

# **Financial Sector Development, SME Financing Constraints, And Economic Recovery In Emerging Economies: Evidence From Post-COVID Panel Data**

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This study examines the pivotal role of financial sector development in alleviating credit constraints faced by small and medium enterprises (SMEs) and its subsequent impact on economic recovery following the COVID-19 shock. SMEs, which account for over 60% of employment in most emerging economies, experienced severe liquidity shortages during the pandemic, exacerbating output contraction and delaying recovery. Despite various policy interventions, persistent financial frictions continue to hinder SME access to credit, raising questions about the effectiveness of financial deepening in supporting inclusive growth.

The paper addresses two core research questions: (i) To what extent does financial sector development (measured by private credit-to-GDP ratio, banking competition, and capital market depth) reduce SME financing constraints? (ii) How do improvements in SME credit access accelerate GDP growth and employment recovery in the post-pandemic period?

Using annual panel data from 45 emerging economies covering 2015–2024, sourced from the World Bank Enterprise Surveys, IMF Financial Access Survey, and national statistical offices, the study employs a two-step system GMM estimator to address endogeneity and dynamic panel bias. SME financing constraints are proxied by the share of firms identifying credit access as a major obstacle, while recovery is measured through real GDP growth and formal employment rates.

Preliminary results suggest that a 10-percentage-point increase in private credit-to-GDP significantly reduces perceived financing obstacles by 6–8% and boosts post-2022 GDP growth by 0.4–0.7 percentage points through the SME channel. Expected findings highlight the complementary role of banking sector competition and fintech adoption.

Key policy recommendations include accelerating credit guarantee schemes targeted at viable SMEs, promoting regulatory frameworks for digital lending platforms, and strengthening creditor rights to encourage financial institutions to expand lending during recovery phases.

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