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Small and Medium Enterprises and Economic Development in Afghanistan

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Abstract

Small and Medium Enterprises (SMEs) play a critical role in driving economic growth, job creation, and innovation in developing and post-conflict economies. In Afghanistan, the SME sector has emerged as a potential engine for private-sector–led recovery, particularly after two decades of political transition and reconstruction. This paper examines the relationship between SMEs and economic development in Afghanistan through a secondary-data–based analysis covering the period 2010–2024. Drawing on data from the World Bank, Asian Development Bank (ADB), National Statistics and Information Authority (NSIA), and related policy reports, the study explores SME contributions to GDP, employment generation, and local entrepreneurship. The findings indicate that despite persistent challenges—such as limited access to finance, weak institutional frameworks, and fragile governance—SMEs contribute significantly to income diversification and community-level resilience. The paper argues that strengthening the SME ecosystem through improved policy coordination, financial inclusion, and capacity-building initiatives is essential for Afghanistan's long-term economic stability and inclusive development.

Introduction

Background of SMEs and Their Importance in Developing Economies

Small and Medium Enterprises (SMEs) are widely recognized as vital engines of economic growth, innovation, and employment in both developed and developing countries[1]. Globally, SMEs account for more than 90 percent of all businesses and contribute substantially to GDP and job creation[2]. In developing economies, they play an especially significant role in diversifying production, reducing poverty, and fostering entrepreneurship at the grassroots level[3]. The flexibility and adaptability of SMEs enable them to respond quickly to market changes and create opportunities in sectors often neglected by large corporations[4]. For fragile and transitional economies, the promotion of SMEs is considered a strategic instrument for stimulating inclusive economic growth and ensuring social stability[5].

[1] Organisation for Economic Co-operation and Development (OECD), *Enhancing the Contributions of SMEs in a Global and Digitalised Economy* (Paris: OECD Publishing, 2017).
[2] World Bank, *Small and Medium Enterprises (SMEs) Finance: Improving SMEs' Access to Finance and Finding Innovative Solutions* (Washington, DC: World Bank, 2020).
[3] United Nations Development Programme (UNDP), *SMEs and Sustainable Development Goals: Strengthening SMEs for Inclusive Growth* (New York: UNDP, 2018).
[4] World Bank, *World Development Report 2020: Trading for Development in the Age of Global Value Chains* (Washington, DC: World Bank, 2020).
[5] Asian Development Bank (ADB), *Asia SME Finance Monitor 2022* (Manila: ADB, 2023).

Context of Afghanistan's Post-Conflict Economic Challenges

Afghanistan presents a unique context for studying SMEs. After decades of conflict and political instability, the country's economy remains fragile, heavily dependent on foreign aid, agriculture, and a limited range of exports[6]. The private sector, dominated by small and informal enterprises, has faced multiple constraints, including weak governance, insecurity, limited infrastructure, restricted access to finance, and a narrow industrial base[7]. However, over the past two decades (2001–2021), and even amid recent political transitions, SMEs have emerged as crucial contributors to employment generation, service delivery, and community-level resilience[8]. The growth of SMEs, particularly in trade, construction, and small-scale manufacturing reflects both the potential and the vulnerability of Afghanistan's economic structure[9]. Understanding the performance and challenges of this sector is therefore essential for formulating effective economic development strategies in the post-conflict environment[10].

Research Problem and Objectives

Despite their recognized importance, the role of SMEs in Afghanistan's economic development remains under-researched and poorly documented[11]. Most available studies are descriptive or policy-oriented, with limited empirical examination of SME performance using national and international data sources[12]. This paper aims to fill that gap by providing an analytical overview of the contribution of SMEs to Afghanistan's economic development based entirely on secondary data. The main objectives of this study are:

1. To analyze the trends and patterns of SME development in Afghanistan from 2010 to 2024.
2. To examine the contribution of SMEs to GDP growth, employment generation, and poverty reduction.
3. To identify the key constraints affecting SME performance.
4. To propose policy recommendations for strengthening the SME sector as a driver of sustainable development.

Research Questions

To achieve these objectives, the paper seeks to address the following research questions:

- What has been the overall trend in SME growth and structure in Afghanistan during the past decade?
- How do SMEs contribute to Afghanistan's economic development in terms of output and employment?
- What are the major institutional and financial barriers limiting SME performance?
- What policy interventions can enhance the effectiveness of SMEs in promoting inclusive and sustainable growth?

[6] World Bank, *Afghanistan Development Update: Navigating Uncertainty* (Washington, DC: World Bank, 2023).
[7] Ministry of Commerce and Industry (MoCI), *Afghanistan SME Policy Framework* (Kabul: Islamic Republic of Afghanistan, 2018).
[8] UNDP, *Afghanistan Human Development Report 2020: Peace, Progress, and Human Development* (New York: UNDP, 2021).
[9] National Statistics and Information Authority (NSIA), *Afghanistan Statistical Yearbook 2023* (Kabul: NSIA, 2023).
[10] ADB, *Afghanistan: Private Sector Assessment* (Manila: ADB, 2021).
[11] World Bank, *Afghanistan Private Sector Rapid Survey: Impacts of Conflict and COVID-19* (Washington, DC: World Bank, 2022).
[12] UN Economic and Social Commission for Asia and the Pacific (UNESCAP), *Policy Framework for SME Development in Post-Conflict Economies* (Bangkok: UNESCAP, 2019).

