# ZAMBIA ECONOMIC BRIEF


## FINANCIAL SERVICES: REACHING EVERY ZAMBIAN

WORLD BANK GROUP

DECEMBER 2014

ISSUE 4

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1818 H Street NW
Washington, DC 20433
USA



This report was prepared by the staff of the Macroeconomic and Fiscal Management and Finance and Markets Global Practices of the World Bank. The findings, interpretations, and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the World Bank's Board of Executive Directors or the countries they represent.

The report was designed, edited, and typeset by Communications Development Incorporated, Washington, DC.

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Photos: Hellen Mungaila and Kelvin Ng'andu

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# Foreword

I am pleased to share the fourth *Zambia Economic Brief* with a focus section on financial inclusion. This Brief is part of a series of short economic updates produced twice a year by the World Bank. Each Brief includes two sections: the Bank's assessment of recent economic developments and outlook in the short to medium term, and its analysis on a specific development topic or theme. The previous three Briefs covered opportunities for human development, jobs, and trade.

Zambia is on a trend of strong growth, but challenges remain in securing macroeconomic stability and making growth inclusive. Until very recently, the government appeared to have gotten better control of the country's fiscal situation. The political transition following President Sata's death will likely play an important role in how Zambia fares on macroeconomic stability and continued growth.

The government has been acting to make growth more inclusive, such as by expanding social cash transfers. With growing empirical evidence finding that financial inclusion is important for economic development and poverty reduction, it has rightly committed to greater financial inclusion for individuals. And there is considerable room for improvement—Zambia ranks below its economic and geographic peers on most indicators of financial inclusion.

This Brief focuses on mobile e-payments and agency banking as modes for expanding financial inclusion. They are well suited to Zambia, where costs of formal banking services are high due to its low population density and the small size of its banking sector. Evidence is mounting that basic payment services can be the first step into the financial system and can open access to other financial services such as savings and loans.

The take-up of mobile e-payments has been limited so far, compared with several other African countries. And providers have yet to achieve scale. But Zambia could be poised for growth in e-payments if service providers, regulators, and policymakers jointly ensure that a viable e-money ecosystem is developed. Channeling government payments through the mobile system could provide volume and scale, particularly in rural areas.

We hope that the findings of this Brief will generate a healthy debate in the country around policies and interventions on financial inclusion for individuals in Zambia. The next Brief, to be produced in 2015, will focus on mining.

Kundhavi Kadiresan
Country Director for Zambia
The World Bank

# Acknowledgments

The fourth Zambia Economic Brief has been prepared jointly by the Macroeconomic and Fiscal Management and Finance and Markets Global Practices of the World Bank. The team was led by Praveen Kumar and included Gunhild Berg, Francesca de Nicola, Asumani Guloba, Gerard Kambou, Uzma Khalil, Loretta Michaels, Philip Schuler, and Dorothe Singer. Useful comments were received from Nalini Kumar and Robin Mearns. Peer reviewers were Leora Klapper and Samuel Maimbo. Hellen Mungaila provided administrative support. Kundhavi Kadiresan, Country Director, Zambia, and Sudarshan Gooptu, Practice Manager, GMFDR, provided overall guidance and advice.

The report was edited and laid out by a team at Communications Development Incorporated, led by Bruce Ross-Larson.

# Executive summary

**In 2014 the final overall deficit is expected to be lower than the 5.7 percent of GDP originally budgeted, reflecting spending cuts and higher than budgeted revenues**

## Recent economic developments and outlook

### Developments in 2014

Zambia's economy is estimated to grow around 6.0 percent in 2014, slower than the 6.7 percent in the previous two years. Growth comes from a bumper maize harvest; rapid expansion in the construction industry—supported in part by public investment in roads; and continued strong growth in services. Following the large fiscal deficit of 6.6 percent in 2013, the economy experienced turbulence during the first half of the year when the kwacha depreciated sharply against the U.S. dollar and other currencies, and inflation pressure increased. However, in response to policy actions, the kwacha stabilized subsequently and regained about half of the lost value, and inflation pressure also ebbed. Average inflation in 2014 is expected to be around 7.8 percent, higher than the targeted 6.5 percent and the 2013 average of 7.0 percent.

The government reasserted control over budget execution during 2014 and the final overall deficit is expected to be lower than the 5.7 percent of gross domestic product (GDP) originally budgeted. This reflects spending cuts and higher than budgeted revenues. Spending cuts have not been uniform, nor have they been made in the most desirable areas. The capital budget suffered the most, falling below budget by around 20 percent, thus undermining efforts to address critical infrastructure constraints. Spending on farm subsidies is double that originally budgeted. Personnel costs have stayed within budget at about 9 percent of GDP.

The government has laid out its medium-term targets for overall deficits until 2017, which show continuous fiscal consolidation. The 2015 budget has proposed an overall deficit of 4.6 percent. However, following the death of President Sata in late October and with upcoming elections (a presidential election in 2015 and general elections due in 2016), risks to continued fiscal tightening have increased. In addition are two issues related to tax policy: changes to the mining tax policy proposed in the 2015 budget; and outstanding value-added tax (VAT) refunds that are large and need to be resolved. There are concerns that the mining tax policy change could have an adverse impact on investment and overall copper recovery from mines, while on refund of input VAT, Zambia's requirements for verifying exports are too stringent and not in line with mineral exporters in the region or around the world.

### Medium-term outlook

The outlook for 2015 and beyond looks favorable but vulnerable to policy slippages and external shocks. The economy is expected to grow 6.7 percent in 2015 and continue growing by around 6.5–7 percent through 2018. New mines are coming on line and will boost Zambia's copper production and exports.

The outlook is subject to significant downside risks stemming from both domestic and external factors. Key domestic risks are associated with the uncertain political

environment that if not well managed could increase fiscal vulnerabilities and currency weakness. External risks relate to increased volatility in global financial markets and delayed economic recovery in industrial countries. The government has succeeded in accessing global capital markets, most recently with a $1 billion Eurobond issued in April. The price of this success is higher exposure to refinancing and currency risk. Declining or even continued weak growth in export markets, combined with the expected gradual decline in copper prices, would dampen Zambia's prospects to benefit from recent investment in new mines.

**Increased access to finance is one of the three pillars of reform pursued by the Zambian government under its Financial Sector Development Plan**

## Financial inclusion: Reaching every Zambian

Financial inclusion, which encompasses access to, use of, and quality of financial services, has attracted considerable attention from Zambian policymakers in the past few years. In 2012, Zambia made a commitment to greater financial inclusion for individuals, as one of the first 17 countries to take action under the Maya Declaration at the meeting of the Alliance for Financial Inclusion. Increased access to finance—along with greater market infrastructure and more competition in the financial sector—is one of the three pillars of reform pursued by the Zambian government under its Financial Sector Development Plan.

Greater attention by the Zambian authorities and policymakers worldwide recognizes the fact that financial inclusion has major effects on people's lives. It helps them save, borrow, reduce costs of transactions, and manage shocks. There is growing empirical evidence that financial inclusion is important for economic development and poverty reduction, and that the poor benefit considerably from basic payment and savings services.

### Where does Zambia stand on financial inclusion?

Financial inclusion increased in Zambia in recent years but still leaves much room for improvement as the country rates below its economic and geographic peers on most indicators. According to data from the Global Findex database, 19 percent of adults in Zambia have an account at a bank, credit union, cooperative, or microfinance institution. Account penetration is on a par with other countries in the Southern African Development Community (excluding South Africa), but is slightly lower than the average for the rest of Sub-Saharan Africa and for other countries in the lower middle-income group.

In the Global Findex survey, 32 percent of Zambian adults reported saving, using formal and informal means. As in the rest of Sub-Saharan Africa, Zambians rely primarily on family and friends for credit. Just 6 percent of adults in Zambia report having borrowed from a bank, credit union, or microfinance institution in the past year.

The use of mobile financial services in Zambia has been slow to catch up and remains very low. Although 62 percent of adults in Zambia report owning a mobile phone, only 5 percent of adults use mobile financial services to pay bills or send or receive money—far lower than the average of 16 percent for Sub-Saharan Africa.

### Barriers to financial inclusion

According to the Global Findex database, nearly 90 percent of adults without accounts in Zambia mention *not having enough money* as a reason for not having an account and 30 percent without an account cite this as the only reason. This is in line with evidence from developing countries overall. The second most reported barrier is the high cost of maintaining an account. Half of those without accounts in Zambia report that they do not have an account because it is too expensive.

Zambia's low population density makes reaching rural low-income individuals especially challenging. Two-thirds of Zambia's population lives in sparsely populated rural areas. In contrast, traditional financial access points, such as bank branches, are concentrated in urban areas—over 60 percent of all commercial bank branches are in Lusaka and the Copperbelt—where higher population density makes it possible for them to operate profitably. These difficulties are compounded by the relatively high incidence of poverty among the rural population. Consequently, Zambia's banking sector is small: the country has fewer bank accounts and bank branches per capita than other countries in the Southern African Development Community and than its economic and geographic peers.

Partly due to its relatively small size, the Zambian banking system is characterized by high interest rate spreads, and high fees and other costs of banking services, all of which create barriers to access for individuals. Policies targeted at enhancing financial inclusion—such as offering basic or low-fee accounts, granting exemptions from onerous documentation, allowing for agency banking, and using bank accounts to make government payments—could be especially effective among those most likely to be excluded: the poor and rural residents.

### Is technology a game changer for individuals' financial inclusion in Zambia?

The gains in communications technology offer new opportunities to reach poor and rural Zambians. In late 2011, mobile network operators started offering mobile money services that can be used to pay bills, make relatively small domestic money transfers, and purchase airtime. Mobile financial services are also offered by some commercial banks as additional services for customers. In addition, technological innovations also allow for the adoption of new banking models, such as agency banking.

But despite the widespread introduction of mobile e-payments, there has been limited take-up and providers have yet to achieve scale. While the two largest mobile network operators claim to have almost 5 million mobile money customers, most of those are only registered, not active, customers. A few banks have introduced low-fee, low-"know your costumer" accounts that are proving popular with consumers, but these types of services are not being broadly introduced. Use of mobile money and money transfer services for bill payments in Lusaka is gaining ground, but it is too early to say whether this will lead to greater use of mobile money or e-payments for person-to-person money transfers, purchases, or saving.

### Developing a viable e-money ecosystem

Zambia is poised for growth in electronic payments, but this growth will not necessarily occur without a multipronged approach to establishing a robust and sustainable ecosystem. Zambia has lagged its neighbors in the growth of electronic payments, but the increase in cellphone use and airtime sharing even in rural areas and the growing popularity of cash-transfer providers and payment services demonstrate that users are willing to try new technologies if the value proposition is clear. Yet service providers, regulators, and policymakers all have to ensure that an enabling environment is developed. A key element of sustainability will be in achieving scale, which will require more interconnection and cooperation between players than seen so far. Moving forward with a national switch project will be crucial in achieving greater interconnection and scale. The development of shared agent networks through different strategies will further support financial service providers in reaching under- and unserved rural areas.

Government payments can play a catalytic role in providing volume and scale in rural areas for financial service providers. The volume of government payments—from salaries to pensions and social cash transfers—has the potential to add substantial volumes of transactions to service providers. Moreover, electronic payments in agriculture could contribute to the move from cash to electronic payments. Smallholder farmers, who number 1.2 million households, typically operate entirely with cash, from input payments to receiving payments for their products.

Leveraging existing infrastructure such as post offices also provides opportunities to increase financial inclusion cost-effectively. In Zambia, ZamPost has the physical infrastructure to reach individuals in rural areas that are not served by commercial banks, and can leverage its popular domestic remittance service (SwiftCash) and its recently acquired deposit-taking license as a microfinance institution to start offering other financial products. The provision of financial services through the post office does not necessarily have to be through a full-fledged postal bank, but it can take several forms, including a partnership model with a commercial bank.

Zambia stands to benefit from a coherent approach to furthering financial inclusion. While the regulatory stance of the Bank of Zambia has been broadly helpful, a clear overall framework would be beneficial. In other cases, such as for ZamPost and NatSave (a government-owned savings bank), it

**Despite the widespread introduction of mobile e-payments, there has been limited take-up and providers have yet to achieve scale**

appears that the government is essentially investing in competing financial service providers. While multiple players can of course be supported, the government should be strategic in how these players use public funds to tackle the low-income market, ensuring that they complement rather than cannibalize each other's efforts. Zambia therefore stands to benefit from developing a national financial inclusion strategy.

SECTION I

# Recent Economic Developments

**Investment in public infrastructure and mining, a rebound in agriculture, and a buoyant services sector were key drivers of growth in Sub-Saharan Africa**

## Recent global and regional developments

### Global: Uneven recovery continues

During 2014 the world economy continued to struggle to gain momentum, with uneven results. Preliminary estimates for 2014 show that global economic output picked up somewhat with growth projected at 2.6 percent, up from 2.4 percent in 2013.[1] The United Kingdom and United States show signs of recovery, with growth projected at around 3.2 percent and 2.2 percent. Yet there is a risk of secular stagnation in the Euro area, Japan's growth has been disappointing at around 0.9 percent, and financial vulnerabilities and actions to slow the real estate market in China are likely to pull down gross domestic product (GDP) growth to 7.4 percent this year.

This modest growth in global output is associated with weak expansion of international trade and low or declining global commodity prices, neither of which is promising for Zambia, a major metals exporter. But softer inflation expectations could delay many countries' expected hikes in policy rates. Low interest rates have allowed many developing countries, including Zambia, to access international bond markets in 2014. The coming years will likely be accompanied by a gradual tightening in financing conditions, however. Thus capital flows to emerging markets will moderate, and investors will be influenced by country-specific vulnerabilities and growth prospects.

1. World Bank Development Prospects Group.

### Sub-Saharan Africa: Steady growth but slowdown in some large economies

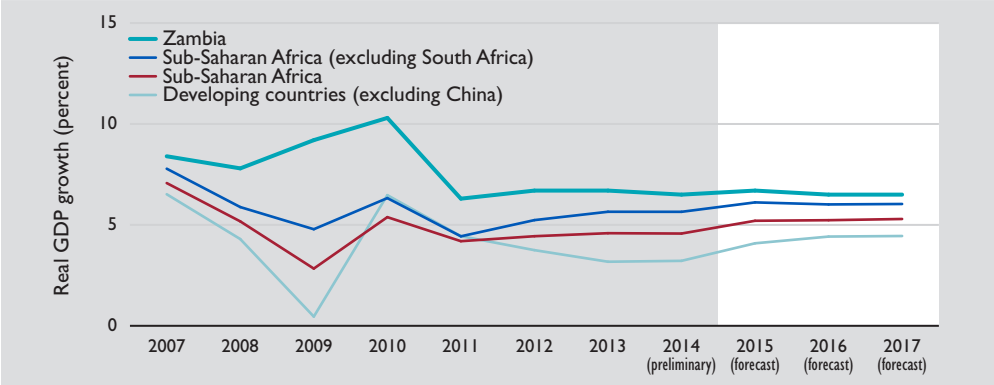
*Growth*

Growth in Sub-Saharan Africa is expected to continue at 4.6 percent in 2014, as in 2013 (figure 1.1), though some of the region's largest economies have slowed.[2] Notably, South Africa's economy expanded a mere 1.0 percent year on year in the second quarter of 2014, slowing from an already weak 1.6 percent in the first, as strikes in the platinum sector dragged down mining and manufacturing output. Oil production declined in Africa's third-largest economy, Angola, with mature oil fields coming off stream, dragging down growth markedly. By contrast, economic activity remained strong in Nigeria, the region's largest economy, with GDP advancing 6.5 percent year on year in the second quarter, up from 6.2 percent in the first. Excluding South Africa, average GDP growth for the rest of the region is expected to hold steady at 5.6 percent, a faster pace than other developing regions, excluding China.

Investment in public infrastructure and mining, a rebound in agriculture, and a buoyant services sector were key drivers of growth in the region. However, the region is seeing a slowdown in foreign direct investment (FDI) inflows, an important source of financing of fixed capital formation, reflecting subdued global demand and weaker commodity prices. FDI inflows are projected to amount to $27 billion in 2014, down from

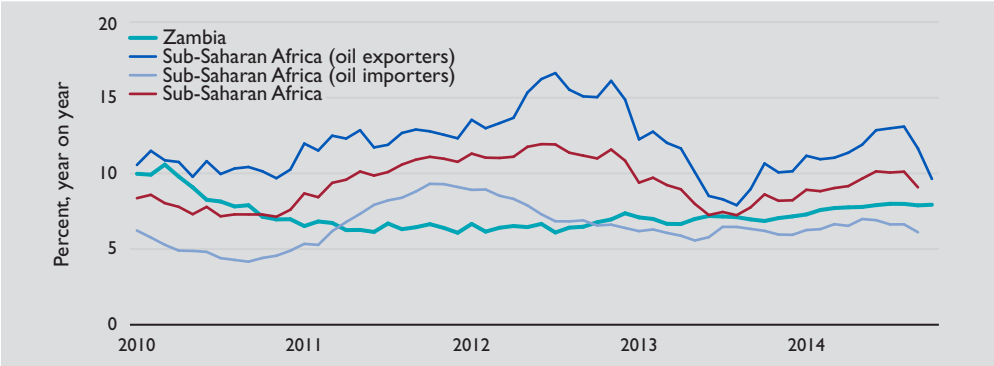
2. This section draws on World Bank (2014a).

Figure 1.1 **Real GDP grew moderately in Africa in 2014**




Source: World Bank 2014a.

Figure 1.2 **Inflation edged upwards in 2014 in Sub-Saharan Africa**




Source: World Bank 2014a.

