrease from its peak of 42.5 percent in 2011.⁹

Young people played an important role in the pro-democracy protests against the former dictator, but many of those invigorated by revolution are still unemployed and are increasingly losing faith in the democracy they helped deliver.

For those who choose not to leave Tunisia, the chances of finding a job—especially a formal job—are rare, since a historically bloated public sector is considered one of the best options for stable employment. Government jobs are still viewed as the most secure and safe option, especially when compared to starting a business, which has significant challenges of its own.¹⁰ Entrepreneurialism is rare, with Tunisia ranking near the bottom (113th out of 140 countries), according to the World Economic Forum (WEF).¹¹

While the formal private sector has faced barriers to growth since the 2011 revolution, the informal economy in Tunisia has grown, with some estimating its size between 35 to 50 percent of Tunisia's GDP in 2016.¹² Those working in the informal economy do not have access to social security benefits nor do they pay income taxes, putting themselves at risk while the government loses out on potential tax revenue.¹³

Youth unemployment and increased informality have created adverse effects beyond Tunisia's anemic economic growth. In the years after the political revolution of 2011, around 6,000 Tunisians joined the ranks of the Islamic State of Iraq and Syria (ISIS).¹⁴ Today, the main threat from terrorism comes from individuals and groups moving across the border to and from Libya, where Tunisians make up the highest proportion of foreign fighters.¹⁵ Worryingly, the fighters and militants have not come from one particular region in Tunisia but from multiple cities and rural areas, meaning that solutions will be needed across the country.¹⁶ The Tunisian government must devise a

8. Some European countries have begun to tailor their visa programs to take advantage of the Tunisian expatriates. France, for instance, is in the middle of creating a visa initiative to attract young, skilled workers from Tunisia. Iman Zayat, "Exodus of highly skilled labour."

9. "Youth Unemployment Rate for Tunisia," Federal Reserve Bank of St. Louis (FRED), last updated 3 May, 2019, <https://fred.stlouisfed.org/series/SLUEM1524ZSTUN>.

10. The World Bank, "Chapter 4 Economic Opportunities," in *Breaking the Barriers to Youth Inclusion* (Washington, DC: The World Bank, 2014), https://www.worldbank.org/content/dam/Worldbank/document/MNA/tunisia/breaking_the_barriers_to_youth_inclusion_eng_chap4.pdf.

11. "The Global Competitiveness Index 4.0 2018 Rankings," World Economic Forum, 2018, <http://reports.weforum.org/global-competitiveness-report-2018/competitiveness-rankings/#series=GCI4.D.11.02>.

12. "Tunisia: Informal economy expands," The Economist Intelligence Unit, June 6, 2016, <http://country.eiu.com/article.aspx?articleid=324281816&Country=Tunisia&topic=Economy&subtopic=Forecast&subsubtopic=Economic+growth&u=1&pid=987817283&oid=987817283>.

13. Ibid.

14. Richard Florida, "The Geography of Foreign ISIS Fighters," City Lab, August 10, 2016, <https://www.citylab.com/equity/2016/08/foreign-fighters-isis/493622/>.

15. Aaron Y. Zelin, *Report: Foreign Fighters in Libya* (Washington, DC: Wilson Center, 2018), <https://www.wilson-center.org/article/report-foreign-fighters-libya>.

16. Ibid.

solution to confront the issues that have marginalized many people in rural and urban areas, even leading some to radicalization.

The challenge is to create the necessary conditions for private sector growth and to ensure that young people see meaningful economic opportunities in Tunisia that dissuade them from extremism and emigration. If it leverages the expertise of longstanding partners and focuses on private sector growth, the newly created Development Finance Corporation (DFC) can play a role in this growth. Tunisia is a small country and solutions are available to its challenges; the key will be to find areas of collaboration and intervention that reform Tunisia's government and its finance sector while providing meaningful opportunities for small and medium enterprise (SME) growth.

The challenge is to create the necessary conditions for private sector growth and to ensure that young people see meaningful economic opportunities in Tunisia that dissuade them from extremism and emigration.

Table 1: Country Summary

Population (2017)	11.5 million ¹⁷
Population under 25 years old	4.4 million, 39.7% of population ¹⁸
GDP per capita (2017)	\$3,464 (WB data), ¹⁹ Lower-middle income economy ²⁰
Fragility	Tunisia is not listed as a fragile state in OECD's States of Fragility 2018 report. ²¹
Main economic sectors	<p>GDP Composition (% by sector in 2017):²²</p> <p>Services (overall): 60.3%²³</p> <p>Industry (overall): 23.2%²⁴</p> <p>Agriculture (overall): 9.5%²⁵</p> <p>Employment Composition (% in 2018):²⁶</p> <p>Agriculture: 15% of employed population</p> <p>Industry: 32.8% of employed population</p> <p>Services: 52% of employed population</p> <p>Top 3 Trade Partners: France (31%), Italy (16%), Germany (13%), Spain (3.3%)²⁷</p> <p>Top 3 Exported Goods: insulated wire, non-knit men's suits, crude petroleum, vehicle parts²⁸</p> <p>Top Industries: financial services, transportation; manufacturing; agriculture and fisheries; and non-manufacturing²⁹</p>
FDI net inflows (2017)	\$809.7 million ³⁰
U.S. presence	USAID / State Department / MCC (forthcoming compact) / OPIC / USTDA / EXIM Bank
Private sector development (Bertelsmann index)	6.27/10. ³¹ Overall, Tunisia ranked 47th in market economies out of 129 countries in the index. ³²
Financial markets development	From a score of 0 (worst) to 1 (best) in the IMF Financial Development Index, Tunisia has a score of 0.4 (or 87th out of 183 countries ranked). ³³ Tunisia scores 0.239/1 (or 93rd out of 183) for the financial institutions subindex and scores 0.074/1 (or 88th out of 183) for the financial markets subindex. ³⁴

17. "Tunisia: Population, total," The World Bank, <https://data.worldbank.org/indicator/SP.POP.TOTL?locations=TN>.

18. "Population by age, sex and urban/rural residence," UN Data, February 20, 2019, <http://data.un.org/Data.aspx?d=POP&f=tableCode%3A22>.

19. "Tunisia: GDP per capita (current US\$)," The World Bank, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=TN>.

20. "Data: World Bank Country and Lending Groups," The World Bank, <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>.

21. The Organization for Economic Co-Operation and Development (OECD), *States of Fragility 2018* (Paris, France: OECD, 2018), <http://www.oecd.org/dac/conflict-fragility-resilience/listofstateoffragilityreports.htm>.

22. Philippe Traupe, *Perspectives Économiques en Afrique 2018 : Tunisie* (Tunis, Tunisia: African Development Bank Group, 2018), https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/country_notes/Tunisie_note_pays.pdf.

23. "Tunisia: Services, value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.SRV.TOTL.ZS?locations=TN>.

24. "Tunisia: Industry (including construction), value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.IND.TOTL.ZS?locations=TN>.

25. "Tunisia: Agriculture, forestry, and fishing, value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=TN>.

26. "Tunisia: Employment in services (% of total employment) (modeled ILO estimate)," The World Bank, <https://data.worldbank.org/indicator/SL.SRV.EMPL.ZS?locations=TN>.

27. "Tunisia," The Observatory of Economic Complexity (OEC), <https://oec.world/en/profile/country/tun/>.

28. Ibid.

29. Ibid.

30. "Tunisia: Foreign direct investment, net inflows (BoP, current US\$)," The World Bank, <https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=TN>.

31. Bertelsmann Stiftung, *BTI 2018: Tunisia Country Report* (Gütersloh, Germany: Bertelsmann Stiftung, 2019), <https://www.bti-project.org/en/reports/country-reports/detail/itc/tun/>.

32. Ibid.

33. Katsiaryna Sviryzdenka, *Introducing a New Broad-based Index of Financial Development* (Washington, DC: IMF, 2016), <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Introducing-a-New-Broad-based-Index-of-Financial-Development-43621>.

34. Ibid.

Opportunities and Challenges for Private Sector Development

The private sector in Tunisia faces obstacles to growth from bureaucratic inefficiencies, lack of access to financing, and poor infrastructure. While Tunisia's business climate is slowly improving per the World Bank's Doing Business indicators, several challenges persist that impede Tunisia's potential economic growth.