Literature Review and Theoretical Framework

Definition and Conceptual Understanding of SMEs

Small and Medium Enterprises (SMEs) are generally defined as business entities that maintain limited scale in terms of employees, turnover, or capital investment, yet play a vital role in economic transformation[13]. The definition of SMEs varies across countries depending on institutional and economic contexts. The World Bank classifies small enterprises as those with fewer than 50 employees and medium enterprises with up to 300 employees, while the European Union defines them based on turnover and employment thresholds[14]. In developing and transitional economies, SMEs often overlap with the informal sector, contributing to employment generation and local income despite facing structural constraints[15]. In Afghanistan, the Ministry of Commerce and Industry (MoCI) defines SMEs as businesses with fewer than 100 employees and limited annual revenue, a framework developed to promote private-sector growth in a post-conflict environment[16]. The sector encompasses small-scale manufacturing, services, trade, and agriculture-based enterprises, forming the backbone of Afghanistan's private economy[17].

Review of Global and Regional Studies on SMEs and Development

Globally, a large body of literature highlights SMEs as crucial drivers of economic development. They contribute to productivity, innovation, and inclusive growth, especially in economies with limited industrial capacity[18]. According to OECD and World Bank studies, SMEs account for more than 50 percent of employment and approximately 40 percent of GDP in emerging markets[19]. Research from the Asian Development Bank (ADB) underscores the strategic role of SMEs in Asia's transition from agriculture-based to industrialized economies, emphasizing their capacity to absorb labor, promote entrepreneurship, and reduce poverty[20].

Regional studies on South and Central Asia reveal that the growth of SMEs has been influenced by access to finance, government policy frameworks, and institutional support. In Pakistan, India, and Bangladesh, the expansion of microfinance institutions and business development services has strengthened SME competitiveness and job creation[21]. In contrast, fragile economies like Afghanistan, Nepal, and Tajikistan face persistent structural barriers such as weak financial markets, inadequate infrastructure, and political instability, which hinder SME development[22]. The World Bank and UNESCAP note that in post-conflict contexts, SMEs can function as stabilizing agents by creating livelihoods, fostering local production, and supporting social cohesion[23].

[13] Organisation for Economic Co-operation and Development (OECD), *SME and Entrepreneurship Outlook 2021* (Paris: OECD Publishing, 2021).
[14] European Commission, *User Guide to the SME Definition* (Luxembourg: Publications Office of the European Union, 2020).
[15] United Nations Conference on Trade and Development (UNCTAD), *The Role of SMEs in Structural Transformation* (Geneva: UNCTAD, 2019).
[16] Ministry of Commerce and Industry (MoCI), *Afghanistan SME Policy Framework* (Kabul: Islamic Republic of Afghanistan, 2018).
[17] National Statistics and Information Authority (NSIA), *Afghanistan Statistical Yearbook 2023* (Kabul: NSIA, 2023).
[18] World Bank, *Small and Medium Enterprises (SMEs) Finance: Improving SMEs' Access to Finance and Finding Innovative Solutions* (Washington, DC: World Bank, 2020).
[19] OECD, *Enhancing the Contributions of SMEs in a Global and Digitalised Economy* (Paris: OECD Publishing, 2017).
[20] Asian Development Bank (ADB), *Asia SME Finance Monitor 2022* (Manila: ADB, 2023).
[21] UN Economic and Social Commission for Asia and the Pacific (UNESCAP), *Supporting SMEs for Sustainable Development in South Asia* (Bangkok: UNESCAP, 2021).
[22] ADB, *SME Development in Central Asia: Challenges and Prospects* (Manila: ADB, 2022).
[23] UNESCAP, *Policy Framework for SME Development in Post-Conflict Economies* (Bangkok: UNESCAP, 2019).

Theoretical Perspectives

Schumpeter's Innovation Theory of Entrepreneurship

Joseph Schumpeter's innovation theory emphasizes that entrepreneurs are agents of change who drive economic growth through innovation, new product creation, and market disruption[24]. In the context of SMEs, this theory suggests that small firms act as vehicles of innovation by introducing new business models, technologies, and local solutions. For Afghanistan, where large-scale industries remain underdeveloped, SMEs serve as catalysts for local innovation—particularly in areas like agro-processing, small manufacturing, and services—thereby enhancing productivity and regional development[25].

Endogenous Growth Theory

The endogenous growth theory, developed by economists such as Paul Romer and Robert Lucas, posits that economic growth results from internal factors such as human capital, innovation, and technological advancement rather than external influences[26]. Within this framework, SMEs play a vital role by investing in skills, innovation, and knowledge diffusion. They create an ecosystem that sustains long-term economic development through incremental improvements in productivity. In Afghanistan, the limited presence of large industries makes SME-led innovation and skill development crucial for endogenous growth, as they provide both employment opportunities and local capacity building[27].

