

## **Njuguna Ndung'u: FIRST in development**

Address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the FIRST Consultative Group Meeting, Nairobi, 24 November 2008.

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Chair, Governing Council of the FIRST Initiative;  
Distinguished members of the Council here present;  
Management and staff of the FIRST Initiative Program Management Unit;  
Distinguished guests;  
Meeting participants;  
Ladies and Gentlemen:

I am pleased to be here this morning at the opening of the FIRST Initiative Consultative Group meeting. My thanks go to the Governing Council and the Program Manager for the kind invitation. Allow me also to thank FIRST Initiative for choosing to host both the Governing and Consultative Group meetings in Nairobi famed as “the Green City in the Sun”. I would also wish to welcome you all to Nairobi and hope that you will extend your stay to enjoy the varied and scenic delights that Kenya offers.

**Ladies and Gentlemen:** This is indeed a “watershed” meeting that comes after the completion of the first four year mandate of FIRST Initiative. I am informed that FIRST Initiative began its operations in 2002 with a five year mandate that was successfully completed in 2007. The mandate was to provide Technical Assistance to support growth and poverty reduction in low and middle income countries by promoting a financial sector that was stable, deep and diversified. This is indeed a noble objective and it is therefore gratifying to note that FIRST will now enter a second phase of operations to run to the end of 2012.

### **Role and significance of FIRST in development**

FIRST mission to deliver flexible, top-quality technical assistance related to financial sector is welcomed in the region where the role of the financial sector is recognized as an engine for development. Most of you in this room can remember vividly the days of financial repression when government legal restrictions prevented financial intermediaries in the economy from functioning at their full capacity. The regulations generally included interest rate ceilings, compulsory credit allocation, and high reserve requirements. The development philosophy has shifted away from direction and control. Governments of developing countries have now realized the great potential of the financial sector in fostering development. The formation of FIRST as an institution was to help developing countries tap the potential support to the development of the financial sector.

The fact that FIRST initiatives always come in after Financial Sector Assessment Program (FSAP) and other assessment have been undertaken by the IMF and the World Bank signals to governments of developing countries that our partners not only perform a “health check” of our financial system but they also offer “health solutions” after a prognosis has been identified.

Many of the projects financed by FIRST initiative have helped countries tighten their adherence to international standards and codes for the financial sector. In doing so, I believe in the assertions that FIRST has helped developing countries achieve part of their development goals of building an efficient, inclusive and transparent financial system. The fact that FIRST works closely with the recipient institutions to prioritize technical assistance activities that are consistent with the recipient country plans is a great plus. It re-defines development partnership of donors and recipient countries.

I note with great pleasure FIRST model of doing business. It encourages recipient governments to identify their financial sector problems, prioritizes them, and then supports viable solutions. It also pools the efforts of several development agencies, leveraging their expertise and reducing duplication. Often, FIRST takes on targeted projects and once completed, FIRST disseminates the results to boost their impact and catalyze long-term support from both development partners and recipient governments.

In Kenya the Vision 2030 has identified that the problems of high interest rate spreads and limited access. The focus then is how to reduce these spreads, raise access and deepen the financial sector. The level of solutions require policy reforms that alleviate market, institutional and political barriers to competition. The Vision 2030 has identified areas in which policy reforms can have a major impact in reducing such barriers and thus increasing the effectiveness and competitiveness of financial intermediation.

Here in Kenya, I would like to acknowledge an initiative such as FinAccess initiated and partly funded by FIRST which has given us the survey information which has become an integral part of financial market processes and analyses. The results have helped us understand some of the issues in the financial sector and have provided us a better understanding on how to develop the sector. There is an increasing body of evidence to support the view that financial sector development contributes to both economic growth and poverty reduction by affording people greater access to finance.

## **Going forward**

Going forward, I have noted with satisfaction that FIRST will seek to strengthen the causal links between its technical assistance and the contributions of deep, orderly financial systems to economic growth, poverty reduction, and social equity. FIRST will do this by increasing its emphasis on achieving market development outcomes, and filling gaps in domestic financial markets. It will also continue to give priority to supporting governments in lower-income countries in developing action plans geared toward these outcomes.

Such a move is welcomed in the region where there has been a very strong upward trend in diversification of economic activities among rural households over the decade. One robust finding of the rural panel analysis is the importance of access to credit as a correlate of escaping from poverty. In Kenya for example, most (70 percent of) Kenyans do not have access to any form of credit. For those who do access loans, there is significant disparity in average amounts – with non-poor households borrowing 42 percent above the average amount, and poor households 77 percent below; the advantage for urban households is even larger, whereas female headed are way below average (World Bank 2008). The question is whether we have adequate financial vehicles for each of these diverse house-holds.

