 DOI: https://doij.org/10.10000/IJLSI.111864

INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

Volume 6 | Issue 2

2024

Investment in Growth: The Symbiotic Relationship between Securities Market and Economic Advancements

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ABSTRACT

Several factors including legal, regulatory, and macroeconomic considerations, as well as market efficiency, have an impact on the trading liquidity of stock markets. Increasing liquidity, access to finance, and stability are all benefits that result from incorporating developing nations into the global financial system. As a result of the correlation between the development of the stock market and continuous economic growth, regulations that are designed to encourage efficient markets must be maintained. Fair policies that are supportive of small businesses are required in India to maximise the role that the stock market plays in economic progress.

SMEs and investors alike. Streamlining procedures allowing small and medium-sized enterprises (SMEs) to get access to financial markets has the potential to increase economic activity. India has the potential to harness its stock market for the purpose of generating wealth and achieving sustainable development if it cultivates an environment that is investor friendly.

***Keywords**: Regulatory, macroeconomics, liquidity, stock market.*

I. INTRODUCTION

The stock market, as a key economic pillar, has a significant impact on the development of business and industry, which has a significant impact on the overall health of the nation's economy,[2] the stock market is a critical cog in the wheel of the economy that facilitates the transfer of funds for economic growth.[3] The stock market enables governments and industry to raise long-term capital for financing new projects, and expanding and modernizing industrial concerns.

The relationship between securities market and economic advancements has been the point of interest among the academicians and scholars. Though the securities market is a very small

[1] Author is a student at Jindal Global Law School, India.
2 (Goel, 2023)
3 Agrawalla, R. K., & Tuteja, S. K. (2007)

percentage of a nation's national economy, but the securities market is a good indicator to understand the sentiments of the investors in relation to the growth of a nation. It is acknowledged that Securities Market may be booming but the economy of the nation might be stagnant as happened in the case of the Covid, a lot of investors came to the stock market while the economy of the nation was standstill, but the stock of the company was rising post covid. The covid period offers the small sample of the broader picture of the mutual effect of the securities market and the economy of a nation.

Post economic liberalization India has opened its borders for foreign investors, one of the effects of liberalization has been on the securities market as well as the companies have more capital to diversify their businesses and expand. The securities market offers a place for the companies to raise the capital the capital raised indirectly helps in the economy of the nation. An important study by Ross Levine and Sara Zervos (1996) finds that the stock market development is highly significant statistically in forecasting future growth of per capita GDP.[4]

the paper explores the inter-relationship of Economic advancements and securities market. The paper is divided in three chapters. The first chapters deal with the definition and characteristics of economic advancement and its characters, the chapter two deals with securities market and chapter 3 deals with the analysis of their relationship, the chapter 3 heavily draws from the emphicial studies conducted by researchers and scholars over a period.

(A) Research Objective

The research objective of this study is to explore and analyse the interdependent connection between securities markets and economic progress. The study aims to analyse the reciprocal influence of developments in securities markets on economic growth, while also identifying the primary factors, trends, and mechanisms that drive this relationship.

(B) Research Question

i. What studies have been conducted to understand the relationship of securities and economy?

ii. What is economy advancement and its characteristics?

iii. How policies changes, rule, and regulations in the securities effect the economy?

iv. How the relationship can be improved?

4 G. N. Bajpai's remarks delivered on March 13, 2003, before SEBI in Mumbai.

(C) Research Methodology

Doctrinal method of research is followed for writing this paper, the author has relied on several articles, websites, and international organization reports.

(D) Literature Review

DOES the stock market play a positive role in the process of economic growth? This remains matter for debate. One line of research says it does: another line regards the role as negligible or even negative.[5] From the World Bank and the International Monetary Fund to individual researchers, several studies have shown a strong correlation between the growth of the economy and the improvement of the securities market. The stock market's performance is statistically very significant in predicting the expansion of GDP per capita in the future, according to landmark research by Ross Levine and Sara Zervos (1996).[6]

The stock market's role in economic growth can be enhanced only if there is a large and active individual investor base.[7]