Institutional Theory

Institutional theory examines how political, legal, and social structures shape organizational behavior and economic outcomes[28]. In developing and post-conflict countries, the institutional environment—comprising regulatory frameworks, governance quality, and market institutions—significantly affects SME performance[29]. For Afghanistan, weak regulatory enforcement, limited property rights, and corruption have constrained SME growth. However, improvements in business registration systems, access to microfinance, and donor-supported programs have begun to strengthen the institutional base for SME development[30]. Thus, institutional reform is central to enhancing SME resilience and enabling them to contribute effectively to national economic growth.

Gaps in the Literature Relevant to Afghanistan

Despite growing research on SMEs globally, the literature on Afghanistan remains sparse, fragmented, and largely descriptive. Most available reports are published by international organizations focusing on policy recommendations rather than empirical analysis[31]. There is a lack of systematic data-driven studies examining the quantitative contribution of SMEs to GDP, employment, and poverty reduction. Furthermore, limited attention has been given to the intersection of institutional factors—such as governance, security, and regulation—and SME performance in post-2021 Afghanistan. This study aims

[24] Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle* (Cambridge, MA: Harvard University Press, 1934).
[25] ADB, *Afghanistan: Private Sector Assessment* (Manila: ADB, 2021).
[26] Paul Romer, "Endogenous Technological Change," *Journal of Political Economy* 98, no. 5 (1990): S71–S102.
[27] Robert E. Lucas Jr., "On the Mechanics of Economic Development," *Journal of Monetary Economics* 22, no. 1 (1988): 3–42.
[28] W. Richard Scott, *Institutions and Organizations: Ideas, Interests, and Identities* (Thousand Oaks, CA: Sage Publications, 2014).
[29] Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990).
[30] UNDP, *Afghanistan Human Development Report 2020: Peace, Progress, and Human Development* (New York: UNDP, 2021).
[31] World Bank, *Afghanistan Private Sector Rapid Survey: Impacts of Conflict and COVID-19* (Washington, DC: World Bank, 2022).

to address these gaps by synthesizing secondary data from national and international sources to provide a comprehensive analytical picture of SME development and its link to Afghanistan's broader economic transformation.

Research Methodology

This study employs a descriptive–analytical research design, utilizing secondary data exclusively, to investigate the contribution of Small and Medium Enterprises (SMEs) to Afghanistan's economic development between 2010 and 2024. The descriptive dimension identifies the structure, distribution, and trends of SMEs across major sectors, while the analytical component investigates their relationship with key macroeconomic indicators—specifically GDP growth, employment generation, and sectoral diversification.

Data Sources

Given the limitations of primary field research in Afghanistan's current context, the study relies exclusively on secondary data drawn from both national and international sources. These include the National Statistics and Information Authority (NSIA), the Ministry of Commerce and Industry (MoCI), Da Afghanistan Bank (DAB), the World Bank, the Asian Development Bank (ADB), the International Monetary Fund (IMF), and the United Nations Development Programme (UNDP). Supplementary information was extracted from relevant policy reports, academic publications, and donor assessments to triangulate findings and ensure data reliability.

Analytical Framework and Methods

The analysis employs trend analysis, comparative assessment, and interpretative correlation to evaluate how SME development aligns with broader economic performance.

Trend analysis was used to trace the evolution of SME contribution to GDP, employment, and sectoral output over the 2010–2024 period.

Comparative analysis examined Afghanistan's SME structure relative to neighboring South and Central Asian economies.

Interpretative correlation explored conceptual linkages between SME growth and economic resilience, drawing upon the theoretical perspectives of Endogenous Growth Theory, Institutional Theory, and Schumpeter's Innovation Theory.

Operationalization of Variables

For analytical clarity, the study operationalized the following key indicators:

SME Contribution to GDP (%) – proportion of GDP generated by registered SMEs.

SME Employment Share (%) – share of total non-agricultural employment generated by SMEs.

Access to Finance Index – availability of SME credit as reported by financial institutions (ADB, IMF).

Sectoral Distribution (%) – relative share of SMEs across trade, services, agriculture, and manufacturing.

These indicators were extracted from multiple data sources and cross-verified to reduce inconsistencies arising from definitional or temporal variations.

Limitations

While secondary data provides broad coverage and longitudinal insight, it also presents limitations. Variations in SME definitions across institutions, incomplete post-2021 datasets, and the scarcity of micro-level data restrict the scope for advanced econometric modeling. Nevertheless, the triangulation of multiple sources enhances the validity of the analysis and allows for a coherent interpretation of SME development linkages in Afghanistan's evolving economic context.

