

Insuring the risks of smallholder agricultural production

by Tonino Zellweger, Agridea

Insuring agricultural risks is considered a field with a potential to grow in the future. Reasons for the expected growth are the globalisation of markets, the changing consumer habits for non-essential foods (coffee, tea, cocoa etc.). However this holds true mainly for agro business and does apply to a much lesser extent to smallholders or poor farming families.

1. Risks to be insured in agricultural activities

While most industrial productions are taking place in protected sites, farming is exposed to a multitude of additional hazards. Some risks it shares with industrial production. Among them are:

- economic risks – price fluctuations, changes in demand
- social risks – war terrorism, theft, accidents
- policy risks – changes in agro subsidies, embargoes, tax policies
- operational risks – the timely and correct use of inputs, availability of labour force.

However, what most affects agricultural activities are

- natural risks – weather (hail, excessive rainfall, drought)

2. Prerequisites for being covered by an insurance

The most important prerequisite is an obvious one. There must be an insurance company who has an interest to invest its money in agricultural insurance business and second who is able to manage its specific requirements (collecting data about weather, yields etc.). So, insuring agricultural activities is quite a com-

plex issue and it becomes even more challenging, when we talk about insuring the agricultural activities of smallholder farmers.

There are a couple of prerequisites which are common to the insurance business in general:

- You need many applicants (farmers in our case) to spread the risk.
- A sense of solidarity is required. It means that a single farmer is willing to consider the premium as a long term investment and part of his fixed costs which might cover the losses suffered by other colleagues.
- The danger covered by the insurance must be similar for all subscribers. A farmer suffering from flood will hardly understand that the risk for drought in another area should be included in the insurance he is paying for.
- There must exist an atmosphere of mutual trust, be it among insured people be it regarding the honesty of the insurance company and its employees. This means e.g. damages must be estimated along objectively controllable criteria and without giving a special treatment to one or the other.

When looking at the above prerequisites it is easily understood that agro insurance started out (e.g. more than 100 years ago in Switzerland) by covering the damage produced by hail. And even today and in a country like Argentina, where agriculture produce is an important export good, cultivated on large extensions and known, crops hail insurance makes up for 95% in agro insurance.

Agricultural business and especially those who grow cash crops for exportation have taken hold of the best land while small holders live in remote areas, where access is difficult. They have been forced to cultivate marginal areas and they mostly grow staple crops for

their own subsistence. This fact and its consequences makes it difficult for any insurance company to venture itself in taking up business with smallholders directly. Looking at the conditions of smallholders it is understandable that any insurance company shies off. The prevailing conditions given below may illustrate the difficulty:

- Staple crops are very often submitted to a control imposed by local government meaning that there is no free market
- There are no reliable data about weather conditions and crop yields covering these unfavourable sites.
- The fields are very small and exposed to even more risks than the surfaces cultivated by agro business.
- The remoteness and the difficulties in access forces insurance companies to invest heavily in time spent for premium collection and control of damage.
- Small holders are more inclined to think about finding means to cover a damage when it has already occurred (ex post) instead of investing for possible damage (ex ante). Their mind set is geared to: damage will hit others but not me and it is time to deal with damage when it has hit my family.

3. Some measures which might help to include also poor farmers' risks

Even though the possibility for insuring small farmers' risks is rather small there are some measures that might get them closer to securing their livelihood and fending off the danger of assuming the whole risk themselves.

- In many cases local banks ask for an insurance before they accept giving credit to farmers. In the case of small farmers this means that their microfinance institution – like a local savings group – could act as an intermediary.
- The local (national or district) government backs up an insurance company by subsidising the premiums. The advantage for the local government consists in the fact that the subsidy can be included in a regular budget, while expenses for relieve after a heavy drought or flood is more difficult to obtain. In fact there are already governments who are in-

vesting in both measures – subsidising premiums and engaging in insuring against calamities.

- Improved observation standards from satellites reduce the time spent for controlling the damages occurred even in remote areas.
- Even in marginal areas structural changes will happen in the future, meaning that less people will manage larger areas and former producers of staple crops will gradually move to the production of higher value crops.

4. Summary

Even though at the moment smallholders aren't ready to be direct clients for insurance companies there are some signs, that they might be potential clients in the future. This means also, that insurance companies should prepare themselves now for a hitherto unknown segment of customers they will work with in the future.