

*Full Length Research Paper*

# Risk, coping mechanisms, and factors in the demand for micro-insurance in Ethiopia

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**This paper is the first result of a policy study carried out for the International Labour Organization (ILO) and the United Nations Capital Development Fund (UNCDF), to determine how micro-insurance can help Ethiopia's poor become more resilient to negative financial shocks. This research focuses on the demand components of micro-insurance, and investigated two main research questions: Do low-income households in Ethiopia need insurance? If so, would they be willing to buy it if it were made widely available? This study answered these two questions through the combination of a thorough literature review and original qualitative research in four socioeconomic systems of Ethiopia: low-income urban workers in Addis Ababa; agro-pastoralists in Hagera Mariam, Oromia; pastoralists in Yabello, Oromia; and coffee farmers in the Southern Nations, Nationalities and People's Region (SNNPR). In addition, this study drew upon original research from Oxfam America's weather insurance pilot in Tigray. The results of this study indicate the answer to both research questions is affirmative, though the final outcome of the second question depends largely upon whether the eventual supply of insurance products is affordable and truly client-centered. Study recommend the Ethiopian government to take adequate consumer protection measures to ensure the healthy development of this infant industry.**

**Key words:** Risk, coping strategies, micro-insurance, Ethiopia.

## INTRODUCTION

*"The slimming of an elephant and the losses of a rich man are not noticeable" (Ethiopian proverb)*

Commissioned by the International Labour Organization (ILO) and the United Nations Capital Development Fund (UNCDF), this study constitutes one step in a much larger effort to determine how micro-insurance can help Ethiopia's poor become more resilient to negative shocks. This study focuses on the demand components of an emerging micro-insurance industry in Ethiopia, and investigated two main research questions:

1. Do the poor in Ethiopia need micro-insurance?

2. If so, would they be willing to purchase such insurance if it were made available?

Through qualitative research of the low-income market, this study identified the key risks that the poor would be interested in covering through insurance, and assess their familiarity and receptiveness to risk pooling and formal insurance. Currently, very few poor Ethiopians enjoy access to micro-insurance, and so most people lack sufficient resources to draw upon in times of emergency (Tadesse and Victor, 2009; Brans et al., 2010). Poverty is exacerbated and sometimes caused by an inability to cope effectively with various economic, environmental, and societal shocks. Micro-insurance can allow needy families to transfer these risks to a third party (Dessai and van der Sluijs, 2007).

By definition, insurance involves a risk pooling mechanism that combines the resources of many policy holders to compensate for the accidental losses of a

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Figure 1. Conceptual framework.

few. Designed specifically for low-income persons, micro-insurance offers protection against specific perils in exchange for regular monetary payments (premiums) proportional to the likelihood and cost of the risk involved (CGAP, 2008). Depending on the provider, micro-insurance may cover threats to health, life, property, livestock, or crops, among other valuables. In the absence of formal insurance markets, the poor typically cope with economic crisis by tapping into their savings, falling into debt, or selling livestock or other assets, often with ruinous results.

It is estimated that globally only eighty million of the world's 2.5 billion poor are covered by some form of insurance (Micro-insurance Agency n.d.). The story in Ethiopia is not much different, as the domestic insurance industry is quite limited. Motor insurance and insurance for large corporations are the most common risk transfer schemes in urban Ethiopia; individual insurance and other social security programs are fairly rare. Country-specific micro-insurance demand studies have been conducted elsewhere to assess interest among needy communities; this study was, however, unable to identify any such country-wide studies for Ethiopia.

### CONCEPTUAL FRAMEWORK

In this section, this study presented a simplified conceptual framework positing the various factors that influence the demand for micro-insurance at the household level. As seen in Figure 1, this study considered the demand for micro-insurance to depend upon two major factors: the need for risk transfer—with insurance constituting a major form of risk transfer—and

the attitude toward insurance:

$$\text{Demand} = \text{Need for risk transfer} \times \text{Attitude toward Insurance}$$

The greater the need and better (“higher”) the attitude toward insurance, the greater will be the demand. Conversely, if need is low or the attitude is negative, it logically follows that the demand will be lower.

To measure the need for risk transfer, this study weighed the balance between the severity and probability of the major risks facing poor households versus their coping capacity to deal with these risks:

$$\text{Need} = \text{Risk severity} \times \text{Risk probability} \div \text{Coping capacity}$$

In this framework, the greater the severity or probability of any risk, the greater the coping capacity must be for dealing with it. This study defined the individual elements of this equation as follows:

1. Severity of risk = magnitude of potential loss in well-being in both the short- and long-term.
2. Probability of risk = likelihood a loss will occur.
3. Coping capacity = ability to decrease the probability of risk *ex ante* or severity *ex post*.

The attitude towards insurance, in turn, depends upon three factors: perception of the value of insurance as a concept (including knowledge of how insurance works in general); the accessibility of insurance products (including affordability and delivery mechanisms); and the trust low-income consumers would have in relation to

**Table 1.** Risk personalities.

		Attitude			
		Risk-averse	Risk-seeking	Risk-accepting	Risk-indifferent
<b>Coping style</b>	Prevent	Planner			
	Adapt		Entrepreneur		
	Control			Fixer	
	Surrender				Fatalist

Source: Douglas and Wildavsky (1982) in Dessai and van der Sluijs (2007).

actual product offerings and providers:

Attitude = Perception of value x Accessibility x Trust

When taken together, the need for and attitude toward insurance give a good picture of the potential demand.