According to the latest World Bank Enterprise Survey (2013), Tunisian businesses claimed that some of the main obstacles to doing business in the country are political instability (50 percent of firms), practices of the informal sector (13.8 percent of firms), and access to finance and labor markets (10.2 percent of firms).³⁵ The WEF 2018 Global Competitiveness Report discusses several challenges to competitiveness. Tunisia receives very low scores in the categories of ICT adoption (45.1 points/100), labor markets (46.4/100), and innovation capability (32.7/100). In context with the other 140 countries in the WEF study, Tunisia ranked particularly low in terms of macro stability (118/140 countries) and its labor market (129/140).³⁶ On the other hand, the 2019 World Bank Doing Business Index states that Tunisia's greatest challenges to conducting business are payment of taxes, trade across borders, and access to credit.³⁷

Foreign direct investment (FDI) has decreased since the Arab spring in 2011 and stood at \$880 million in 2017. The main foreign investing countries are France (40 percent of total FDI in the first half of 2018), Qatar (16 percent), and Italy (13 percent). The United States represents only 1.5 percent of FDI in Tunisia.³⁸ While the country's solvency, economic diversification, and proximity to European markets present clear advantages over other neighboring countries, foreign investors struggle with social and political instability, an overly bureaucratic and inefficient government, and lack of necessary infrastructural reforms.³⁹

35. The World Bank and International Finance Cooperation (IFC), *Enterprise Surveys: Tunisia -2013* (Washington, DC: The World Bank and IFC, 2015), <https://www.enterprisesurveys.org/~media/GIAWB/EnterpriseSurveys/Documents/Profiles/English/tunisia-2013.pdf>.

36. Klaus Schwab, *The Global Competitiveness Report 2018* (Geneva, Switzerland: World Economic Forum, 2018), <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>.

37. "Ease of Doing Business in Tunisia," The World Bank, <https://www.doingbusiness.org/en/data/exploreeconomies/tunisia#>.

38. "Bilan de l'investissement étranger durant les douze mois de l'année 2018," Invest in Tunisia, January 30, 2019, http://www.investintunisia.tn/Fr/bilan-de-l-investissement-etrananger-durant-les-douze-mois-de-l-annee-2018_50_201_D319.

39. "Tunisia: Foreign Investment," Santander Trade, <https://en.portal.santandertrade.com/establish-overseas/tunisia/foreign-investment>.

Macroeconomic and Political Instability

Those lamenting the fact that democracy has not yet delivered sufficient economic growth are onto something; Tunisia's economy is indeed in a precarious macroeconomic situation.⁴⁰ Since the revolution, the government has failed to make the hard decisions necessary for economic reform. In the views of many, Tunisia has had a political revolution, but the economic revolution is yet to come. Tunisians' perceptions of the country's economic status remain static since 2013, illustrating a gap in the government's economic progress and public opinion.⁴¹ Government popularity remains low as many young Tunisians face dismal job prospects upon graduation. There are significant economic reforms that must take place for Tunisia to achieve greater economic success, but these will come at significant political costs in the short term. No democratically elected government to date has been willing to take that risk. It remains to be seen whether the government that results from elections called in the wake of the death of President Beji Caid Essebsi in July 2019 will be any different.⁴²

Since the 2011 revolution, there has been lingering political uncertainty regarding the fragility of the democratic transition and subsequent government institutions. The International Finance Corporation (IFC) classifies Tunisia as “semi stable” politically, with its economic conditions classified as “medium.”⁴³ While each subsequent election—presidential and municipal—has contributed in some way to the strengthening of Tunisia's political and democratic institutions, the lack of economic progress could distort Tunisians' perceptions of democracy and lead to potential civil unrest if left unresolved.

Tunisia has had a political revolution, but the economic revolution is yet to come.

Economic optimism remains low, especially since the late president, Beji Caid Essebsi, focused more on signaling reform than actually reforming. Inflation—currently 7.5 percent per year—is a serious impediment to private sector growth.⁴⁴ Tunisia's public debt to GDP ratio is very high, at 61.9 percent in 2016.⁴⁵

Compounding these macroeconomic challenges is an overly protective approach to trade. Tunisian businesses have difficulty exporting products and consumers struggle to purchase what goods are imported—mainly due to the non-convertibility of the Tunisian

40. “Tunisia: Inflation, consumer prices (annual %),” The World Bank, <https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations=TN>.

41. Michael Robbins, *Tunisia Five Years after the Revolution: Findings from the Arab Barometer* (Washington, DC: Arab Barometer, 2016), https://www.arabbarometer.org/wp-content/uploads/Tunisia_Public_Opinion_Survey_2016_Democracy.pdf.

42. AFP, “Tunisia to bring forward presidential polls after Essebsi's death,” Aljazeera, July 25, 2019, <https://www.aljazeera.com/news/2019/07/tunisia-bring-presidential-polls-essebsi-death-190725155650285.html>.

43. International Finance Corporation, *Islamic Banking Opportunities Across Small and Medium Enterprises in MENA* (Cairo, Egypt: The World Bank Group), <https://www.ifc.org/wps/wcm/connect/c7065bee-c150-4c1a-bc2e-c06d90b6246f/Executiv+Summary+final+31-8-2014+.pdf?MOD=AJPERES&CVID=kwN8rY8>.

44. “Inflation rate, average consumer prices: Annual percent change,” IMF, <https://www.imf.org/external/data-mapper/PCPIPCH@WEO/ADVEC/OEMDC/TUN>.

45. “Accueil,” République Tunisienne Ministre des Finances, http://www.finances.gov.tn/index.php?option=com_content&view=article&id=39&Itemid=323&lang=fr.

dinar.^{46,47} Moreover, capital controls imposed on residents are a fundamental constraint to growth. Limitations to hard currency access particularly affect SMEs, entrepreneurs, and new market entrants by impacting their ability to become internationally competitive.

The dinar has been depreciating over the years, which has meant the share of public debt to GDP has grown.⁴⁸ At the same time, the Tunisian international reserves for currency have fallen and inflation has steadily risen. If the dinar continues to depreciate, it could improve Tunisia's current account deficit by making the prices of its domestic goods and services more competitive in foreign markets.⁴⁹ These issues are likely to get worse without currency policy reform (e.g., lifting the crawling peg and fixing the non-convertibility issues which would likely result in short-term inflationary pressures), which is exactly one of those “short-term pain, long-term gain” actions that politicians have to date been unwilling to take.

Lack of SME and Startup Financing

Aside from a weak macroeconomic environment and political instability, lack of access to finance, especially for SMEs, is a significant obstacle for doing business in Tunisia. There is not enough technical assistance (TA) to structure deals and not enough “soft” or risky capital (e.g., first-loss capital and equity financing) that incentivize the finance sector into the SME space. Capital markets in Tunisia are underdeveloped, and the banking sector is crippling risk-averse.⁵⁰ The private banking sector either lends to public institutions or to a few established family oligopolies. Though some SME financing products may exist officially, few are deployed in practice.

According to the IFC, SMEs contribute 51 percent of Tunisia's GDP and provide 68 percent of its jobs. Manufacturing represents 41 percent of Tunisia's SMEs, while 21 percent are involved with trade and commerce.⁵¹ Yet SMEs are underserved financially. A cap of 13 percent on what banks are allowed to charge in interest (whereas many believe the market, left to its own devices, would show interests rates of 20 percent as closer to the mean) was imposed in 2014 through a law meant to support SMEs by not overburdening them with interest payments.⁵² In practice, it has almost completely crowded private finance out of the SME lending space.⁵³ Instead, private banks utilize a lower risk, collateral-based lending approach, whereby they get financing at preferential rates via the Central Bank of Tunisia and lend that capital back to other parts of the government,

46. “Pillar 7: Product market,” World Economic Forum, http://reports.weforum.org/global-competitiveness-report-2018/competitiveness-rankings/?doing_wp_cron=1561644428.6395599842071533203125#series=GCI4.C.07.

47. The Tunisian dinar has a crawling peg, which is different from being pegged directly to a global reserve currency. To accomplish this, the central bank uses a range of values within which they hold the dinar on foreign exchange markets. The value of the dinar can fluctuate, but it will always stay within that certain range. George W. McKenzie, “International Monetary Reform and the ‘Crawling Peg,’” Federal Reserve Bank of St. Louis, February 1969, https://files.stlouisfed.org/files/htdocs/publications/review/69/02/Reform_Feb1969.pdf.

48. Ibid.

49. Ibid.

50. “Soundness of banks,” World Economic Forum, http://reports.weforum.org/global-competitiveness-report-2018/competitiveness-rankings/?doing_wp_cron=1561644428.6395599842071533203125#series=EOSQ087.

51. IFC, *Islamic Banking Opportunities*.

52. The World Bank, *Snapshot Financial Inclusion in Tunisia Low-Income Households and Micro-Enterprises* (Washington, DC: The World Bank, 2015), <http://documents.worldbank.org/curated/en/861061467998506998/pdf/96222-REVISED-Box393219B-PUBLIC-ENGLISH-2015-Tunisia-Financial-Inclusion-Snapshot-EN-10-06.pdf>.