**Inflation rose above target in many countries, including Zambia, prompting a tightening of monetary policy**

$28.3 billion in 2013, primarily reflecting reduced flows into South Africa and Nigeria.

*Inflation edged upwards*

Inflation edged upwards across the region in 2014 (figure 1.2), due in part to higher food prices, although this does not presently pose a major concern for most countries. The uptick was most visible in the frontier market countries that also sustained large currency depreciations and fiscal looseness—notably Ghana, where inflation was in double digits. Inflation rose above target in many countries, including Zambia, prompting a tightening of monetary policy.[3] Inflation in Zambia, in single digits, remains below the regional average.

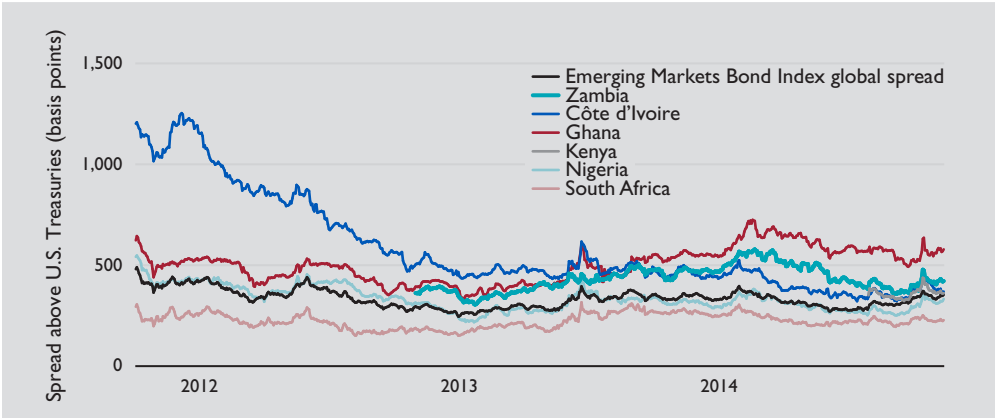
3. The finance minister announced in the 2014 budget speech the objective of reducing inflation to 6.5 percent by the end of 2014. "2014 Budget Address by Hon. Alexander B. Chikwanda, Minister of Finance, Delivered to the National Assembly," October 11, 2013, www.zambia.or.jp/docs/2014nationalbudgetaddress.pdf.

*External borrowing from capital markets grew further in 2014*

In the second half of the year, the region experienced a strong increase in Eurobond sovereign issuances, including a maiden issuance by Kenya. Year to date, total issuance for the region including South Africa amounted to $6.9 billion (above 2013's $6.5 billion). Several countries made a successful return to the international bond markets. Zambia's $1.0 billion sale of 10-year dollar-denominated government bonds in April 2014 was followed by those of Côte d'Ivoire ($750 million) and Senegal ($500 million) in July and Ghana ($1.0 billion) in September. Many of the issuances were highly oversubscribed, with orders reaching $8 billion for Kenya and nearly $5 billion for Côte d'Ivoire.

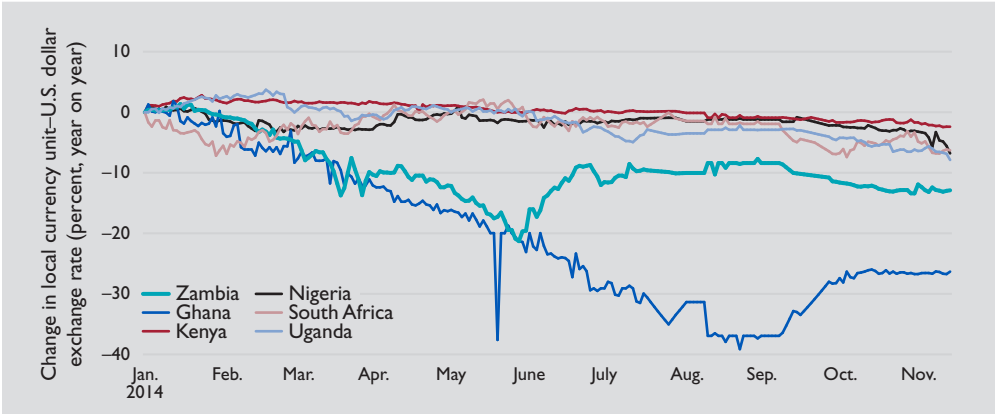
Sovereign spreads on Africa's bonds over 10-year U.S. Treasuries fell across the board from their February 2014 peak (figure 1.3). The average spread of Zambian bonds during November was 157 basis points (bps) below their peak of 579 bps, and South African and Nigerian spreads fell by 78 bps

Figure 1.3 **Sovereign bond spreads in Africa fell in 2014**




Note: Spreads are calculated as differences in basis points over 10-year US treasury notes.
Source: Bloomberg.

Figure 1.4 **The region's currencies have generally stabilized**




Source: Bloomberg; World Bank 2014a.

**Actions taken by the Bank of Zambia and signs that the fiscal situation could be improving have helped stabilize the kwacha and put Zambia on a path that converges with the rest of Africa**

and 64 bps during the same period. As the global emerging market bond index has started to rise since its June 2014 low of 271, the continued decline in African spreads points to declining borrowing costs in the region. However, spreads on bonds issued by Ghana and Zambia—countries experiencing significant fiscal deficits—remain above those issued by other sovereigns in the region.

In the current environment of still benign financial market conditions, most of the region's currencies have stabilized (figure 1.4), after significant volatility early in the year, which could help contain inflation pressures. Actions taken by the Bank of Zambia (BoZ) and signs that the fiscal situation could be improving (discussed later) have helped stabilize the kwacha and put Zambia on a path that converges with the rest of Africa.

*Commodity prices weakened further*

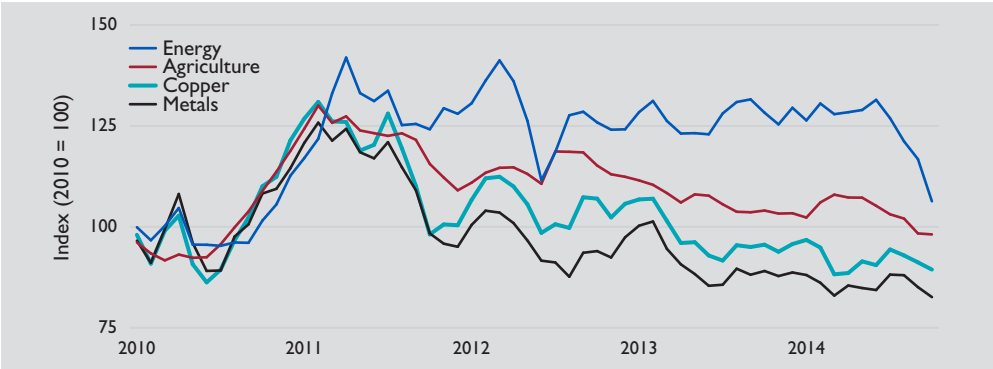
Commodity prices weakened further in 2014 (figure 1.5). As of October, oil prices had declined 15.7 percent during 2014, and agriculture and metals were down 4.1 percent and 6.2 percent respectively for the year, reflecting increased supply and weakening demand, notably from China, the largest metal importer.[4] Among metals, the price of iron ore fell the most during 2014, decreasing by 36.8 percent as of October, while the price of copper had dropped by 7.6 percent. In contrast, aluminum, nickel, and zinc registered price increases.

*Ebola has hurt several economies*

The 2014 outbreak of Ebola disease in West Africa has taken a devastating human and economic toll. The World Bank estimates that

4. World Bank Development Prospects Group.

Figure 1.5 **Commodity prices weakened further**




Source: World Bank 2014a.

**Zambia's economy is estimated to grow around 6.0 percent in 2014, slower than the 6.7 percent in the previous two years**

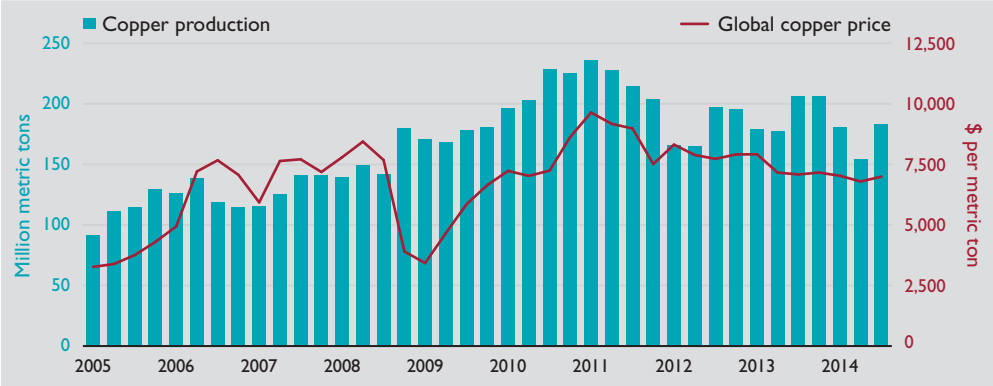
the epidemic will reduce economic output of the three most affected countries—Guinea, Liberia, and Sierra Leone—by $359 million in 2014, shaving 2.1–3.4 percentage points off these countries' annual GDP growth rates. The spillover cost on West Africa as a whole is expected to be in the range of several billion dollars in lost 2014 GDP (World Bank 2014b). Countries that have succeeded in containing outbreaks—such as Nigeria and Senegal in 2014 and Uganda during past episodes—have done so by raising public awareness of the disease, building surveillance and detection capacity, and responding swiftly to new cases of infection by identifying and testing those who have come into contact with affected persons.

## The state of Zambia's economy

*Economic growth slowed in 2014*

Zambia's economy is estimated to grow around 6.0 percent in 2014, slower than the 6.7 percent in the previous two years (see annex table A1). Growth comes from a bumper maize harvest and rapid growth in construction, supported in part by public investment in roads and continued strong growth in services. Agriculture is projected to rebound to more than 6.5 percent growth in 2014 after shrinking by 7.4 percent in 2013. Growth in maize output is supported largely by sizable government subsidies in its production and price support. Copper output has declined following operational problems in some mines. During 2005–10 mining output registered an average annual growth of 20.5 percent following privatization of copper mines and significant FDI inflows; mining output has fluctuated since then with three out of the four years registering negative growth (figure 1.6). Construction has been growing fast for the past several years and is projected to grow more than 8 percent in 2014 and to account for a sixth of GDP growth. In previous price cycles, increases in copper prices and output have been accompanied by a boom in construction and services. In 2014, services are likely to account for the bulk of growth.

Figure 1.6 **Zambia copper production and global prices**




Source: BoZ, Ministry of Finance, and World Bank staff calculations.

*The exchange rate stabilized after sharp depreciation in the first half*

The first half of 2014 witnessed considerable fluctuations in foreign exchange markets, although conditions have stabilized toward the end of the year. After holding steady against the U.S. dollar and the British pound during most of 2013, the kwacha depreciated sharply against global currencies during the first five months of 2014 (figure 1.7). By the end of May it had lost 19 percent of its value against the dollar and 22 percent against the pound. More benign global conditions combined with interest rate hikes by BoZ have helped the kwacha regain around half these losses. The strengthening of the U.S. dollar and political uncertainty after late October have had an effect on the kwacha in recent weeks, but it has largely been stable.

*Inflation is higher than the targeted 6.5 percent*

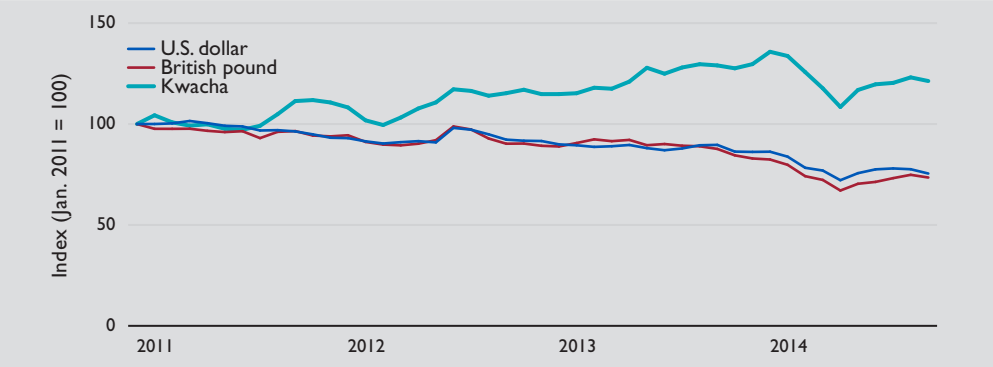
Inflation has been edging upwards over the past year in Zambia as in other countries in the region (figure 1.8). Higher import prices induced by the depreciating kwacha, an increase in electricity tariffs, and increased public wages all put pressure on consumer prices. During 2014 inflation fluctuated between 7 percent and 8 percent. The average for the year is expected to be around 7.8 percent, compared with 7.0 percent in 2013 and 6.5 percent targeted.

To contain inflation and depreciation pressures, BoZ undertook several measures to tighten monetary policy. It raised the policy rate to 12 percent in April and increased the statutory reserve ratio to 14 percent, from 8 percent. It also intervened in foreign exchange markets to contain volatility. More recently, the policy rate was raised again in November to 12.5 percent.

Tighter liquidity conditions that resulted from the monetary policy actions pushed up yields on government securities (see figure 1.8). The relative stability in the kwacha and inflation in July 2014 enabled the central bank to gradually start easing liquidity conditions. Yields on government securities, after

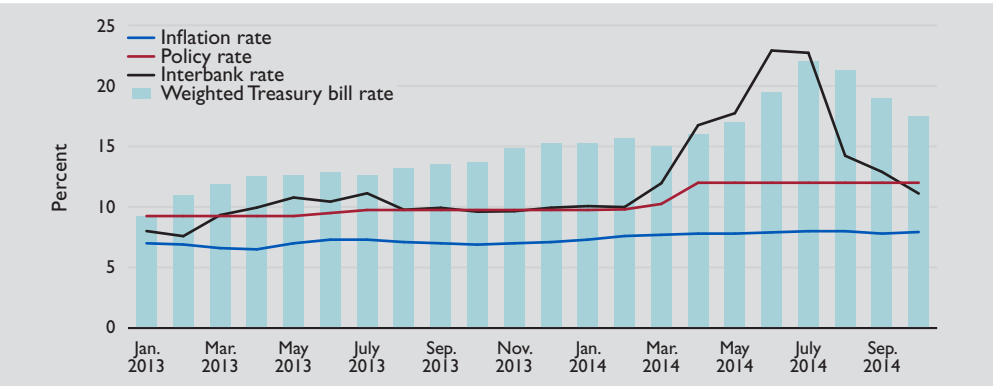
**Inflation in 2014 fluctuated between 7 percent and 8 percent, and is expected to end the year with an average of 7.8 percent**

Figure 1.7 **The kwacha shows depreciation globally, 2011–14**




Note: Higher values indicate appreciation of the kwacha, lower values depreciation.
Source: BoZ.

Figure 1.8 **Inflation and interest rates trend up**




Source: BoZ.

peaking in July, had started edging downwards. The weighted yield on Treasury bills declined to 17.5 percent in October from 22 percent in July 2014, although it remains above the 2012 average of 11 percent. Recently, yields on government securities have started climbing again due to political uncertainty.

**Based on preliminary outturn data as of September 2014, domestic revenue was 7.3 percent above projection for the first three quarters while total expenditure was 10.0 percent below budget**

*The fiscal situation had begun to improve but faces risks in view of coming elections*

The 2014 budget had planned a lower fiscal deficit than in 2013 and the government managed to bring a measure of control to budget execution after the difficulties faced in 2013.[5] The 2015 budget presented to Parliament in October maintains the stance of fiscal tightening by proposing an overall fiscal deficit of 4.6 percent of GDP. The medium-term expenditure framework for 2015–17 plans for continued fiscal consolidation with the overall deficit narrowing to 3.2 percent by 2017 (Ministry of Finance 2014). However, following the death of President Sata and with upcoming elections (a presidential election in 2015 and general elections due in 2016), risks to continued fiscal tightening have increased. In addition are two tax-policy issues of concern: changes to the mining fiscal regime proposed in the 2015 budget; and large outstanding value-added tax (VAT) refunds that need to be resolved.

Fiscal year 2014 is expected to end with a lower deficit against the 5.7 percent budgeted (table 1.1). Based on preliminary outturn data as of September, domestic revenue was 7.3 percent above projection for the first three quarters while total expenditure was 10.0 percent below budget. The projected deficit would be higher still if outstanding input VAT refunds totaling more than K4.3 billion, being withheld by the Zambia Revenue Authority due to noncompliance with VAT rules on export verification, were netted out of domestic revenues. The decline in total expenditure is going to be a net result of relatively large cuts on the capital budget (around 20 percent) and significant overspending on purchases of maize by the Food Reserve Agency.[6] Spending on the Farmer Input Support Program is also projected to be around 2.5 times more than originally budgeted.

In 2015 the decline in the overall deficit would result from higher domestic revenues and continued restraint on total expenditure. Part of the increase in domestic revenues (about 0.9 percent of GDP) would come from a substantial change in the mining tax regime. The draft budget proposes replacing the current two-tier system of mineral royalties and corporate income taxes with a "simplified mining tax structure": 8 percent mineral royalty for underground mining and 20 percent for open-cast mining operations as a final tax, and 30 percent corporate income tax on income from tolling and processing of purchased mineral ores. But as discussed just below, the change in the mining tax regime could have a negative long-term impact on copper output and investment.

