PressAcademia
www.pressacademia.org/conferences
GBRC
ISBN 978-605-06192-7-0
PressAcademia Procedia
YEAR 2023 VOLUME 17
9th Global Business Research Congress, June 15, 2023, Istanbul.

DOES PUBLIC DEBT IMPEDE FINANCIAL DEVELOPMENT IN JORDAN? SOME MACRO AND MICRO ANALYSES

DOI: 10.17261/Pressacademia.2023.1776
PAP- V.17-2022(31)-p.185-186

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To cite this document
Omet, G., (2023). Does public debt impede financial development in Jordan? some macro and micro analyses. PressAcademia Procedia (PAP), 17, 185-186.
Permanent link to this document: http://doi.org/10.17261/Pressacademia.2022.1776

ABSTRACT

Purpose- It is widely acknowledged that banks (and stock markets) provide economies with a number of useful services, including the promotion and allocation of savings, monitoring of investments, and others. Given their importance, the International Monetary Fund (IMF) has been publishing what is called the "Financial Development Index for more than 180 economies. On a scale of 0 to +1.0, the Index ranks countries based on how developed their financial institutions (banks and insurance) and financial markets (stock market) are in terms of three sub-pillars: Depth, Access, and Efficiency. The depth dimension of banks and insurance includes bank credit to the private sector to Gross Domestic Product (GDP) ratio. Within this context and given the fact that public debt in Jordan has been increasing at an alarming rate, this paper sets out to investigate the impact of public debt on bank credit to the private sector at both the macro level and micro level. In more specific terms, the purpose of this paper is to provide answers to two questions: First, what is the impact of public debt on aggregate credit to the private sector? Second, what is the impact of public debt on bank-level credit to the private sector?
Methodology- To provide an answer to the first question, the paper uses annual data (1982 – 2021) on bank credit to the private sector, bank credit to the government, and the discount rate. stationarity. The used techniques include stationarity test, optimal lag structure, co-integration, and vector error-correction (VECM) estimation. To answer the second question, the paper uses annual bank level data (2010 – 2021) for all 13 listed Jordanian banks. The fact that this data includes both time series and cross-section elements, panel data analysis is used to measure the impact of bank credit to the government on bank credit to the private sector.
Findings- The results clearly show that bank credit to the governments has a significant and negative impact of bank credit to the private sector. This is an unfortunate finding as it implies that public debt does impede financial development.
Conclusion- As far as the bank-level results are concerned, the results show that their lending behaviour to the government does affect their credit to the private sector. On average, banks that lend more to the government, ceteris paribus, lend less to the private sector. The government should look at the status of its public finance and work on reducing its borrowing.

Keywords: Jordan, public debt, bank credit, diversification, time-series analysis, co-integration.
JEL Codes: E50, E51, E52.

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