QUARTERLY REPORT

FOR JANUARY 1 - MARCH 31, 1982

FOR GRANT No.AID/LAC/IGR-1297

INSTITUTO INTERAMERICANO DE COOPERACION PARA LA AGRICULTURA
INTER-AMERICAN INSTITUTE FOR COOPERATION ON AGRICULTURE
INSTITUT INTERAMERICAIN DE COOPERATION POUR L'AGRICULTURE
INSTITUTO INTERAMERICANO DE COOPERAÇAO PARA A AGRICULTURA

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SC/MZ-44
June 18, 1982

Mr. Albert Brown
Chief, LAC/DR/RD
2242 NS - USAID
Washington D.C. 20523
U. S. A.

Ref: USAID GRANT AID/LAC/IGR-1297

Dear Mr. Brown:

I am pleased to submit 10 copies in English of the Quarterly Report for the first calendar quarter of 1982. As we anticipated in the Quarterly Report for the Third Quarter of last year, maintaining all components in full operation with the $1,025,000 obligated for CY-82 has been difficult. We are fortunate that devaluations in two project countries have relieved some of the strain. This situation, however, is temporary as prices are adjusted fairly rapidly. The $105,000 of additional cash flow to be obligated this year will be needed if the current levels of staffing and operations are to be maintained. The problem is particularly acute in Panama where our disbursements will reach the initial subgrant of $612,000 in August of this year. Unless substantial economies are achieved, we will be obligated to make transfers between line items.

Our present financial projections indicate that the initial grant of $4,046,000 to IICA will sustain the project only until the end of the present calendar year. IICA has given this project a high priority, and we are pleased with what has been achieved in both the project countries and in other non-project countries. IICA from its own resources is funding agricultural insurance work in Perú, Colombia, Paraguay, Honduras, Costa Rica, Jamaica, the Windward Islands, and Trinidad and Tobago. In addition, we have played an active role in establishing agricultural insurers in Venezuela and Chile; with the former IICA has a technical assistance agreement.

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As was contemplated by the initial grant, IICA has institutionalized the agricultural credit program and has established a hemisphere wide technical assistance program. We in IICA are most interested in continuing as the implementing agency. We believe that the decision stage has now been reached. IICA would like to participate actively in planning an extention of this important activity. We will be contacting you in the near future to discuss how IICA can participate in the decision-making process for the second stage of this project.

Sincerely yours,

José Alberto Torres
Director of Multizonal Projects

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Pursuant to Section (1) of Attachment 1 of the above cited grant and Amendment 2 dated May 30, 1980, I have prepared the following Quarterly Report for the first calendar quarter of 1981.

The first quarter of the year is the period of least activities in the project countries. It has provided us with the opportunity to carry out numerous administrative tasks such as preparing a new statute for Bolivia, developing new products such a livestock insurance in Ecuador and Bolivia and planning new crops insurance programs in all project countries.

In addition, we have carried out an extensive cost analysis of all project components. I believe it will be possible to stay within the $1,025,000 obligated for the present year only by severely cutting field operations of the insurers. The additional $105,000 to be obligated will relieve much of this strain. Our present projection is that the initial grant of $4,046,000 will be consumed by year's end.

Should you wish any further information, please contact me.

/s/ Dr. William M. Gudger
Head, Crop Credit Insurance Division

PROJECT ACTIVITIES IN PANAMA

The first quarter of the year in Panamá is a period of little agricultural activities. We have used this period to collect data from farmers and to review coverages and premium rates. As reported in the Second Annual Report, the overall experience of the insurer, ISA, continues to be positive.

However, since the end of the last calendar year, ISA has suffered heavy losses in its sorghum insurance. These losses have forced a substantial upward revision of the premium rates. The increase, to 9% in some cases, is being divided between the farmers and the government which has agreed to subsidize the premium. For the first time, the stop loss reinsurance was called in to help support the loss. Both our studies and those of the reinsurer indicated a higher sorghum premium was required.

Other premium rates are under review utilizing the portfolio management model that our research component has developed. Both the pure risk premium and the required administrative "loading" are being reviewed. We anticipate that there will be both upward as well as downward adjustments in various regions of Panamá.

Our extensive research effort, based primarily in Panamá, is now beginning to produce empirical results, the first of which were presented at the San José Conference. By the end of the third quarter, we expect to have several important studies of agricultural insurance at the farm level, the insurer level and the impact of insurance on the banking system. The state of this research is reviewed extensively in the research section of this report.

PROJECT ACTIVITIES IN BOLIVIA

The Bolivian Agricultural Insurer, ASBA, continues to confront a situation which restricts its growth. The crisis of the Bolivian economy continues with the Peso under increasing pressure. A large devaluation is inevitable, and as a consequence a further erosion of the reserve.