Fiscal consolidation faces bigger risks now. The 2015 budget is premised on a continued freeze of civil service wages. It also assumes that the Food Reserve Agency's maize purchases in 2015 will not exceed 0.5 million tons. Both these assumptions may not hold. The 2014 freeze on public wages is coming under political pressure and overspending on agriculture subsidies has been a recurring feature of Zambian budgets under the Patriotic Front government. Every year higher subsidies than planned result in ad hoc budget cuts and accumulation of arrears. Holding the line on the wage freeze and maize purchases may become more difficult: the new president will face general elections less than two years after assuming office. It is possible that fiscal restraint may lose out to populist preelection spending.

*Tax policy issues—change to the mining fiscal regime and outstanding VAT refunds*

The proposed change to the mining fiscal regime has several drawbacks. Due to different cost structures, and thus profitability, that are inadequately captured by the open

5. In 2013, the fiscal balance deteriorated sharply, ending the year with an overall deficit of K8.2 billion versus a K5.0 billion deficit originally projected in the budget.

6. In October, the Minister of Agriculture announced that the Food Reserve Agency had already purchased more than double the strategic reserve requirement of 500,000 tons of maize to keep domestic prices high in the face of the bumper harvest.

**Table 1.1 2014 budget with preliminary and projected outturns**

(millions of kwacha)

| | 2014 | | | 2015 |
|---|---|---|---|---|
| | Original budget | Preliminary (year to date) | Projected annual | Proposed budget |
| Total revenue and grants | 31,615 | 23,019 | 32,192 | 36,318 |
| Domestic revenue | 29,539 | 22,912 | 30,635 | 35,104 |
| Tax revenue | 24,457 | 19,544 | 25,896 | 25,345 |
| Income taxes | 10,781 | 8,926 | 11,972 | 11,793 |
| Out of which mining company tax | 2,253 | 1,403 | 1,869 | 0 |
| Value-added tax | 8,099 | 7,032 | 8,707 | 6,577 |
| Customs and excise | 5,577 | 3,564 | 5,182 | 6,975 |
| Export duty | 6 | 22 | 36 | |
| Nontax revenue | 5,082 | 3,368 | 4,738 | 9,759 |
| Out of which mineral royalty | 2,186 | 1,329 | 1,963 | 5,937 |
| Grants | 2,077 | 108 | 1,557 | 1,214 |
| Total expenditures | 41,049 | 27,912 | 40,428 | 44,970 |
| Expenses | 29,755 | 22,349 | 31,390 | 32,152 |
| Personnel costs | 15,497 | 11,595 | 15,552 | 16,604 |
| Use of goods and services | 5,202 | 3,206 | 4,524 | 5,267 |
| Interest payments | 3,040 | 2,602 | 3,510 | 3,594 |
| Grants, transfers, and subsidies | 3,986 | 3,775 | 4,936 | 4,544 |
| Out of which Farmer Input Support Program | 500 | 986 | 1,309 | 1,338 |
| Social benefits | 966 | 579 | 813 | 1,021 |
| Other expenses | 1,063 | 593 | 2,054 | 1,123 |
| Out of which Food Reserve Agency | 1,013 | 593 | 2,033 | 1,073 |
| Assets | 10,919 | 5,248 | 8,644 | 12,436 |
| Nonfinancial assets | 9,839 | 4,788 | 8,012 | 11,918 |
| Financial assets | 1,079 | 460 | 632 | 519 |
| Liabilities | 376 | 315 | 394 | 382 |
| *Changes in balance* | *0* | *747* | *1,302* | |
| Fiscal balance | –9,434 | –4,146 | –6,934 | –8,653 |
| Financing | 9,434 | 4,146 | 6,934 | 8,653 |
| Net domestic | 2,902 | 1,612 | 3,075 | 3,072 |
| Net external | 6,532 | 2,535 | 3,858 | 5,581 |
| GDP | 166,474 | 166,474 | 166,474 | 189,783 |

Note: Grant receipts assumed to be 75 percent of budget. Additional Food Reserve Agency spending assumed to be financed domestically.
Source: World Bank staff calculations from Ministry of Finance data.

pit–underground distinction (box 1.1), different mines will face very different effective tax rates on their income. Apart from being inequitable, the changes could see mines that lose out constantly engaged in negotiations with the government, leading to an unstable fiscal regime. Some hard-hit mines may curtail or completely close their operations, hurting jobs (generally, the high-cost mines are also those with higher employment).

The proposed increase in royalty rates could also have a significant impact on Zambia's subsoil wealth through increases in the cut-off grade. This would result in lower overall copper recovery, and preliminary calculations show that lost in situ value of resources could be sizable. When extended to the undiscovered copper potential of Zambia, the lost in situ value is even larger, representing potential permanent value erosion to Zambia's copper wealth.

The proposed fiscal regime is characterized as a "simplified fiscal regime" but may not turn out to be administratively simple. Since many mines blend ores from both open-pit and underground mines, calculation and verification of the royalty payments will require in-depth assessment of the metal

**Box 1.1 The proposed change to the mining tax regime**

The proposed change is meant "to achieve a more equitable distribution of mineral wealth between the government and the mining companies." Historically, the government's total tax take from the mining sector has not met expectations, for several reasons including tax incentives granted by the government, large tax "assets" resulting from unredeemed capital redemption allowances, and overall lower profitability of several mining companies. In addition, the government faced challenges in administering profit-based taxes. But in the past few years, the mining tax take has averaged around 3 percent of GDP, a level similar to that in other comparable countries; it was set to grow further in the medium term due to larger inflows of corporate income taxes.

The proposed new regime appears to be designed to circumvent the issues discussed above by avoiding profit-based taxes altogether. It distinguishes profitability of mines by their mining method—open pit versus underground. A higher royalty rate for open pits suggests that they are considered more profitable. Yet the method is a rather crude way to distinguish profitability. Zambia has open-pit mines with much higher per unit costs than underground mines, and vice versa.

**The requirements for documentation beyond the conventional proof of export introduce a significant drag on Zambia's export competitiveness**

content of the raw ores, as opposed to verification of concentrates. This will move the requirements for physical audits of production one step back in the value chain where the logistics associated with sampling will be a challenge and assessment will be plagued with uncertainty. Furthermore, the inclusion of an ad valorem royalty for mining companies, while maintaining the profits tax system for processing facilities, may create incentives for domestic profit shifting.

The cumulative impact of the proposed changes highlights the need for caution. The government should consider postponing the proposed changes and undertake a careful assessment of the likely impact of the proposed changes on investment and revenues. The government could also create the legal means necessary to obtain information from companies, allowing the authorities to project fiscal revenues from the mining sector into the future. The draft Mines and Minerals Act affords an excellent opportunity to effect the necessary changes. Otherwise, continuing to strengthen capacity to implement profit-based taxes should attract top priority.

Government measures on refunding input VAT to exporters have implications for export competitiveness and the overall cost of doing business. In an effort to combat fraudulent claims for VAT refunds, in 2013 the government amended Rule 18 of the Value Added Tax General Rules of 1997. The revised rules require that exporters seeking refund of input VAT provide not only tax invoices for goods exported and proof that the customer paid for the goods, but also documentation showing that goods have been shipped out of Zambia and have been imported into the country of destination, and that export proceeds have been deposited in a domestic bank.[7] As of September 2014, the Zambia Revenue Authority had withheld K4.3 billion (2.6 percent of GDP) in VAT refunds on the ground that exporters did not meet the requirements of Rule 18 (*Zambia Daily Mail* 2014).[8]

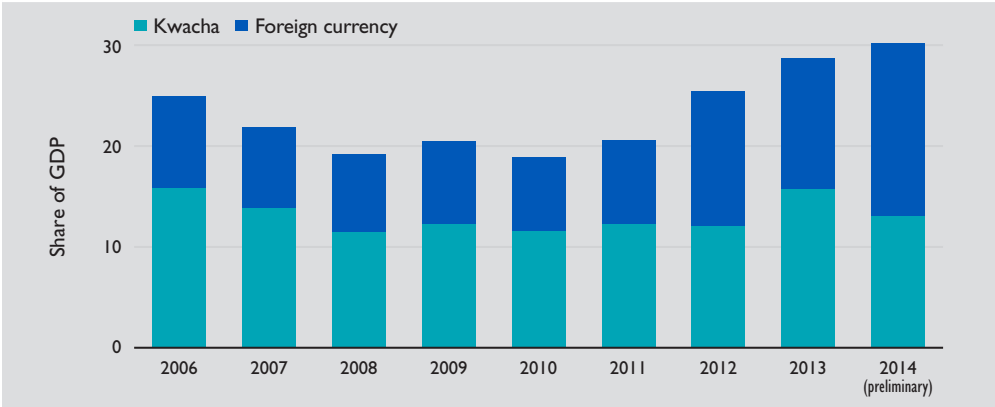
All countries employing VAT require some form of verification of export. Typically a customs declaration or VAT invoice satisfies this requirement. In contrast, requiring proof of payment, of importation of the goods into another country, and of deposit of funds in a domestic account runs counter to standard practice. Indeed, a survey of mineral exporters in the region and around the world finds that no country makes such requirements.[9] Apart from departing from international practice these requirements have the effect of transforming the VAT into an export tax rather than a consumption tax. Combined with the additional administrative costs, the requirements for documentation beyond the conventional proof of export introduce a significant drag on Zambia's export competitiveness. Nor do these provisions of Rule 18

7. These are provisions (b), (d), and (e) of Rule 18. The latter two requirements were provisions of the VAT General Rules of 1997, but had not been strictly enforced.

8. Zambia Revenue Authority Commissioner General Berlin Msiska also reported that it had paid out K762.3 million to exporters who had submitted receipts and export certificates in compliance with Rule 18.

9. Countries surveyed include Australia, Canada, Chile, Namibia, Peru, and Tanzania. Rules in the European Union, New Zealand, and United Kingdom were also reviewed because many countries have based their VAT rules on practices in these jurisdictions.

Figure 1.9 **Public debt is rising but remains sustainable**




Source: IMF and World Bank.

achieve the stated policy objective of reducing fraudulent VAT refund claims.

In his 2015 budget speech, the minister of finance announced that the issue of VAT refunds will be resolved in an expeditious and amicable way. In that vein it is expected that the government will balance the need to secure its revenues with the need to maintain an attractive investment climate. In addition, it will be important to improve the underlying capacity to administer conventional proof-of-export rules for VAT refunds.

*Zambia's external debt is sustainable but debt portfolio has become costlier and riskier*

Government debt grew rapidly between 2010 and 2013, when it reached 28.7 percent of GDP (figure 1.9).[10] Most of the recent growth in debt is external and commercial. Foreign currency debt as a share of GDP doubled between 2011 and 2014, primarily because of 2012 and 2014 Eurobond issues, which mature in 2022 or 2024. In the domestic market, the government increased its short-term domestic borrowing in late 2013 and early 2014 to finance the budget deficit, which had the effect of pushing up short-term interest rates.

The 2013 Bank–International Monetary Fund (IMF) debt sustainability analysis concluded that overall public debt remains sustainable under the baseline scenario. This conclusion likely holds in 2014, too. Even though the analysis projected debt to rise slightly in the medium term, the debt is expected to decline gradually in the longer term. The largest risks to debt sustainability come from delayed fiscal adjustment and negative shocks to GDP growth, highlighting the importance of maintaining fiscal discipline before the elections.

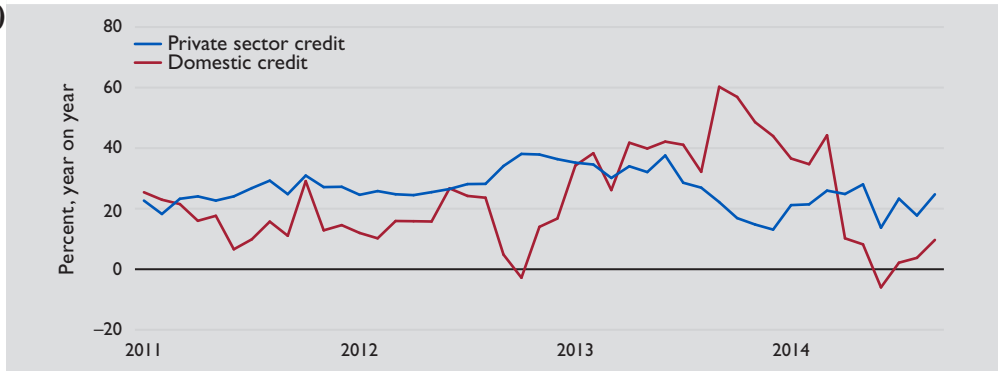
The cost of borrowing has increased, however, as the government has shifted toward borrowing in the market rather than from concessional sources. To some extent this is a consequence of rising national income and improved management of the economy. But Zambia faces higher costs in the international sovereign bond market than do many of its neighbors. With Ghana it shows higher sovereign spreads than other countries (see figure 1.3), reflecting these countries' less favorable fiscal positions among market-access countries. Bolder measures to curtail growth in personnel spending or to broaden the tax base would help reduce costs of future bond issuances.

Zambia's debt portfolio has also become riskier. The portfolio is highly exposed to refinancing risks because of a large share of Treasury bills. The "bullet" structure of the two Eurobonds, which together make up around 40 percent of the external debt portfolio, also contributes heavily to higher refinancing risk in the coming years. In addition, the portfolio is exposed to greater exchange rate risk. Depreciation of the kwacha would raise Zambia's debt servicing costs, particularly if this were to occur when the Eurobonds mature (2022 or 2024). To manage foreign exchange risk, issuance of the large Eurobonds makes coordination between the Ministry of Finance and the central bank more important than it was in the past.

**The largest risks to debt sustainability come from delayed fiscal adjustment and negative shocks to GDP growth**

10. This section summarizes findings of the World Bank and IMF, with MEFMI and UNCTAD (2014).

Figure 1.10 **Private sector and domestic credit growth**




Source: BoZ.

**Strong growth in private sector credit since 2009 has supported economic activity in Zambia**

Government borrowing is not guided by a published debt management strategy nor informed by explicit analysis of the tradeoffs between risks and costs. The two-year debt management strategy prepared in 2008 was not approved by cabinet. The government is aware of the need also to develop a strategy to address the large bullet repayments of the 2012 and 2014 Eurobonds.

*Credit growth and banking sector performance*

Strong growth in private sector credit since 2009 has supported economic activity in Zambia. In 2013, with the sharp downturn in credit growth and increased government borrowing (figure 1.10), there was some crowding out of private investment by the public sector. The rate of growth in private credit picked up again in 2014, rising to 25 percent year on year in September 2014 from 13 percent in December 2013. Lending to government peaked in February 2014, and the banking sector's gross claims on the central government declined by 19 percent between February and September.

The banking sector has been performing well over the past year as several financial soundness indicators show (see annex table A3). As of end-September 2014, capital adequacy was stable at 26 percent, against 27 percent at the end of 2013. Nonperforming loans as a share of total loans decreased to 6.4 percent from 7.1 percent at the beginning of the year, and more than 75 percent of these nonperforming loans were provisioned for. Liquidity indicators also improved, while earnings and profitability remained stable in the last quarter of 2013 and in the first half of 2014.

*Caps on lending rates*

The October 2013 issue of the Zambia Economic Brief (World Bank 2013b) had discussed the issue of caps on lending rates[11] and cautioned about their impact on business strategies of commercial banks and microfinance institutions (MFIs). Recent evidence collected by BoZ shows that the effects of caps have been counter to what was intended in some cases. Lenders responded to caps on rates by introducing new or higher fees, which has meant that, in some instances, the effective rate including fees has remained close to pre-cap levels. These fees have reduced transparency in pricing of loans.

Instead of promoting financial inclusion, credit to small and medium enterprises appears to have been rationed, and there has been no evidence of growth in personal loans to nonsalaried employees or salaried employees at small firms—virtually all personal loans are made through agreements with employers for automatic payroll

11. In January 2013 BoZ imposed a cap on interest rates that commercial banks and microfinance institutions could charge for loans. This was implemented as a cap on spread above the BoZ policy rate. Commercial Bank Circular 25/2012 set this margin at 9 percentage points, making 18.25 percent the maximum lending rate at that time, when the policy rate was set at 9.25 percent. The corresponding circular for nonbank financial institutions capped interest rates charged by developmental MFIs initially at 30 percent for nonbanks (conventional MFIs) and 42 percent for developmental MFIs. Rates subsequently rose along with the BoZ policy rate: the bank lending rate to 28 percent, nonbanks to 42 percent, and developmental MFIs to 64 percent by April 2014.

deductions.[12] Consequently, only individuals who work for the state or large corporations have access to personal loans. The average loan size has grown since the caps were imposed, contrary to the policy's objective of supporting small borrowers.

Policies other than interest rate caps are needed to address the underlying structural determinants of the high cost of credit in Zambia. Other analysis suggests that large interest rate spreads are explained mainly by high overhead costs resulting from the small size of the market, high labor costs, inadequacies in credit information systems, and weaknesses in the creditors' rights enforcement framework (IMF and World Bank 2009). Also, policymaking is itself constrained by scarcity of information. There are few disaggregated and standardized data on volumes and costs across market segments. Therefore, it is important to address the underlying structural barriers to reasonably priced credit.

## Economic outlook

Zambia's medium-term growth prospects look favorable, assuming that current trends continue. Real GDP growth is projected to strengthen to an annual pace of 6.7 percent in 2015 from 6.4 percent in 2014, and to stabilize at an average of 6.5 percent in 2016–17. Under the baseline scenario, investment in mining and infrastructure combined with the rebound in agricultural production is expected to continue to support growth. With new mines opening up, copper production is expected to rise, helping drive GDP growth.