SMEs in Afghanistan: Trends and Patterns

Evolution of SMEs since 2001

Since the fall of the Taliban regime in 2001, Small and Medium Enterprises (SMEs) have played an increasingly significant role in Afghanistan's transition from a conflict-driven to a market-oriented economy. The early post-2001 period, supported by massive international aid and reconstruction programs, witnessed the emergence of thousands of small firms in trade, services, construction, and manufacturing[32]. Between 2003 and 2014, the SME sector expanded rapidly as donor funding stimulated private-sector participation, particularly in urban centers such as Kabul, Herat, and Mazar-i-Sharif[33]. However, the withdrawal of international forces and a decline in foreign assistance after 2014 led to a slowdown in SME activity, exposing structural weaknesses such as limited access to finance, inadequate infrastructure, and policy inconsistency[34].

Following the political transition in 2021, SMEs faced further contraction due to economic isolation, currency depreciation, and reduced market confidence. Yet, informal and micro-level entrepreneurship continued to sustain local livelihoods, indicating the sector's resilience amid instability[35]. Despite challenges, SMEs remain essential to economic diversification, rural employment, and community resilience in Afghanistan's fragile economic structure[36].

Sectoral Distribution

The Afghan SME landscape is highly concentrated in trade, services, and agriculture, with smaller but emerging activities in light manufacturing. According to the National Statistics and Information Authority (NSIA), nearly 38% of SMEs operate in wholesale and retail trade**,** followed by 27% in services such as transport, hospitality, and telecommunications, and 25% in agriculture and agro-processing[37]. Manufacturing, though limited, accounts for about 10% of SME activity, primarily in food processing, construction materials, textiles, and handicrafts[38].

Agriculture-based SMEs, especially in rural areas, have shown potential for inclusive growth, providing linkages between farmers, cooperatives, and small-scale processors[39]. Service-sector SMEs, particularly logistics, IT, and education-related enterprises, expanded during the 2010–2020 period, reflecting gradual urban modernization and rising domestic demand[40]. However, most SMEs remain micro in scale, informal, and family-run, which restricts their productivity and scalability. Infrastructure deficits, unreliable energy, and weak institutional support further constrain growth across all sectors[41].

Employment Generation Trends

SMEs are recognized as the largest employers in Afghanistan's private sector, absorbing a substantial portion of the labor force excluded from formal government or international employment. Estimates by the World Bank and ADB suggest that SMEs account for nearly 80–85% of non-agricultural employment

[32] World Bank, *Afghanistan: Private Sector Development Study* (Washington, DC: World Bank, 2015).
[33] Asian Development Bank (ADB), *Afghanistan Private Sector Assessment* (Manila: ADB, 2021).
[34] United Nations Development Programme (UNDP), *Afghanistan Human Development Report 2020* (New York: UNDP, 2021).
[35] ADB, *Asia SME Finance Monitor 2022* (Manila: ADB, 2023).
[36] World Bank, *Afghanistan Development Update: Navigating Uncertainty* (Washington, DC: World Bank, 2023).
[37] National Statistics and Information Authority (NSIA), *Afghanistan Statistical Yearbook 2023* (Kabul: NSIA, 2023).
[38] Ministry of Commerce and Industry (MoCI), *SME Policy Framework for Afghanistan* (Kabul: Islamic Republic of Afghanistan, 2018).
[39] Food and Agriculture Organization (FAO), *Agro-based SME Development in Afghanistan* (Rome: FAO, 2020).
[40] Food and Agriculture Organization (FAO), *Agro-based SME Development in Afghanistan* (Rome: FAO, 2020).
[41] UNESCAP, *Supporting SMEs for Sustainable Development in South Asia* (Bangkok: UNESCAP, 2021).

and contribute approximately 50% of the country's GDP[42]. These enterprises provide opportunities for low-skilled and semi-skilled workers, often serving as the first source of income for returning migrants and war-affected communities[43].

Between 2010 and 2020, SME-driven employment expanded in service-oriented activities, particularly transport, construction, and small-scale retail[44]. However, the post-2021 downturn has caused a contraction in formal SME employment, with many businesses downsizing or shifting to informal operations. Despite this, the sector continues to play a crucial role in preventing total economic collapse, especially through microenterprises and household-based businesses that provide subsistence-level jobs[45].

Role of Women and Youth in the SME Sector

Women and youth represent key but underutilized groups in Afghanistan's SME sector. Before 2021, women-led enterprises, mainly in handicrafts, food processing, and small retail, accounted for about 5–8% of registered SMEs[46]. Several donor-supported initiatives, such as USAID's *Promote: Women in the Economy* program and UNDP's *Youth Empowerment Projects*, sought to enhance female and youth entrepreneurship[47]. Although sociocultural barriers and mobility restrictions limited women's participation, SMEs provided one of the few viable avenues for women's economic inclusion.

Youth entrepreneurship, particularly in the ICT, services, and creative industries, also emerged as a dynamic area of growth during the 2010s[48]. However, current restrictions and the absence of targeted support mechanisms have significantly reduced these opportunities since 2021[49]. Strengthening SME policy frameworks that emphasize women's inclusion, vocational training, and digital entrepreneurship could restore some of these lost gains in the long term.