Following Douglas and Wildavsky (1982) in Dessai and van der Sluijs (2007), the study proposed four risk personalities in relation to the demand for micro-insurance: the Planner, the Entrepreneur, the Fixer, and the Fatalist (Table 1). The Planner does not like to take risks and seeks to manage them through prevention. In contrast, the Entrepreneur seeks risk, but manages potential negative repercussions by adapting as needed in the short-term. The Fixer accepts that risks are a normal part of life and seeks to control the negative effects ex post. The Fatalist is indifferent to risk, and does not believe risk can be managed, because life is capricious and one's fate is out of one's control.

While one might expect the Planner to be the most likely client for insurance, this is not necessarily correct because a relatively new financial product or service provider is often, in itself, seen as risky. While these personality types constitute a useful framework for discussion, it is likely that most people exhibit personality elements of all four categories.

## LITERATURE REVIEW

### Defining poverty in Ethiopia

Although the definition and measurement of poverty may vary from study to study, for our purpose, poverty may be defined as a condition in which families live with unacceptably high risks with few tools to manage those risks. The term "unacceptable risk" describes the likelihood of an event whose probability of occurrence and consequences are so high. Poverty may:

1. Increases the severity of risks: A small earthquake in poor countries kills many more than in rich countries due to impoverished communities' inadequate access to safe housing.
2. Increases the probability of risks: The poor have a

harder time protecting themselves. For instance, the inability to purchase a mosquito net increases the risk of contracting malaria.

3. Decreases coping capacity: The poor have few assets to serve as a cushion. Risk can be a source of persistent poverty as it leads households on the edge of survival to seek to choose low risk but low return activities (Rosenzweig and Binswanger, 1993).

4. Decreases awareness of financial tools: Low levels of education and access to public services means many poor people are unaware of financial tools.

5. Decreases access to financial tools: Financial providers believe that the poor do not constitute a profitable market, and therefore do little to try to reach them.

Micro-insurance tailored to the needs of the poor can be a very important step in helping low-income families manage risks and eventually escape impoverishment. Poverty exerts a profound influence on the demand for micro-insurance in a variety of ways. Shimeles's (2005) study shows that it was easier for rural households to exit poverty as well as to re-enter it. Earlier study by Dercon (2002) indicates that during bad harvest season about 60% of the population in Ethiopia could be poor. Although the statistics differ from study to study, it is clear across the board that poverty is pervasive and severe in many parts of Ethiopia.

### Major risks facing households in Ethiopia

To estimate the need for micro-insurance, this study explored the various types of common dangers, the poor face and the coping mechanisms used to counter them. Because the study cannot discuss every relevant risk here, we have chosen to focus on the major insurable categories, though in some places the study refer to important "non-insurable" risks given their influence on poverty levels. Because Ethiopia is an agrarian nation, this paper focused more on rural households than urban ones.

#### Health risks

Illness represents the most commonly cited risk in all the

regions included in this study. Per capita health expenditure in Ethiopia is estimated at USD \$7.10, far below the minimum (USD \$34.00) necessary to meet primary health care needs in a developing country (WHO, 2006). Bodily injury is not uncommon, likely because low levels of education and development mean a disproportionate number of people are engaged in manual labor under frequently unsafe conditions. Ethiopia also has the dubious distinction of suffering the highest per capita rate of car fatalities in the world, and many of the participants of this study's focus group discussions said they had experienced the impact of a traffic accident either directly or indirectly. In terms of illness, the Center for National Health Development in Ethiopia estimates that "as much as 80% of the health problems in the country are due to preventable communicable and nutritional diseases". Common infections in Ethiopia include malaria, HIV/AIDS, TB, and nutritionally-related diseases. Generally, females face greater health risks than men.

### ***Risk of death***

Even among the world's least developed countries, figures for life expectancy in Ethiopia are below normal, with males living an average of 53 years and women an average of 55 (CSA, 2006). The country's early death rate stems largely from low levels of health; participants in the Oromia region also cited death due to clan conflict as a problem. Beyond the emotional pain associated with the loss of a loved one, death imposes a heavy financial burden on surviving family members, especially when it involves the demise of the primary male breadwinner. Given Ethiopian culture's strong emphasis on a dignified funeral, burial costs frequently entail significant expense. One study found that funerals cost the average low-income household 25% of yearly consumption.

### ***Risks to property: Loss or damage***

Property damage negatively affects both Ethiopians' livelihood and their resources. Fire poses a threat particularly to urban dwellers, while floods are of concern for citizens living around the Awash River Basin, Dire Dawa and certain lowland areas in the southwestern parts of the country. Some study participants complained about theft, although official crime statistics indicate that stealing is a relatively low level concern compared to other sources of property loss (CSA, 2006).

### ***Agricultural risks: Crop and livestock loss***

A study in the Northeastern Highlands of Ethiopia indicates that, "the most common way by which households became destitute was after they experienced severe or

repeated crop failure due to drought or other natural causes which led to the sale or death of their livestock assets" (Amare, 2003).

Major factors for crop loss in Ethiopia include adverse weather, crop diseases, pests, poor agronomic practices (that is, weeding, tillage, fertilizer application), and additional post-harvest causes of spoilage including untimely rains, inadequate storage facilities, and improper handling and processing techniques.