53. European Investment Bank (EIB), *Tunisia Neighbourhood SME financing* (Luxembourg: EIB, 2015), https://www.eib.org/attachments/efs/economic_report_neighbourhood_sme_financing_tunisia_en.pdf.

state-owned enterprises, and/or a few large companies. Though returns are also lower, the security and predictability of this model disincentivizes lending to SMEs, which would require greater risk mitigation (especially since credit histories and ratings agencies are rare),⁵⁴ lower-than-market returns (because of the 2014 law), and more people to manage an increased number of loans.

*SMEs contribute 51 percent of Tunisia's GDP
and provide 68 percent of its jobs . . . yet SMEs
are underserved financially.*

The Tunisian economy is mainly composed of microbusinesses and SMEs, but there is also a new start-up trend worth noting. Social media and new technology products have sparked an interest in the entrepreneurial mindset, especially as some young Tunisians find success. In the eyes of many Tunisians, start-ups are all about innovation and knowledge-based products and can be a good opportunity for an educated and highly skilled population. Start-ups also require different types of financing (e.g., angel investments) which, like financing for SMEs, is not prevalent in Tunisia. Many start-ups need venture capital, which is different from what SMEs need. Angel investing is nascent, with only a few angels (e.g., Carthage Business Angels)⁵⁵ providing financing, training, and incubation support. Even where angel funding does exist, it is often provided by wealthy Tunisians who are themselves business owners in a country where archaic legal structures give little power to the start-up owner in the case of conflict. Though start-ups may appreciate access to angel funding, many do not want to accept the strings attached to it.

However, a common fear regarding venture capital or even angel investors is that while they provide financial resources and support in the beginning phases, 84 percent of businesses fail within two years, in part because these types of investors do not provide mentorship and support to expand and sustain businesses. The problem for early-stage investors in these markets is that it is effectively very difficult to earn a risk-adjusted return—achieving exits from equity positions is arduous. There are many initiatives to support start-ups, but they are often scattered. Most of this support is supply-driven, dictated by the state or donors, and completely disassociated from the investment needs of risk investors. The Tunisian American Enterprise Fund (TAEF) is taking the initiative to curate an entrepreneurship environment through its targeted investments in the SME space.

Weak Infrastructure

Poor infrastructure in Tunisia hinders private sector development,⁵⁶ with two main issues being poor interior roads and an underperforming port in Sfax. Additionally, the Tunis-Carthage International Airport would need significant upgrading were Tunisia to become

54. In 2016, the first steps to create a private credit bureau were taken by the Italian company CRIF, which entered into a partnership with the Tunisian company Mitigan. Joachim Bartels, "CRIF and Mitigan partner to develop a full-fledged credit and insurance bureau in Tunisia," Business Information Industry Association, December 5, 2016, <https://www.biiia.com/crif-and-mitigan-partner-to-develop-a-full-fledged-credit-and-insurance-bureau-in-tunisia>.

55. "Homepage," Carthage Business Angels, <http://www.cba.tn/>.

56. IFC, *Islamic Banking Opportunities*.

the bridge between Europe, the West, and the rest of Africa it desires to be. With the growing competitiveness of Tunisair—Tunisia’s national carrier—and increase in foreign travelers and tourism rates, improvements to Tunisia’s main airport are necessary.⁵⁷

Poor interior roads make travel to and from Tunisia’s rural parts more difficult, isolating those areas from the wealthier, coastal, and more urban areas. Per the Oxford Business Group, Tunisia has a 39 percent rural access rate based on its interior roads and highways—well-below the 58 percent MENA average.⁵⁸ In response to this challenge, the World Bank launched the Road Transport Corridors Project in 2015 to decrease transportation costs and time, improve the quality and safety of roads, and increase the overall interconnectivity of rural and urban areas.⁵⁹ More support in this area is needed, especially since many of the young people at risk of emigration or radicalization live outside of the comparatively wealthier coastal regions. These coastal regions have much better road systems and are better positioned to take advantage of almost all commercial industries. The inland areas are predominately agricultural, and most people there live in poverty. Just three coastal cities—Tunis, Sfax, and Sousse—account for roughly 85 percent of Tunisia’s GDP.⁶⁰ Improving interior roads and connectivity in the mainland would decrease time to market for agricultural products, decrease logistics costs, and generally be critical for more widespread development in the country.

The port city of Sfax is a strategic hub, especially considering that 96 percent of Tunisia’s foreign trade occurs by sea. Improvements to Sfax’s infrastructure are imperative for continued economic growth and are sorely needed.⁶¹ Congestion remains a persistent issue, though the issues behind this are more governance and corruption related. However, when coupled with dated hard infrastructure, Sfax’s port is operating well below its potential. One plan is to develop a deep-sea port at Enfidha, a proposed plan from 10 years ago that would allow for special container cargos to pass and therefore increase foreign trade.⁶² The Chinese government has been eyeing the smaller port city of Zarzis for similar reasons. However, even developing Enfidha and Zarzis will not resolve the issues in Sfax, which Tunisia needs for economic growth.

57. “Transport infrastructure spending fueling Tunisia’s economic growth,” Oxford Business Group, <https://oxfordbusinessgroup.com/overview/revamping-system-transport-infrastructure-spending-set-fuel-economic-growth>.

58. “Building on its reputation for stability, Tunisia is in the midst of upgrading its infrastructure,” Oxford Business Group, <https://oxfordbusinessgroup.com/overview/gearing-building-its-reputation-stability-country-midst-upgrading-its-infrastructure>.

59. “Projects and Operations: TN-Road Transport Corridors,” The World Bank, <http://projects.worldbank.org/P146502?lang=en>.

60. “Paving the Way to Better Development in Tunisia,” The World Bank, July 14, 2015, <http://www.worldbank.org/en/news/feature/2015/07/14/paving-the-way-to-better-development-in-tunisia>.

61. “Tunisia exploring new development for maritime infrastructure,” Oxford Business Group, <https://oxfordbusinessgroup.com/analysis/exploring-options-already-well-developed-maritime-infrastructure-looks-set-evolve-further>.

62. Ibid.

Fostering Private Sector Growth: The Role of the New DFC in Tunisia

While it may not be able to resolve all the challenges listed above, the new DFC has the potential to support private sector growth in Tunisia with new capabilities and the ability to work more closely with other development partners (Boxes 1 and 2) to provide financial assistance and technical expertise in different sectors. The largest multilateral institution operating in Tunisia is the World Bank, which invested \$930 million in 2018. Among bilateral donors, the European Union, Germany, and France are the most important players (Figure 1).

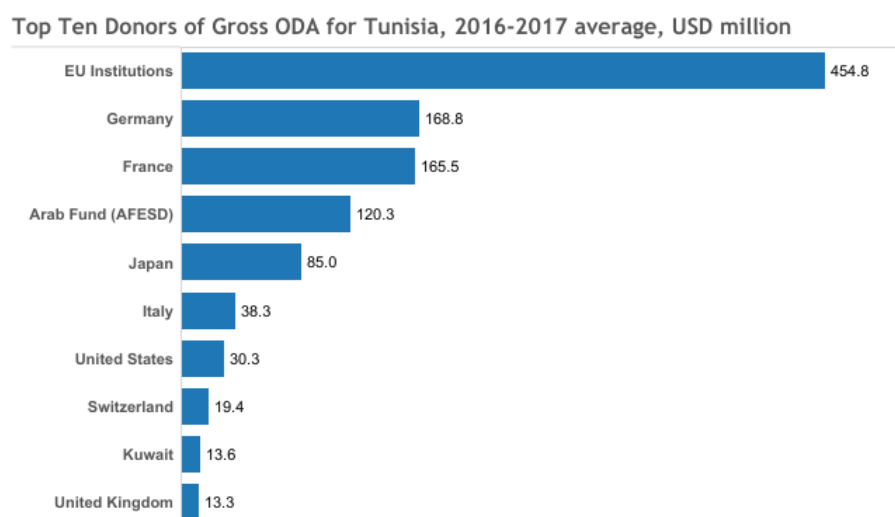
The good news is that the many development actors in Tunisia have diagnosed similar challenges to economic growth as in this report and are already working on critical areas like SME finance. The DFC should target high-impact sectors with high potential for job creation. More importantly, the DFC should focus its efforts on crowding in private capital of all types, working closely with other U.S. government actors (e.g., TAEF, the U.S. Agency for International Development (USAID), the Millennium Challenge Corporation (MCC)) and other international partners to achieve this goal.