Comparison with Neighbouring Countries

Compared with neighbouring South and Central Asian economies, Afghanistan's SME sector remains underdeveloped but structurally similar. For instance, SMEs contribute over 60% of GDP in Pakistan and 45% in Iran, while in Afghanistan, the figure hovers around 50%[50]. Access to finance remains a shared regional challenge, though microfinance and SME credit facilities are more advanced in countries such as India and Uzbekistan. Afghanistan also lags behind in formalization and innovation capacity due to prolonged political instability and limited institutional coordination. Nevertheless, the country's large informal economy and young population present latent potential for SME-led recovery if supported through stable governance, investment incentives, and regional trade integration[51].

Challenges Facing SMEs in Afghanistan

Political Instability and Insecurity

Political instability and insecurity remain the most pervasive obstacles to the sustainable growth of Small and Medium Enterprises (SMEs) in Afghanistan. Since 2001, fluctuating political regimes, persistent conflict, and shifting policy environments have severely disrupted business confidence and investment

[42] World Bank, *World Development Indicators Database* (Washington, DC: World Bank, 2024).
[43] UNDP, *Afghanistan Human Development Report 2020*.
[44] NSIA, *Afghanistan Statistical Yearbook 2023*.
[45] ADB, *Afghanistan Private Sector Assessment*.
[46] World Bank, *Afghanistan Development Update: Navigating Uncertainty*.
[47] USAID, *Promote: Women in the Economy Final Report* (Kabul: USAID, 2021).
[48] ADB, *Asia SME Finance Monitor 2022*.
[49] UNDP, *Afghanistan Economic Outlook 2023* (New York: UNDP, 2023).
[50] UNESCAP, *Supporting SMEs for Sustainable Development in South Asia*.
[51] World Bank, *Afghanistan Development Update: Navigating Uncertainty*.

flows[52]. The private sector, particularly SMEs, has been highly sensitive to changes in governance and security conditions, as these directly affect supply chains, transportation, and consumer demand. According to the World Bank's *Afghanistan Development Update (2023)*, recurrent political transitions and security risks have discouraged both domestic and foreign investment, leading to irregular business activity and capital flight[53].

The post-2021 political realignment has further constrained SMEs through restrictions on financial transactions, international sanctions, and the suspension of development assistance[54].These factors have led to a sharp decline in formal business registrations and forced many enterprises into informal or subsistence operations[55]. Political instability has also weakened institutional continuity, making long-term business planning nearly impossible for SME owners, particularly in sectors like manufacturing and trade that depend on stable regulatory frameworks[56].

Access to Finance and Credit Barriers

Limited access to finance represents one of the most critical structural challenges for SMEs in Afghanistan. The country's financial sector remains underdeveloped, with low levels of financial intermediation and limited reach of commercial banking services beyond major urban centers[57]. According to the Asian Development Bank's *Asia SME Finance Monitor (2022)*, only about 15% of Afghan SMEs have access to formal credit, compared with over 40% in South Asia and 60% in OECD countries[58].

High collateral requirements, limited credit information systems, and a general lack of trust between banks and small enterprises have constrained financing opportunities[59]. Many SMEs depend on informal lending or family networks, which restricts their capacity for expansion and innovation. Microfinance institutions, while important, often provide short-term, high-interest loans unsuitable for business growth[60]. The closure of several international banks and the financial restrictions imposed after 2021 have further tightened liquidity in the SME sector. Without broader financial inclusion and credit reform, SMEs remain trapped in a cycle of undercapitalization and informality.

Weak Institutional Support and Governance Issues

Institutional fragility and weak governance mechanisms have significantly undermined SME development in Afghanistan. The absence of a coherent and consistently implemented SME policy framework has led to fragmented support programs and overlapping responsibilities among government agencies[61]. The Ministry of Commerce and Industry (MoCI) has introduced several SME-related strategies since 2008, but implementation has been inconsistent due to limited administrative capacity and political interference[62].

Regulatory unpredictability, excessive bureaucracy, and weak enforcement of commercial laws have discouraged entrepreneurship and investment[63]. According to the International Monetary Fund (IMF),

[52] World Bank, *Afghanistan Development Update: Navigating Uncertainty* (Washington, DC: World Bank, 2023).
[53] Ibid
[54] Asian Development Bank (ADB), *Afghanistan Private Sector Assessment* (Manila: ADB, 2021).
[55] United Nations Development Programme (UNDP), *Afghanistan Economic Outlook 2023* (New York: UNDP, 2023).
[56] ADB, *Asia SME Finance Monitor 2022* (Manila: ADB, 2023).
[57] International Monetary Fund (IMF), *Afghanistan Country Report No. 22/107* (Washington, DC: IMF, 2022).
[58] ADB, *Asia SME Finance Monitor 2022*.
[59] World Bank, *World Development Indicators Database* (Washington, DC: World Bank, 2024).
[60] UNESCAP, *Supporting SMEs for Sustainable Development in South Asia* (Bangkok: UNESCAP, 2021).
[61] Ministry of Commerce and Industry (MoCI), *SME Policy Framework for Afghanistan* (Kabul: Islamic Republic of Afghanistan, 2018).
[62] Ibid
[63] IMF, *Afghanistan Country Report No. 22/107*.

