Innovations for Poverty Action

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Crop Price Indemnified Loans for Farmers: A Pilot Experiment in Rural Ghana

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Abstract

Farmers face a particular set of risks that complicate the decision to borrow. We use a randomized experiment to investigate (1) the role of crop-price risk in reducing demand for credit among farmers and (2) how risk mitigation changes farmers' investment decisions. In Ghana, we offer farmers loans with an indemnity component that forgives 50 percent of the loan if crop prices drop below a threshold price. A control group is offered a standard loan product at the same interest rate. Loan uptake is high among all farmers and the indemnity component has little impact on uptake or other outcomes of interest.

Introduction

Farmers face a particular set of risks that complicate the decision to borrow. Factors that are almost entirely unforeseeable and outside of their control, such as crop prices and weather patterns, have an enormous impact on farmers' fortunes—and on their ability to repay any loans they have taken. As such, some farmers are believed reluctant to take loans to finance seemingly profitable ideas for fear of not being able to repay. Paradoxically, from a bank's perspective, these may be excellent clients.

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