Consumption is also expected to remain strong in 2015–17. Reduced imported inflation, aided by a benign global inflation environment, a relatively stable currency, and a strong maize harvest, is expected to help contain inflation pressures, which should allow for some gains in real disposable incomes. These effects, coupled with the large increase in public sector wages enacted in September 2013, should continue supporting private consumption and domestic demand, which will contribute to headline growth. Government consumption is projected to grow at a moderate pace, allowing for some fiscal consolidation, which could be a drag on economic activity. Efforts to contain wages and salaries and streamline less productive expenditures on goods and services should help enhance the overall efficiency of public spending.

With copper production set to rise, export growth should remain positive, although softening copper prices could slow it. In China—a major destination for Zambia's exports—economic growth is expected to slow from 7.7 percent in 2013 to 7.4 percent in 2014 and to an average of 7.1 percent in 2015–17 as it makes the transition from an investment-led growth strategy toward greater emphasis on domestic consumption. Meanwhile, on the import side, the demand for capital goods is projected to remain strong, as the government continues to front-load infrastructure investments and as private consumption remains strong. Reflecting these trends and the weakening of commodity prices, net exports are expected to make a marginal contribution to overall growth.

**A sudden increase in volatility in financial markets and slower growth in emerging markets are among the major external risks to Zambia's growth outlook**

### Risks to Zambia's economic outlook

The outlook is subject to significant downside risks stemming from both domestic and external factors. Key domestic risks are associated with expansionary fiscal policy and currency weaknesses. A sudden increase in volatility in financial markets and slower growth in emerging markets are among the major external risks to Zambia's growth outlook.

#### *Domestic risks*

Budgetary concerns and currency weaknesses will remain sources of vulnerability for Zambia over the next 12 months, particularly if fiscal discipline is relaxed before the elections. Notably, a resumption of looser fiscal policy could deteriorate an already weak fiscal position, depleting fiscal buffers further and leaving limited fiscal space to respond to exogenous shocks. An IMF program is not yet in sight despite authorities' request for one. Public sector wage pressures and the two elections (2015 and 2016) could make it harder for the authorities to maintain the pace of fiscal consolidation.

12. Among other provisions, these arrangements employers give lenders the right to have employee benefits attached to offset any remaining loan obligation should the borrower leave her or his current position.

Currency concerns are also likely to continue. A combination of weak export growth, high import demand, and negative investor sentiment could cause the kwacha to weaken against the dollar, particularly if investors come to believe that the economy has a high level of macroeconomic vulnerability, adding to inflation pressures in the country. While moderate food prices and prudent monetary policies could see inflation remain low, currency-induced price pressures will pose a persistent threat.

*External risks*

A sudden increase in risk premiums and in global financial markets' volatility from their current low levels remains a key downside risk for Sub-Saharan Africa. It would not only hit South Africa, which depends heavily on portfolio capital flows to finance its current account deficit, but also other frontier markets such as Ghana, Nigeria, and Zambia, which have increased their reliance on external market financing. Recent episodes of capital market volatility suggest that countries with large macroeconomic imbalances would face strong downward pressure on their exchange rate and high currency-induced inflation. Besides financial risks, countries in Sub-Saharan Africa face the risk of Ebola-related disruptions spreading.

SECTION 2

# Financial Services—Reaching Every Zambian

**Innovations in the payments landscape, such as mobile financial services and agency banking, as well as leveraging existing infrastructure, such as post offices and government payments and transfers, can help expand financial inclusion**

There is substantial evidence that financial inclusion is important for economic development and poverty reduction, and that the poor benefit tremendously from basic payment and savings services.[1] But expanding financial inclusion and reaching low-income individuals is especially challenging in Zambia due to the country's low population density. Two-thirds of the population lives in sparsely populated rural areas. Traditional financial access points, such as bank branches, are, though, concentrated in urban areas where higher population density makes it possible for traditional financial institutions to operate profitably. This section explores how innovations in the payments landscape, such as mobile financial services and agency banking, as well as leveraging existing infrastructure, such as post offices and government payments and transfers, can help address this challenge.

## Financial inclusion and its impact on development

Financial inclusion encompasses access to, use of, and quality of financial services. This section focuses on financial inclusion of individuals rather than micro, small, and medium enterprises as Zambia has committed to significantly increase access to finance for individuals as part of the Maya Declaration[2] of 2011 and to allow for a more in-depth analysis of the challenges in that area and possible means to address them. In addition, its focus is on access to and use of formal accounts, payments, savings, and credit products, even though financial institutions offer an array of financial services, including insurance and pension products, which are equally important for managing the financial lives of low-income individuals.

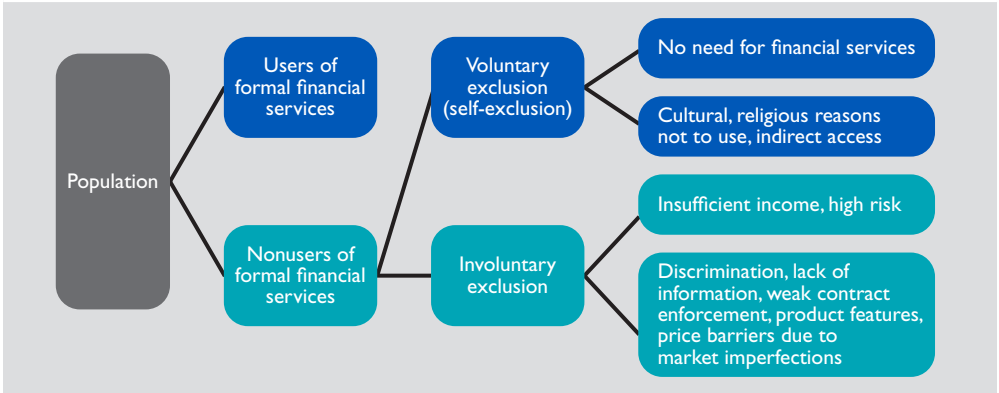
Financial inclusion has major effects on people's lives. Without inclusive financial systems, individuals and firms need to rely on their own resources to meet their financial needs, such as saving for retirement, investing in education, taking advantage of business opportunities, and confronting systemic or idiosyncratic shocks. In addition, transactions between parties would be costlier and riskier to undertake without such systems. From a policy perspective, greater financial inclusion also holds the promise of potentially making other policies more effective and efficient. For example, widespread availability of electronic payments makes it easier to implement pro-poor policies that rely on electronic payments for conditional cash transfers or social transfers to the poor and disadvantaged.

Financial exclusion is problematic and deserves policy action when it is involuntary. That is the case when individuals would like to use financial services but are excluded by barriers—high account fees, long distances,

1. See, for example, World Bank (2013a) for an overview of the literature.

2. Under this Declaration facilitated by the Alliance for Financial Inclusion in a meeting at the same time as the G20 meeting in Mexico, February 2012, countries voluntarily committed to financial inclusion targets.

Figure 2.1 **Voluntary and involuntary financial inclusion**




Source: World Bank 2013a.

**Providing individuals with accounts with saving and payment services has significant positive effects, including increasing savings, women's empowerment, and productive investment**

and lack of suitable products—that result from market failures (figure 2.1). Generally, financial inclusion as a policy goal should of course only be pursued with full consideration of its costs and benefits. The distinction between voluntary and involuntary financial inclusion is not always straightforward, however. For example, individuals might report no need for currently offered financial products, but might be interested in better designed products tailored to their needs. In addition, indirect access—for example, through someone else in the family—is not a substitute for direct financial inclusion. The literature highlights that ownership of an account and thus one's assets provides greater decisionmaking power on how the money is spent (World Bank 2013a).

Financial inclusion is a distinct dimension of financial development. Commonly used measures of financial development (such as financial depth, measured by domestic credit to the private sector as a percentage of GDP) are imperfectly correlated with the use of formal accounts by individuals. For a given level of financial depth, countries can have hugely varying levels of account use. Financial systems are also assessed on their efficiency and stability. A greater use of formal accounts is associated with higher efficiency of financial institutions. Efficiency can be measured by the lending–deposit interest rate spread of financial institutions, but the relationship is also robust to a number of alternative measures. There is no significant correlation between account penetration and financial stability (World Bank 2013a).

Financial inclusion matters for economic development and poverty reduction. There is growing evidence in the academic literature that providing individuals with accounts with saving and payment services has significant positive effects, including increasing savings (Aportela 1999; Ashraf, Karlan, and Yin 2006), women's empowerment (Ashraf, Karlan, and Yin 2010), productive investment (Dupas and Robinson 2013a), and consumption, investment in preventive health, productivity, and income (Dupas and Robinson 2013a,b; Ashraf, Karlan, and Yin 2010).[3]

Among policymakers, interest in the potential transformative power of financial inclusion has increased. The World Bank announced a new initiative to provide universal financial access to all working-age adults by 2020 during the 2013 annual meetings. In international forums, such as the Group of Twenty (G20), financial inclusion has moved up the reform agenda. The G20 has created the Global Partnership for Financial Inclusion (GPFI), a platform for all G20 countries, interested non-G20 countries, and stakeholders to advance work on financial inclusion, including the implementation of the Financial Inclusion Action Plan. At their February 2012 meeting in Mexico, G20 leaders agreed to follow through on the recommendations of the 2011 GPFI report (GPFI 2011), and take the financial inclusion agenda forward to concrete results. At a simultaneous meeting of the Alliance for Financial Inclusion, Zambia made a commitment to greater financial inclusion as one of the first 17 countries to take action under the Maya Declaration. Increased access to

3. See World Bank (2013a) for a more detailed discussion.

**Box 2.1 Definitions and terminology**

The financial services industry is rapidly changing in terms of innovations and players, and many of the terms are being used interchangeably, which can get confusing. For this report, we use the following:

*Mobile banking* refers to the ability to access one's bank accounts via a mobile device, either a phone or a tablet. In many regards this is just another form of online banking. It is largely an additive service to existing bank customers.

*Mobile money* is the term commonly used to describe prepaid stored value wallets that are accessed via the user's mobile device. This service is commonly offered by mobile network operators or third-party providers and is not generally considered a deposit account, although there are growing examples of banks that are offering their customers the ability to link their deposit accounts to their mobile wallet accounts.

*Mobile payments* refer to the ability to transfer funds, either from one user to another or for making purchases. Mobile payments can be associated with bank accounts or with mobile wallets offered by mobile money providers.

*E-money* refers to a digital form of currency that is prepaid with fiat currency—that is, an equal amount of local currency has been used to "purchase" the e-money and it can be exchanged for local currency. Many policymakers use the term e-money to refer to all digital currency, regardless of the service provider or the channel it is offered through; thus many emerging policy guidelines around new payment services like mobile money or prepaid card services are often referred to as e-money guidelines.

finance, along with enhanced market infrastructure and increased competition in the financial sector, is one of the three pillars of reform pursued by the Zambian government under its Financial Sector Development Plan.

Contributing to the focus on financial inclusion have been major breakthroughs in technologies that have created new delivery mechanisms for cost-effective outreach. Examples include the spread of cell phones and mobile banking and low-cost point-of-sale (POS) devices (some definitions are in box 2.1). In addition to technological advances, innovations in business models (such as agency banking), regulatory changes, and increased competition from outside the traditional financial sector are promising developments for furthering financial inclusion.

**Innovations in business models, regulatory changes, and increased competition from outside the traditional financial sector are promising developments for furthering financial inclusion**

## Where does Zambia stand on financial inclusion?

This section draws largely on data from the Global Financial Inclusion (Global Findex) database.[4] Collected in 2011, the database measures how adults (ages 15 years and older) in 148 economies save, borrow, make payments, and manage risk, surveying at least 1,000 individuals in each economy for a nationally representative sample (box 2.2).

### Account ownership

Financial inclusion as measured by ownership of accounts has increased in Zambia in recent years but there is still much room for improvement. According to data from the Global Findex database, 19 percent of adults in Zambia have an account at a bank, credit union, cooperative, or MFI (figure 2.2). This share is in line with the FinScope estimate of 14 percent of adults using a bank product and 23 percent of adults using formal financial services (bank or nonbank financial institution) in 2009.[5] Overall, account penetration is on a par with the rest of Southern African Development Community (SADC) countries[6] if South Africa is excluded, but is slightly lower than the average for the rest of Sub-Saharan Africa as well as the average for other countries in the lower middle income group, and about half of account penetration in developing countries in general.

In Zambia as elsewhere, account penetration varies by individual characteristics (figure 2.3). Only 12 percent of people in the lowest income quintile have a formal

4. The Global Findex database is available at http://www.worldbank.org/globalfindex. All reported regional or income group averages are population weighted. Updated data from the Global Findex are being collected in 2014 and will be available in spring 2015.

5. FinScope considers as "financially included" anyone who uses a formal or informal financial product, which increases their more widely reported estimate to 37 percent. A new round of FinScope data collection for Zambia is planned in the near future.

6. Global Findex data are unavailable for SADC member countries Namibia and Seychelles.

**Nineteen percent of adults in Zambia have an account at a bank, credit union, cooperative, or microfinance institution**

## Box 2.2 Overview of available global financial inclusion data

Global financial inclusion data are available from several sources that can be broadly distinguished along the supply and demand sides of financial inclusion.

**Supply side (providers of financial services):**

*Financial Access Survey*

- Collects annual supply-side data provided by country regulators to the IMF.
- 182 economies participated in the 2012 Financial Access Survey.

*Global Survey on Consumer Protection and Financial Literacy*

- Collects data on regulatory frameworks, institutional arrangements and enforcement mechanisms, and financial capability.
- 114 economies participated in the first survey launched in 2013.

**Demand side (users of financial services):**

*Global Findex*

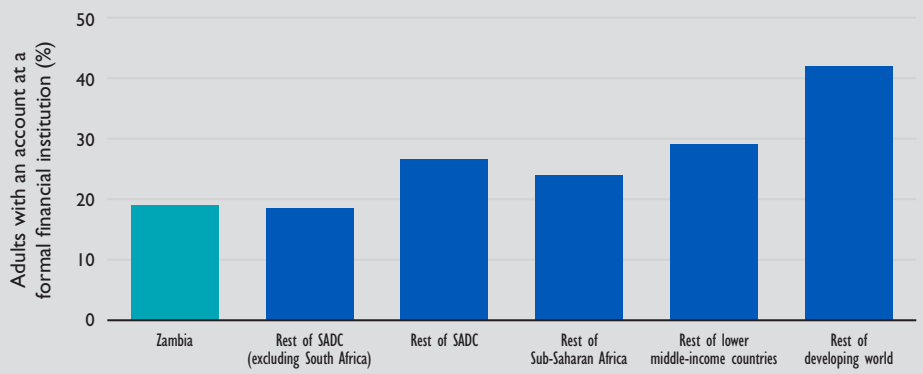
- Measures the use of financial services (accounts, payments, savings, credit, and insurance) by individuals through addition of questions to the Gallup World Poll.
- Surveyed over 150,000 individuals from 148 economies (at least 1,000 individuals per economy) in 2011. The latest round of data is being collected in 2014.

Demirguc-Kunt and Klapper (2013) provide a detailed description of the Global Findex database.

Aside from global surveys, there are also country-led efforts to collect data on the use of financial services. Such national surveys have the advantage that they allow countries to tailor their financial inclusion definitions to the local context—at the cost of international comparison, however. To improve comparison across countries, countries in some instances have modified existing surveys or agreed to similar methodologies within a subregion. One such example is FinScope, a survey that measures the use of financial services by individuals in countries across Africa, including Zambia.

This Brief primarily relies on data from the Global Findex database given that it is currently the only database that collects data on financial inclusion from the perspective of the user of financial services that allows for consistently benchmarking Zambia against its neighboring countries, Sub-Saharan Africa, and developing countries in general. Data from the FinScope survey is available for Zambia for 2009 and reference is made to how these data compare with the Global Findex data from 2011.

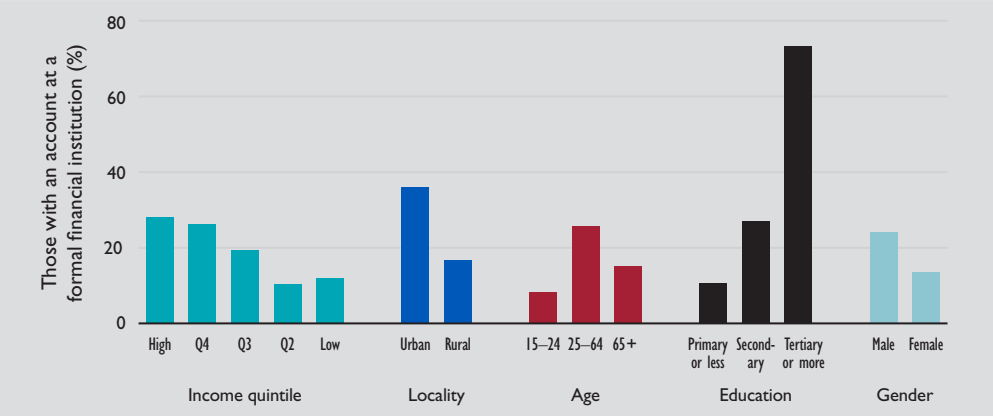
## Figure 2.2 Account penetration, 2011




Note: Data for Zambia are for 2012.
Source: Demirguc-Kunt and Klapper 2013.