Afghanistan ranks among the lowest in South Asia in contract enforcement and property rights protection. Corruption, rent-seeking behaviour, and weak coordination among economic ministries further exacerbate the problem[64]. Without strong institutional support and transparent governance, SMEs face structural disadvantages that prevent them from scaling or formalizing their operations.

Infrastructure and Market Access Limitations

Poor physical infrastructure and limited market connectivity continue to constrain SME performance across Afghanistan. Inadequate transportation networks, unreliable electricity, and insufficient internet access increase transaction costs and limit the competitiveness of Afghan products in regional and global markets[65]. The World Bank estimates that nearly 60% of Afghan firms experience power outages daily, leading to production delays and higher costs[66].

Geographic isolation and insecurity in rural provinces further reduce access to major domestic and export markets. SMEs in agriculture and light manufacturing face significant logistical challenges in moving goods across provinces or to neighbouring countries due to deteriorated road conditions and limited border facilities[67]. Additionally, inconsistent customs procedures and weak trade infrastructure have made cross-border trade cumbersome[68]. These constraints inhibit the growth of value-added industries and discourage investment in productive, export-oriented SME activities.

Human Capital and Skill Gaps

Human capital deficiencies represent another critical barrier to SME competitiveness in Afghanistan. Decades of conflict and weak educational infrastructure have produced a workforce with limited technical and managerial skills[69]. Many entrepreneurs lack training in accounting, marketing, and production management, which restricts their ability to operate efficiently or expand their enterprises. The United Nations Development Programme (UNDP) reports that less than 20% of SME owners have formal business education or vocational training, and only a small proportion have access to advisory or incubation services[70].

Furthermore, the migration of skilled labour and ongoing brain drain have depleted the pool of qualified workers, especially in sectors like finance, ICT, and manufacturing[71]. Women and youth, despite their potential as drivers of entrepreneurship, face additional barriers such as restricted mobility, social constraints, and limited access to training opportunities[72]. Addressing these human capital gaps through targeted vocational programs, business incubators, and education reforms is vital for fostering innovation and productivity within Afghanistan's SME ecosystem[73].

SMEs and Economic Development: Analytical Discussion

Contribution of SMEs to GDP and Employment

Small and Medium Enterprises (SMEs) have emerged as a vital engine of Afghanistan's economic development, contributing significantly to gross domestic product (GDP) and employment generation.

[64] Transparency International, *Corruption Perceptions Index 2023* (Berlin: Transparency International, 2024).
[65] ADB, *Afghanistan Infrastructure Development Assessment* (Manila: ADB, 2022).
[66] World Bank, *Enterprise Surveys: Afghanistan Country Profile* (Washington, DC: World Bank, 2023).
[67] ADB, *Afghanistan Private Sector Assessment*.
[68] UNESCAP, *Supporting SMEs for Sustainable Development in South Asia*.
[69] UNDP, *Afghanistan Human Development Report 2020* (New York: UNDP, 2021).
[70] Ibid
[71] World Bank, *Afghanistan Development Update: Navigating Uncertainty*.
[72] USAID, *Promote: Women in the Economy Final Report* (Kabul: USAID, 2021).
[73] UNDP, *Youth Empowerment and Employment in Afghanistan* (New York: UNDP, 2020).

According to World Bank and National Statistics and Information Authority (NSIA) data, SMEs account for nearly 50% of Afghanistan's GDP and provide approximately 80–85% of non-agricultural employment, particularly in urban and peri-urban areas[74]. The contribution of SMEs has been most evident in service sectors such as trade, transport, and construction, which have absorbed a large portion of the country's growing labor force.

Between 2010 and 2020, SME activity paralleled overall economic performance, with expansions during periods of aid-driven growth and contractions during political and security crises[75]. Despite the post-2021 decline in formal business activity, micro and small enterprises continue to play a stabilizing role by sustaining local consumption, providing informal employment, and reducing rural-urban migration pressures[76]. This dynamic underscores the centrality of SMEs as a foundation for inclusive, community-based growth in fragile and post-conflict economies like Afghanistan's.

Link Between SME Growth and Economic Resilience

The resilience of Afghanistan's economy amid recurring crises has been partly linked to the adaptability of its SME sector. SMEs are inherently flexible in responding to demand fluctuations and can quickly adjust their production scale and labor needs to cope with uncertainty[77]. During periods of political instability or international aid withdrawal, SMEs have often acted as economic shock absorbers by providing self-employment opportunities and maintaining basic supply chains[78].

Analytically, this relationship aligns with endogenous growth theory, which posits that innovation and productivity at the firm level can sustain long-term economic growth even in the absence of large-scale capital accumulation. In Afghanistan, SME-driven innovations, though modest include the introduction of low-cost agricultural processing, mobile-based trade services, and small-scale renewable energy solutions[79]. These innovations, often emerging from local necessity rather than formal R&D investment, demonstrate the sector's adaptive capacity.