Several research papers support this notion by analysing various economic, social, political, and policy factors that could influence economic growth. Despite controlling for these factors, the link between stock market liquidity and economic growth remains robust. Additionally, using different estimation techniques, periods, and country samples consistently demonstrates the significant role of stock market development in explaining future economic growth. Empirical studies have provided robust evidence supporting the positive relationship between investment and economic growth across various countries and regions. For instance, research by Barro and Sala-i-Martin (1992) suggests that increases in investment levels have a significant and positive impact on per capita GDP growth rates over the long term. Similarly, studies by Borensztein et al. (1998) and De Long and Summers (1991) emphasize the pivotal role of investment in fostering economic convergence and reducing income disparities among nations. (Srinivasan, P., & Prakasam, K. 2014.) inferred that the stock market development indicators viz. market capitalisation and turnover ratio have a positive influence on economic growth in India[8]

II. DEFINING ECONOMIC ADVANCEMENTS

The economy is the system that regulates the distribution of resources via the interplay between

5 (Nagaishi 1999)
6. G. N. Bajpai's remarks delivered on March 13, 2003, before SEBI in Mumbai.
7 Supra 4
8 Srinivasan, P., & Prakasam, K. (2014.)

 [ISSN 2581-9453]

production and consumption. Making products and providing services is all about satisfying customer needs. Our economic system is this, in a nutshell.[9].

The transformation of developing economies into developed ones is known as economic development. The transformation of low-income nations into high-income ones, in other words. Improving the general population's health, well-being, and academic level is another aspect of economic growth.[10]

(A) Characteristics of Economic Development

Gross Domestic Product[11]: A rising GDP signals economic expansion. When GDP grows (especially without inflation), workers and businesses tend to fare better.It reflects increased production, higher incomes, and greater economic activity. Economists, businesses, and policymakers use GDP to gauge an economy’s health and overall performance.

Economic diversity refers to the extent to which a region or economy engages in a wide range of economic activities. A region with high economic diversity utilizes various industries and sectors to drive its economic growth and development. For instance, if a region heavily relies on a single industry, such as oil production, it is considered economically undiverse. Conversely, a region that features a vibrant mix of industries, such as manufacturing, personal services, and oil production, is deemed more economically diverse.[12]

Liberalisation: Policies promoting openness to trade and investment are vital for sustained economic growth, as evidenced by global trends. No country has achieved significant economic success in recent decades without embracing globalization and opening its economy to the world. Trade liberalization, coupled with foreign direct investment (FDI), has been a key driver of East Asia's economic prosperity, exemplified by the significant reduction in average import tariffs from 30 percent to 10 percent over the past two decades. Outward-oriented countries consistently experience faster growth rates compared to inward-looking ones, with the benefits of trade liberalization outweighing the costs by more than a factor of 10. Recent examples, such as India, Vietnam, and Uganda, illustrate how countries that have opened their economies have witnessed accelerated growth and poverty reduction. Developing countries that sharply lowered tariffs in the 1980s outpaced those that did not in terms of growth during the 1990s.[12]

III. SECURITIES MARKET

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9 Supra 2
10 Singer, M. (2024, February 7).
11 (Gross Domestic Product: An Economy’s All, 2019) [12] Chmura Staff, 2022
12 IMF Staff, *Global Trade Liberalization, and the Developing Countries*

India's securities market has a long history, when the Bombay Stock Exchange (BSE) was established in 1875, making it one of Asia's oldest stock exchanges. Securities is a way of channelling funds from the investor (small and big) to the company. The stock market provides a platform for trading in securities. In the past, there were several stock exchanges in India dealing in varieties of securities, but many of them ceased to operate after following the "exit policy" of the SEBI, currently, officially there are in total 6 stock exchanges while "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) are two national stock exchanges of India. Each has fully electronic trading platform with around 10,000 participating broking outfits."[13] and most of the volume of trade in securities dealing in India is through these platforms.

With the advancement of the internet and digitalization of the trading, there has been increase in the number of investors from the public in the stock market. Stock Market has become an alternative investment option which if done rightly offer greater returns than other form of trading.