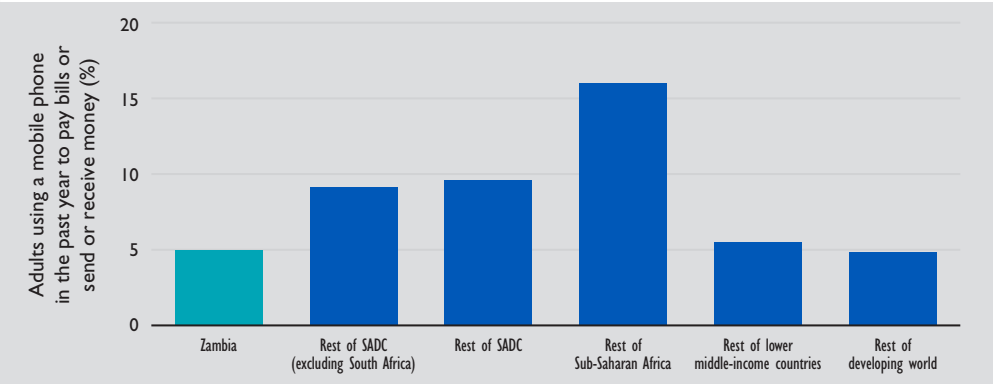
account, against 28 percent in the highest income quintile. The gap between urban and rural residents is substantial: while 36 percent of adults living in urban areas have a formal account, only 17 percent of the almost two-thirds of Zambians living in rural areas do so. Adults ages 25–64 and those with a higher level of education are also more likely to have an account. For example, 73 percent of adults with tertiary education or more own a formal account compared with only 27 percent of those with secondary education. Among those with primary education or less, the account ownership rate is even lower at 11 percent. Women are far less likely than men to have a formal account: the gender gap is almost 10 percentage points.

Figure 2.3 **Account penetration by individual characteristics, 2012**




Source: Demirguc-Kunt and Klapper 2013.

Figure 2.4 **Use of mobile financial services, 2011**




Source: Demirguc-Kunt and Klapper 2013.

**While mobile phone penetration is high in Zambia, use of mobile financial services is still very low**

The gap in account ownership between Zambians in urban versus rural areas persists even when controlling for gender, education, age, income, marital status, and employment status. Econometric analysis using the Global Findex confirms that rural versus urban residency is a statistically significant determinant of account ownership.[7] Similarly, the differences in account ownership identified by comparing averages by gender, education, age, and income are also statistically significant in a multivariate econometric analysis.

## Mobile financial services

Mobile financial services have emerged as an alternative to traditional banking in many developing countries and allow people who are otherwise excluded from the formal financial system to perform financial transaction relatively cheaply, securely, and reliably. While mobile phone penetration is high in Zambia, use of mobile financial services is still very low. According to data from the Global Findex, 62 percent of adults in Zambia report owning a mobile phone but only 5 percent of adults use mobile financial services to pay bills or send or receive money (figure 2.4). This compares with 54 percent penetration among adults in the rest of Sub-Saharan Africa overall for mobile phones and 16 percent for the use of mobile financial services. Within Sub-Saharan Africa the use of mobile financial services varies greatly, as high as 68 percent in Kenya, due to the widespread use of M-PESA. In the other SADC member countries[8] the average use of mobile financial services is 10 percent, or about twice as high as in Zambia.

Among those who use mobile financial services in Zambia, most also have an account at a formal financial institution.

7. Regression results are available on request.

8. Global Findex data are unavailable for SADC member countries Namibia and Seychelles.

**The most common way of saving in Zambia is through informal means only**

While 52 percent of adults in Sub-Saharan Africa who use mobile technology to transfer money are otherwise unbanked, that percentage is just 20 percent in Zambia. This may on the one hand be due to the early development stage of mobile financial services in the country and the fact that early adopters of new technologies tend to be richer, more educated individuals who are also more likely to have a formal account. The relatively high cost of mobile services may also contribute to their low use, as suggested by the comparison with other Sub-Saharan African and SADC countries (figure 2.5). On the other hand, this might be because mobile financial services in Zambia are often offered in conjunction with an account at a bank (see below).

### Saving and borrowing

In Zambia 32 percent of adults save, in line with the global average in developing countries. Of adults who reported saving in Zambia in the year prior to the survey, 37 percent report having used a formal account and 19 percent report having used a community savings club only (figure 2.6). The most common way of saving, however, is through informal means only (44 percent). Informal saving includes saving with a person outside the household, assets such as gold or livestock, or keeping it in the home. Savings in the form of livestock and crop output are common in rural areas of Zambia.

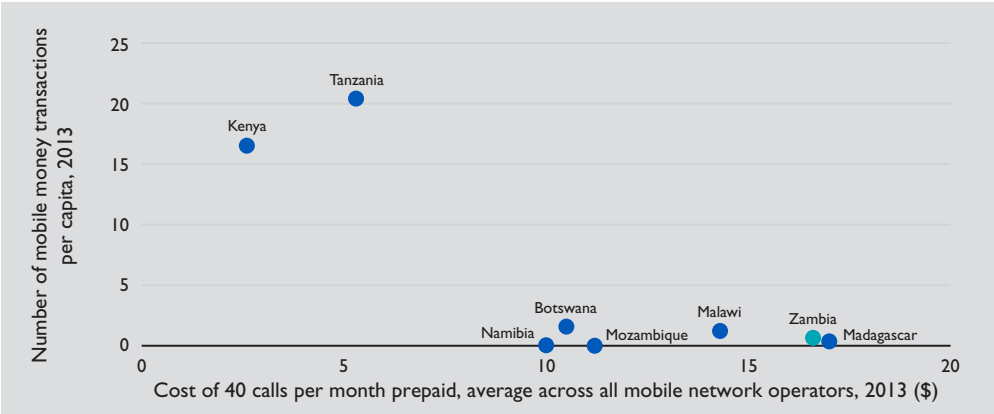
As in the rest of Sub-Saharan Africa, Zambians rely primarily on family and friends for credit. Just 6 percent of adults in Zambia report having borrowed from a bank, credit union, or MFI in the past year while 7 percent of adults report having borrowed from a store over the same period (figure 2.7). In this Zambia is not very different from the rest of the developing world. Globally, 9 percent of adults report that they borrowed from a formal financial institution in the past 12 months. In contrast, the share of adults who have borrowed informally is many times higher, with 42 percent of Zambians reporting to have borrowed from family and friends in the past year. The importance of friends and family as a source of loans holds universally except in high-income economies (World Bank 2013a). Zambia's proportion of those borrowing from family and friends, while similar to the rest of Sub-Saharan Africa, is much higher than in other developing countries.

People borrow for a variety of reasons. Data from the Global Findex show that in Zambia the most common reason is to pay school fees, which 3 percent of adults report (figure 2.8). This is followed by loans for emergency and health purposes, purchase of home, home construction, and a funeral or wedding. People may also borrow for other reasons not captured in the survey, such as starting a business. In contrast to the rest of Sub-Saharan Africa and indeed other developing countries, reported reasons for loans are very low. In the rest of the developing world, emergency or health purposes are the most commonly reported reasons for an outstanding loan (11 percent), followed by school fees (5 percent).

### What are the barriers to financial inclusion?

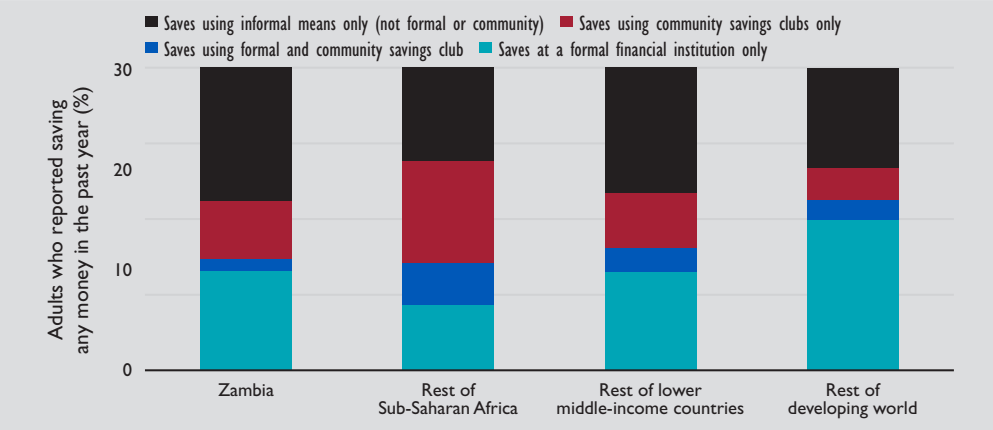
According to the Global Findex database, nearly 90 percent of adults without accounts

Figure 2.5 **Cost and use of mobile money**



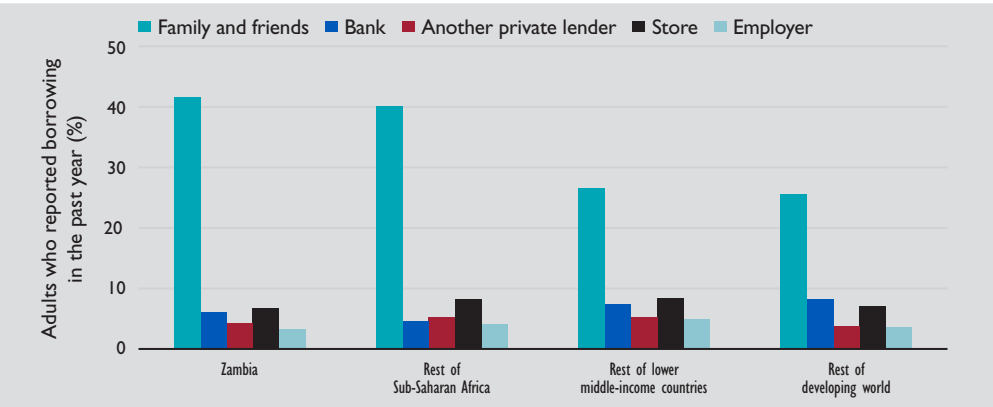

Source: Financial Access Survey (IMF) and Research ICT Africa.

Figure 2.6 **Formal and informal savings, 2011**



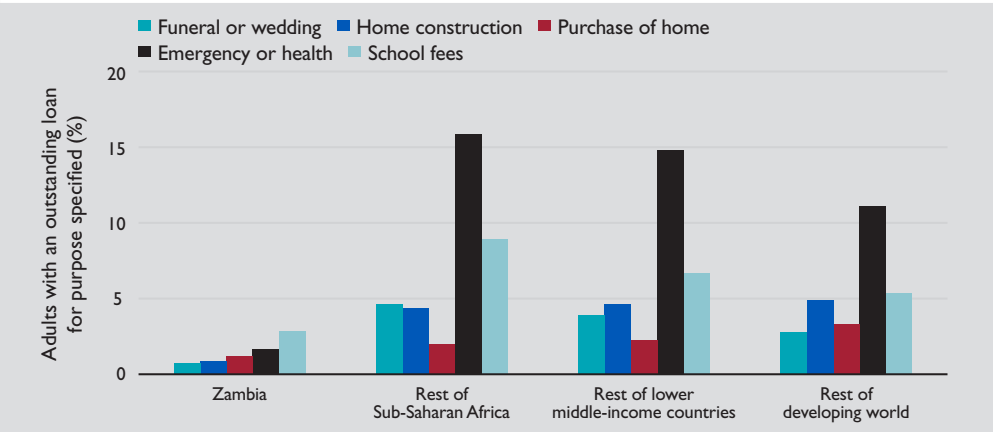

Source: Demirguc-Kunt and Klapper 2013.

Figure 2.7 **Sources of credit, 2011**




Source: Demirguc-Kunt and Klapper 2013.

Figure 2.8 **Reasons for loans, 2011**

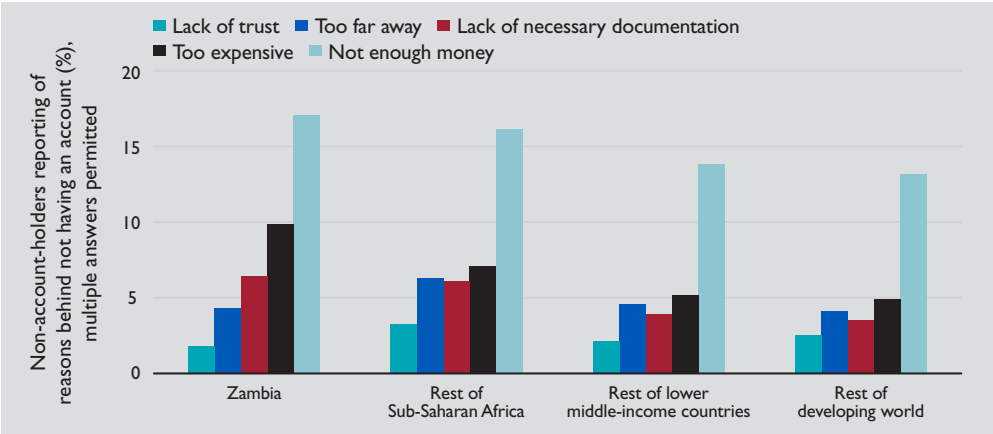



Source: Demirguc-Kunt and Klapper 2013.

**About 42 percent of Zambians borrowed from family and friends in the past year, similar to the rest of Sub-Saharan Africa but much higher than in other developing countries**

in Zambia mention *not having enough money* as a reason for not having an account (figure 2.9) and 30 percent without an account cite this as the *only* reason. This is in line with evidence from developing countries overall. The second most reported barrier is the high cost of maintaining an account. Half of those without accounts in Zambia report that they do not have an account because it is too expensive. This proportion is higher than for adults without an account in the rest of Sub-Saharan Africa and twice

Figure 2.9 **Self-reported barriers to formal account use, 2011**




Source: Demirguc-Kunt and Klapper 2013.

**People who are poor, young, unemployed, out of the workforce, less educated, or living in rural areas are less likely to have a bank account**

as high as that for adults without accounts in developing countries on average. A third of non-account-holders in Zambia also cite lack of documentation as one of the main reasons for not having an account, on a par with the average in Sub-Saharan Africa. Zambian respondents are less likely than the unbanked in other Sub-Saharan countries to cite distance, or lack of trust, as a reason.

An econometric analysis of Global Findex data finds that across countries cost as a self-reported barrier is correlated with objective measures of cost. This analysis considered country-level characteristics and policies as well as individual characteristics to explain whether individuals had a formal account and used it. The analysis found that a higher level of account ownership is associated with a better enabling environment for accessing financial services, such as lower banking costs, greater proximity to financial service providers, and fewer documentation requirements to open an account. At an individual level, people who are poor, young, unemployed, out of the workforce, less educated, or living in rural areas are less likely to have an account. The analysis concluded that policies targeted at enhancing financial inclusion—such as offering basic or low fee accounts, granting exemptions from onerous documentation, allowing for agency banking, and using bank accounts to make government payments—are especially effective among those people who are most likely to be excluded: the poor and rural residents (Allen and others 2012).

## Lay of the land of the supply side of financial inclusion

Zambia's banking sector is small. The country has fewer bank accounts and bank branches per capita than other SADC countries and than its economic and geographic peers (table 2.1). The Zambian banking system is characterized by high interest rates, and high fees and other costs of banking services, all of which create significant barriers to access for individuals. Outstanding commercial bank deposits have averaged around 27 percent of GDP in Zambia, 9 percentage points below the regional average and 21 points lower than other lower middle-income countries.

MFIs still play a minor role in Zambia.[9] As of 2012, MFIs shared about 100,000 clients across 33 registered MFIs that can be placed in two broad categories: development oriented and consumption lending, the latter of which are often referred to as "payday lenders." Neither of these two groups is thriving. The market for payroll-based consumer lenders is almost saturated, given the relatively low numbers of salaried workers in Zambia.[10] Almost 90 percent of the microfinance sector's portfolio is managed by consumption-lending MFIs, which are based mainly in Lusaka and the Copperbelt. Table 2.2 lists

9. The liberalization of the banking sector in the 1990s and the consequent cost-saving closure of bank branches in rural and semi-urban areas offered an opportunity for MFIs to expand, but they have never been able to capitalize on these moves.

10. The total number of salaried workers is about 700,000, or 6 percent of the population according to the World Development Indicators.

**Table 2.1 Banking sector outreach**

| | Bank accounts per 1,000 adults | Bank branches per 100,000 adults | Bank deposits to GDP (%) |
|---|---|---|---|
| Zambia | 274 | 5 | 27 |
| SADC (excluding South Africa) | 500 | 6 | 46 |
| Lower middle-income countries | 640 | 11 | 48 |
| Sub-Saharan Africa | 464 | 5 | 36 |

Source: Global Financial Development database.

**Table 2.2 Top 10 MFIs in Zambia**

| MFI | Report date | Loans ($) | Borrowers | Deposits ($) | Depositors |
|---|---|---|---|---|---|
| FINCA–ZMB | 2013 | 16,363,318 | 45,559 | — | 84,178 |
| CETZAM | 2009 | 2,513,353 | 5,423 | 394,146 | 5,423 |
| MBT | 2011 | 1,952,186 | — | 855,012 | — |
| AMZ | 2012 | 1,770,791 | 10,579 | 257,688 | — |
| PRIDE–ZMB | 2006 | 1,510,279 | 3,687 | 158,658 | 4,930 |
| PFSL | 2006 | 599,835 | 2,851 | — | 0 |
| Harmos | 2009 | 501,993 | 3,366 | 114,405 | — |
| MLF Zambia | 2012 | 311,868 | 3,228 | 0 | 0 |
| E-MFI | 2008 | 154,030 | 984 | 0 | 0 |

Note: Development (or deposit-taking) MFIs include FINCA–ZMB, CETZAM, and PRIDE–ZMB. Salary-based lenders include MBT, AMZ (Agora Microfinance Zambia Ltd), PFSL (Pulse Financial Services Limited), Harmos, MLF Zambia (Microloan Foundation Zambia), and E-MFI (Empowerment Micro Finance Institution Ltd).
Source: MixMarket.

