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Financial development as an agent of the human development: An economic perspective and prospects of human excellence

Shumila Cheshti

Research Scholar, Department of Economics, AMU, Uttar Pradesh, India

Abstract

The working of Modern economies depends largely on the finance which is the transfer of the resources from the surplus units to the deficit units. This job in an economy is carried out by its financial system. Financial system consists of the financial markets, financial intermediaries and the financial instruments. Understandably, financial system plays an indispensible role in the growth of economies as far as the growth in terms of the wealth or more specifically the growth of GDP is concerned. The shifting of the countries parameter of betterment from simple growth to the overall development has undoubtedly made the role of financial system more important but at the same time has landed more complexities to it. UNDP defined Human development as the "the process of enlarging people's choices", said choices being allowing them to "lead a long and healthy life, to be educated, to enjoy a decent standard of living", as well as "political freedom, other guaranteed human rights and various ingredients of self-respect". Financial development on the other hand is defined as the development in the size, efficiency and stability of and access to the financial system. The paper examines the relationship between the two and the ways of making it complimentary by analysing the various indices of Human development (as developed by the UNDP) and various indices of the financial development in terms of access, depth, efficiency and stability. It is observed from the study that the financial development is essential and has got a good prospect for ensuring the Human Development.

Keywords: financial development, human development, UNDP, human development indices, financial development index

Introduction

Human being, as the most intelligent race, has always strived for excellence depending upon his judgement about it. Any sort of development, be it of sciences or religion has been the result of this quest. In Economics until recently (1970s), growth of the Gross Domestic Product (GDP), of a country, was seen as the end in this regard. Later, this concept changed to the development i.e. the overall social, political and economic well-being. This led to the vast research for finding its determinants and the practical policy implications. One of the major outcomes in the course has been the development of money and subsequently the development of finance. The role of financial system in the process of growth has been little contentious. Whilst Schumpeter (1911) emphasised its importance in the determination of growth, Economists like Charles Kindleberger (1978) found in a study that too much bubbles are formed in the credit expansion which can then result in the financial crisis or Hyman Minsky (1975) who argued that economic stability can lead to financial instability as financiers take more risk. However, most of the working of economies in present times takes place through financial system.

Financing is simply the transfer of resources from the surplus to the deficit units. It takes place through financial sector. Financial sector consists of the financial markets, financial intermediaries and the financial instruments. Financial markets are markets in which funds are moved from people who have an excess of available funds (and lack of investment opportunities) to people who have investment opportunities (and lack of funds). They also have direct effects on personal wealth, and the behaviours of businesses and consumers. Therefore, they contribute to increase the production and the efficiency in the overall economy. Financial markets (such as bond and stock markets) are markets in which securities are traded. Securities (also called financial instruments) are financial claims on the issuer's future income or assets. They represent financial liabilities for the individual or firm that sells them (borrower or issuer of the financial claim) in return for money and financial assets for the buyer (lender or investor in the financial claim). By definition, therefore, the sum of financial assets in existence will exactly equal the sum of liabilities. Governments and corporations raise funds to finance their activities by issuing debt instruments (bonds) and equity instruments. Bonds are securities that promise to make periodic payments of a sum of money for a specified period of time. Stocks are securities that represent a share of ownership in the firm. Financial intermediaries are economic agents who specialise in the activities of buying and selling (at the same time) financial contracts (loans and deposits) and securities (bonds and stocks). Note that financial securities are easily marketable, while financial contracts cannot be easily sold (marketed). Banks form the largest financial institution in most of the economies. They accept deposits (loans by individuals or firms to banks) and make loans (sums of money lent by banks to individuals or firms): therefore, they borrow deposits from people who have saved and in turn make loans to others. In recent years, other financial intermediaries, such as mutual funds, pension funds, insurance companies and investment banks, have been growing at the expense of banks.