Livestock production is also plagued by many problems including a lack of access to improved breeds, inadequate supplies of fodder, poor nutrition, limited research on livestock, and abysmally low levels of access to veterinary services. According to the CSA, the national, annual mortality rate for cattle, sheep and goats is 8 to 10, 14 to 16 and 11 to 16%, respectively (CSA, 2004/2005). For the Somali region of Ethiopia, Baars (1999) estimates much higher mortality rates, with camels at 30%, cattle at 22%, and ruminants at 46%.

## **RESEARCH DESIGN**

The methodology used in this study is primarily qualitative but, where possible, quantitative data and estimates are provided. This study was conducted through:

1. A thorough literature review of primary and secondary sources;
2. Interviews with key informants and discussions with focus groups that involved four livelihood groups (urban workers, coffee farmers, pastoralists, and agro-pastoralists);
3. Research related to Oxfam America's Horn of Africa Risk Transfer for Adaptation (HARITA) pilot with rainfed, cereal farmers.

The field research was carried out in August and September, 2008. This involved several research methods including focus group discussions (FGDs), participatory rapid appraisal tools (PRA), in-depth interviews, and key informant interviews. Once the livelihood groups were defined, this study chose three major regions for the field research. The key criteria were:

1. Locations where a large number of target clients are located, as measured by high population areas of the country;
2. Locations where potential insurance distribution channels are dense, as measured by the density of microfinance institutions, savings and credit cooperatives, insurers, and producer cooperatives;
3. Locations where this study could conduct our research in an economic and timely manner.

Based on these criteria, this study chose for the field research, three administrative regions namely; Oromia, Southern Nations, Nationalities and Peoples Region (SNNPR), and Addis Ababa. Although, other regions like Amhara and Tigray also fulfilled our selection criteria, this study was unable to cover them in focus group discussions due to time and budget constraints. (Note, however, that for Tigray, this study draws on research from HARITA). Participants were selected purposively, based on their participation or non-participation in the credit programs of micro-finance institutions (MFIs) and / or the development and relief activities of non-governmental organizations. In the end, a total of 95 participants were involved in FGDs and PRAs covering various topics related to insurance demand, risks, and coping mechanisms. In addition, a total of 48 individual interviews, with approximately 10 to

12 individuals per region, were conducted in all study areas. Key informant interviews were also conducted with people from various institutions who are believed to have a good understanding of their community and micro-insurance concepts.

## RESULTS AND DISCUSSION

### Major risks by region

Because risk is a large part of daily life in Ethiopia, this study found that FGD participants possessed a firm understanding of risks and threats to their livelihood. With the exception of universal risks such as death and illness, risks appear to vary from region to region, especially between urban and rural areas. These results are expected given the differences in socioeconomic conditions. List of risks most prevalent in Ethiopian life according to respondents in all regions is given subsequently.

#### **Urban workers, Addis Ababa**

Key informants in urban areas consider property loss due to damage (e.g. fire) and theft to be risks second only to death of the household head, and illness, particularly HIV/AIDS. Households in Addis Ababa are also concerned with a high cost of living and high unemployment rates. One FGD respondent explained:

*“Death and illness are not as such risks that we worry about; instead what is worrying is unemployment. This is for us being dead alive [sic]. It is “kiffu mitich” (a bad disease which occurs frequently and regularly). By this we do not mean that death and illness are not risks. But for us they are less serious and they are expected. If they do happen, they attack one family member at a time, singly. Economic hardship in the form of lost income, however, makes all members perish.”*

In addition, an interview with a staffer from women in self employment (WISE), an NGO based in Addis Ababa, ranked illnesses, business failures, price fluctuations, and HIV/AIDS as the primary risks facing low-income, self-employed women in the city. Second, death, fire, and car accidents are of concern. In-depth interviews with clients of WISE revealed similar risks to those in the foregoing, with death and property loss ranking highest, market risks and unemployment next, and finally a variety of others including illness, death, car accidents, business failure, fire, price volatility, electric accidents (though what this means exactly is unclear), falling in a pit, sexual harassment, divorce, lack of market access, lack of a place to work, and theft.

#### **Coffee farmers, Yirgacheffe (SNNPR)**

Households in SNNPR, primarily populated by coffee-

growing farmers, were particularly concerned about crop failure. Coffee-farmers are most threatened by crop damage due to coffee berry disease. In Yirgacheffe, participants estimated ETB 5000 to 7000 per season in losses per household due to coffee berry diseases. However, we are somewhat doubtful that the figures would be this high. Other significant threats include death of the household head, illness, theft, and coffee price fluctuations.

#### **Pastoralists, Oromia Region**

Pastoralists in Yabello ranked drought as their primary risk, as they linked it to the loss of grazing land, water, animal mortality, low market prices (due to emaciated cattle), and human illness. Summing up, the group explained:

*Risk is drought that affects our livestock. When our livestock are affected by lack of food, we will also be affected by lack of food. We depend on livestock for every requirement in life. In our community loss of livestock is risk. We are nothing apart from our livestock. Our wealth and health is our livestock.*

FGD participants mentioned conflict with other clans over grazing and a water resource as a risk that is relatively unique to the region. Such conflict sometimes results in loss of property, and on some occasion, life.