**More than 60 percent of all commercial bank branches are in Lusaka and the Copperbelt**

the main players in microfinance, based on data from MixMarket, to which not all institutions report. The recent introduction of interest rate caps led to the closure of four MFIs, yet new MFIs are still entering the sector. Notably in late 2012, Zambia's Post Office was licensed as ZamPost Microfinance Zambia Limited.

Unlike in many other Sub-Saharan countries, financial cooperatives are not common in Zambia. There are only 30 savings and credit cooperatives registered at the Department of Cooperatives, and it appears that financial cooperatives do not enjoy a good reputation because of a lack of initiative and absence of good internal governance (ILO CoopAfrica 2009). Apart from the MFIs, the nonbank financial institution (NBFI) subsector includes 7 leasing companies, 4 building societies, the Development Bank of Zambia, the National Savings and Credit Bank (or NatSave, a government-owned savings bank), and 61 bureaus de change.[11] These NBFIs tend to specialize in niche markets and so have limited influence. Apart from the NBFIs, small community-based non-deposit-taking non-governmental organizations are active in some rural areas.

### The geography of financial inclusion

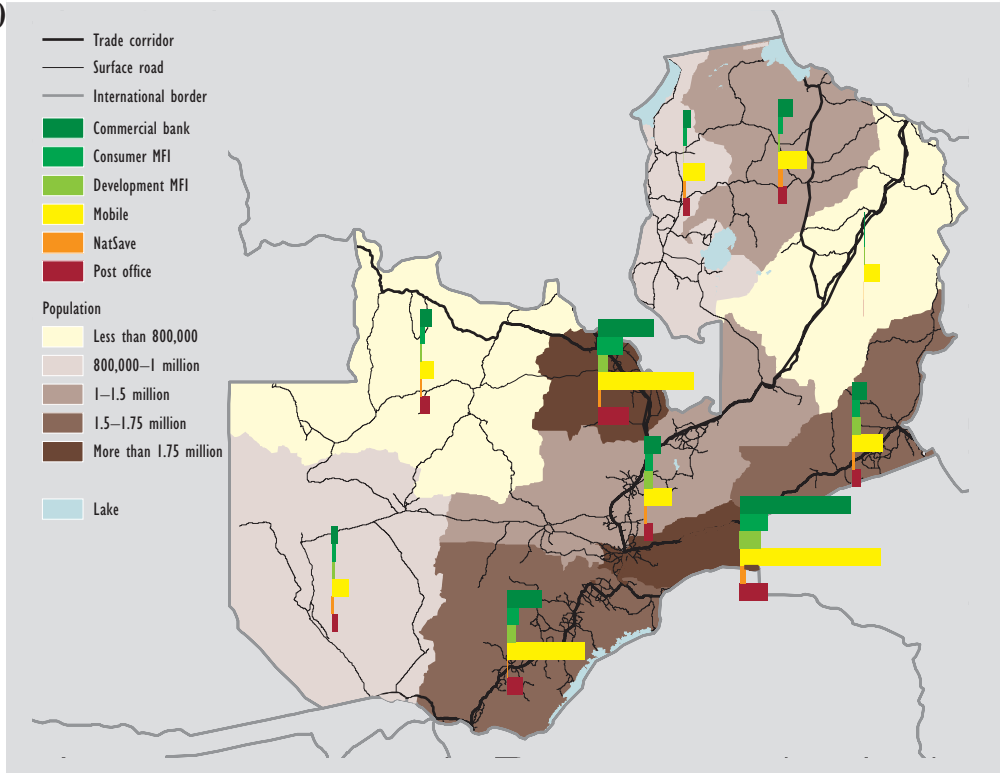
Financial service access points are highly concentrated in Lusaka and a few other densely populated urban centers along the main trade corridors (figure 2.10): more than 60 percent of all commercial bank branches are in Lusaka and the Copperbelt. Conversely, 25 percent of districts[12] in poorer provinces are not served by any branch of either a commercial bank or an NBFI regulated by BoZ. The imbalance in coverage is less severe among mobile agents and post office branches, of which 51 percent and 48 percent respectively are present in Lusaka and the Copperbelt.

Multiple factors explain this dearth of financial access points. Zambia's low population density in rural areas makes it costly to serve customers outside the few urban centers because it is difficult to reach economies of

11. Zambia also has a credit bureau, the Credit Reference Bureau Africa Limited.

12. This figure is an approximation and may not be factual due to the recent increase in the number of districts as part of decentralization. The number of districts as of April 2014 stands at 105.

**Figure 2.10 Map of financial service access points, Zambia**




Source: BoZ, Census, MixMarket.

**Zambia's low population density in rural areas makes it costly to serve customers outside the few urban centers because it is difficult to reach economies of scale**

scale.[13] These difficulties are compounded by the relatively high incidence of poverty among the rural population (figure 2.11). The figure shows that the number of physical bank and NBFI branches increases as provinces become more densely populated and developed.

Despite the challenges, some banks have expanded their branch networks outside the main urban areas to reach the unbanked population in rural areas. Among the first to adopt this strategy was NatSave, established by the government in 1972 with the explicit mission to serve rural areas especially and to mobilize savings. NatSave maintains a sizable branch network in rural areas with more than half its 33 branches outside urban centers, and plans to further expand its business by setting up 50 new branches over the next five years. NatSave offers savings products, with differentiated fees for urban and rural costumers, as well as personal and commercial loans. Payday lending accounts for the vast majority of the lending portfolio, despite the recent growth of financing of equipment purchases.

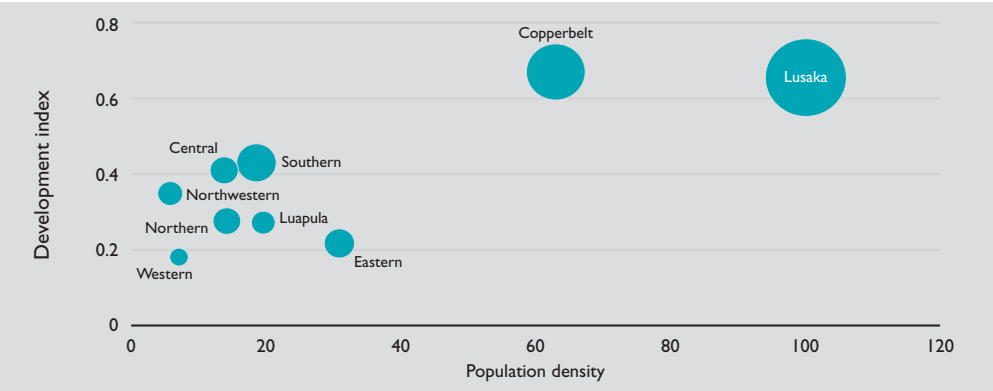
A strong branch network across the country has proved valuable for ZamPost, especially for its domestic remittances services. ZamPost has gained a leading position in domestic remittances by leveraging its network of more than 200 branches and 30 agents in 105 districts. SwiftCash is the preferred instrument for domestic financial transfers. In a move to diversify its financial base using its recently acquired MFI license, ZamPost has started providing salary-backed loans and plans to venture into group and small-business lending and to start taking deposits.

### Innovations in financial inclusion

Over the past years Zambia has witnessed improvements in its communication technology. Since the mid-2000s, mobile phones and Internet connections have become increasingly more common (figure 2.12), and as of 2012 nearly 80 percent of the population had a mobile subscription, according to the Zambia Information and Communications Authority. Nevertheless, major infrastructure challenges persist. The lack of electricity with which to power mobile phones and cell towers, limitations in mobile network coverage, and poor roads and transport networks are

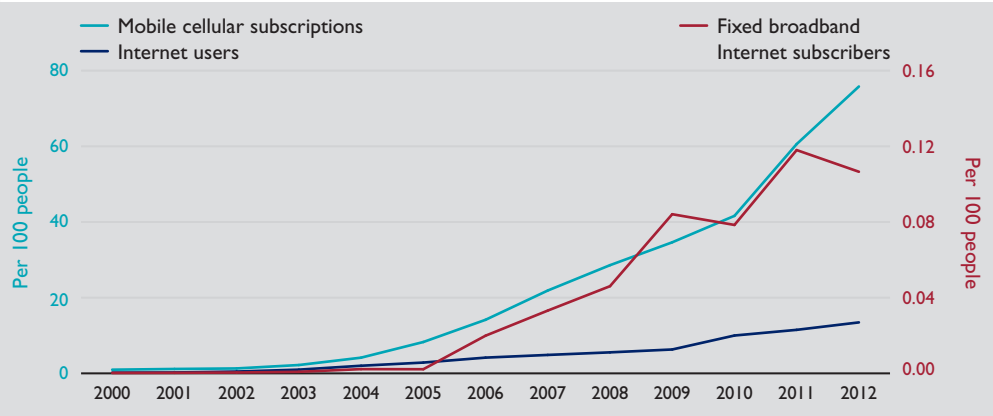
13. For instance, the setup costs for a bank branch are estimated at $300,000–$500,000, which is high for the region.

Figure 2.11 **Financial service access points—development challenges**




Note: The population density and development index are plotted on the horizontal and vertical axes respectively. The size of the circles captures the number of financial service access points in a province.
Source: BoZ, Census, and SNDP.

Figure 2.12 **Growth in technological infrastructure**




Source: World Development Indicators.

**Since the mid-2000s, mobile phones and Internet connections have become increasingly more common, and as of 2012 nearly 80 percent of the population had a mobile subscription**

all hindrances, especially in rural areas. The authority's recent decision to build 169 telecom towers in rural unserved areas and share their use across all mobile operators is a positive first step.

The development of technological infrastructure offers new opportunities for mobile financial services. In late 2011, mobile network operators (MNOs), specifically Airtel and MTN, started offering mobile money services that can be used to pay bills, make relatively small domestic money transfers (below $1,000), and purchase airtime. Compared with commercial banks, MNOs have lighter "know your costumer" (KYC) requirements to open an account, compensated by limits on the size of transactions and total balances.[14] Mobile financial services are also offered by some commercial banks as additional services for existing customers. Typically banks extend access to deposit accounts, and sometimes savings accounts, via mobile phone and Internet, to reduce long lines at their branches (table 2.3). The large success of First National Bank's e-wallet among urban consumers is indicative of strong demand for simpler and more accessible banking products. Prepaid debit cards are another example of flexible products. They are becoming available at most banks, but still involve standard KYC requirements and are therefore mainly used by existing urban account holders, rather than by underserved groups.

Technological innovations also allow for the adoption of new banking models, such as agency banking. Commercial banks are collaborating with MNOs and other partners in expanding more cost-effectively. MNOs are increasingly expanding the number of

14. Typically, a National Registration Card, driver's license, or voter's license is sufficient, without the need for proof of address.

**Table 2.3 Access to mobile and Internet banking**

| Financial institution | Accessible via | | | | |
|---|---|---|---|---|---|
| | USSD | Desktop/laptop | iOS | Android | BlackBerry |
| First National Bank | Yes | Yes | Yes | Yes | Yes |
| Barclays Bank | Yes | Yes | Yes | Yes | No |
| Zanaco | Yes | Yes | No | No | No |
| Investrust | Yes | No | No | No | No |
| Standard Chartered | Yes | Yes | No | No | No |
| StanBic | No | Yes | No | No | No |
| Cavmont | No | Yes | No | No | No |
| Ecobank | Yes | Yes | No | No | No |
| United Bank of Africa | Yes | Yes | No | No | No |
| Access Bank | Yes | Yes | No | No | No |

USSD = Unstructured Supplementary Service Data.
Source: Information on website of each individual bank.

**The collaboration between banks and mobile network operators has large potential, allowing for a wider range of products while reducing liquidity-management issues**

agents for mobile financial services, with mobile money agents present in all districts, though they do not seem to be operational at all times, such that service reliability is still a concern (see also Bankable Frontiers Associates 2012). The collaboration between banks and MNOs has large potential. On the one hand, it allows for a wider range of products and, on the other, reduces liquidity-management issues. Yet the success of these partnerships is not guaranteed. After pulling out of its collaboration with Zanaco, ZamPost is now working with United Bank of Africa to offer prepaid cards. Zanaco has launched its own network of agents, and while they are still few (only 160 agents across 90 districts) and not operating at full capacity, their numbers are expected to grow steeply.

Technology improvements have brought groundbreaking solutions in retail payments, especially for domestic money transfers and bill payments. New and competitive players have entered this segment and are steadily expanding their range of services and clients served. Regulated as a designated payment system, Zoona is becoming the main competitor of SwiftCash, ZamPost's money transfer service. Both offer over-the-counter services via their 200 post office branches and 320 agents respectively, and Zoona's market share has reportedly increased to around 40 percent of transactions. Zoona can rely on a sizable network of agents and a leaner structure resulting in lower transaction costs. Consumer trust in both ZamPost and Zoona agents is high, although customer loyalty to ZamPost seems to be mainly among older adults, while younger adults tend to favor Zoona. However, their services are not necessarily cheap: while SwiftCash tariffs came down last year to match Zoona's fees, postal money orders remain very expensive, in the 7–10 percent range.[15]

The other major domestic payment service is provided by Kazang, whose mobile POS systems are purchased by merchants for facilitating payments. Kazang has around 3,000 merchant outlets—2,000 of them active daily—with the majority of their transactions being cellular airtime purchases, along with a growing bill payment business for electricity and television service. Kazang recently launched a money transfer service, Kazang Money, and has 130 outlets that can do money transfers. A new player is Roraima Data Services, which is also the provider of the SwiftCash platform. Roraima is promoting the Cash4Africa money transfer service in Zambia, with the Zambian Cooperative Federation as a distribution partner. Commercial banks have played a marginal role in retail-payment channel innovations. One exception is First National Bank, which is introducing new terminals (mini- or "slimline" ATMs), but progress remains hampered by a lack of cash-in/out agents.

Some commercial banks have made an effort to develop low-end products, although progress has been slow and availability is limited. Zanaco has launched two products

15. International remittances are serviced largely by Western Union, which has a partnership with the Post Office, and MoneyGram, but these services are expensive and have smaller, mostly urban, agent networks.

in this segment: Xapit and Cultiv8. Though similar, the two products are differentiated by the fact that Cultiv8 is designed specifically to be integrated with MNOs. It already works with Airtel Money and will soon be available for MTN's customers. Barclays' Tonse accounts are aimed at the low end, and the bank is apparently speaking with a major cotton producer about providing farmer salaries via Barclay's debit cards, but whether this will be launched, and whether there will be enough ATMs or cash-in/out agents in rural areas to properly service the farmers, is unclear.

## Is technology a game changer for financial inclusion for individuals in Zambia?

In the last decade new technologies have vastly improved the potential for expanding financial inclusion: as seen, transaction costs and geographic distances have traditionally been some of the main impediments to expansion. Technologies such as electronic payment solutions, mobile technology, credit information systems, and universal individual identification can help overcome some of these traditional barriers. Given Zambia's low population density, especially in rural areas, technological innovations and payment solutions have an important role in harnessing the country's financial inclusion potential. This part now describes recent developments, challenges, and opportunities in more detail, drawing on international examples as appropriate. It ends by highlighting policy considerations for the future.

### Electronic payments

While Zambia has lagged its neighbors in the growth of electronic payments (e-payments), the sector is slowly expanding and innovating, and citizens are starting to accept the use of digital financial services in place of cash. The growing penetration of cellphone use and airtime sharing, even in rural areas, and the growing popularity of alternative cash transfer and payment services such as Zoona and Kazang demonstrate that users are willing to try new technologies if the service is convenient and the value proposition is clear.

In Kenya the popular M-PESA tagline of a cheaper, easier way to "send money home" resonated with the many Kenyans who worked in cities but retain strong ties to their home villages. The Zambian cultural context differs from Kenya though, and people's financial pain points focus more on issues like inconvenience of paying bills and documentation requirements for opening accounts. In addition, there may be other issues at play, including saturation and business models. While there have been positive developments in Zambia, most service providers still need to develop products and services that cater to the unique needs of the rural, low-income market, and not just compete for the same small group of corporate and high-end clients in Lusaka (box 2.3). There is a tendency to assume that the government needs to conduct broad financial education programs to stimulate demand. While financial education would certainly be useful, providers can also tailor their products and messaging better, so that they meet the needs of the population.

Despite the widespread introduction of new mobile e-payments in the last few years, there has been limited take-up so far and providers have yet to achieve scale. While the two MNOs—Airtel and MTN—claim to have almost 3.1 million and 2 million mobile money customers, respectively, most of them are only registered, not active, customers. Customer awareness of the benefits of

**Service providers need to develop products and services that cater to the unique needs of the rural, low-income market, and not just compete for the same small group of corporate and high-end clients in Lusaka**

**Box 2.3 XacBank's mobile banking challenges in Mongolia**

In Mongolia, with a lower population density than Zambia, XacBank launched Amar mobile banking in 2009 to reach residents outside the capital of Ulaanbaatar. The Amar service is performing well, with over 123,000 clients, who have access to 845 agents and 1,108 merchants. As of mid-2013, the service was conducting over 50,000 transactions a month, worth $3.5 million.