Given its geographical proximity and colonial history, Tunisia has a special relationship with Europe—particularly France. Europe is a top destination for Tunisian exports. One-third of Tunisia’s exports go to France, while Italy and Germany receive 16 percent and 13 percent, respectively.⁶³ Moreover, Tunisia and the European Union have often collaborated through partnerships on shared economic interests like scholarships for Tunisian students, targeted financial assistance, diversified investment instruments, and the refurbishment of Tunisian health centers.⁶⁴ Neighboring North African countries remain a minimal part of Tunisia’s total export destinations. More opportunities exist for trade between Tunisia and its neighbors, but that is primarily because there is nowhere to go but up. Algeria makes up 2.6 percent of Tunisia’s total trade, whereas Libya and Morocco represent 2.4 percent and 1.1 percent, respectively. Greater regional integration and economic partnerships will be necessary for economic growth in Tunisia.

63. “Tunisia,” OEC.

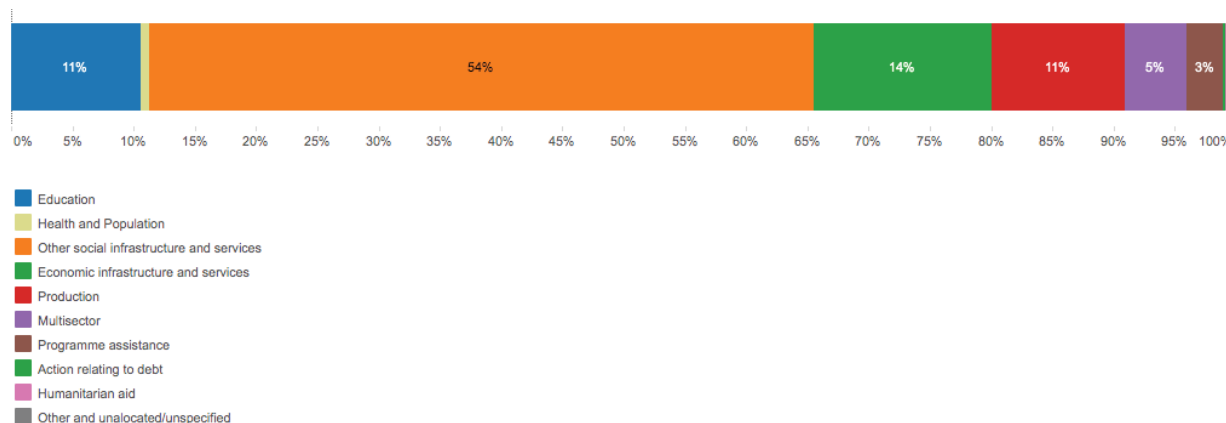
64. “The EU-Tunisia partnership also helps boost Tunisia’s economy,” European Commission, October 25, 2018, https://ec.europa.eu/neighbourhood-enlargement/news_corner/news/eu-tunisia-partnership-also-helps-boost-tunisia%E2%80%99s-economy_en.

Figure 1: Top 10 Bilateral Donors in Tunisia, 2016-2017



Source: “Aid at a glance charts,” OECD, https://public.tableau.com/views/OECDDACAidataglancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

Figure 2: Bilateral ODA by Sector, 2016-2017



Source: “Aid at a glance charts,” OECD, https://public.tableau.com/views/OECDDACAidataglancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

The 54 percent of “other social infrastructure and services” includes sanitation, sewage, and other subsectors of education and health that are categorized separately from the main health and education sectors by the OECD.

“Tunisia,” OEC.

BOX 1: MULTILATERAL DEVELOPMENT PARTNERS IN TUNISIA

- **World Bank Group:** At the end of 2018, the World Bank reported that it had committed \$930 million to Tunisia, counting both the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD) portfolios.⁶⁵ Many of the funds are being directed towards the reform of state-owned enterprises (SOEs) and the energy, sanitation, and social services sectors. The **International Finance Corporation (IFC)** had a total portfolio of \$2 billion in 2018 and 83 active advisory projects in Tunisia.⁶⁶ A major focus of IFC operations in Tunisia has been technical assistance for SMEs. This has included a 2013 agreement among the Amen Bank, the IFC, and IFC Management company funds to invest \$48 million for bank lending support.⁶⁷ In addition, the IFC committed \$22 million in North African SME financial support to the Maghreb Private Equity Fund III. The IFC has also been a major contributor to a trust fund facility for SMEs started several years ago with the objective of improving the overall business climate in the country. The IFC has also provided assistance to banks, small start-ups, and government regulators. For example, the IFC has conducted a banking training seminar, completed a country assessment on the legal institutions, and created a capacity building program with the Central Bank of Tunisia.⁶⁸
- **European Bank for Reconstruction and Development (EBRD):** Founded in 1991, the EBRD started its mission to enable countries to transition into open-market economies in response to the economic and political effects of the Cold War era. Today, the EBRD, which has stakeholders from 69 countries (including the European Union and the European Investment Bank), works to promote sustainable and inclusive free-market states by improving various areas of development. Through financial investment projects, business advisory services, and financing tools and syndication, the EBRD impacts a wide range of industries, from agribusiness to infrastructure and transport across three continents. In Tunisia, the EBRD has had 40 projects since its first one in 2012, mainly focusing on building democratic institutions and a more open market economy. With a total of €856 million (or \$957 million) in investments and 54 percent of the overall portfolio being implemented in the private sector, the EBRD promotes economic inclusion and the expansion of the private sector's reach and improves access to finance. By focusing on good governance, the EBRD also supports Tunisia's competitiveness in the open market and overall economic development.⁶⁹

65. "The World Bank in Tunisia," The World Bank, <https://www.worldbank.org/en/country/tunisia/overview#2>.

66. "IFC in Middle East and North Africa," IFC, https://www.ifc.org/wps/wcm/connect/REGION_EXT_Content/IFC_External_Corporate_Site/Middle+East+and+North+Africa.

67. IFC, *Islamic Banking Opportunities*.

68. "MSME TA Facility in Tunisia," IFC, https://www.ifc.org/wps/wcm/connect/region_ext_content/ifc_external_corporate_site/middle+east+and+north+africa/priorities/smes/msme+ta+facility+in+tunisia.

69. "The EBRD in Tunisia," *European Bank for Reconstruction and Development*, <https://www.ebrd.com/tunisia.html>.

- **African Development Bank (AfDB):** The AfDB had a Tunisia portfolio of 1.33 billion UA (1.76 billion USD) in 2017, with 43 operations—37 in the public sector and 6 in the private sector, along with 26 technical assistance projects.⁷⁰ The AfDB has made entrepreneurship a key focus of its ongoing Tunisia country strategy.⁷¹ A center for entrepreneurial excellence is in the process of being established through annual appropriations to a variety of private sector actors. These funds could be lines of credit or direct financing through capital investments.⁷² The AfDB is also leading an investment project called Tunisia Digital 2020, which aims to modernize administrative processes and improve infrastructure in broadband.⁷³ The Tunisian Minister of ICT is focused on this and others, including the World Bank, are following suit with similar projects.
- **Arab Fund for Economic and Social Development (AFESD):** The main catalyst for development financing from the greater Middle East has been the Kuwait-based AFESD. While they have a small physical presence in the country, the AFESD has extended 57 total signed loans to Tunisia over the years, totaling \$3.5 million in 2018. The loans have been directed at projects that include roads, dams, and industrial parks. The fund has also tendered 16 grants within the country, the majority of which were focused on similar programs. Multiple grants were also directed toward academic research reports and cultural preservation projects.

70. The UA is the official currency of the AfDB. As of January 2019, 1 UA equaled 4.16698 Tunisian dinar. African Development Bank (AfDB), *Tunisia Country Strategy Paper: 2017-2021* (Tunis, Tunisia: AfDB, 2017), https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Tunisia-1-_Country_Strategy_Paper_2017-2021.pdf.