#### **Agro-pastoralists, Oromia Region**

Farmers in Hagera Mariam were primarily concerned about crop failure due to drought and disease and death of livestock. For crop loss, participants said a typical household could lose up to ETB 10,000 in revenue, while they might lose up to ETB 3,000 for livestock loss. They were also worried about illness (yellow fever, TB, and diarrhea) and injuries due to car accidents, death of the household head, price fluctuations, and to some degree, the loss of property due to fire when it is used to clear land. When it comes to drought in contrast to other risks, participants expressed relative hopelessness, often saying they can only turn to the Almighty for help:

1. “Most of the risks we face are related to drought; hence we depend on God to save us.”
2. “We do not have any control over drought.”
3. “Drought is God’s will—we cannot prevent it. I ask Him to save me.”
4. “All people whether male or female, rich or poor depend on God to save us from drought and loss of animals. We are Christians. People are becoming religious.”

Like pastoralists, agro-pastoralists bemoaned the

occasional clan conflict citing infrequent, but difficult clashes where “the winner always confiscates all the loser possesses (usually cattle).” Participants recalled conflicts in 1984, 1987, and 1990, which for some led to permanent migration. Migration was perceived as extremely stressful as it entails a loss and acquisition of a residence, assets left behind, and health challenges.

### Coping mechanisms

With the previous view, overview of risks and poverty profile of households in Ethiopia, this study now turn to coping mechanisms, the third element is the “need equation”. To mitigate and deal with risks, Ethiopians rely on three categories of coping mechanisms: self-insurance, community-based arrangements, and external assistance. Performance of these three categories is examined in terms of their risk coverage, accessibility, timeliness, and cost, as follows:

*Coping capacity = coverage x accessibility x timeliness x cost*

These elements are defined as follows:

1. Coverage: How well does the strategy deal with different risks (that is, idiosyncratic and mass covariant) and what level of “compensation” is provided in relation to the size of the shock?
2. Accessibility: How accessible is the strategy to everyone, regardless of wealth and social position?
3. Timeliness: How quickly does the strategy provide relief following a shock?
4. Cost: How stressful is the strategy in terms of a household’s immediate financial outlays, compromised future earnings or security, or loss of social capital?

This study explored some of the most important coping strategies for the poor in Ethiopia as shown subsequently.

### Self-insurance

Coming in many different forms, self-insurance entails the retention of risk, meaning that any loss is absorbed and “compensated” by one’s own assets (for example, savings and current or future income). Saving is an *ex-post* response to insure consumption over time. It is the most common form of self-insurance and effective method for coping with the majority of economic shocks (Manje and Churchill, 2002). It is adaptable to any kind of unforeseen event and can be drawn upon quickly.

The advantage of cash savings is liquidity when there is no time to sell in-kind assets or when they fetch a low price. Livestock have the potential advantages of producing off-spring (and more income and savings). The

livestock rental arrangements explored in Tadesse (2010) is evidence for the existence of alternative asset accumulation mechanisms when markets for credit are missing. The rental contracts also avoid the problem of assets indivisibility (lumpyness) peculiar to livestock. In addition, the arrangement also enable the poor to invest their labor in livestock upkeep and use animal products from the rented in cow (if not offsprings ) in case of shock to smooth consumption.

Despite the benefits of cash savings, Ethiopia has a relatively low rate of overall savings, precautionary or otherwise. From the poor’s point of view, the disadvantage of precautionary savings is that it takes a lot of time to build substantial reserves, and shocks frequently come before reserves are sufficient. They also require sacrifices in consumption, and for those living on a few dollars a day, saving is a challenge.

Nonetheless, empirical evidence shows that even the very poor can save. Admassie et al. (2005) found that the average amount of savings in poor rural Ethiopia ranges from ETB 1,000 to 2,000 (less than USD \$100 to 200) per year. While more and more Ethiopians are beginning to save through formal financial institutions, most still stash them insecurely in a box at home. Saving at home allows households to avoid tax duties and bureaucratic paperwork involved in formal deposits or withdrawals. Further, many deposit-taking institutions require photo identification, an initial deposit, and some degree of literacy are no minor obstacles for the poor.

Finally, lack of awareness and low interest rates on capital deposited availability contribute to the low rate of participation in formal savings programs (Admassie et al., 2005). Another important saving method in Ethiopia is *iqqub*, an informal rotating savings and credit association whereby members can access their contributed money when their turn comes up. This allows relaxing capital constraints in case of unforeseen events or investing in a new production/consumption activity.

**Credit:** Credit serves as an insurance substitute when market opportunities for risk sharing are limited (Besley, 1995). The author argues that pure credit arrangement, rather than a contract with contingencies is likely to be less optimal in risky environments. This indicates the role of informal contractual arrangements to cope with economic shocks in risky environments. Credit markets are significant to the discussion of insurable risks mainly in two ways.

1. Reducing vulnerability *ex-ante*: Economic shocks are easier to weather when one is wealthier. This is because credit, used wisely, can help build wealth.
2. Coping with shocks *ex-post*: Once a shock occurs, credit can be used to fund necessary and wise consumption, such as emergency medical care or food. It is not always obvious how the poor will repay their loans if they do not even have enough income for normal consumption in the first place; however, sometimes a

basic level of consumption (that is, minimum caloric intake) is necessary before any productive activities can become possible.

### **Community based risk management arrangements**

*“When spiders’ webs unite, they can tie up a lion.” In Amharic “Dire bi’yabere anbessa yasere.”*  
- Ethiopian Proverb

Community based risk management arrangements are more relevant to cope with idiosyncratic (uncorrelated) shocks but are likely to fail in the face of correlated shocks unless household has systems to transfer the risk outside of their community/village (Battamishra and Barrett, 2010 ). The importance of extra-regional risk sharing systems are found in literature, including, credit and transfers between distant relatives, (Rosenzweig, 1988; Miller and Paulson, 2000); migration and marriages (Rosenzweig and Stark, 1989) and ethnic networks (Deaton and Grimard, 1992).

