Promoting Resilience and Food Security through Risk-Contingent Credit in Africa

Piloting market-based risk management solutions for smallholder farmers

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IFPRI has piloted a market-based, innovative, risk management solution in the form of Risk-Contingent Credit (RCC) in Kenya. RCC is a linked financial product that embeds insurance protection within its structure. When protection is triggered, it offsets outstanding loan payments that are due to the lender. The RCC product mitigates drought-related agricultural risks and provides access to credit for smallholder farmers, while simultaneously reducing the amount of collateral required. This project is intended to further improve the RCC design and the aim is to scale up to other regions.

Country context

In Kenya, RCCs are being piloted in the counties of Machakos and Embu in Kenya’s eastern province. In Ethiopia, local administrative units (“woredas” and suitable “kebeles”) are to be selected from the Oromia region. These counties and kebeles are in a semi-arid climatological zone and are located in hilly terrain. They receive very low annual rainfall of around 700 mm per year. As a result of the low rainfall, agriculture is almost exclusively practised by smallholder farmers. In Kenya, maize is the dominant food crop, although there is some intercropping with perennial fruits or other cash crops. In Ethiopia, maize and teff (cereal crop) are the major crops, augmented by some intercropping with fruits and vegetables. Most smallholder farmers have limited resources and little or no access to credit. The primary risks faced by these farmers are failures in the annually occurring long and/or short rains. While rainfall is variable in the long and short rain periods, the failure of one or other (or sometimes both) rainfalls causes great hardship, and almost certain default on loans taken out by farmers.

Project description

Agricultural risks such as those resulting from rain failure are a major contributor to low agricultural productivity in Sub-Saharan Africa. This applies directly with respect to crop yields being compromised and indirectly in terms of reducing investments in production inputs, which would be lost during droughts. New production technologies, better seeds or machinery provide one avenue for increasing productivity and improving farm incomes in the face of climate change. Yet many farmers lack sufficient access to credit for purchasing these technologies, either because they do not have the required collateral, or because the interest rate of the credit is too high. This is primarily due to information asymmetries in the prevailing underdeveloped insurance markets. Women are particularly constrained in their access to credit because they often do not have assets that could serve as collateral due to lack of access to land rights, or inheritance laws that disadvantage women. Consequently, many farmers in Sub-Saharan Africa are capital-constrained and remain in a steady state of low productivity, high vulnerability to drought or other extreme climate events, and consequently persistent poverty.

The project entitled Promoting Resilience and Food Security through Risk-Contingent Credit in Africa, funded by the German Federal Ministry of Economic Cooperation and Development (BMZ), will address these challenges by piloting a market-based, innovative risk management solution in the form of Risk-Contingent Credit (RCC). RCC is a linked financial product that embeds insurance protection within its structure. When protection is triggered, it offsets outstanding loan payments that are due to the lender. IFPRI’s pilot in Kenya from 2016 – 2020 has proven effective in terms of agricultural investment, productivity, and income (read more about the evidence in this report). It has a high potential for scaling up to other least developed countries. Currently RCCs are being expanded in other regions of Kenya and Ethiopia.
Challenges and lessons learned

COVID-19 significantly affected the RCC project. Project partners had to adapt to the new reality of a world with COVID. COVID-19 prevented us from travelling and communicating in person. The lack of personal interaction with banking and insurance partners is particularly challenging as these private partners are accustomed to personal interactions. The project team managed to work closely and virtually with banking and insurance partners to process insurance payouts and the closeup of farmers’ loans. The long-term relationship and the trust built over previous years played a major role.

Project villages within Machakos county (by Yating Ru)

Since this new project has not yet started interventions, learn about beneficiaries’ experience with similar risk-contingent credit solutions enhancing resilience in rural Kenya in this video.