Financial Institutions And Economic Growth

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ABSTRACT

Financial institutions plays an important role in stimulating financial development and thereby the growth of the economy in any country. However the causal effect of these financial institutions can't be generalized as the development of financial institution is quite different in nature and scale in different countries. This paper explores the relationship between financial institutions and economic growth in the Indian economy. We find that insurance institutions do promote the economic growth. We also find that financial development is most potent in delivering extra growth. It is also found that it is growth in the economy that causes development of banking institutions. This paper reviews the economic theory with particular focus on role of financial sector for economic growth.

Keywords: Economic Growth, Financial Institutions, Banks, Insurance, India.

INTRODUCTION

Economic growth implies a long-term rise in per capita national output. Such an increase in output in developed countries has been associated with radical changes in production techniques and organization in the institutional setup. In developing countries like India Industrialization is necessary for the rapid economic growth. The financial liberalization efforts taken by various developing economies had crucial impact on their financial institutions. With the passage of time many of these economies have achieved high rates of economic growth for such growth rates financial sector development played an important role in promoting the growth of the economy to remarkable levels. Financial development means the process of creation and improvement in the financial structure which includes the Interaction of financial institutions, financial markets and financial services. Considering this fact, the present study brings whole and have analyzed how such development is related with economic growth. Development of insurance and banking institutions is one of the crucial elements that plays an important role in stimulating financial development and thereby the growth of the economy.

KEY FINANCIAL INSTITUTIONS IN INDIA

Industrial finance corporation of India [IFCI]

Industrial credit and investment corporation of India [ICICI]

Industrial development bank of India [IDBI]

State financial corporation of India[SFCs]

Unit trust of India [UTI]

life insurance corporation of India [LIC]

Role of Financial institutions

Role as a Financial Intermediary

Role as a Catalytic Agent

Role as a Promoter

Role as a Counselor

Role as a Creator of money

They provide a convenient and effective link between saving and investment. They pool the savings of people with peculiar characteristics and notions about safety,liquidity,return and the safety of the savings. Financial institutions channel the fund mobilized by them to those who required more funds. This is why they known as "gapfillers".They play the role of catalytic agent to bring about economic and social change in a country through dynamism and innovativeness in their operations. Rate of growth of an economy depends upon the speed with which financial institutions respond to the infrastructural demand of the country. They accept public deposits and lending money against it for funding transaction they create further deposits. This role has assumed grater importance in the growth of economy. As a promoter these institutions undertake comprehensive growth potential surveys of the existing industrial structure of the various part of the country which can be established in different regions in near future.

As a friend, philosopher and guide, they consult corporate borrowers regarding selling off assets not needed for the organizational success etc..

DEVELOPMENT IN INSURANCE AND BANKING INSTITUTIONS IN INDIA

The establishment of the Indian financial system evolved as a result of planned economic policy that gave much significance to it. The initiation of this policy led to some important developments in the country that include the establishment of financial institutions crucial for the growth of the country as well as nationalization of important institutions including State Bank of India in 1955, Life Insurance Corporation of India (LICI) in 1956, Insurance companies represent such financial institutions as are concerned with pooling savings of the people and investing them in productive outlets. They pool savings through premiums by providing life cover protection.

And General Insurance Corporation (GIC) in 1972. The Indian financial system experienced a completely regulated regime dominated by public sector banks and state regulated insurance companies till 1990. However the state ownership and control continuously repressed the financial system and seriously harmed it. The introduction of New Economic Policy in 1991 gave special attention to financial reforms on account of deterioration of financial health, autonomy, soundness and resonance of the financial sector. This policy led to the introduction of reforms especially in banking and insurance sector through liberalization, privatization and globalization. As a result, in the banking sector, private and foreign banks were allowed to set up and operate banking business in India along with other major reforms that include deregulation of interest rates, reduction of cash reserve.

CONCLUSION

This paper reviewed the role as well as the relationship between the financial institutions, which is represented by the banking, and insurance institutions and economic growth. In the study I find that there is long run relationship between financial institutions and economic growth in India. It is also witnessed that there exists a bi-directional causal relationship between development of insurance institutions and economic growth in the short run. This bi-directional relationship is probably due to the role played by the insurance institutions in Indian economy. Insurance companies channelize the savings for longer period of time and make it available for long-term investment in the market that promotes the growth of the economy. With this, the level of development of the economy helps to improve the level of economic activity along with generating demand in the market which pushes the penetration of insurance market that ultimately helps in their institutional development. As the study finds that insurance institutional development also leads economic growth, the government and policy makers should therefore make concrete strategies to enhance insurance institutional development in order to encourage economic growth in India.

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