

I4: The Index Insurance Innovation Initiative to Fight Poverty

REMOVING THE RISK OF POVERTY

BASIS, the United States Agency for International Development, the Food and Agriculture Organization of the United Nations, the Micro-Insurance Innovation Facility of the International Labour Organization, and Oxfam America announce the creation of the **Index Insurance Innovation Initiative (I4)**. This initiative is a response to the overwhelming evidence that uninsured risk can drive people into poverty and destitution, especially those in low-wealth agricultural and pastoralist households. Risk can cause people to shy away from high-return activities or pursue defensive savings strategies that cut off sustained accumulation of productive assets. Risk also inhibits the development of rural financial market, which reinforces risk's negative impacts.

Finding ways to deal with risk and thus reduce poverty has long been a goal of development policy. **I4** is developing a global action plan to reduce risk and poverty among small-scale agricultural and pastoralist households. While there is ample theory to show that index insurance can alter poverty dynamics, there is still much to learn about its effectiveness in practice. To rigorously test the hypothesis that by removing correlated risk from smallholder agricultural and pastoral systems we can reduce poverty and deepen financial markets in agricultural areas, the **I4** team will design and implement a new generation of livelihood-optimized index insurance contracts. Potential impacts include improving technology uptake by farmers, thus increasing their incomes, attracting lenders into rural markets, and reversing the dynamics that create destitute families, thus reducing the massive costs of direct aid programs.

I4 PILOT PROGRAMS

It is likely that index insurance will not work in all environments. In order to explore the boundaries of its effectiveness, **I4** will roll out up to 10 pilot projects across Africa, Asia and Latin America, strategically choosing a diversity of agro-ecological, economic and social environments. Each program will directly impact 5000 small-scale agricultural or pastoralist households.

Drawing from recent experience in Peru, Kenya, and elsewhere, the pilot programs will follow best practice guidelines designed to overcome the significant challenges to making this form of insurance work. Selection will be determined by the ability to achieve the following.

Growth opportunities. Pilots will operate in locations where insurance can be interlinked with growth opportunities. Insurance is valuable in helping families maintain their living standards in the face of income fluctuations, yet its greatest value—and perhaps the key to its sustainability—may arise when it can be linked with new economic opportunities. When insurance helps a farmer access credit that has been unavail-

The costs of risk can be devastating

Risk makes people poor. A recent study suggests that a significant portion of the smallholders who dominate Peruvian coastal agriculture refrain from borrowing for fear of putting their land at risk as collateral. In 2008, a pilot index insurance program in the valley of Pisco, Peru was launched. By offering cotton farmers protection against default in years in which average valley yields fall below 85% of the historic average, the pilot studies whether insurance increases credit supply by reducing lenders' risk, while encouraging farmers to invest in higher-yield activities and technology.

Risk keeps people poor. In the pastoral regions of northern Kenya, risk creates a poverty trap, and each season more people collapse into indigence and food-aid dependence. In the region, a Productive Safety Net (PSN) will rely on an index insurance mechanism intended to prevent households falling into poverty, while allowing them to accumulate assets. This should help improve finance markets, which can spur investment and growth.

See **BASIS Brief 2008-07**, available at www.basis.wisc.edu for information about the Peru and Kenya pilot programs.

able in the past, or adopt new technologies that increase yields, then this added value allows farmers to both protect consumption and enhance their investment in income and assets.

Rigorous impact evaluation and research methods. Each pilot will embed a rigorous research agenda into the design and offering of the index insurance product. The research plan must include a strategy to effectively identify the impact of the insurance on credit market participation, farmer adoption of technology, and household income and wealth.

Informed uptake. Each pilot will include an appropriate educational and outreach strategy to ensure that farmers in the pilot region fully understand index insurance and what the product both can and cannot offer farmers. These efforts will build on financial education games developed by BASIS that help create demand for index insurance by improving farmer knowledge of and trust in the product.

Sustainability. The development of the insurance contract and the selection of local partners must have the goal of developing the insurance market so that it remains viable and grows after the program is completed.

Local scale-up and dissemination. In order to maximize impact in the host country, each pilot will be expected to clearly communicate both the methodology of product design and research results to the local insurance industry. In addition, the pilot will promote technology transfer and enhance local technical capacity for the design, implementation, and supervision of index insurance products. Finally, the pilots must demonstrate collaboration with private sector partners (insurance companies and microfinance institutions) to promote the scaling up of the index insurance market beyond the region of pilot implementation.

At a global level, **I4** will promote the development of index insurance beyond the pilot programs. This will be achieved by synthesizing lessons learned from the individual pilots and creating a set of global best practices for the design and implementation of index insurance. Results will be widely disseminated.

THE RIGHT TIME FOR PARTNERSHIP

To meet its objectives, **I4** will operate as a tripartite alliance between the scientific, NGO, and policy communities. Experts from these groups will form the governance structure. The private sector—insurance and reinsurance companies, as well as microfinance institutions—also will be a vital player in the work.

As a partnership between leading scientists and NGOs with substantial experience in this area, **I4** will combine the rigorous scientific methods of the former and the local knowledge and credibility of the latter. The policy community will be represented by key individuals from bilateral and multilateral aid agencies. These include the United States Agency for International Development, the United Nations' Food and Agriculture Organization and World Food Programme, the International Fund for Agricultural Development, the Micro-Insurance Innovation Facility of the International Labour Organization, Oxfam America, and the World Bank.

Risk devastates lives. Index insurance is a promising innovation that can help protect vulnerable families while also spurring economic growth. Now is a propitious time to invest in the partnerships that can achieve this strategically-structured development impact.



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