Financial stability and development are a crucial prerequisite and a facilitator of reforms in other sectors, including private sector development, infrastructure, housing, and social policies. Financial sector development is vitally linked to growth and poverty reduction. Well-functioning financial systems channel funds to productive uses essential for a country's transformation.

## **Financial services**

In Kenya, we have identified that a well-functioning financial system is critical to accelerating economic growth. That is, a vibrant and globally competitive financial sector will drive high levels of savings and finance Kenya's investment need.

According to the Financial Access Survey 2007, by FSD Kenya, the banking sector serves only 19 per cent of Kenya's bankable population with 8 per cent being served by other financial services providers such as MFIs and SACCOs. 38 per cent are totally excluded and 35 per cent rely on informal financial services providers. The evidence is also that access to

financial services outside the main cities still remains limited. The introduction of MFI's, the SACCO's and CRBs will produce the best financial infrastructure to reach all segments of the economy and information flow to help them function properly.

For Kenya to achieve its aspirations of Vision 2030, the levels of investment will require a continuous increase in the level of national savings to sustain economic growth. In this regard, financial sector reform measures will be implemented and more savings products developed to support the requisite national savings.

To do so I intend to suggest areas where support of FIRST initiative will be most welcomed in Kenya's case, but also applies to most countries in SSA:

- **Enhance the role of the Government in the financial sector** to provide a legal, regulatory, and supervisory framework that promotes soundness and competition in the sector. More support for the review, amendment and drafting of financial sector laws and regulations that govern all the regulators with the objective of strengthening their effectiveness.
- **Reduce the existing deficiencies in the clearing and settlement mechanisms in national payment systems.** The modernization of the national payment system has included, among other things, the introduction of Real Time Gross Settlement (RTGS) and the Kenya Electronic Payments and Settlement System (KEPSS) to all participants. But now require enhancement to ensure overall adoption.
- **Increasing access to credit.** The major impediments to growth in developing countries especially in SSA is the insufficient access to credit for large segments of the population and enterprises, especially micro, small and medium sized ones. Areas which FIRST can support include: improvements in the operation of the government registries including: assistance to the Companies Register to enable the Registry clear the backlog in filing and allow for speedy and accurate information sharing of corporate information and data; improvements in the land registration system through digitizing land records; establishment of a legal and regulatory framework for the operation of a credit reference bureau that would facilitate the much needed information flow among the credit granting institutions.
- **Improve the financial legal environment.** The legal system in the region currently faces major challenges in supporting effective financial intermediation. Furthermore, the drafting, implementation and application of the legislative and regulatory reforms, require strong capacity in the judiciary and in the legislative and executive offices charged with legislative drafting and law revision.
- **Clear and effective laws backed by a strong and credible judiciary** are an essential element in creating an environment that is conducive to business and financial activity. Enforcement of contracts in the financial sector is a major signaling mechanism that helps the financial sector development and innovation intermediation.
- Develop a financial sector that reflect the economic structures of the country and avoid temptations of one size fits all. Most SSA are characterized by formal and informal finance. The process of formalization requires understanding of the economic structures.

## Conclusion

In conclusion, I realize that the issues for discussion during this meeting are vital to the financial sector at this crucial time when the world is seeking solutions to the global financial crisis; the Central Bank of Kenya and the Ministry of Finance are interested and also party to the issues being discussed here. The financial sector reform agenda is now even more

urgent in the wake of the ongoing global financial crisis. I am informed that you spent a good part of yesterday discussing the crisis and I am sure that you came up with useful proposals that you will be sharing. It is inevitable that there will be fundamental changes to the global financial architecture and institutions that govern it. This will pose a greater challenge to developing countries that are already resource constrained and yet need to quickly embrace these changes. Again, partners such as FIRST Initiative will be called upon to quickly deploy technical assistance to client countries.

Targeted technical assistance in the financial sector will support governments' effort to deepen a market based economy which contributes to a sustainable fiscal position and improved allocation of resources. Broad-based financial and legal sector reforms will directly contribute to improving equity and reducing poverty through expanding access to financial services. Poverty is sustained by exclusion in the market. The poor benefit from financial services by providing a safe haven for their savings. The route to savings together with investment opportunities that promise returns is the road to enhance poverty reduction. These objectives will be achieved through provision of technical expertise and building capacity to implement our countries' financial sector and legal sector reforms whenever required.

I therefore look forward to the output of today's discussions that should enable FIRST to meet and exceed the monumental expectations from client countries in its second phase of operations.

On that note, it is my honour and pleasure to declare the FIRST Consultative Group Meeting officially open and to wish you fruitful deliberations.

**Thank you.**