A n expert committee on infrastructure finance that I chaired recently looked at India’s infrastructure requirements and the financing and debt needed to meet them. The committee concluded, first of all, that the public sector would have to continue investing at roughly the same proportion of GDP, which means an annual increase of 6% to 7% if the economy is growing at 6% to 7%. On top of this, private sector investment in infrastructure would have to increase substantially. None of that would happen in either the public sector or the private sector unless India could develop a major debt market.

If such a market does emerge, then the subcontinent, and India in particular because of its size, could have a huge bond market in the next 5, 15, or 30 years. In 1991 India had 23 cities with a population of over 1 million and about 300 cities with over 100,000. The number of issuers of bonds could be huge if each of these cities, and also each state in India, were to issue bonds. The issuers would come from bodies such as urban development authorities, special purpose vehicles, and public-private partnerships that would develop the infrastructure needed. In other words, if the bond market develops, there will be no shortage of issuers, but rather hundreds of them.

On the supply side, the National Council of Applied Economic Research has been studying the consumer behavior of more than 300,000 households across India since 1985, in both rural and urban
areas. In its survey, the council is examining what people are buying to get an idea of how the markets are developing, and, secondarily, how household incomes in India have changed in the last 13–14 years. On the basis of these changes from low to middle and higher incomes, the council can predict with some confidence what will happen over the next 10 years.

One dramatic finding so far, which presumably can be applied to other countries in the region, concerns the number of households in the low income category. The Council roughly defines the low income level as the income level below which people do not buy much beyond their essential food and subsistence requirements. As of 1995, the approximate proportion of families in India in this low-income category was 50%. With 6% to 6.5% growth in the next 10 years, that proportion is projected to fall to about 15%.

The importance of this finding in the context of debt market development is that in the early to mid-1990s only half of the Indian population had savings, particularly financial savings, of any kind. As that proportion goes up to, say, 85%, financial savings will see an enormous increase. In 1995, at the high income level group which has the highest savings rates, comprised about 5% of total households. Within 10 years, this proportion could increase to about 15%. If all these predictions are correct, then the overall savings rate in India would go up from about 25% to 35% over the next 10 years, with similar changes across the region. All these savings require investment instruments because the savings will not go up unless such instruments are available. This is where the bond market comes in: all these developments—economic growth, infrastructure investment, increased savings rates—will not happen without the market infrastructure and avenues by which people can invest. In turn, this is where pension funds, mutual funds, insurance funds, and investment banks come in.

For a country at India’s stage of transition, “safe” debt instruments are far more important than in developed countries. As families begin to move into the savings mode, they must not suffer big losses as a result of unsafe debt instruments; if they do, they will withdraw from the market. This is what happened in the Indian equities market in 1993–94: as new investors got burned, they withdrew. The same could easily happen in the bond market. Therefore
it is very important to make these instruments safe for the investor, by enhancing the credit quality of the issuers. This will require a lot of work in terms of improving the accounts and increasing the information of municipal bodies, state government, parastatals, and private sector issuers.