The securities market enables individuals with limited resources to invest in activities beyond their individual capacity. Rather than undertaking an entire venture on their own, individuals can invest whatever amount they can afford and prefer in enterprises operating in various activities. For example, someone may not have the means to start or manage a business independently but can still participate in the growth and success of enterprises by purchasing securities such as stocks or bonds. By investing in these securities, individuals become stakeholders in the enterprises, sharing in their profits and losses based on their investment. This democratization of investment opportunities allows individuals, regardless of their financial means, to participate in economic activities, foster entrepreneurship, and potentially earn returns on their investments. Thus, the securities market serves as a platform for individuals to channel their savings into productive investments and contribute to the overall growth and development of the economy.[14]

The securities market fosters economic growth to the extent that it[16]-

(a) raises real savings and capital formation from any given level of national income,

(b) boosts net capital inflow from outside, the securities market promotes economic

13 (Keshav, Evolution of Securities and Investment Law in India and Concept of Securities and Kinds of Securities, 2019, p. 1.3)

14 Extract of speech given by Chairperson of SEBI Mr.G. N. Bajpai at SEBI at Mumbai on March 13, 2003.

16 Supra11

growth.

(c) improves investment productivity by allocating funds more effectively, and

(d) lowers capital costs.

IV. ANALYSIS

The securities market facilitates economic globalization by connecting economies worldwide. Through this connection, capital enters economies as portfolio investments, driving growth. This influx of capital fuels innovation and expansion, benefiting businesses. By participating in the securities market, economies integrate into the global financial system, attracting diverse investors. Ultimately, the securities market plays a vital role in fostering cross-border collaboration and contributing to global economic prosperity.

On the other hand, there is a lot of data to back up the idea that more stock market liquidity leads to faster economic development. How can this be? Let's look at three indices of market liquidity, or the ease with which stocks may be bought and sold.

The liquidity of a country's stock market is a crucial determinant of its efficiency and attractiveness to investors. One commonly used measure to assess stock market liquidity is the total value of shares traded on the country's stock exchanges relative to its GDP. This ratio indirectly reflects the ease of trading securities within the market.

The value of equity transactions as a share of national output can vary significantly based on the costs and risks associated with buying and selling securities. Generally, if trading securities is expensive or risky, there will be less trading activity in the market over time. Therefore, this ratio provides valuable insights into the liquidity dynamics of different countries' stock markets.

To understand the liquidity landscape across countries, Levine, R. (1997). categorizes 38 countries into four groups based on their value-traded-to GDP ratios. The nine countries with the lowest liquidity, indicating the most illiquid markets, are placed in the first group. Conversely, the nine countries with the highest liquidity, reflecting the most liquid markets, are placed in the fourth group. The remaining countries are divided into the second and third groups, each comprising ten countries, which represent varying degrees of liquidity falling between the extremes.

Countries with more active stock markets in 1976 saw their economies expand at a much quicker pace than those with less active markets in the 18 years that followed, as shown in Chart 1. Liquidity in the stock market seems to be strongly correlated with the possibility of economic development.

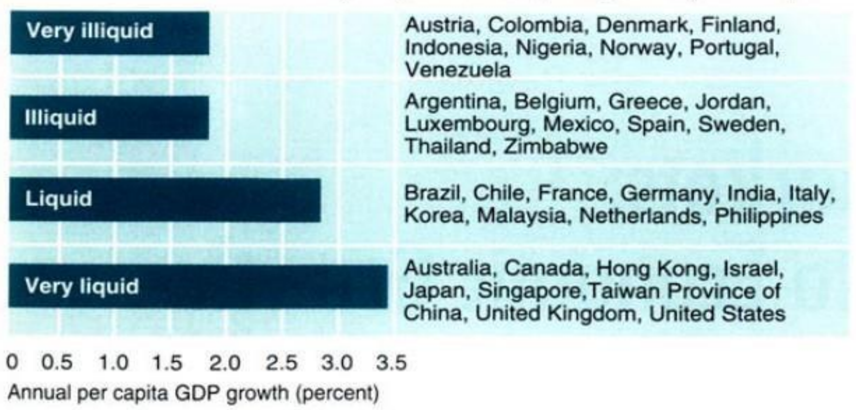
The rationale behind this correlation lies in the role of liquid stock markets in facilitating capital allocation, investment, and risk management. Liquid markets provide investors with the ability to buy and sell securities quickly and at minimal cost, thereby enhancing market efficiency and fostering investor confidence. In contrast, illiquid markets may deter investors due to higher transaction costs and greater uncertainty regarding the execution of trades.