Despite its success, however, XacBank failed to understand its customers when it launched Amar and so suffered poor uptake. While it established a large agent network to serve customers, the initial service itself had limitations that lowered usefulness: it required a bank account to be opened, it imposed transaction limits that did not allow for salary payments, and the service did not allow for airtime top-up or bill payments, both of which were important to customers. The bank has since addressed these issues and improved service considerably, leading to much greater uptake and use.

mobile money remains low; agents are little used, poorly incentivized, and often illiquid; and both players have reportedly had platform problems. A few banks have introduced low-fee, low-KYC accounts that are proving popular with consumers, but these types of services are not being broadly rolled out. Other banks are looking to facilitate bulk mobile money payments to their corporate clients who need to pay rural employees, which will play an important role in developing a viable system, but success will be highly dependent on the mobile money providers having a wide enough network of liquid agents in the areas served.

**Shared agent networks will be critical to allow broad coverage for financial service providers**

It is critical that banks and mobile money providers work together to ensure a smooth rollout of such services. Use of mobile money and money transfer services for bill payments in Lusaka is gaining ground, but it is too early to say whether this will lead to greater use of mobile money or e-payments for person-to-person money transfers, purchases, or savings.

An important payment service that has not yet been properly developed in Zambia is low-value merchant payments, which consumers interact with on a daily basis. Even consumers who use mobile money or bank cards tend to cash out at an agent or ATM, and then use the cash to purchase goods. Achieving scale for a sustainable e-payments sector will require convincing consumers as well as merchants and retailers to use new e-payment systems at the point of purchase, and doing so will often involve links to existing POS and sales-tracking systems (for larger merchants) and simple receipt-printing capabilities (for smaller merchants). Few merchants want to spend time and energy building up such capabilities, certainly not before seeing evidence of customer demand and benefit to their business.

One approach that has worked well in Kenya is the use of a third-party merchant payment company Kopo Kopo,[16] which enables merchants to accept mobile money payments from multiple service providers, and handles all back-end integration and settlement services on the merchant's behalf. The use of payment aggregators like Kopo Kopo has led to rapid uptake of mobile money for merchant payments in Kenya, and encouraged competitors to enter the market. Another approach slowly being introduced in Zambia is the use of mini-POS systems that merchants and other vendors can use to easily take card payments.[17]

Shared agent networks will be critical to allow broad coverage for financial service providers. Reaching the many under- and unserved rural areas of Zambia is an impossible task for any one player to achieve cost-effectively. Rather than competing for the same limited number of promising agents in a sparsely populated area, service providers can explore ways to cooperate at the agent level. Not only would this spread the costs of agent management across more providers, but it would also enhance the business case for the agents themselves, who will have more services to provide to their customers. There are multiple ways of developing shared agents beyond the use of retailers: the establishment of service centers in district headquarters where various e-government and financial services can be accessed; enlistment of selected teachers as reward for superior performance; partnerships across various agricultural dealers, unions, and cooperatives; and shared use of a mobile banking van that can visit the most remote areas regularly.

Government payments can play a catalytic role in providing volume and scale in rural areas for financial service providers. The volume of government payments, from salaries to pensions and social cash transfers, has the potential to add significant volumes of transactions to service providers, and can make a critical contribution to commercial viability in rural areas. The Ministry of Community Development's plan to start paying social transfers electronically is a welcome start. Currently 60,000 households in 18 districts are benefitting from the K70 or K140 monthly transfers depending on eligibility, with the target of reaching 189,000 households in 50 districts by the end of 2014. Transfers are currently entirely in cash and taking place bi-monthly to reduce transaction costs. Funds are transferred to a bank branch in the district, to be picked up and distributed by school teachers. This is not only costly but also time-intensive for the school teachers

16. Kopo Kopo, http://kopokopo.com.

17. ZipZap Mobile Payments, http://www.zipzap.co.za.

**Box 2.4 The Connected Farmer Alliance as an example of digital financial services in agriculture**

The Connected Farmer Alliance (CFA) is a public–private partnership that seeks to promote commercially sustainable mobile agriculture solutions and increase productivity and revenues for 500,000 smallholder farmers in Kenya, Mozambique, and Tanzania, including 150,000 women. It also aims to increase revenues for agribusinesses and agriculture value-chain service providers.

Launched in 2012, CFA is a partnership between the U.S. Agency for International Development, Vodafone, and TechnoServe. It works with farming communities and supply-chain businesses to develop and scale mobile applications that will enable rural households to make and receive payments securely, access other financial services such as microinsurance, and connect to local and multinational agribusinesses, especially those working in priority value chains of Feed the Future, the U.S. government's global hunger and food security initiative.

CFA's workstreams include developing business-to-business services that lower transaction costs and reduce risks for agribusinesses to source from smallholder farmers; designing, testing, and launching new mobile money services to allow farmers to save and invest their money; and helping farmers fully use the business-to-business and mobile money services developed in the first two phases by developing a new generation of mobile value-added services targeting agriculture.

To date, CFA is facilitating communications and transactions for some 6,300 smallholder farmers and three agribusiness clients. In Tanzania, the program is working with a flower seed exporter and a rice processor to facilitate management and disbursement of loans to farmers and outgrowers. And in Kenya, it is working with a multinational beverage firm to manage information and communication with around 5,000 mango and passion-fruit farmers.

**A determined government effort is needed to move its financial transactions from cash to electronic to reach the "last mile"**

and involves considerable insecurity when the funds are picked up and stored in the schools before they are distributed. International experience suggests that electronic government transfers are especially powerful if they come with the additional feature of a basic bank account that can be used for savings and, eventually, credit. It is important, however, that these accounts are not associated with fees or minimum balances.

Electronic payments in the agriculture sector could contribute to the move from cash to electronic payments. Smallholder farmers, who number 1.2 million households, typically operate entirely with cash, from input payments to receiving payments for their products (CSO 2011). Not only does this entail costs of cash distribution for agricultural companies, it also presents risks to recipients in terms of safety and security. Some firms have experimented with vouchers for smallholder payments, and some efforts are under way to engage agro-dealers in digital payment services, but it is unclear how successful these programs will be or whether they will tie in to the greater national payment system.

Some specialized programs in this area have been launched in other countries, such as the Connected Farmer Alliance[18] in Kenya, Mozambique, and Tanzania, which could provide examples for Zambia in developing solutions (box 2.4). Indeed, similar ICT-based innovative products are piloted in Zambia by SANGONeT, a South African nongovernmental organization, and International Development Enterprises (iDE)-Zambia, with the support of the Gates Foundation. "Lima Links" is the name of the mobile application launched in 2013 providing a wide array of information to vegetable farmers, from weather data to market prices, to help raise their agricultural productivity and bargaining power. The Ministry of Agriculture and Livestock plans to pilot an e-voucher system in the coming months under the Farmer Input Support Program.

A determined government effort is needed to move its financial transactions from cash to electronic to reach the "last mile." Efforts here should in the long run include incoming payments, such as taxes and fees, as well as outgoing government-to-person payments, including pensions, grants, and salaries. Some initiatives have started, such as the Revenue Authority's efforts at e-payments and Kitwe City Council's project with MTN to collect levies from bus operators and traders via mobile money, but it would be useful for national and local governments to work together on developing uniform solutions. The Single Treasury Account being set up at the real-time gross settlement system to facilitate government payments will be useful for that. (See annex B.)

18. Connected Farmer Alliance, http://www.technoserve.org/our-work/projects/connected-farmer-alliance.

**With their widespread presence in rural and poor areas, post offices can be among the leaders in increasing financial inclusion**

### From payments to other financial services

New payment service providers can be important in fostering financial inclusion. For many of the unbanked, money-transfer and payment service providers will be their first—often only—link to the formal financial system. As payments are typically made at a local agent equipped with either a mobile phone or some form of payment terminal, users can easily send cash to far-flung contacts and pay their key bills, such as utilities. What is critical is the trust that these agents and payment services have built up within their community; people often know the agents, who may be local retailers or other trusted individuals, and the service itself is straightforward, fast, convenient, and low cost. When it comes to addressing the specific needs of users—in this case for simple, reliable, and cheap payments—mobile operators and newer, smaller players such as Zoona and Kazang typically do a better job than traditional banks at understanding their customers.

Providing basic payment services can be the first step into the financial system and open access to other financial services. Kazang has introduced a stored wallet product, although it is too early to know what the uptake will be. In 2012 Zoona started to offer a payment solution to distributors of SAB Miller, the national brewing company. The distributors, who are small and medium enterprises, can deposit funds at Zoona agents or participating banks. Zoona is planning to add other distribution chains and start servicing the distributors' suppliers. To support the business of the distributors, Zoona has started to partner with financers to offer working capital and expansion loans. The data that Zoona and other payment providers are collecting on payments made by its users are a powerful means for assessing creditworthiness for financial institutions as they allow them to track incoming and outgoing payments on a daily basis.

Another example of data use comes from Tanzania, where First Access developed a platform that collects mobile payment data to predict credit risk for borrowers in informal markets and to create a credit score, as an alternative to records from credit bureaus.[19] Based on the extensive mobile money data collected by M-PESA, Safaricom and Commercial Bank of Africa launched M-Shwari, a product that allows M-PESA customers to save and borrow. The loan underwriting is entirely based on the M-PESA transaction history of the customer. With about 33,000 loans approved every day, more than 2 million subscribers, and nonperforming loan rates of 2–3 percent, it is clear that there is demand for such products and that they can be commercially viable. In addition, Econet in Zimbabwe has recently announced its own credit product alongside its mobile wallet savings service for EcoCash customers. (EcoCash Save and EcoCash Loans are offered in partnership with Steward Bank.)

Leveraging existing infrastructure such as post offices also provides opportunities to increase financial inclusion cost-effectively. With their widespread presence in rural and poor areas, post offices can be among the leaders in increasing financial inclusion. In Zambia, ZamPost has the physical infrastructure to reach individuals in rural areas currently not served by commercial banks, and can leverage its popular domestic remittance service (SwiftCash) and its recently acquired deposit-taking MFI license to start offering additional financial products to its clients. Provision of financial services through the post office does not necessarily have to be through a fully fledged postal bank but can take several forms, including a partnership model with a commercial bank, as in Brazil (box 2.5). This is based on the concern that post offices may not have the right skills or capacity to create a postal bank or to develop and manage financial products, especially credit products, themselves—but partnership models can often help. At the moment, ZamPost's microfinance subsidiary primarily offers salary-backed loans with low default risk, but as it plans to expand its loan products its credit risks will likely increase. For ZamPost it would be worthwhile assessing the options.

### Agency banking

Agency banking provides an opportunity for financial institutions such as commercial banks to extend financial services into rural areas cost-effectively. Given the high cost of establishing bricks-and-mortar branch networks, it is more sensible for banks to partner

19. First Access, http://www.first-access.org/.

**Box 2.5 Partnership models can be successful for increasing financial inclusion through the post office**

Post offices around the world have adopted different business models and different types of financial services. Most of them provide some cash-merchant services, including remittance services either on behalf of remittance service providers or using their own proprietary product. In some countries, post offices also offer financial services beyond cash-merchant services, including deposit and savings accounts and credit products. To offer those products post offices can either go alone or partner with a commercial bank (Berthaud and Davico 2013).

The most successful postal financial inclusion model on the number of unbanked people eventually entering the formal financial system is Banco Postal in Brazil. More than 10 million accounts were opened between 2002 and 2011 after Banco Postal was set up under a partnership with an existing financial institution (Ansón and Bosch Gual 2008). This partnership model provided Brazilian Post with financial sector expertise and an investor in modernizing its network and infrastructure. It also allowed Brazilian Post to earn fees and commissions on financial products offered—without taking on the risk.

with a third-party retailer or company authorized to provide a select number of services on behalf of the bank. These services typically start with simple payment services but can also include account opening and deposits as well as loan repayments. In Kenya, the agency banking model, as pioneered by Equity Bank (box 2.6), has proved successful in extending financial services to the rural and lower income population, profitably. In Zambia several financial institutions are considering—or starting to be engaged in—agency banking. Although BoZ considers approval for agency banking case by case, a clear regulatory framework will be important in creating a supportive environment in the future. And for agency banking to have considerable impact on financial inclusion, banks will need to engage closely with their new potential customers, understand their lives and needs, and design products accordingly.

### Toward a viable e-money ecosystem

A clear and conducive regulatory framework is important for e-payments to grow. BoZ has pursued a "test and learn" approach to digital innovation in financial services and is now formalizing the regulatory framework to create clarity for all participants. It will be important to ensure that bank and nonbank service providers are treated equally so that there will be a level playing field for third-party agents conducting similar functions. It will also be important for BoZ to balance the need for new payment providers to be viable and suitably risk averse, while not unduly burdening them with excessive capital requirements and fees that will keep smaller—often more innovative—players out of the market.

An appropriate consumer protection framework is necessary to ensure public trust in an e-money ecosystem. Government and financial service providers need to make sure that individuals are educated about their options and clear on dispute-resolution procedures, and that appropriate safeguards are in place to address (among other elements) data privacy and security concerns. This is especially important as the expansion of e-money and e-payments will bring those with weaker financial capabilities into the

**An appropriate consumer protection framework is necessary to ensure public trust in an e-money ecosystem**

**Box 2.6 How Kenya's Equity Bank was successful at reaching the lower end of the market**

Equity Bank was founded as Equity Building Society in 1984. Its transformation from a technically insolvent mortgage financer in 1993 into a fast-growing microfinance bank and then a commercial bank now listed on the Nairobi Securities Exchange and Uganda Securities Exchange has attracted widespread attention.

Its growth was due to an innovative business model that focused on providing financial services to underserved segments largely ignored by traditional commercial banks. It succeeded by tailoring its products to its customers, including being less restrictive on collateral for small loans and moving its branches and, later, agents—existing businesses licensed to provide selected products and services for the bank—closer to its customers. Refocusing its operations around this new customer base and bringing in new standards of service won Equity Bank a large and loyal customer base. In expanding financial inclusion across Kenya, it also generates sustainable profits. Equity Bank agents today can perform a range of services on behalf of the bank, including opening accounts, accepting deposits, paying out withdrawals, and accepting bill payments.

In recent years, Equity Bank has expanded beyond Kenya into other East African countries.

Source: World Bank 2013a; information at http://www.equitybank.co.ke/.

financial system. Without such a framework in place, consumers could lose trust in the system.

Addressing the lack of financial services in rural areas will require the full interoperability of bank and nonbank financial service providers. Beyond BoZ's large-value real-time gross settlement system, the ZECHL clearing house, and the ZAMLINK ATM switch for some of Zambia's smaller banks, there is no interconnection between financial services providers. BoZ's planned national payments switch has the potential to address this interoperability challenge, but must fully include nonbank payment service providers. Cost-effectively serving low-income, rural populations will need to include access not just to new technologies such as mobile phones, ATMs, POS devices, and online services, but also across the many parties that people want to deal with financially, whether friends and family, employers, merchants, schools, utilities, or government. No one provider or sector can justify an investment in all these elements or handle the contractual requirements of dealing with so many players. Rather, multiple players must be able to interconnect where necessary to provide citizens with a wide range of services, and must be able to do it on fair and equitable cost and access terms. Having a national payments switch that all players can connect to will also aid service providers in establishing partnerships for developing solutions by removing the need for customized, and costly, platform integration efforts. It will also be important for the national switch to be able to route and track transactions based on mobile phone numbers, for those users who do not have formal accounts with standard routing numbers.

**Addressing the lack of financial services in rural areas will require the full interoperability of bank and nonbank financial service providers**

Government can support broad-based financial inclusion and electronification of payments by clearly committing to these goals. BoZ's plans to adopt a tiered KYC framework, agency banking regulations, and a new e-directive are positive moves for furthering financial inclusion, especially in rural areas. However, all these initiatives have been in the making for a relatively long time. It will therefore be important that they move toward fruition without further delay. As indicated by several private players, it will also be important for BoZ to consider all third-party players as valid payment-system participants in the new regulations if it wants to see the sector grow. From the government side, signaling its commitment to e-payments—by way of supporting digital signature programs and urging large-bill recipients such as utilities to accept digital receipts as proof of payment—has powerful potential.

The national identification system being developed also has great potential if it is made easily available online to all service providers in the country. While the vast majority of Zambians have a National Registration Card, the cards are not easily verified and are susceptible to fraud. By developing a robust, online database of secure identification cards that can be easily verified, financial service providers can much more easily—and cheaply—conduct KYC and credit checks on potential customers, streamlining the account-opening process and making access more convenient to users. The greater efficiency can also go a long way in reducing the cost of service provision.

## Conclusions

Technological innovations and payment solutions will be an important enabler in bridging the last mile in financial inclusion in Zambia, one of the least densely populated countries in Sub-Saharan Africa. Establishing bank branch networks across the country will not be realistic beyond a certain point given the need for economies of scale. Instead, new developments in the payments landscape—mobile financial services, agency banking, the leveraging of access points set up by payment providers or the post office, government payments—can all help address this challenge. Electronic payments are often the first entry point into the financial system, and the data generated by them can be powerful for accessing other financial products. It will be important to support these innovations and the development of added services through an enabling regulatory framework that is sufficiently clear and that provides a level playing field between bank and nonbank service providers. Implementing the agency banking regulations, the e-directive, and the tiered KYC framework will be important here.