71. Ibid.

72. Ibid.

73. Key informant interview.

BOX 2: MAIN BILATERAL PARTNERS IN TUNISIA

- **KfW Development Bank (KfW Bankengruppe):** KfW is Germany's premier development bank or development finance institution (DFI) with a portfolio of \$1.1 billion in Tunisia.⁷⁴ KfW is helping establish a new Tunisian development bank called the Banque des régions (planned to begin operations in late 2019), to which KfW will commit nearly \$133 million and provide technical assistance. This bank is being developed through the private banking sector to provide SME funding. KfW has focused its attention on water projects including irrigation, water storage challenges, coastal water, climate change, and groundwater issues—some are long-term strategies and others are related to acute water shortages in the southern region of Tunisia where desertification has become a major concern. It has been estimated that roughly 6 percent of Tunisia's rural residents do not have a connection to a water supply.⁷⁵
- **The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ):** The German international development agency, GIZ, is mainly focused on local governance, natural resource protection, and migration. Their work on migration included the 2017 opening of an information center in Tunis, where interested persons can receive advice on prospects in the Tunisian and German labor markets.
- **Other European DFIs:** PROPARCO (France), the European Investment Bank (EIB), and others are present in Tunisia, though not as active as their German counterparts. The EIB's major infrastructure project from the past few years was the construction of the Sbikha-Jelma highway.⁷⁶ The EIB also invested \$85.7 million into a program to improve Tunisian schools.⁷⁷
- **Agence Française de Développement (AFD):** The AFD has funded 90 projects across several sectors in Tunisia over the past 25 years. The agency has supported programs in sustainable agriculture, youth skill building, and water systems management. AFD's support has included nearly every part of its financial toolkit, including grants, loans, and guarantees. AFD's total expenditures within Tunisia were roughly \$200 million in 2016.⁷⁸
- **Japanese International Cooperation Agency (JICA):** JICA has been working with Tunisia since 1975. Over that period, it has provided aid in the form of technical assistance, ODA loans, and volunteers for development projects.⁷⁹

74. "Tunisia," KfW, <https://www.kfw-entwicklungsbank.de/International-financing/KfW-Development-Bank/Local-presence/North-Africa-and-Middle-East/Tunisia/>.

75. Ibid.

76. "Tunisia: Project Financing," Export.gov, July 14, 2019, <https://www.export.gov/article?id=Tunisia-Project-Financing>.

77. "Aid at a glance charts," OECD.

78. "Tunisia," AFD, <https://www.afd.fr/en/page-region-pays/tunisia>.

79. "Tunisia," JICA, <https://www.jica.go.jp/tunisia/english/index.html>.

What about China?

Chinese economic activity has been growing steadily throughout Africa in recent years, and Tunisia is no exception. However, Tunisia has eyed China's involvement with more skepticism than some of its African neighbors, wary of unsettling a history of connectivity with Europe and the West.⁸⁰ Consequently, China's investments in Tunisia have been more public sector-focused and under the watchful eye of the government.⁸¹ This creates an open opportunity for the U.S. and European allies to play a primary partner role in the private sector space. But China's ambitions are broad, and this space will not be unoccupied for long.

In 2018, Tunisia officially became a part of China's Belt and Road Initiative (BRI) in hopes of expanding trade with international markets. A key part of the agreement was the addition of a new air route to increase the number of tourists, which would also provide a way for Tunisia to obtain more foreign currency.⁸²

Following the BRI agreement in 2018, the Chinese and Tunisian governments signed an agreement in January 2019 that authorized donations totaling 270 million yuan (\$37 million) in order to continue more investment between the two countries and encourage closer ties.⁸³ The Chinese were previously engaged in building a university hospital in Sfax and a youth sports complex. In 2018, there were a series of meetings where Chinese officials made investment commitments, including the opening of a potential car plant run by the Chinese state-owned SAIC Motor Corporation. The development of the city of Zarzis, a southern port which could serve as a powerful trade hub and alternative to Sfax, was also discussed. It has been reported that Tunisian officials feel strongly about the potential benefits of the investments discussed in January 2019.⁸⁴

80. Key informant interview.

81. Key informant interview.

82. Lamine Ghanmi, "Tunisia joins China's Belt and Road Initiative as it seeks to diversify trade, investment," *Arab Weekly*, September 9, 2018, <https://thearabweekly.com/tunisia-joins-chinas-belt-and-road-initiative-it-seeks-diversify-trade-investment>.

83. Tunis Afrique Presse, "Tunisia: China Grants Tunisia Two Donations Worth 108 Million Dinars," *allAfrica*, January 11, 2019, <https://allafrica.com/stories/201901140457.html>.

84. Lamine Ghanmi, "Tunisia joins China's Belt and Road Initiative."

Opportunities for the DFC

Since 2011, the United States has provided nearly \$400 million to Tunisia for its democratic transition, specifically technical and financial support to Tunisia's private sector, security, and civil society (Textbox 3).⁸⁵ USAID provided Tunisia with \$48 million in foreign aid in 2017 and increased the total to \$81.5 million in 2018.⁸⁶

The United States and Tunisia have a historically strong trade relationship that was solidified by the signing of the Trade and Investment Framework Agreement in 2002, which paved the way for what would become a mutually beneficial trade relationship for years to come. Representatives of the two countries have met regularly since 2002 to discuss further strengthening the trade ties.⁸⁷ Goods (primarily machines, minerals, and animal and vegetable products) traded between the United States and Tunisia were valued at \$1.2 billion in 2018, which is three times the amount traded in 2000.⁸⁸

BOX 3: ACTIVE U.S. DEVELOPMENT PROGRAMS IN TUNISIA

- **United States Agency for International Development (USAID):** USAID is the largest U.S. agency in Tunisia with a portfolio of \$48 million (2017) comprised of \$20 million for the banking and financial sector, \$13 million for the government and civil society, and \$7.9 million for business and other services.⁸⁹ In 2018, USAID provided Tunisia \$81.5 million (partially reported).⁹⁰ The largest current project is a \$20 million grant to the Tunisian-American Enterprise Fund (see below), followed by \$5.8 million for the Business Reform and Competitiveness Project.⁹¹ USAID also has the Supporting Youth and Empowering Local Communities project which is aimed at helping communities target

85. "Fact Sheet: The President's Framework for Investing in Tunisia," The White House, April 4, 2014, <https://obamawhitehouse.archives.gov/the-press-office/2014/04/04/fact-sheet-presidents-framework-investing-tunisia>.

86. "U.S. Foreign aid by country," USAID, https://explorer.usaid.gov/cd/TUN?implementing_agency_id=1.

87. "Joint Statement of the U.S.-Tunisia Trade and Investment Council," United States Trade Representative, May 28, 2019, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/joint-statement-us-tunisia-trade-and>.

88. Ibid. and "What does the United States export? (2017)," OEC, https://oec.world/en/visualize/tree_map/hs92/export/usa/all/show/2017/.

89. "U.S. Foreign aid by country," USAID.

90. Ibid.

91. "Democracy and Governance," USAID, <https://www.usaid.gov/tunisia/democracy-and-governance>.

drivers of instability and address them promptly at the local level.⁹² The Tunisia Jobs, Opportunity, and Business Success (Tunisia JOBS) program identifies constraints to growth and assists SMEs.⁹³ Tunisia JOBS also works on a job matching program that connects companies with job seekers to address the gap in job availability and employer needs.

- **Tunisian American Enterprise Fund (TAEF):** This unique investment fund of \$100 million was set up by USAID after the revolution in 2011. Using the initial seed money provided by USAID, the fund uses microfinance and other loans to SMEs to drive entrepreneurship and economic growth and to expand employment, especially via start-ups. As of 2017, TAEF had disbursed \$38 million from its initial \$80 million in funding, with the additional \$20 million available in mid-2018.⁹⁴ The enterprises TAEF supported in those industries ranged from small family-owned businesses to much larger start-up firms.⁹⁵
- **Millennium Challenge Corporation (MCC):** In December of 2016, the Millennium Challenge Corporation (MCC) selected Tunisia as eligible to receive a compact. The compact had been in the works ever since Tunisia could be classified as a lower-middle income country following the 2011 democratic transition. It has been estimated the compact could total \$292 million and will focus on removing economic regulations in the labor market as well as addressing water scarcity.⁹⁶
- **Overseas Private Investment Corporation (OPIC):** OPIC has historically played a more niche role when compared to other DFIs present in Tunisia. It has channeled some of its investments into private equity funds in the country to help entrepreneurs who do not have access to capital resources. The main fund that OPIC has supported is the Emerging Capital Partners (ECP), which is a private equity fund that supports investments toward African start-ups and small businesses.⁹⁷ Additionally, OPIC signed a \$50 million guarantee agreement with three banks in Tunisia in 2015.⁹⁸
- **American Chamber of Commerce:** The American Chamber of Commerce is completing a program they have been running since January of 2018, Export Lab, which is focused on providing business coaching to SMEs with the aim of reaching young entrepreneurs

92. Ibid.

93. "Economic Growth and Trade," USAID, <https://www.usaid.gov/tunisia/economic-growth-and-trade>.

94. "Homepage," TAEF, <http://www.taefund.org/ar2017/#letter>.

95. Ibid.

96. Samantha Parks, "An MCC Compact for Tunisia," The Project on Middle East Democracy, February 1, 2017, <https://pomed.org/an-mcc-compact-for-tunisia/>.