Countries with liquid stock markets tend to attract more investment capital, both domestic and foreign, which can stimulate economic growth through increased funding for businesses, innovation, and infrastructure development. Moreover, liquid markets are often associated with greater market depth, breadth, and transparency, which further contribute to economic dynamism and resilience.

the liquidity of a country's stock market plays a vital role in shaping its economic trajectory. By providing a conducive environment for investment and capital formation, liquid stock markets can serve as catalysts for sustainable economic growth and development. Therefore, policymakers and market participants alike should prioritize efforts to enhance market liquidity and promote a vibrant and robust financial ecosystem.

Chart 1

Initial value-traded ratio (1976) and subsequent growth (1976–93)



Source: International Finance Corporation.

Note: Initial liquidity is measured as the ratio, in 1976, of the value of shares traded to GDP.

The market capitalization, which represents the total value of stocks listed on the exchange, serves as the second measure of liquidity in assessing the vibrancy of a stock market. The turnover ratio, derived from market capitalization, measures the level of trading activity relative to the overall size of the stock market.

Chart 2 illustrates those countries with higher turnover ratios, indicating greater trading activity relative to the size of the stock market, tended to experience faster economic growth. Specifically, the analysis reveals that countries with more liquid markets in 1976 demonstrated accelerated growth rates between 1976 and 1993.[15]

The correlation between turnover ratio and economic growth underscores the importance of liquidity in driving market dynamism and fostering economic development. A higher turnover ratio suggests increased investor participation and trading activity within the stock market, reflecting a deeper level of liquidity and market efficiency.

Countries with more liquid markets often attract greater investor interest and capital inflows, fuelling investment opportunities and capital formation. The heightened trading activity not only enhances market liquidity but also contributes to price discovery, market transparency, and overall market functioning.

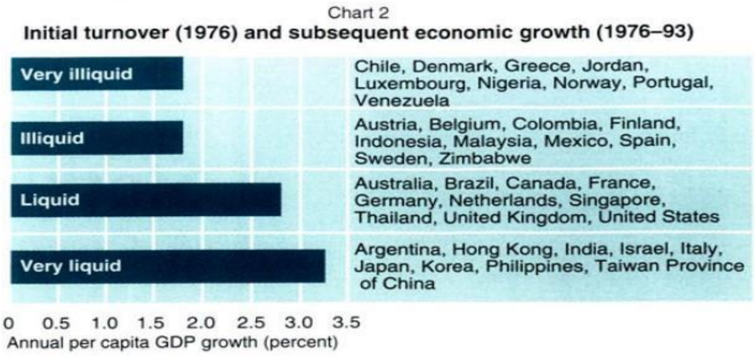
The positive relationship between liquidity and economic growth can be attributed to several factors. Liquid markets provide investors with greater flexibility in buying and selling securities, reducing transaction costs, and improving market accessibility. Moreover, liquid markets are conducive to capital allocation, enabling efficient resource allocation and investment deployment across various sectors of the economy.[16] It is permitted to argue that because the stock markets respond aggressively and fast to events that may not have much long-term relevance, they may not always adequately reflect the status of the economy. Traders and investors often accuse the markets of "overreacting" or "not properly accounting for a particular move."[17]

Furthermore, liquid markets facilitate risk management and portfolio diversification for investors, fostering confidence and stability within the financial system. The ability to swiftly execute trades and access market information empowers investors to make informed decisions, thereby enhancing market liquidity and promoting market integrity. It is indisputable that markets and the economy tend to trend in the same general direction over time. Nonetheless, the financial markets frequently respond to news stories and policy announcements that may not have any influence on a country's macroeconomic fundamentals in an extreme manner (on either side)[18]

