

PROMOTING ADOPTION OF IMPROVED PRODUCTION TECHNOLOGIES AMONG SMALLHOLDERS IN GHANA VIA COUPLED CREDIT AND INSURANCE CONTRACTS

Background

Index insurance, which covers the policyholder based on an external index such as rainfall or other weather-related measures rather than individual losses, has the potential to improve the lives of farmers in the developing world by allowing them to manage the risks of droughts, floods, or other natural disasters. However, index insurance has produced disappointing results in many developing countries in which it has been implemented. Index insurance has proven especially ineffective when borrowers can easily default on loan repayments without suffering major consequences such as loss of collateral. When widespread default occurs due to a natural disaster, lenders suffer along with the farmers.

In such situations it is clear that the farmer, the insurer, and the lender are undeniably linked. If insured farmers experience widespread drought, the insurer experiences heavy losses and consequently demands higher insurance rates than most smallholder farmers in a developing country can afford. If farmers cannot afford the insurance, they will not buy it. Without insurance, they are reluctant to take on the additional risk of a loan and are thus unable to afford to adopt new technologies that would allow them to increase their income. Lenders who experience widespread loan defaults due to disasters either raise the interest rates for agricultural production loans or engage in more restrictive credit rationing.

Project Summary

Researchers supported by the Feed the Future Innovation Lab for Assets and Market Access are hoping to break one part of this vicious cycle by introducing a new type of loan product. In the event of a drought or other insured event, the amount of the loan the farmers are required to repay to the lender is reduced (if not eliminated) since the outstanding balance is automatically covered by the insurance payout received by the lender. When index insurance is integrated into lenders' credit portfolios and loan policies, the incentives for strategic default by smallholders are curtailed, substantially reducing the negative impacts of widespread loan defaults on lenders due to an extreme weather event. By managing systemic risk due to widespread weather shocks using index insurance, the lender should be able to provide more loans to smallholders at lower interest rates.

Anticipated Impacts

Lessons learned from this study will inform policymakers throughout the developing world about the potential for index insurance to promote economic transformation of the agricultural sector. The project will work closely with GAIP and the University of Ghana to implement an aggressive outreach and education program to raise public awareness about the use of contingent-credit index insurance. Through these efforts, the project expects to have significant impact on building a sustainable agricultural insurance system and enhancing the performance of the agricultural credit system to the benefit of both farmer and lender.

PROJECT OVERVIEW

Lead PI

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Partners

African Center for Economic Transformation (ACET), Ghana Agricultural Insurance Programme (GAIP)

Timeline

2013 - 2016

Key Innovation

Interlinked credit and insurance

Funding

\$700,182

Commodity

Maize

Region

Northern

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