A recent study in Tanzania by De Weerd and Dercon (2006) find that risk sharing among households such as gift-giving and credit without interest from social networks- found to be the most important strategy for coping with shocks. Although past studies find some degree of risk sharing and thus of insurance against weather, use of such systems is not so widespread as to cover all households, nor do they come even close to providing a fully efficient insurance mechanism (Battamishra and Barrett, 2010). Most households are therefore still left with no insurance against correlated risks, the main source of which is weather. Ethiopians in both urban and rural areas enjoy a rich tradition of informal community risk and resource sharing mechanisms based on principles of social solidarity. The most common community-based risk management arrangements in Ethiopia include *iddir* (burial societies operating through membership dues to cover funeral costs when a person in a member’s family dies), sharecropping, livestock sharing, and agricultural and financial cooperatives.

Empirical evidence in southern Ethiopia indicates that landlord provides interest free inputs to tenants with financial problems (Tadesse et al., 2009). In livestock sharing contracts a severely cash constrained livestock tenant form contracts with rich livestock lords residing either in distant area or within the same community. This allows the poor to have access for animal products such as butter, milk, cheese and manure for crop production which would have been difficult to get them without the contract. Similarly, the rich also get offspring (productive asset). This allows the livestock lord to store assets (livestock) in productive form as livestock reproduce (Tadesse, 2008). Livestock sharing/rental contracts are common beyond the southeastern highlands (Wolaita and Sidama zones) as well. In pastoral areas, a

household that has suffered a loss negatively affecting its access to milk and butter can borrow a cow from very close friends or relatives under an arrangement called *dabare*; after the family has had time to recover, the affected household is required to return the cow. Pastoralist areas also count on their strong social linkages and relationships during social and economic crisis, through a system called *buusaa gonofaa*. Under the arrangement, fellow community and clan members contribute food and up to 10 heads of cattle per individual following a loss of livestock. For households that have lost all of their livestock, they can expect to receive from their clan as many heads of cattle as they had before; however, those who have lost animals as the result of mismanagement or negligence may receive only a few.

### **Iddir as a potential insurance distribution channel:**

Primarily designed to deal with the financial burden of burial, as mentioned earlier represents a considerable and necessary expense due to its important cultural and religious significance (Mariam, 2003). *Iddir* members are required to pay fixed monthly contributions (often a few birr per month) to cover expenses when a member or a member’s family member dies. Well-defined rules and obligations that are often recorded in writing and codified through mutually agreed regulations and accounting (Dercon et al., 2007). Ability to attract different socio-economic groups with restrictions based on ethnicity or religion relatively rare in practice. While most *iddir* only focus on compensating loss associated with death, some provide cash transfers or loans for other risks including illness, property damage including fire, death of livestock, and crop failure (Dercon et al., 2007). Other *iddir* have moved beyond their roots as funeral societies and begun to offer loans to construct homes, host weddings, and cover health benefits. In Mariam’s (2003) study, about 20% of *iddir* provided help for health-related problems including obtaining loans to cover all medical costs.

### **External assistance**

Finally, to manage risks, Ethiopians also turn to external assistance from institutions that are headquartered or supported by funds outside the area of intervention (Table 2).

Support provided by external actors includes both *ex ante* and *ex post* risk management. *Ex ante* assistance covers a very wide range of initiatives including micro-entrepreneur income generation, savings and credit-led schemes, environmental rehabilitation, agricultural productivity enhancements, and other development projects. *Ex post* support focuses on interventions like cash and grain transfers in response to emergencies that affect very large numbers of people at once (for example, drought, flooding, ethnic conflict, and cross-border war). Because the number of institutions providing external assistance is so large and the types of assistance so

**Table 2.** Common forms of external assistance.

<i>Ex Ante</i> risk management	Microfinance schemes Micro-entrepreneur business training Productive Safety Net Program Cooperative Formation and Promotion Vocational training Environmental rehabilitation HIV/AIDS education training
<i>Ex Post</i> risk management	Food-for-work Cash-for-work Food aid

Source: Authors.

**Table 3.** Summary of coping mechanisms.

Type of mechanism	Coverage	Accessibility	Timeliness	Cost
Self-insurance	All risks low "benefits"	The poor generally have low capacity to build reserves	Most timely of all strategies	High cost as loss is borne directly
Community mechanisms	Idiosyncratic risks low "benefits"	The poorest excluded	Relatively timely	Less costly
External assistance	Covariant risks uncertain "benefits"	Uneven access	Very late Not dependable	Least costly

Source: Authors.

varied, this study cannot catalog them all. One of the most important to mention here is the Productive Safety Net Program (PSNP), a well-established, government social protection program serving 8 million chronically food insecure households. In 2005, the Ethiopian Food Security Office established the PSNP as a system of transferring cash and food to vulnerable households *before* they reach a crisis point. This assistance is coordinated through government and financial channels in exchange for beneficiaries' work to build community assets such as water harvesting structures or to reclaim environmentally degraded areas through reforestation and other conservation projects.

The motto of the PSNP is to provide "predictable transfers for predictable needs". As of 2008, the PSNP had grown into one of the largest, social protection programs in Africa. Early impact studies suggest that the PSNP is superior to traditional, emergency food aid programs in significantly increasing household welfare (UNDP, 2007; Sharp et al., 2006).