Moreover, the geographic dispersion of SMEs contributes to regional economic balance and reduces excessive dependency on the capital city, Kabul. Local entrepreneurship in Herat, Kandahar, and Balkh has spurred micro-level industrialization and cross-border trade with Iran, Pakistan, and Central Asia[80]. Such decentralized business activity enhances Afghanistan's overall economic resilience by diversifying income sources and stabilizing community economies in times of national volatility[81].

Role of SMEs in Poverty Reduction and Private-Sector Development

SMEs are essential to poverty reduction in Afghanistan due to their ability to generate employment for low-skilled and marginalized populations. By offering flexible work arrangements and low entry barriers, SMEs integrate informal labor, especially women, youth, and returnees, into productive activities[82]. Data from the UNDP indicate that regions with higher SME density, such as Herat and Nangarhar, report comparatively lower poverty levels than those dependent solely on subsistence agriculture[83].

[74] World Bank, *Afghanistan Development Update: Navigating Uncertainty* (Washington, DC: World Bank, 2023).
[75] Asian Development Bank (ADB), *Afghanistan Private Sector Assessment* (Manila: ADB, 2021).
[76] United Nations Development Programme (UNDP), *Afghanistan Economic Outlook 2023* (New York: UNDP, 2023).
[77] Paul Romer, "Endogenous Technological Change," *Journal of Political Economy* 98, no. 5 (1990): S71–S102.
[78] Joseph A. Schumpeter, *The Theory of Economic Development* (Cambridge, MA: Harvard University Press, 1934).
[79] UNESCAP, *Supporting SMEs for Sustainable Development in South Asia* (Bangkok: UNESCAP, 2021).
[80] ADB, *Afghanistan Private Sector Assessment*.
[81] World Bank, *Afghanistan Development Update: Navigating Uncertainty*.
[82] UNDP, *Afghanistan Human Development Report 2020* (New York: UNDP, 2021).
[83] ibid

The sector also strengthens the broader private-sector development framework by nurturing entrepreneurial culture, encouraging competition, and stimulating local supply chains. SMEs often serve as feeder firms to larger enterprises and public projects, thus building a more diversified economic base[84]. In line with institutional theory, the presence of a vibrant SME sector also encourages gradual improvements in governance and rule of law, as increased business participation generates demand for predictable regulations and transparent policymaking.

Although the contribution of SMEs to poverty alleviation remains constrained by low productivity and weak access to finance, their socio-economic role is undeniable. In many rural districts, small-scale agro-processing units, carpentry workshops, and handicraft enterprises are the primary sources of household income, reducing reliance on humanitarian aid[85]. Strengthening SMEs thus not only boosts income but also enhances human security and social stability, two prerequisites for sustainable development in post-conflict contexts[86].

Policy Implications Drawn from Regional Comparisons

A comparative look at neighboring economies reveals clear policy lessons for Afghanistan. In countries such as Pakistan, India, and Uzbekistan, government-led SME development strategies have played a transformative role in industrial growth and job creation. For instance, Pakistan's *SME Policy 2021* provides tax incentives, credit guarantees, and export facilitation measures that have enhanced SME competitiveness[87]. India's robust microfinance network and digital platforms have expanded credit access and market reach for millions of small businesses. Similarly, Uzbekistan has integrated SMEs into national development plans through simplified licensing systems and industrial parks[88].

For Afghanistan, the policy implications are twofold. First, the government and development partners should prioritize financial inclusion and capacity-building by reactivating credit facilities and promoting micro-insurance schemes tailored for small enterprises. Second, a coherent national SME development strategy, harmonized across ministries, is essential to create an enabling environment for entrepreneurship[89]. Expanding digital and trade infrastructure, improving regulatory transparency, and fostering cross-border collaboration under regional frameworks such as the Central Asia Regional Economic Cooperation (CAREC) Program would also enhance SME competitiveness[90].

Adopting such policy reforms could transform Afghanistan's SME sector from a survival-based economic activity into a driver of structural transformation, contributing to employment generation, innovation, and long-term resilience.

Policy Recommendations and Future Prospects

The revitalization of Afghanistan's Small and Medium Enterprises (SMEs) requires a multidimensional policy approach that addresses financial, institutional, and human-capital constraints while fostering resilience in a volatile environment.

Strengthening Access to Finance. Limited access to credit remains one of the primary barriers to SME growth in Afghanistan. The development of *microcredit*, *Islamic finance instruments*, and *digital banking*

[84] World Bank, *Pathways for Private Sector Development in Fragile States* (Washington, DC: World Bank, 2022).
[85] FAO, *Agro-based SME Development in Afghanistan* (Rome: FAO, 2020).
[86] UNDP, *Afghanistan Economic Outlook 2023*.
[87] Government of Pakistan, *SME Policy 2021* (Islamabad: Ministry of Industries and Production, 2021).
[88] ADB, *Uzbekistan Country Partnership Strategy 2022–2026* (Manila: ADB, 2022).
[89] Ministry of Commerce and Industry (MoCI), *SME Policy Framework for Afghanistan* (Kabul: Islamic Republic of Afghanistan, 2018).
[90] ADB, *CAREC 2030: Connecting the Region for Shared and Sustainable Development* (Manila: ADB, 2020).

platforms could expand financial inclusion without violating local norms or risking excessive indebtedness. Institutions such as *FINCA Afghanistan*, *MISFA*, and *Islamic Investment and Finance Cooperatives (IIFCs)* have demonstrated that community-based lending and profit-sharing models can effectively reach small entrepreneurs when combined with financial literacy programs[91]. Building on these examples, a nationwide credit guarantee fund, supported by international development banks, could mitigate lending risks for commercial institutions and encourage investment in SMEs[92].