Zambia has potential for growth in electronic payments, which will play a key role in financial inclusion, but this growth will not

necessarily occur on its own without a multipronged approach to establishing a robust and sustainable ecosystem. Although electronic payments were introduced in Zambia in 2001—six years before M-PESA was launched in Kenya—Zambia lags its neighbors in the growth of electronic payments. Still, the country shows signs that the tide may be turning. The increase in cellphone use and airtime sharing even in rural areas and the growing popularity of cash transfer providers and payment services, such as Zoona and Kazang, demonstrate that users are willing to try new technologies if the value proposition is favorable. Yet service providers, regulators, and policymakers all have to ensure that an enabling environment is developed. A key element of sustainability will be in achieving scale, which will require more interconnection and cooperation than seen right now. Moving forward with the national switch project will be crucial in achieving greater interconnection and scale. The development of shared agent networks through different strategies will further support financial service providers reaching under- and unserved rural areas.

The government has a catalytic role to play in furthering financial inclusion by moving its financial transactions from cash to electronic payments so as to provide the needed scale to electronic payments. The sheer volume of government payments—from salaries to pensions and social transfers—can make a key contribution to the commercial viability of financial services in rural areas, and can help them reach low-income households especially. In the long run, incoming payments, such as taxes and fees, should also be moved to the electronic channel. In the meantime, support can be provided for digital signature schemes to allow companies to accept digital receipts as proof of payment.

Leveraging existing infrastructure such as post offices also provides opportunities to increase financial inclusion cost-effectively. ZamPost has the physical infrastructure to reach individuals in rural areas unserved by commercial banks, and can leverage its popular domestic remittance service (SwiftCash) and its recently acquired deposit-taking MFI license to start offering additional financial products. The provision of financial services through the post office does not necessarily have to be through a full-fledged postal bank; it can take several forms, including a partnership model with a commercial bank. This is based on the concern that post offices may not have the right skills or capacity to create a postal bank and develop and manage financial products, especially credit products, themselves, while partnership models can often be advantageous. For ZamPost it would be worthwhile to assess the options.

Zambia stands to benefit from a coherent approach to furthering financial inclusion by developing a national financial inclusion strategy. While the regulatory stance of BoZ has been broadly helpful, a clear overall framework would be beneficial. In other cases, as for ZamPost and NatSave, it appears that the government is essentially investing in competing financial service providers. While multiple players can of course be supported, the government should be strategic in how these players use public funds to tackle the low-income market, ensuring they complement rather than cannibalize each other's efforts. Such a strategy would therefore help the government think through long-run decisions, and could also help define a national coordination structure for implementing the financial inclusion agenda and an appropriate monitoring mechanism to measure these initiatives' success.

**Zambia stands to benefit from a coherent approach to furthering financial inclusion by developing a national financial inclusion strategy**

## ANNEX A

# Economic Data

### Table A1 Growth by main sectors, 2005–13

(percent of GDP, unless otherwise stated; constant price = 2010)

| | 2005–10 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Primary sector | 6.8 | 0.6 | 1.7 | –0.6 |
| Agriculture, forestry, and fishing | –2.0 | 8.0 | 6.8 | –7.4 |
| Mining and quarrying | 20.5 | –5.2 | –2.7 | 5.9 |
| Secondary sector | 6.6 | 8.5 | 10.3 | 8.4 |
| Manufacturing | 4.5 | 8.0 | 7.2 | 4.5 |
| Electricity, gas, and water | 3.1 | 8.2 | 4.1 | 5.9 |
| Construction | 9.2 | 8.9 | 13.6 | 11.4 |
| Tertiary sector[a] | 9.5 | 7.8 | 7.1 | 8.6 |
| Wholesale and retail trade | 6.8 | 7.5 | 4.0 | 5.2 |
| Restaurants, bars, and hotels | 5.4 | 7.9 | –2.6 | 2.2 |
| Transport, storage, and communications | 23.1 | 13.7 | 12.8 | 12.4 |
| Financial institutions and insurance | –0.2 | 4.9 | 12.0 | 12.2 |
| Real estate and business services | 7.8 | 2.9 | 3.7 | 3.1 |
| GDP[b] | 8.5 | 6.3 | 6.7 | 6.7 |
| GDP less mining | 6.6 | 7.0 | 7.0 | 6.1 |
| *Memorandum items (ZMK billions)* | | | | |
| GDP at current market prices | 63,511.6 | 115,352.8 | 128,370.1 | 144,775.4 |
| GNI at market prices | 52,656.2 | 109,737.3 | 126,653.6 | 140,615.6 |

a. Includes community, social, and personal services and others.
b. Includes taxes and less financial intermediation services indirectly measured.
Source: Zambian authorities, IMF, and World Bank staff estimates.

### Table A2 Central government finances, 2010–14

(percent of GDP, unless otherwise stated)

| | 2010 | 2011 | 2012 | 2013 | 2014 budget | 2014 projected |
|---|---|---|---|---|---|---|
| Revenue | 15.6 | 17.5 | 19.1 | 18.9 | 19.0 | 19.2 |
| Tax | 13.1 | 15.6 | 15.0 | 14.7 | 14.7 | 15.6 |
| Income taxes | 7.1 | 9.2 | 8.0 | 6.8 | 6.5 | 7.2 |
| Value-added tax | 3.2 | 3.4 | 3.7 | 5.1 | 4.9 | 5.2 |
| Excise taxes | 1.4 | 1.4 | 1.7 | 1.6 | 1.9 | 1.8 |
| Customs duties | 1.3 | 1.5 | 1.6 | 1.2 | 1.4 | 1.3 |
| Nontax[a] | 1.1 | 1.3 | 2.4 | 2.2 | 3.1 | 2.8 |
| Grants | 1.4 | 0.6 | 1.7 | 1.9 | 1.2 | 0.8 |
| Expenditure | 18.1 | 19.3 | 22.3 | 25.5 | 24.0 | 23.9 |
| Current expenditure | 15.5 | 15.9 | 16.2 | 18.8 | 18.1 | 19.1 |
| Out of which wages and salaries | 6.5 | 6.4 | 7.3 | 8.2 | 9.3 | 9.3 |
| Out of which interest payments | 1.4 | 0.9 | 1.4 | 1.5 | 1.8 | 2.1 |
| Out of which Farmer Input Support Program | 0.6 | 0.8 | 0.7 | 0.8 | 0.3 | 0.8 |
| Out of which Strategic Food Reserve | 1.2 | 1.5 | 0.2 | 1.6 | 0.6 | 1.2 |
| Out of which fuel subsidy | 0.1 | 0.2 | 0.6 | 1.1 | 0.0 | 0.0 |
| Capital expenditure | 2.6 | 3.4 | 6.2 | 6.7 | 5.9 | 4.8 |
| *Changes in balance/budget carryovers* | — | — | — | — | — | 0.8 |
| Overall balance (including grants)[b,c] | –2.4 | –1.8 | –3.2 | –6.6 | –5.0 | –3.8 |
| Financing[b] | 2.4 | 1.8 | 3.2 | 6.6 | 5.0 | 3.8 |
| External (net) | 0.2 | 1.0 | 3.1 | 1.9 | 1.1 | 2.3 |
| Domestic (net) | 2.2 | 0.8 | 0.1 | 4.8 | 3.9 | 1.5 |

a. Includes mineral royalties.
b. Less expenditure on financial assets; see table 1.1 in the main text.
c. On cash basis, including budget carryovers.
Source: Ministry of Finance, IMF, and World Bank.

Table A3 **Financial soundness indicators, 2008–14**

(percent)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Sept. 2014 |
|---|---|---|---|---|---|---|---|
| Capital adequacy | | | | | | | |
| Regulatory capital to risk-weighted assets | 18.6 | 22.3 | 22.1 | 19.2 | 21.3 | 26.8 | 26.2 |
| Tier I regulatory capital to risk-weighted assets | 15.7 | 18.9 | 19.1 | 16.8 | 19.4 | 24.5 | 23.9 |
| Capital to total assets | 9.9 | 11.2 | 10.4 | 10.2 | 12 | 14.1 | 14.9 |
| Asset quality | | | | | | | |
| Past due advances (NPLs) to total advances | 7.2 | 12.6 | 14.8 | 10.4 | 8.1 | 7.0 | 6.4 |
| Loan loss provisions to nonperforming loans | 104.6 | 86.6 | 80.3 | 76.7 | 73.5 | 83.2 | 77.4 |
| Bad debt provisions to advances | 6.1 | 10.9 | 11.9 | 8 | 6 | 5.8 | 4.1 |
| Loan concentration | | | | | | | |
| Households | 30.1 | 30.9 | 32.2 | 30.8 | 34.3 | 34.5 | 33.2 |
| Government and parastatals | 1.9 | 3.1 | 4.6 | 4.7 | 3.9 | 2.1 | 2.9 |
| Agriculture | 16 | 19 | 17.6 | 17.7 | 22.6 | 20.2 | 17.7 |
| Mining | 5 | 4 | 3.2 | 4.2 | 5.7 | 6.6 | 6.5 |
| Manufacturing | 11 | 12 | 12.7 | 12.2 | 11.3 | 9.5 | 12.2 |
| Construction | 4 | 3 | 5.8 | 4.2 | 3.7 | 3.5 | 3.1 |
| Services | 9 | 8 | 7 | 7.1 | 3.9 | 4.1 | 2.4 |
| Others | 23 | 20 | 16.9 | 19.1 | 14.6 | 56.1 | 58.0 |
| Earnings and profitability | | | | | | | |
| Return on average assets (cumulative) | 3.6 | 2.1 | 2.9 | 3.7 | 3.9 | 3.4 | 3.9 |
| Return on equity (cumulative) | 20.8 | 9.4 | 12.1 | 25.5 | 20.8 | 18.2 | 19.0 |
| Gross interest income to total gross income | 66.6 | 65.1 | 58.6 | 59.3 | 61.3 | 64.5 | 65.5 |
| Gross noninterest income to total gross income | 33.4 | 34.9 | 41.4 | 40.7 | 38.7 | 35.5 | 34.5 |
| Net interest margin | 10.4 | 10.7 | 9 | 8.1 | 8.4 | 8.3 | 8.3 |
| Liquidity | | | | | | | |
| Liquid assets to total assets | 35.5 | 38 | 43.8 | 40.3 | 36 | 38.9 | 34.7 |
| Liquid assets to total deposits | 49.9 | 52.6 | 58.5 | 53.3 | 49 | 52.6 | 48.2 |
| Advances to deposits ratio | 66.3 | 60.1 | 53.1 | 57.1 | 66 | 61.4 | 64.1 |
| Exposure to foreign currency | | | | | | | |
| Foreign currency loans to total gross loans | 42.1 | 36.4 | 32.8 | 39.1 | 28.7 | 25.6 | 28.4 |
| Foreign currency liabilities to total liabilities | 35.8 | 38 | 39.6 | 39 | 22.9 | 30.4 | 33.3 |
| Net open position in foreign exchange to capital | 6.9 | 2.5 | 4.1 | 5.5 | 2.8 | 3.6 | 3.8 |

Source: BoZ.

Table A4 **Selected balance of payments indicators, 2009–14**

($ millions, unless otherwise stated)

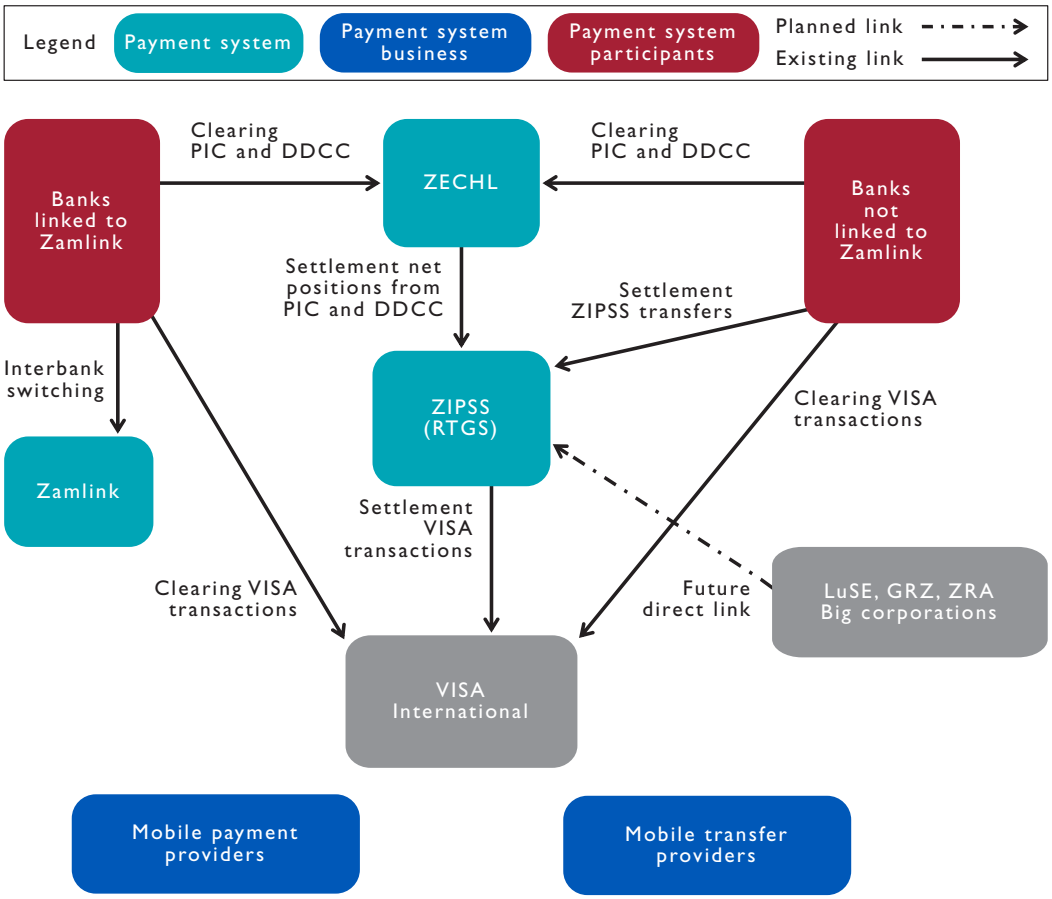
| | 2009 | 2010 | 2011 | 2012 | 2013 preliminary | 2014 projected |
|---|---|---|---|---|---|---|
| Current account | 538.5 | 1,144.4 | 705.0 | 775.0 | 194.0 | –139.3 |
| Trade balance | 829.4 | 2,704.0 | 2,206.0 | 1,437.0 | 1,451.0 | 1,459.7 |
| Exports | 4,242.8 | 7,414.0 | 8,660.0 | 9,363.0 | 10,646.0 | 9,868.8 |
| Out of which copper | 3,179.3 | 5,767.9 | 6,660.2 | 6,294.0 | 6,911.0 | 7,664.6 |
| Out of which nontraditional exports | 899.7 | 1,190.0 | 1,596.6 | 2,693.5 | 3,312.0 | 2,097.3 |
| Imports | –3,413.4 | –4,710.0 | –6,454.0 | –7,926.0 | –9,195.0 | –8,628.2 |
| Out of which petroleum | –535.8 | –618.1 | –530.5 | –930.6 | –1,200.5 | –1,441.5 |
| Services (net) | –464.5 | –628.1 | –723.6 | –783.4 | –874.3 | –880.2 |
| Income (net) | –418.7 | –1,363.0 | –1,155.3 | –333.5 | –770.9 | –1,046.7 |
| Current transfers (net) | 516.0 | 431.8 | 378.0 | 454.0 | 389.0 | 327.3 |
| Capital and financial account | –154.8 | –1,301.3 | –384.7 | 104.7 | –474.0 | 633.9 |
| Capital account | 237.3 | 149.7 | 151.3 | 222.7 | 295.0 | 169.0 |
| Financial account | –392.1 | –1,451.0 | –536.0 | –118.0 | –769.0 | 465.0 |
| Out of which FDI and portfolio investments | 350.4 | 707.5 | 1,180.6 | 3,332.0 | 1,720.0 | 2,274.6 |
| Overall balance | 540.1 | 115.0 | 202.0 | 727.0 | –345.0 | 467.7 |
| Financing: change in NIR (minus indicates an increase) | –540.1 | –115.0 | –202.0 | –727.0 | 345.0 | –467.7 |
| *Memorandum items* | | | | | | |
| Current account (percent of GDP) | 3.5 | 5.6 | 3.0 | 3.1 | 0.7 | –0.5 |
| Gross international reserves | 1,758.4 | 1,896.5 | 2,166.9 | 2,457.0 | 2,251.0 | 2,535.0 |
| In months of prospective imports | 3.7 | 3.0 | 2.8 | 2.8 | 2.6 | 2.7 |
| GDP | 15,328.3 | 20,265.4 | 23,731.9 | 24,940.8 | 26,830.1 | 26,894.0 |

Source: Zambian authorities, IMF, and World Bank staff estimates.

ANNEX B

# Overview of Payment System Infrastructure

Zambia Interbank Payments and Settlement System (ZIPSS) is the real-time gross settlement system run by the Bank of Zambia (BoZ). It was launched in 2004 to reduce credit and settlement risks in the banking sector. But it is not widely used partly because of high fees charged by some banks. Zambia Electronic Clearing House Limited (ZECHL) is jointly owned by BoZ and commercial banks and clears checks and electronic interbank direct debit and credit debit transfers. It has one daily interaction with ZIPSS, and is operated through a manual process leaving room for errors and delay. Zamlink is a bank switch owned and mainly used by six relatively small banks. Interoperability with larger banks through Zamlink involves switching through VISA International, with clearing infrastructure located outside the country. Monetary and time costs dissuade larger banks from using this switch. Zambia is pursuing a national switch. ZECHL and BoZ are currently in the second round of the procurement process to progressively develop interoperability of ATMs and POSs, mobile banking, and branch banking. BoZ estimates to complete these three phases by end of 2016.




Source: Bankable Frontier Associates.

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