97. "Emerging Capital Partners: Investing in Africa's small businesses," OPIC, <https://www.opic.gov/opic-action/featured-projects/middle-east-north-africa/emerging-capital-partners-investing-africa%E2%80%99s-small-businesses>.

98. "The Overseas Private Investment Corporation OPIC, Tunisian Banks Sign Agreement to Support Small Medium-size Enterprises," U.S. Embassy in Tunisia, March 5, 2015, <https://tn.usembassy.gov/opic-tunisian-banks-sign-agreement-to-support-small-medium-size-enterprises/>.

specifically, as well as female business owners.⁹⁹ Currently, AmCham's portfolio consists of 45 projects that support SMEs.

Building on existing U.S. activities and those of other like-minded development partners, the new DFC should:

- Foster collaboration among development partners;
- Use new financial tools with new partners; and
- Invest in sectors which have high development impact.

99. "AMCHAM Tunisia Export Lab," American Chamber of Commerce in Tunisia, http://www.amchamtunisia.org.tn/portfolio_post/amcham-tunisia-export-lab-2/.

Fostering Collaboration Among Development Partners

The DFC could foster more concrete collaboration between the multilateral development banks (MDBs) and bilateral DFIs operating in Tunisia. It can also benefit from piggybacking on existing collaborations.

One challenge to collaboration is that often the World Bank Group, for example, can be in competition with other international financial institutions (IFIs) when it comes to concrete investment opportunities.¹⁰⁰ The DFC could leverage other development institutions' due diligence and build off of existing portfolios. DFIs have their go-to local actors and networks. One criticism however is that they are not opening their networks to other actors in the country and are selective about working with only small actors, which creates a niche community of implementing partners that does not appeal to entrepreneurs.

One opportunity for the DFC to engage with many development actors all at once is by engaging with Compact with Africa (CwA) efforts.¹⁰¹ Initiated under the German G20 presidency to promote private investment in Africa, the CwA is a platform through which the United States can collaborate with other development partners, especially the European bilateral agencies and the International Monetary Fund (IMF), AfDB, and World Bank.¹⁰² In addition to participating in CwA-linked finance efforts in Tunisia, the United States should look to play a coordination role and focus efforts on SME growth.

While there is a need for increased job creation in Tunisia—especially for unemployed and idle youth, there is also a need for better job matching and placement. Education system reforms could serve as a solution to this problem in evaluating supply (student skills, interests, and discipline) and demand (job market, opportunities for growth, etc.) to help identify and connect youth and companies with one another. However, this initiative would require more technical assistance to better equip the educational institutions to match students with relevant industries. While USAID has seen success with its Tunisia

100. Key informant interview.

101. Key informant interview.

102. "About the Compact with Africa," G20 Compact with Africa, <https://www.compactwithafrica.org/content/compactwithafrica/home.html>.

JOBS program, there are certain limitations to their job creation abilities. The new DFC could potentially bridge this gap in Tunisia, where its investments can directly stimulate job creation; the American Chamber of Commerce in Tunisia, for example, is one institution that the DFC can work with closely to identify the strategic sectors for investments.

Lastly, there will be opportunities for collaboration with other DFIs due to the DFC's enhanced development finance toolkit and the lifting of the U.S. sponsor requirement. With limited staff presence on the ground, the DFC could partner with other DFIs working in Tunisia (such as KfW and the EBRD) to leverage their strengths. The KfW, for example, may have established or planned water, energy, and other infrastructure projects that would benefit from the type of capital offered by the new DFC. By collaborating, the DFC can share the burden of project preparation and increase the potential impact of each dollar it invests.

Using New Financial Tools with New Partners

One of the major barriers to working with OPIC in the past in Tunisia was its comparatively low-risk tolerance (i.e., OPIC tended to be risk averse in its investments, both in terms of the type of capital invested and the sectors of engagement). The new DFC has an opportunity to use its new development finance toolkit and new authorities more creatively. The ability of the DFC to take first-loss positions, deploy technical assistance funds, scale up the use of guarantees, and take equity stakes in start-ups and riskier investments are some of the tools it could use to increase its impact in Tunisia.

It is important for the new DFC to develop first-loss guarantees to take on more risk. This instrument is used to cover the junior tranche of a given project whereby the guarantor, in this case the DFC, would be paid last in case the project fails.¹⁰³ The use of these guarantees makes it more attractive for other investors to invest in a project because they recoup their money first and hence decrease their risk. For example, the European External Investment Plan, through its financing mechanism, the European Fund for Sustainable Development (EFSD), provides first-loss guarantees through their Intermediate Lending for micro, small and medium-sized enterprises (MSMEs) and their MSME Investment Platform (MIP).¹⁰⁴ The AfDB is utilizing these kinds of guarantees to blend finance and take more risks.¹⁰⁵ All of these efforts prioritize deployment of the guarantee in cases where private capital is interested but not necessarily engaged yet. The DFC should do the same.

Technical assistance will be an important supplemental component to the DFC's financing. TA helps developing countries by providing advice to the private sector and governmental departments. The goal is typically to increase the effectiveness of certain projects or to build capacity.¹⁰⁶ In addition, technical assistance helps to structure pools of funding to train venture capitalists, which is important for Tunisia's burgeoning start-up presence.

103. "What financial instruments are available to cover the costs of building a mini-grid?" USAID, <https://www.usaid.gov/energy/mini-grids/financing/instruments>.

104. European Commission, *Summaries of the EU External Investment Plan: Guarantees* (Brussels, Belgium: European Commission, 2019), <https://ec.europa.eu/europeaid/sites/devco/files/181213-eip-28-guarantees-brochure-final.pdf>.

105. Key informant interview.

106. "Technical Assistance in Cultural Governance," UNESCO, <http://www.unesco.org/new/en/culture/themes/cultural-diversity/cultural-expressions/programmes/technical-assistance/what-is-technical-assistance>.

In some instances, once individuals complete their training, they graduate and become managers of venture capital funds at places like AfricInvest.¹⁰⁷ Technical assistance is particularly important on the equity investment front and needs to be available throughout the life of the investment.¹⁰⁸ The DFC should look to deploy its TA resources through established partners and/or groups like the Financial Services Volunteers Corps that have deep local knowledge of the Tunisian financial sector.¹⁰⁹

The new DFC could also provide investment-related technical assistance to SMEs in terms of their structure, business models, and financial management. To help with financing challenges of the SMEs and current capacity issues of existing platforms, the DFC could support an SME networking platform to help make first engagements easier and match them to financing options. Without plans to significantly increase the size of its footprint in Tunisia, the DFC could also invest greater resources in funds like TAEF's SME fund and in similar products at local private equity firms like AfricInvest, providing growth-capital investments to SMEs.¹¹⁰ Since Tunisia is a relatively small country, funds that seek out SMEs with regional growth potential should be of particular interest.

Providing loans in the local currency and developing local currency bond markets are critical for companies that want to minimize currency mismatches, especially given the non-convertibility issues with the Tunisian dinar presented above. The DFC could leverage the technical assistance work of the U.S. Department of Treasury's Government Debt Issuance and Management Program,¹¹¹ which has assisted many developing countries in creating regulatory frameworks and markets for local currency government securities. This work has also included the pursuit of closer coordination between the finance departments and central banks of these countries, which is something that is needed in Tunisia as well.¹¹²

Moreover, there are some interesting takeaways from other DFI experiences that the DFC could replicate or in which it could co-invest. One such example is the effort by the government of the Netherlands in 2012 to set up a fund in Tanzania to help decrease poverty and encourage sustainable development.¹¹³ The Equity for Tanzania Ltd. (EFTA) fund built an investment structure by creating three separate investor classes in the fund—two focused on equity (one of which was first-loss) and one focused on debt.¹¹⁴ EFTA was constructed in this fashion to offer protection for certain classes of investors who had varied investment risk profiles. The group of investors who signed onto the fund included charities, foundations, high net-worth individuals, and impact investors—all with different goals, risk tolerances, and types of capital. Per the most recent report from the Global Impact Investing Network (GIIN), the fund had raised \$4.8 million in capital and the managers of the fund were reporting the structure worked well. This is a model worth exploring for SMEs in Tunisia.

107. Key informant interview.

108. Key informant interview.

109. "Global Impact: Tunisia," Financial Services Volunteer Corps (FSVC), <https://www.fsvc.org/countries/tunisia/>.

110. "The Firm," AfricInvest, <http://www.africinvest.com/the-firm/investment-approach/>.

111. "About: Office of Technical Assistance - Government Debt Issuance and Management Program," U.S. Department of the Treasury, <https://www.treasury.gov/about/organizational-structure/offices/Pages/OTA-government-debt.aspx>.