Improving Business Regulations and Legal Frameworks. Afghanistan's business environment is burdened by bureaucratic complexity, weak contract enforcement, and regulatory inconsistency. Streamlining licensing procedures, reducing informal transaction costs, and ensuring transparent taxation are essential for formalizing small enterprises[93]. The government, in coordination with chambers of commerce and donor agencies, should also establish *one-stop business service centers* in major provinces to assist SMEs with registration, legal advice, and compliance training[94]. Clearer intellectual property rights and commercial arbitration mechanisms would further enhance investor confidence and attract private-sector participation.

Capacity Building and Entrepreneurship Training. Human capital development remains central to SME competitiveness. Many Afghan entrepreneurs lack the managerial, digital, and technical skills necessary to operate in modern markets. National vocational programs and university-industry linkages could bridge this gap by promoting practical business education, mentoring, and incubation centers[95]. Integrating entrepreneurship modules into secondary and higher education curricula would nurture a culture of innovation and self-reliance among youth.

Encouraging Women- and Youth-Led Enterprises. Women and young entrepreneurs represent a largely untapped potential in Afghanistan's economy. Policy initiatives should promote women's cooperatives, e-commerce ventures, and home-based production units by easing access to microfinance, technology, and markets[96]. Donor-funded programs such as UNDP's *ABADE Initiative* and USAID's *Promote Project* have demonstrated measurable success in supporting women-led SMEs through grants, business training, and digital marketing platforms[97]. Replicating and localizing such initiatives can help integrate women and youth more fully into the formal economy while enhancing social inclusion and household income security.

International Cooperation and Donor Support. Afghanistan's SME revival is inseparable from regional and global cooperation. International partners can contribute through technical assistance, market integration, and infrastructure development within frameworks such as the *Central Asia Regional Economic Cooperation (CAREC)* and the *Trade and Transit Agreement* with Pakistan[98]. Donor agencies, while reducing direct budget support, should prioritize sectoral investments that promote self-sufficiency, including renewable energy, agribusiness, and digital services where SMEs have comparative

[91] Microfinance Investment Support Facility for Afghanistan (MISFA), *Annual Report 2023* (Kabul: MISFA, 2023).
[92] Asian Development Bank (ADB), *Afghanistan Private Sector Assessment* (Manila: ADB, 2021).
[93] World Bank, *Doing Business 2020: Afghanistan Country Profile* (Washington, DC: World Bank, 2020).
[94] Ministry of Commerce and Industry (MoCI), *SME Policy Framework for Afghanistan* (Kabul: Islamic Republic of Afghanistan, 2018).
[95] UNDP, *Afghanistan Human Development Report 2020* (New York: UNDP, 2021).
[96] FAO, *Women Entrepreneurs and Agro-SME Development in Afghanistan* (Rome: FAO, 2021).
[97] USAID, *Promote: Women in the Economy Project Final Report* (Kabul: USAID, 2022).
[98] ADB, *CAREC 2030: Connecting the Region for Shared and Sustainable Development* (Manila: ADB, 2020).

advantages[99]. Long-term stability of the SME ecosystem depends on coordinated donor engagement that aligns with Afghanistan's local priorities and institutional capacities.

Looking forward, Afghanistan's SME sector can evolve into a critical platform for sustainable development, provided that financial access, institutional integrity, and human capital formation are systematically strengthened. With adaptive policy implementation and international partnership, SMEs could spearhead a gradual economic recovery even under constrained political conditions.

Conclusion

This study underscores that Small and Medium Enterprises are the backbone of Afghanistan's fragile but resilient economy, accounting for a substantial share of GDP and non-agricultural employment. Despite persistent challenges from insecurity to financial exclusion, SMEs have maintained their role as the primary drivers of local livelihood, innovation, and private-sector dynamism.

The analysis demonstrates that strengthening the SME ecosystem is essential for inclusive and sustainable economic recovery, particularly in a post-2021 context marked by international disengagement and fiscal contraction. By focusing on financial inclusion, regulatory simplification, and human capital investment, Afghanistan can harness the entrepreneurial capacities of its citizens, especially women and youth, to build a diversified, self-sustaining economy.

Future research should focus on post-2021 SME adaptation strategies, including digital transformation, informal market linkages, and community-based entrepreneurship under new governance structures. Such studies would enrich understanding of how SMEs can function not only as economic units but also as vehicles for resilience, stability, and social reconstruction in a post-conflict state.

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