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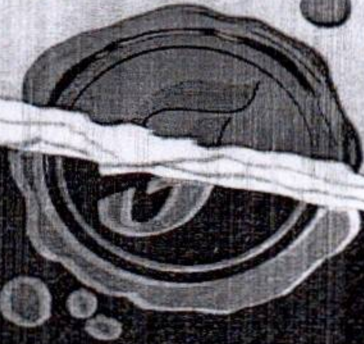

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FINANCIAL SYSTEM AND ECONOMIC DEVELOPMENT

Authored By

Prof. Dr. Yasmeen Ismail Shaikh

Associate Professor in Commerce, Shri. Shahu Mandir mahavideyalaya, Parvati, Pune – 09.

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Contents

Sr. No.	Name of Topic	Page No.
102	ASSISTANCE PROVIDED TO OLD AGE PERSONS IN TELANGANA STATE: SPECIAL FOCUS ON AASRA PENSION	527-530
103	MODI'S DOCTRINE OF INDIAN FOREIGN POLICY IN THE CONTEMPORARY GLOBAL WORLD	531-536
104	ROLE OF INNOVATION AND SMARTNESS IN ORGANISATIONAL RESILIENCE AND RECOVERY IN THE TIMES OF COVID-19: A CASE STUDY OF JW MARRIOTT HOTELS AND RESORTS	537-543
105	IMPACT OF GLOBALISATION ON INCOME INEQUALITY IN INDIA	544-555
106	FINANCIAL SYSTEM AND ECONOMIC DEVELOPMENT	556-55[illegible]
107	CONTENT ANALYSIS OF UGC SPONSORED STATE AND NATIONAL LEVEL CONFERENCE PROCEEDING ON LIBRARY AND INFORMATION SCIENCE	559-5[illegible]
108	IMPACT OF GST ON NON-BANKING FINANCIAL INSTITUTION	574-5[illegible]
109	A CRITICAL ANALYSIS OF THE DOMESTIC CLIMATE POLICY IN INDIA	578-5[illegible]
110	A CRITICAL ANALYSIS OF THE PRISON SYSTEMS IN INDIA	[illegible]
111	TEACHER EMPOWERMENT AND NEP 2020	[illegible]
112	A COMPARATIVE STUDY OF HISTORICAL AND FAIR VALUE MEASUREMENT: A CASE STUDY OF INFOSYS LIMITED	[illegible]
113	PRESENT CONDITIONS OF GOVERNMENT HIGH SCHOOLS AND ADMINISTRATIVE BEHAVIOUR OF THE HEADS	[illegible]
114	MEASURING THE SCOPE OF FORENSIC ACCOUNTING FOR FRAUD DETECTION AND PREVENTION: A CUSTOMER'S PERSPECTIVE	[illegible]

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FINANCIAL SYSTEM AND ECONOMIC DEVELOPMENT

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Abstract
The financial system comprises all financial markets, instruments and institutions. Today would like to address the issue of whether the design of the financial system matters for economic growth. According to cross-country comparisons, individual country studies as well as industry and firm level analyses, a positive link exists between the sophistication of the financial system and economic growth. While some gaps remain, the financial system is vitally linked to economic performance. Nevertheless, economists still hold conflicting views regarding the underlying mechanisms that explain the positive relation between the degree of development of the financial system and economic development.

Introduction
The euro area money market is among the most integrated parts of the financial system. The conduct of one common monetary policy in the euro area brought about immediate integration of the unsecured segments of the money market, mainly the interbank market and the short-term derivatives market. The secured segments of the money market, that is the repo market and the markets for short-term securities, are also increasingly integrated, but they still suffer from underlying problems with the management of collateral. Nonetheless, the outlook is promising. The euro area bond market has also developed rapidly. Notably, the private segments of the euro area bond market have flourished since the introduction of the euro.
The launch of the euro on 1 January 1999 was a historic event. Eleven national currencies were converted into one single currency overnight. Greece became the twelfth EU Member State to adopt the single currency on 1 January 2001. The newly created currency area of the twelve participating European Union Member States has a considerable weight in the world economy. It accounts for around 20% of world GDP and world exports. The successful launch of the euro, which is a key element in the creation of a stable and prosperous Europe, has boosted the integration of financial markets in the euro area. This process of integration in European financial markets coincided with the trends towards globalisation and securitisation.
Another essential European initiative was the adoption by the Commission, in May 1999, of a programme for the completion of the Single Market for financial services. This programme, the Financial Services Action Plan, lists a series of measures with indicative priorities and timetables. The project considered as a whole and its inherent philosophy are capable of enhancing economic growth. In this perspective, a handful of specific initiatives deserve a particular mention. A first initiative is the adoption of the European Company Statutes, which is essential to enhance the level-playing field between European firms and to provide a suitable legal framework for transnational conglomerates. A second important aspect is the Risk Capital Action Plan, which would help redirect financial flows towards fast-growing small and medium-sized enterprises.
The rapid growth achieved by European securities markets has taken place notwithstanding remaining regulatory obstacles to their integration. The European authorities are fully aware of the need to address this problem. Several obstacles have been identified in the recent Report of the Committee of Wise Men.