### Summary of coping strategies

The foregoing coping mechanisms are important adjustments to the missing or imperfect credit and insurance

markets in Ethiopia. However, results from key informants and in-depth individual interview both in urban and rural- emphasized the ineffectiveness of current coping strategies (Table 3). Therefore, without sufficient coping strategies, poor households can find themselves locked into a cycle of poverty by staying in low-risk, low-yield economic activities in order to reduce their exposure to extreme shocks. Alternatively, they may take out emergency loans, default on borrowed funds, and sell productive assets like livestock. If liquidation takes place at a time when others are also trying to liquidate, assets may have to be sold at fire sale prices.

### Attitudes toward Insurance

The discussions thus far have demonstrated an overwhelming need for more robust risk coping mechanisms in Ethiopia, but, as explained in the conceptual framework section of this paper, need does not automatically translate into demand. What matters is whether the poor will recognize the value of a well-designed insurance contract enough to give up precious funds for it. Common attitudes towards insurance in this study's field work were reflected in statements like: insurance is for "those who have money," and "people with lots of business



transactions,” “people with lots of property”. For the few who thought insurance was immediately relevant to the poor, they usually thought it was in the context of mandatory credit-life policies.

### **Perception of insurance's value**

Prospective clients in Ethiopia possess a limited understanding of the costs and limitations of formal risk transfer. To wit, one FGD participant in Oromia with a passing knowledge of insurance explained it as a vehicle protection scheme in which “the government replaces the car to the owner if an accident happens.” As such, it is premature to conclude that they will definitely purchase insurance if it is offered. However, FGD participants expressed nearly unanimously that with some explanation, insurance was an easy concept to understand.

Most participants in Addis Ababa had heard of the concept of insurance from advertisements, NGOs like WISE, Micro Finance Institutions (MFIs), friends, relatives, radio and television, while in rural areas, some people had learned about it from insured truck drivers passing through their towns. Members of the coffee cooperative unions in Yergachife (YCFCU) said that they had learned of insurance from the cooperative management who had purchased protection against fire and theft on behalf of the union.

Agro-pastoralist households in Oromia also said they were well aware of vehicle insurance coverage from truck drivers, and they thought they would like to have a similar cover for their livestock. The agro-pastoralists also said they have learned about insurance from the local MFI, Oromia Credit and Saving Co-operatives (OCSCO), which has a credit-life scheme. The focus group facilitators noted that “participants easily understood the concept of insurance when introduced to them and even they started to talk about it before this study introduced the concept of formal insurance.”

However, even in contexts where potential clients should be familiar with insurance, not everyone is aware of it. For instance, many FGD participants said they did not know that their MFIs offer credit-life policies. Legesse 2008 came to a similar conclusion.

In his study, on Addis Credit and Saving Institution (ADCSI's) compulsory micro-insurance scheme for borrowers “almost all respondents were unable to mention micro-insurance as one of the products that ADCSI delivered throughout. Unfortunately, all the respondents were poorly informed about the specific product features” (Legesse, 2008).

The good news is that people can be made aware and educated. The few borrowers who knew about ADCSI's credit life products were able to cite some of the major benefits of coverage. Respondents listed (in decreasing order): reducing the debt burden on the family or personal guarantor (53%), allowing one's business to continue (presumably after a shock), and finally providing

compensation through the plan's saving scheme to the (surviving) family” (Legesse, 2008).

This study found that familiarity with *iddir* was a key to comprehension in areas not already acquainted with formal risk transfer: areas without *iddir* (Yabello and Tigray) required much more explanation before being able to evaluate insurance's merits. In contrast, participants familiar with micro-finance and *iddir* quickly recognized the value of risk transfer.

In all regions studied, this study found that the poor viewed the concept of insurance with enthusiasm. The following are representative statements from the field research:

1. “Insurance is very helpful and important as long as the payment is appropriate—we are eager to benefit from it.” (Urban worker, Addis Ababa).
2. “We expect this good idea to be reality” (Agro-pastoralist, Oromia).
3. “Insurance is very important especially for Borana people, because every year we are under pressure of losing our livestock. Currently we do not have such a service.” (Pastoralist, Oromia)
4. “We always face serious risks in relation to our coffee and enset and we need to have protection for them” (Coffee farmers, SNNPR).

This study believed it is safe to assume that many low-income Ethiopians, understand the theoretical value of formal risk transfer.

### **Accessibility of insurance products**

For insurance products to be accessible, they must be both affordable and highly relevant to client needs. While the current micro-finance sector in Ethiopia has found a way to offer affordable products, they have done less well in terms of tailoring products around their customers. A recent report from the Association of Ethiopian Microfinance Institutions (AEMFI) concludes that the micro-finance sector is stuck in “traditional supply-driven financial products” versus “demand-driven products, which involve market research and new product development” (Amha, 2008).

This study explores concerns about demand-driven product design and the affordability of micro-insurance in the Ethiopian context as follows.

**Will the poor buy insurance if it is offered?** The case for micro-insurance is strong, but none of this matters if the poor are uninterested in opening their wallets. Will the poor be willing or able to buy insurance if it is offered? Or more accurately put: will enough poor people purchase insurance to make micro-insurance schemes viable? These questions are explored subsequently.