112. Ibid.

113. "Peak II (Providing Unemployment and Knowledge), Report: Catalytic First-Loss Capital," GIIN, <https://thegiin.org/peak-ii>.

114. GIIN, *Issue Brief: Catalytic First-Loss Capital* (New York, NY: GIIN, 2013), 17, <https://thegiin.org/assets/documents/pub/CatalyticFirstLossCapital.pdf>.

Investing in Sectors with High Development Impact

The new DFC has an opportunity to invest in key sectors in Tunisia that can create jobs but are currently underserved by private actors. Tunisia's most urgent economic issue is unemployment—specifically for its youth. Though every effort should be made to support broad reforms that address the structural deficiencies discussed above—and thus crowd in greater and more types of private capital—and support SMEs and start-up culture, there are three targeted sectors in which the DFC could explore opportunities. These are by no means the only sectors in Tunisia (tourism, for example, is a growth industry); they are simply the ones where the DFC, with its updated toolkit and via strategic investments, could have an immediate and lasting impact.

Agricultural Value Chains

Tunisia's agriculture industry is a significant employer of youth, comprising one in five rural jobs.¹¹⁵ However, Tunisian youth are not typically attracted to agriculture jobs despite its important share of Tunisia's GDP (12 percent).¹¹⁶ This is likely because the agriculture sector in Tunisia is underdeveloped (i.e., most jobs are in the field). Overall, value-add of agricultural products cultivated in Tunisia is very low and significant investments are needed to have better-transformed products that can be exported. The DFC could invest in agro-processing value chains, focusing less on the farms themselves and more on facilitating finance, insurance, marketing, and new technologies for farming.

One area of specific growth lies in Tunisia's growing and increasingly prominent olive oil industry. The EBRD and the Food and Agricultural Organization of the United Nations (FAO) have supported Tunisian olive oil growers. Their work has assisted approximately 100 farms and oil millers in increasing their business competitiveness.¹¹⁷ Although people have made olive oil in Tunisia for centuries, the country has only recently grown to become one of the largest olive oil producers for European markets.¹¹⁸ Much of their

115. The World Bank, "Chapter 4 Economic Opportunities," in *Breaking the Barriers to Youth Inclusion*.

116. Ibid.

117. Volker Ahlemeyer, "EBRD and FAO support sustainable olive oil production in Tunisia," European Bank for Reconstruction and Development, February 20, 2018, <https://www.ebrd.com/news/2018/ebrd-and-fao-support-sustainable-olive-oil-production-in-tunisia.html>.

118. "FAO and EBRD support sustainable olive oil production in Tunisia," FAO, March 19, 2018, <http://www.fao.org/support-to-investment/news/detail/en/c/1109542/>.

export volume for this product has been and continues to be in bulk, but even that has begun changing recently. The bottled oils have been placed in such high regard that they have even started to win awards in international competitions for their quality. However, Tunisian olive oil still has a comparatively small global market share. Tunisian exporters often send raw oil to Italy and Spain for packaging and branding.¹¹⁹ The DFC and other DFIs could help develop this sector.

On-farm capabilities need strengthening as well. To keep up with demand, modernize their production processes, and increase sustainability by decreasing water use, many agrobusinesses have invested in advanced irrigation systems. The EBRD and FAO have also been working on creating connections between government officials, olive growers, olive oil processors, and exporters to facilitate a broader network so the industry can continue to expand in international markets.¹²⁰ The DFC should support these efforts.

Light Manufacturing

The automotive industry could be a growth sector given the geographic proximity to European markets as well as Tunisia's technically skilled yet comparatively cheap workforce. Industry and manufacturing constitute 32.2 percent of youth employment in urban areas and 23.8 percent of youth employment in rural areas.¹²¹ Tunisia exported \$457 million in auto parts in 2017 but only \$5.4 million in cars.¹²² While the production of parts has allowed it to become a key part of the global supply chains for automotive production, Tunisia still does not have much of a manufacturing presence. Most of the work on that front is just the assembly process for small cars. Other international automotive companies could outsource part of the value chain to Tunisia; however, the ports create a bottleneck for Tunisia's import/export potential because they are state-run, which has created corruption and low capacity issues.¹²³ The Tunisian government also has a quota on vehicle imports due to (somewhat misplaced) hopes that the domestic auto industry would benefit from reduced imports.¹²⁴

Tunisair, the largest airline company in Tunisia, still receives large amounts of government subsidies. Despite the subsidies, the company only maintains 28 aircraft and has struggled to compete with the other domestic and foreign airlines. Tunisair has also had to expand routes to other countries in the region just to keep up with the competition.¹²⁵ One of those major competitors has been Royal Air Maroc (RAM), the main Moroccan airline. In contrast to Tunisair (a state-owned enterprise), RAM has 55 aircraft and has consistently been adding to its international destinations, including Miami in April of this year.¹²⁶

119. Key Informant Interview.

120. "Raising the profile of Tunisian olive oil," FAO, November 17, 2017, <http://www.fao.org/support-to-investment/news/detail/en/c/1067761/>.

121. The World Bank, "Chapter 4 Economic Opportunities," in *Breaking the Barriers to Youth Inclusion*.

122. "Tunisia," OEC.

123. Key Informant Interview.

124. "Tunisia - Automotive Parts/Services/Equipment," Exports.gov, July 14, 2019, <https://www.export.gov/article?id=Tunisia-Automotive-Parts-Services-Equipment>.

125. "Tunisia - Aircraft/Airport Ground Support/Aeronautics," Exports.gov, July 14, 2019, <https://www.export.gov/article?id=Tunisia-Aircraft-Airport-Ground-Support-Aeronautics>.

126. PR Newswire, "Here's looking at you, MIA! Royal Air Maroc launches Miami-Casablanca route," *Markets Insider*, April 4, 2019, <https://markets.businessinsider.com/news/stocks/here-s-looking-at-you-mia-royal-air-maroc-launches-miami-casablanca-route-1028087674>.

There are areas for growth and improvement within the Tunisian airline industry, especially if the sector itself (and Tunisair in particular) privatizes.

Infrastructure

Infrastructure investments are needed in Tunisia because, as discussed above, an ineffective port at Sfax, an antiquated national airport, and poor interior roads are to the point of being major barriers to economic growth. OPIC has traditionally not done much in infrastructure finance, but the needs in Tunisia and the fact that this is the area in which Chinese investments are being made, mean that the new DFC may need to reconsider this historic reticence to infrastructure. Though it is unlikely the DFC will bring the same volume of infrastructure investment to the table as the AfDB, World Bank, EIB, or even the EBRD, there are opportunities to co-finance, including in the more niche private infrastructure spaces.

Needs and opportunities for infrastructure development differ between the wealthier coastal and poorer interior regions of Tunisia. Coastal regions have much better road systems and are better positioned to support commercial industries. The inland areas are almost all agriculture-based economies in which most people live in poverty. Improving roads and connectivity in the mainland could have widespread development impact in the country while also connecting young entrepreneurs in rural areas (e.g., in agriculture value chain-related businesses) to larger markets for their goods and services. In the absence of large infrastructure-focused capital, the DFC should focus its comparatively limited resources on strategic, trade-enabling infrastructure (e.g., greater cold storage capacity at the Sfax port like what was done in neighboring Morocco's Tangier port with the support of U.S. financing and guarantees).¹²⁷ Approaching these challenges via trade, private sector development, and geostrategic lenses, the DFC should explore individual investments and partnerships with like-minded DFIs (e.g., KfW) and MDBs (e.g., EBRD, AfDB) in infrastructure development in Tunisia.

127. "Coldstore in Tanger Med," Friopuerto, <http://www.friopuerto.com/ma/en/coldstore-tanger-med>.

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Previously, Mr. Runde held senior leadership roles at the International Finance Corporation (IFC). From 2005 to 2007, he was director of the Office of Global Development Alliances (GDA) at the U.S. Agency for International Development (USAID), and he led the GDA partnership initiative by providing training, networks, staff, funds, and advice to establish and strengthen public-private partnerships. His efforts at USAID leveraged \$4.8 billion through 100 direct alliances and 300 others through training and technical assistance.

Mr. Runde is the chairman of the Advisory Committee on Voluntary Foreign Aid (ACVFA) and serves on the board of the International Foundation for Electoral Systems (IFES), the Millennium Challenge Corporation (MCC) Advisory Council, and the Ashesi University Foundation (a private university located in Accra, Ghana). Mr. Runde is a regular contributor to The Hill and hosts a podcast series, Building the Future with Dan Runde: Freedom, Prosperity, & Foreign Policy.