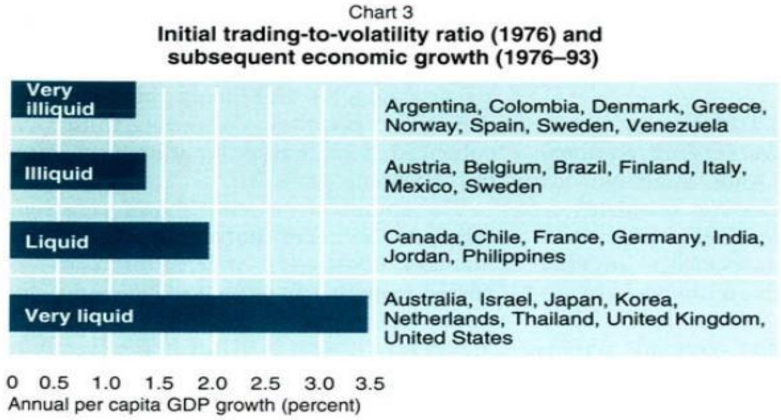
liquidity derived from market capitalization, plays a significant role in driving economic growth and prosperity. Countries with more liquid markets tend to experience accelerated economic expansion, driven by increased investor participation, capital formation, and market efficiency. As such, policymakers and market participants should prioritize efforts to enhance

15 Levine, R. (1997).
16 Levine, R. (1997).
17 (Goel, 2023)
18 (Goel, 2023)

market liquidity, promote investor confidence, and foster a vibrant and resilient financial ecosystem conducive to sustainable economic development.



Source: International Finance Corporation.
Note: Initial turnover is measured as the ratio, in 1976, of the value of shares traded to market capitalization.



The third measure of liquidity considers the value-traded ratio relative to stock price volatility. In simple terms, this measure assesses how effectively a market can handle significant trading volumes without causing large fluctuations in stock prices. Chart 3 visually represents this relationship.[19]

Countries with more liquid stock markets in 1976, characterized by higher trading-to-volatility ratios, tended to experience faster economic growth over the subsequent 18 years compared to countries with less liquid markets. This correlation highlights the importance of market liquidity in driving economic expansion.[20]

In essence, the findings suggest that a well-functioning and liquid stock market is closely associated with economic prosperity. When investors can easily buy and sell securities without causing drastic price fluctuations, it fosters market stability and investor confidence. This, in turn, encourages investment, capital formation, and overall economic growth.

The strong relationship between stock market liquidity and economic growth underscores the

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19 Levine, R. (1997).
20 Levine, R. (1997)

importance of fostering vibrant and efficient financial markets. Policymakers and market participants should prioritize efforts to enhance market liquidity, improve market infrastructure, and implement investor-friendly regulations. By doing so, they can create an environment conducive to sustainable economic development and prosperity for all.[21]

V. Conclusion

The liquidity of the stock market is affected by systems that are related to law, regulation, accounting, taxes, and supervision. Investors' comfort and convenience while buying and selling shares is directly correlated to the efficacy of trading systems. Additionally, market liquidity is impacted by political and economic climates. The easiness of trading shares is more important for growth than the size or volatility of the stock market.[22]

Integrating emerging markets into the global capital markets aligns domestic securities prices with those in other parts of the world. Essentially, when emerging markets become more connected to global financial systems, the prices of their securities tend to reflect broader market trends and investor sentiment observed internationally. This integration allows investors to trade securities more efficiently across borders and facilitates a more transparent and interconnected global financial landscape. As a result, emerging markets can benefit from increased liquidity, improved access to capital, and greater stability, while investors gain opportunities for diversification and portfolio growth on a global scale[23].

Because improved stock markets lead to more robust economies over time, it is prudent to adopt long-term strategies that foster well-developed stock markets in India.[24]

Improving the stock market's ability to support small and medium-sized businesses (SMEs) and individual investors is crucial for India's long-term economic development. It is critical to establish rules that are kind to these groups, if not supportive of them. An important factor in maintaining market stability and liquidity is the participation of small home investors, who constitute a significant portion of the market. By providing them with clear and equitable rules, we can boost market efficiency and increase their trust in the stock market.

Moreover, SMEs constitute the backbone of India's economy, driving innovation, employment, and economic growth. Streamlining regulations to facilitate SMEs' access to capital markets can unlock their growth potential and stimulate economic activity. Simplified listing requirements, reduced compliance burdens, and enhanced investor protection mechanisms can

21 Levine, R. (1997).
22 supra
23 Levine, R. (1997)
24 Agrawalla, R. K., & Tuteja, S. K. (2007.

 [ISSN 2581-9453]

encourage SMEs to tap into the capital market for financing and expansion.

By fostering an investor-friendly environment and promoting SME participation, India can harness the full potential of its stock market as a catalyst for sustainable economic development, job creation, and wealth generation for all stakeholders.

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