**Willingness and ability to pay:** Measuring the actual

**Table 4.** Range of premiums FGD participants might be willing to pay for insurance.

Livelihood groups	Minimum premium cited (ETB/year)	Maximum premium cited (ETB/year)
Urban workers	200	2,400
Coffee farmers	100	10,000
Pastoralists	120	12,000
Agro-pastoralists	50	1,000

Source: Authors.

willingness and ability of Ethiopians to pay for micro-insurance is a tricky issue that cannot be measured in the abstract. This demand study has been based on primarily qualitative and some partial quantitative research. As such, all that can be said with certainty is that there is strong interest in insurance in principle across the country.

Certainty about demand (in terms of potential numbers of clients, viable premium rates, etc.) requires new research and deep analysis based on quantitative estimates of interest in specific products (actual terms including benefit levels, policy exclusions, premium rates, claims procedures, etc.) with regards to specific providers (the trustworthy and the less than trustworthy).

With these caveats, below are scanty and unreliable bits of evidence that hint at actual willingness and ability to pay. For instance, a study in rural Ethiopia indicates that needy households are willing to pay up to ETB 10 (USD \$1) per month per household for health insurance. The USD \$1 is slightly higher than the amount, study participants had been paying for *iddir* premiums (Asfaw and Braun, 2004).

Nearly all FGD participants said they would be interested in purchasing insurance, explaining the main reason they had not done so already was ignorance that the service existed. Table 4 lists the range of figures mentioned in the discussions. Telling comments included the following about how much participants thought coverage should cost:

1. "Death: ETB 200 to 300 annually; illness: ETB 150 to 200; fire ETB 15 to 200; loss of property ETB 150 to 200; and business failure ETB 500" (Urban Worker).
2. "5% of my annual income" (Urban Worker).
3. "One head of cattle to insure my 17 cows" (Agro-Pastoralist).
4. "ETB 500 per year for life, cattle, and crop insurance" (Agro-Pastoralist).
5. "I can pay ETB 1,000 per year for life insurance—this is similar to purchasing your life; you can't get life from the market. It is a really good idea" (Agro-Pastoralist).
6. "Yes, I can pay ETB 500 for family death, ETB 1000 for crop failure, and ETB 1000 for livestock death" (agro-pastoralist).

Ability to pay is another matter. Clients of WISE currently pay five birr per month for health insurance, but

apparently, even this amount is not affordable for many of the NGO's clients as the interviewees and staff at WISE explained that many women are missing their premium payments. One client, however said "there are a few people complaining about the five birr premium payment, which is expensive according to them. As to my opinion, it is cheap relative to its benefits." In any case, FGD participants were nearly unanimous in expressing concern that the premium payments be geared toward their income levels and needs. Again this evidence is scanty and not sufficient to design any insurance programs, but this study is confident that a substantial number of Ethiopians are interested in purchasing insurance.

**In-kind premium payments:** Asfaw and Braun (2004) examined household willingness to pay for health insurance in terms of labor contributions. The result indicates that households are willing to contribute ETB 14 worth of labor to be a member of the hypothetical health insurance scheme (Asfaw and Braun, 2004). For instance, for a premium level of ETB 3 per month per household, 83 percent of respondents are willing to contribute to a community-based health insurance scheme in terms of labor but only 42 percent in terms of money (Asfaw and Braun, 2004). Generally, it was shown that households' willingness to pay for community based health insurance schemes in terms of labor is higher than their willingness to pay in cash.

Precedents for in-kind premium payments exist. FGD participants in Hagere Mariam said that poorer members of the community are allowed to work off *iddir* membership fees. These findings indicate that cash is a binding constraint for many low-income households; as such, an insurance program that offered the chance to purchase cover through in-kind labor payments would have a much better chance at succeeding. In this context, it might be possible to link them to the PSNP or other cash-for-work programs. Oxfam America's HARITA pilot and other pilots are investigating potential linkages like this to the broader risk management and social protection system in Ethiopia.

In late May 2009, Ethiopia's Nyala Insurance Company offered a HARITA affiliated risk management package. PSNP participants were given the opportunity to participate in an innovative insurance-for-work arrangement. Over the course of two days, approximately 600 farmers attended project enrolment activities, and 200

households signed up for the package. Roughly 38% of enrollees were female-headed households (recognized as the poorest of the productive poor) and 65% of enrollees were participants in the PSNP. By definition, these two groups constitute the most vulnerable farmers in Adi Ha. At the outset of this project, the received wisdom was that agricultural risks for farmers this poor were nearly uninsurable. Over time, as livelihoods improve and farmers graduate from the PSNP, they become candidates for the commercial insurance market where they can pay for insurance in cash. Already, 35% of the enrollees (ones who are better off and not in the PSNP) did pay in cash, using the disposable assets they had built over time. These initial results, suggest that in-kind premium payments may constitute a vital breakthrough in extending effective access to insurance and holistic risk management to the most vulnerable households in Ethiopia.

### ***Trust in specific insurance products***

For clients to agree to purchase an entirely intangible product like insurance, they must possess a high degree of trust in the insurance product and the insurer. At its core, insurance is a simple promise, and anyone who is seen as unable or unwilling to honor that promise does not have a viable product.

Fortunately, for prospective micro-insurance providers the field research overall found a general positive or neutral attitude toward all potential suppliers. With a few exceptions, participants frequently generally had no experience or good experiences with all the distribution channels this study tested: microfinance institutions, savings and credit cooperatives, agricultural cooperatives, *iddir*, insurance companies, and banks. Where skepticism was expressed, it was usually around cooperatives and *iddir*.