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Annex: Project Description

Background

The Project on Prosperity and Development (PPD) at CSIS partnered with the Smith Richardson Foundation (SRF) in January 2019 on a research project examining the strategic directions for the new U.S. development finance institution, the United States International Development Finance Corporation (DFC). This report provides an independent, medium-term assessment for the DFC as it begins operations in October 2019. The recommendations produced in this report lay out a vision for the next 5 to 10 years that are acceptable to both sides of the U.S. political spectrum—Republicans and Democrats alike.

CSIS was one of the Better Utilization of Investment Leading to Development (BUILD) Act’s key architects. Over the past seven years, CSIS participated in several Congressional hearings and produced numerous research materials in support of the BUILD Act and development finance modernization (see Annex C for a listing of related research). Starting in 2011, CSIS has run a very active program to strengthen and enable development finance in the United States. Some examples of our written work include “Sharing Risk in a World of Dangers and Opportunities” (2011), “Development Finance Institutions Come of Age” (2016), and, most recently, “The BUILD Act Has Passed: What’s Next?” (October 2018). PPD Director Daniel F. Runde testified twice regarding the BUILD Act.

The DFC is not designed to be simply another development finance institution—in addition to a greater proposed focus on development impact, it is an agency also embedded in the U.S. foreign policy and national security architecture. This report offers concrete and independent ideas on how the DFC can better support U.S. national security interests but also highlights its limitations. Within this context, the three key U.S. national security challenges that CSIS highlights include a) China’s rising influence in the developing world, b) actions the United States and others can do to further mitigate violent extremism, and c) addressing the root causes of migration. The main questions we sought to answer through this project are:

How the DFC can support U.S. foreign policy, development, and national security goals via a series of key strategic questions:

- *Where and how can the DFC counter the rise of China as a development player?*

- *Where and how can the DFC address instability and counter the rise of violent extremism?*
- *Where and how can the DFC address the root causes of migration?*

CSIS approached the project through a two-part method:

- a bottom-up approach, consisting of country case studies to better understand local stakeholders' views on the DFC; complemented by
- a top-down approach, consisting of the expertise of Washington-based policymakers and high-level staff from allied development finance institutions.

During the first half of 2019, CSIS met key stakeholders (U.S. embassy teams, local business leaders, country government officials, and multilateral development agencies) in three developing countries to gather views on the ground on how the DFC could be most effective in meeting their country's needs. CSIS focused on three very different but strategically important regions of the world: Central America, North Africa, and Southeast Asia. Within these regions, we chose the Philippines, Tunisia, and Guatemala as country case studies due to a large U.S. influence or presence and their representation of the three key U.S. national security challenges of China's rise, violent extremism, and youth migration. Over 25 experts were consulted in each country. These case studies have been published as separate papers.

CSIS also convened two private roundtable discussions in Washington, D.C., with nearly 30 stakeholders from various academic institutions, multilateral development banks, private sector entities, and allied development agencies. Finally, 15 in-person interviews were conducted to better understand how the DFC can fit into a changing development landscape, work more collaboratively with other partners, focus on the proper sectors, and achieve its development impact and financial goals.

Country Case Studies

CSIS chose the Philippines, Tunisia, and Guatemala as case studies to provide a series of lessons learned for future programs by the United States International Development Finance Institution (DFC). These countries are representative of the major U.S. geostrategic issues of China's rise as a development player, violent extremism, and forced migration. In choosing the countries, CSIS sought to balance representation in different regions and varied economic structures and development status (two are lower middle income—the Philippines and Tunisia—while one is a fragile, upper-middle-income country—Guatemala). These case studies have been published as separate papers.

In each country, CSIS met with government officials, executives from businesses, directors of aid agencies, high-level staff at U.S. embassies, security actors, bilateral development finance institutions (DFIs) and multilateral development bank (MDB) representatives (the Asian Development Bank [ADB], the Inter-American Development Bank [IADB], the African Development Bank [AfDB], and the World Bank), chambers of commerce members, and think tanks. CSIS also interviewed counterparts of the DFC, such as Japanese, Korean, and German stakeholders in both the private and public sector, to hear their perspectives.

During the first half of 2019, CSIS interviewed 80 stakeholders in those three countries (31 in Tunisia, 22 in the Philippines, and 27 in Guatemala) as well as 15 experts from

DFIs and other development agencies. CSIS also undertook an extensive desk review that utilized the publications listed in Annex C.

The following questions were asked in all three countries:

- What are some areas that you think the new DFC will be able to pursue in collaboration with other development finance institutions (DFIs)?
- What concrete joint projects or products should be pursued? What new products or approaches would you like the new DFC to undertake?
- If you have ever collaborated with the Overseas Private Investment Corporation (OPIC), what were the main barriers hindering the process?
- How can the DFC leverage the work of the other U.S. development agencies (OPIC, Millennium Challenge Corporation [MCC], Export-Import Bank of the United States [EXIM], U.S. Agency for International Development [USAID])?
- What types of new financing instruments are needed?
- Do you see a role for the new DFC in working with impact investors?
- What do you foresee as the DFC's main limitations?
- What three key technologies will have the most impact in achieving the Sustainable Development Goals?
- How can DFIs accelerate and enable the adoption of key technologies in developing countries?
- How have DFIs in the past supported telecommunications infrastructure development (e.g., cellphones)?
- With new technologies like big data or 5G wireless communication entering the markets, how can DFIs be more strategic about the risks they pose to society?

The Philippines exemplifies a developing country where the contested security and economic forces of China and the United States are present. Its location in the South China Sea makes it an attractive area of investment for U.S. and Chinese firms. The Philippines case study was meant to inform the DFC on the tools, technical assistance programs, and sectoral approaches that Southeast Asian countries need but China cannot offer. Questions to stakeholders in the Philippines included:

- What strengths do you identify in the U.S. approach (government programs, private sector) compared to China's? What are the U.S. weaknesses?
- What are some areas that you think the new DFC will be able to pursue in collaboration with other DFIs on the ground? (e.g., infrastructure? Small and medium-sized enterprise [SME] development? entrepreneurship?)
- How should the DFC approach infrastructure financing?
- What tools and approaches are most needed in the Philippines? Southeast Asia?
- How can the DFC collaborate with the government of the Philippines and its other partners to engage youth and counter violent extremism? What are the most promising economic sectors to engage youth?

Tunisia is a good example of the Middle East and North Africa (MENA) region's challenges, which include weak private sectors, youth disengagement from the workforce, and the potential for violent extremism. The youth unemployment rate in Tunisia has not dipped below 30 percent since 2010. Even youth that are highly educated (tertiary level) struggle with unemployment levels over 60 percent because of the low demand for highly skilled labor in Tunisia. These high levels of unemployment have led to as many as 6,000 suspected Tunisian youth joining violent extremist groups in recent years.¹²⁸ The Tunisia case study aimed to guide the DFC on how it can collaborate and work with allies and other DFIs, specifically in economic sectors that can engage youth. Questions to stakeholders in Tunisia included:

- What should be the DFC approach to private sector development in Tunisia?
- What tools and approaches are most needed in Tunisia? North Africa?
- What are the most promising economic sectors to engage youth?
- How can the DFC collaborate with the government of Tunisia and other partners on the ground to engage youth and counter violent extremism?

With close to 17 million people, Guatemala is a good representation of the problems in the Northern Triangle—particularly the perennial challenge of migration that stems from a lack of jobs and internal security. The challenges in the Northern Triangle will likely last for the next 20 years and will continue to impact U.S. national security. Countries in the Northern Triangle face a significant gang and criminal activity problem that magnifies a lack of economic opportunity as gangs find recruits among the region's unemployed or underemployed. Although there is less overall gang violence in Guatemala, Guatemalans migrate mostly to the United States because of extreme poverty, especially among its very large indigenous community. The Guatemala case study strived to inform the DFC strategy on the specific tools and approaches that are needed to develop the private sector in ways that mitigate economic migration. Questions to stakeholders in Guatemala included:

- What are the most successful approaches and financing instruments to develop the private sector in Guatemala? What are the main challenges? What should be the DFC's role?
- Which promising industries or sectors should the DFC focus on in order to trigger economic growth and employment?
- How can the DFC leverage the work of other U.S. government programs in combatting the root causes of migration?
- How can the DFC collaborate with the government of Guatemala and other partners on the ground to provide better alternatives to migration?

128. Counter Extremism Project, "Tunisia: Extremism & Counter-Extremism," (New York, NY: 2019), Counter Extremism Project, https://www.counterextremism.com/sites/default/files/country_pdf/TN-07252019.pdf.

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