Determinants of Credit to the Private Sector in Countries of the Arab League: Is Economic Diversification Under Way?

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EXECUTIVE SUMMARY

This article aims to study the impact of credit to private sector growth in countries of the Arab League and its impact on the degree of economic diversification. The above stated objective is achieved through econometric modeling and testing of a credit demand model taking into consideration credit to the private sector as an explained variable and GDP, lending interest rate, and export concentration index as explanatory variables. Credit to the private sector was found to be positively correlated to economic activity and negatively linked to the level of economic concentration.

Keywords: Credit to the private sector, Credit demand model, Economic diversification, Arab countries

INTRODUCTION

Countries of the Arab League are 22\(^1\) in total. Although they all share the language, and some of them have common colonial past experiences, their economic realities, structures, and institutions are very diverse. For instance, seven out of the 22 countries are OPEC\(^2\) members. Saudi Arabia accounts alone for about one-fifth of the world’s conventional oil reserves. Taken together, Saudi Arabia, Iraq, Kuwait, UAE, and Libya account for half of the world’s conventional oil reserves. On the other hand, four of them are classified as low income economies (according to the World Bank Classification). Other economies of the group are more diversified and present different patterns of economic growth.

This diversity provides great incentives for research, especially when it comes to the explanation and prediction of patterns of economic growth, taking into consideration all the factors that might affect the growth performance of those countries. In addition, this group of countries, and specifically the oil producers, has a particular importance as they are seen as the main providers of energy sources for the world through their fossil fuel production.

Economic growth in general depends on the availability of sources of financing for the private sector enterprises, whether through the banking sector or through capital markets. We will show in the article that the above group of countries relies more on the banking sector as a source of financing of their economic growth. Therefore, the proposed direction of this research takes the above group of countries as a study area and aims to investigate the pattern of growth of those countries, more specifically with a focus on the role of credit to the private sector.

This paper therefore aims to investigate the behavior of credit to the private sector using a traditional credit demand model enriched by an indicator of economic diversification. This approach has been adopted due to the well-established idea among

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1 Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestinian Territories, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, Yemen

2 Organization for Petroleum Exporting Countries [www.opec.org](http://www.opec.org)