The urban clients of WISE said they most trust MFIs and “other” institutions; savings and credit cooperatives were also trusted. Seen to be slightly less reliable were *iddir* and cooperatives, while banks were “trusted a lot” or “not trusted at all.” Insurance companies were viewed as “somewhat trustworthy.” Pastoralists preferred to work with a local NGO. Agro-pastoralists felt that the local MFI and *iddir* are the most trustworthy institutions. Nonetheless they would prefer for insurance to be provided by a separate institution, adding “but if it is mandatory to come with other institutions it should be [the MFI], the only organization we trust.”

In sum, prospective micro-insurers in Ethiopia seem to be starting with no major credibility challenges, and it will be especially critical for pioneering schemes to function fairly and effectively in order not to destroy this infant industry. This study also found that certain design features will serve as strong signals of a scheme’s trustworthiness.

A reputation for timely, transparent, and fair payouts: Insurers must focus on disbursing payouts before families are forced to make tough decisions, for example, selling business equipment to pay medical bills. They must explain the covered perils and limitations of coverage clearly so there are no unpleasant surprises later. And, they must strive for the highest standards of fairness in their dealings. Frequently, because the poor are socially marginalized, they do not enjoy skills in self-assertion or advocacy. That is, they may quietly accept a powerful insurer’s decision to deny a claim, while secretly seething with anger at a perceived injustice. Particularly, when the micro-insurance industry has not been well-established and the poor do not know what to reasonably expect, insurers should be slow to deny claims, and when they do, they are best served in persuading the claimant that the denial is fair. Positive word-of-mouth experiences early on are going to be critical to the market’s growth.

A well-functioning appeals process will also need to be in place: Ethiopia has few consumer protection systems. Rarely can goods that malfunction be returned, and service providers who perform shoddy work go unpunished. Again, as marginalized people, low-income clients are unlikely to find satisfaction to consumer protection problems in the marketplace.

The PSNP, however, is one area where low income households have some experience with an appeals process. As such, the program could provide important lessons about future insurance appeals systems. A 2006 study of the program revealed that although PSNP participants appreciated the scheme, they were unhappy about a number of elements, including unfair targeting of beneficiaries, and late payments, especially in months when cash was most needed. The most common method for PSNP appeal submission was directly to *kebele* or *woreda* officials, with 81 percent of those households who appealed going to *kebele* authorities and 19% to *woreda* authorities (Sharp et al., 2006).

Although the PSNP has put this system into place, it is neither widely understood nor organized enough to be effective. As a result, 79% of those who did not make an appeal reported that they failed to do so, only because they were unclear about whom to contact or because there was no one in charge of complaints. Other factors have also rendered the process ineffective. Although appeals are designed to be informal and non-judicial, they often require written testimonials or hearings which can be prohibitive for the most vulnerable participants (the uneducated, elderly, and female). Other external factors such as social pressure can also steer individuals away from lodging a complaint. For example, in cases where individuals are required to point to a community member who is better off than themselves but receiving PSNP benefits, social pressure often ensures the appeal never happens (Sharp et al., 2006). In short, any appeals process set up for micro-insurance needs to be well-advertised, simple, friendly to the socially marginalized

and vulnerable, and free from political and social manipulation.

## CONCLUSIONS AND POLICY IMPLICATIONS

Various Ethiopian microeconomic studies and impact assessments of the country's social protection programs suggest that predictable, small insurance payouts could represent an important step toward poverty reduction. This study found that the poor see great value in the concept of risk transfer, but they would need insurance to be offered in a way that is centered on their needs and ability to pay for coverage. Bundling insurance with other services like credit could potentially increase access, affordability, and effectiveness of risk transfer services. Ultimately, then, Ethiopians do need micro-insurance; whether or not they would purchase it, however, depends upon whether or not the eventual supply of products is truly client-centered.

In order to reach the vastly underserved individual client market in the country, current and potential micro-insurers need to prioritize client-centered products. Doing so will require designing backwards toward affordability, accessibility, and reliability. Because micro-insurance in Ethiopia is still a young industry, insurers will need to invest for the long-term and not be too impatient about securing high returns immediately. Cooperation with not-for-profit oriented institutions will bring down the cost of product design, marketing, distribution, and claims. Particularly, at the early stages of market development before trust is firmly established, insurers should be quick to compensate and slow to deny claims.

Finally, with its responsibilities to protect and promote the public good across all sectors, the federal government should take a holistic approach to integrate micro-insurance into the national risk management strategy. This would mean investigating how micro-insurance could work in synergy with other public programs like the national Productive Safety Net Program or macro-level risk transfer schemes, such as the World Food Programme's weather derivative insurance project, established to provide the government contingency funds in the case of catastrophic national drought.

International donors interested in supporting the development of micro-insurance should seriously examine their current bias towards funding of ex post risk management. Currently, Ethiopia receives the most emergency assistance in Africa, but the least long-term development assistance—despite the fact that handling risk after a shock tends to be very cost inefficient. Moreover, the unreliability of international assistance in terms of timing, amounts, and coverage is undermining the country's resiliency. Donors should strive to increase the transparency and dependability of their aid, in part by backing insurance-based support mechanisms in Ethiopia.

The poor want micro-insurance. Now, it is up to the

supply-side actors to provide products that serve their needs and that are affordable. To build the market, concerted effort among stakeholders on the supply side should prioritize (1) increasing awareness through popular channels, (2) making products accessible, and (3) above all else, building confidence in the market.

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