Objectives:
1. Outline the participants in the financial markets.
2. Describe the share and debt markets, and name their collective name.
3. The instruments of the money and bond markets.
4. Distinguish between fixed-interest and interest-bearing markets.
5. The foreign exchange market.
6. List the derivative instruments and briefly describe them.
7. Elucidate the organization of the financial markets.
8. Describe the primary market issuing methods.

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Methodology:

The Present study is related to Financial Markets for Economic Growth. For the present investigation the literature, book's from different disciplines has been referred.

The Financial System Matter for Economic Growth:

Financial markets instruments and institutions provide opportunities for investors to specialize in particular markets or services, diversify risks, or both. Financial markets play a critical role in the accumulation of capital and the production of goods and services. The price of credit and returns on investment provide signals to producers and consumers—financial market participants. Those signals help direct funds to the consumers, businesses, governments, and investors that would like to borrow money by connecting those who value the funds most highly to willing lenders. In a similar way, the existence of robust financial markets and institutions also facilitates the international flow of funds between countries.

In addition, efficient financial markets and institutions tend to lower search and transactions costs in the economy. By providing a large array of financial products, with varying risk and pricing structures as well as maturity, a well-developed financial system offers products to participants that provide borrowers and lenders with a close match for their needs. Individuals, businesses, and governments in need of funds can easily discover which financial institutions or which financial markets may provide funding and what the cost will be for the borrower. This allows investors to compare the cost of financing to their expected return on investment, thus making the investment choice that best suits their needs. In this way, financial markets direct the allocation of credit throughout the economy—and facilitate the production of goods and services.

The Role of Financial markets For Economic Growth:-

Many of these initiatives may appear to be unimportant and somewhat "esoteric" regulatory changes. However, they can provide a real boost to the smooth operation of markets and, therefore, to economic growth. For example, obstacles to the cross-border use of collateral prevent the further cross-border integration and consolidation of clearing and settlement infrastructures, thus hindering the integration of European money, bond and equity markets. A smooth electronic integration of trading, clearing and settlement operations would help reduce transaction costs substantially.

The approach of focusing on price stability is by now the conventional wisdom in industrialized countries. In the case of Europe, this consensus on the contribution of price stability in the medium term to promoting long-term growth is explicitly enshrined in the Statute of the ESCB, which states unambiguously that "the primary objective of the ESCB shall be to maintain price stability in the medium term." The ECB is convinced that by rigorously fulfilling this mandate, monetary policy is making its most effective contribution to the realization of strong output growth and satisfactory employment prospects.

The best contribution that monetary policy can make to the smooth functioning and integration of European financial markets and to economic growth is to maintain a steady medium-term price stability orientation. Such a policy will be beneficial, as it will minimize the adverse effects of inflation and high inflation uncertainty. As we all know, price stability is beneficial in numerous ways. It not only creates a climate for higher economic activity over the medium term, but also reduces the economic and social inequalities caused by the asymmetric distribution of the costs of inflation among the various economic agents. In addition, in an environment of low inflationary expectations, inflation risk premier become relatively less important as a determinant of financial prices. As a result, other factors such as credit risk can play a larger role in the price formation mechanism. Ultimately, this results in a more efficient allocation of financial resources.

Financial stability and the role of central banks in banking supervision:

One line of argument would support a large role for central banks in supervision, since they have traditionally played a large role in macro-prudential analysis and the preservation of financial stability and therefore have acquired a strong expertise in this field. Furthermore, smooth access of central banks to micro-prudential information would also be profitable from the perspective of another traditional central banking area, namely the oversight of payment systems.

Also the design of prudential regulation plays an important role from a growth perspective. Supervision is the guardian of financial stability, which in turn crucially determines the capability of the financial system to allocate resources efficiently and absorb liquidity shocks. Financial crises can have a deep and protracted