The primary agricultural lender, BAB, continues to undergo reorganization and recapitalization is under way, thus few agricultural production loans are made. As a consequence, ASBA has temporarily lost its major source of insured loans.

The reorganization of ASBA as a mutual company is still in the approval process. The Bolivian Ministry of Planning is presently studying the proposed reorganization. We are hopeful that a favorable decision will soon be forthcoming.

ASBA unfortunately must follow the fortunes of the Bolivian economy. The current crisis has not permitted the planned growth. There simply is little credit to insure. To offset these problems, we are attempting to negotiate with other lenders in the private sector. These negotiations have led to the signing of agreements with several cooperatives and regional development corporations as well as with the Interamerican Development Bank (IDB). In the IDB program, ASBA will insure about 2,000 head of imported milk cattle valued at about $1,000 each. The coverage, initiated after the acclimatization period, will initially be 70% of the replacement value. ASBA has negotiated a quota-share treaty to enable it to take so large a dollar sourced risk.

In addition, ASBA continues to negotiate with La Cruzeña in Santa Cruz. We expect to reach an agreement under which La Cruzeña will market ASBA products. The final points to be negotiated are the underwriting criteria, the loss adjustment procedures, and the amount of retention by La Cruzeña. We are hopeful that a coinsurance treaty can go into effect this year.

While the development of ASBA has been slower than anticipated due to the performance of the Bolivian economy, we remain optimistic about the medium term perspectives of the insurer. ASBA has become a competent professional small insurance company with a dynamic management and an outstanding field staff. When the Bolivian economy begins its recovery and when credit again begins to flow in large volumes, ASBA should be well situated for a rapid expansion.

PROJECT ACTIVITIES IN ECUADOR

The Ecuadorian insurer is now in full operation and is writing both agricultural and livestock insurance. At present, potatoes are insured in the mountains while corn and rice are insured on the coast. For the first cycle after the pilot test, a limit of 140 policies established. By mid-February all had been placed.

The livestock program is still in the pilot phase but is growing steadily. As high value animals are insured, a cautious approach to developing the business is advisable. Both the Holstein Association and IDB have requested insurance, the former for exhibitions and the latter for a $6 million livestock loan.

Information is currently being collected for a baseline study of two new areas. We expect that CONASA can extend coverage to both Salcedo and Imbadura for the potato and corn crops next year.

CONASA's technical development is quite impressive. The field staff is compassed of very high quality people who have shown admirable enthusiasm and competence in their work.

Administratively, CONASA has several problems which we believe can be resolved in the next few months and certainly before the third quarter. These problems have made it unadvisable to sign the financial assistance agreement, although the technical assistance continues normally. The financial status of CONASA is thus precarious as neither IICA nor the Ecuadorian Central Bank have made their 1982 contribution. However, as soon as a mutually agreeable program for administrative restructuring is agreed upon, the subgrant money will quickly resolve CONASA's liquidity crisis.

PROJECT ACTIVITIES IN RESEARCH

Our research component has now reached the stage of empirical analysis. After long methodological work and extensive data collection, we have created a data bank and the methodological tools to begin undertaking extensive empirical studies. The first fruit of this was the Conference on Agricultural Risks, Insurance and Credit held in San José. The co-sponsers, IICA and IFPRI will also jointly publish the papers of the conference as soon as possible.

The farm level evaluation of the first two years of the project in Cochabamba, Bolivia, revealed important positive effects of insurance. The potato producers who used the insured new technology improved yields by over 100 percent, with a higher proportion of quality #1 potatoes. The net returns obtained at the farm level that were 25 percent higher than those obtained in the previous year. More importantly producers' decided to continue using the improved technology and to insure their investment even without official credit. These long term benefits would definitely overcome the high cost of the program in the first year. To continue the research in Bolivia a full time technician was hired beginning in January.

The farm level anthropological studies in Los Santos, Panama, revealed a generalized negative attitude towards compulsory insurance. On the other hand, when insurance was understood by the farmer, more than 50 percent of them would voluntarily insure their crops and livestock at current premiums. These results induced the Panamanian insurer to expand its information and education program.

Two farm level ex-ante analyses of the effects of insurance were generated through a risk programming model of small farms in the districts of Bugaba, in Chiriquí Province and in the district of Guarane in the Azuero Peninsula. The Bugaba farms are highly diversified, and semicommercial, with an average of two insurable crops per unit. Model results indicate that the typical farmer in Bugaba will not be significantly affected by the presence of insurance under present conditions. In addition, such farmer would not have purchased insurance on a voluntary basis. The principal reason for the above results relate to the relatively hi premium rates for this particular district, and the high yield variation r ed for the activation of the insurance mechanism.

These conclusions might be modified as more data become available since the current time series of yields is short and insufficiently disagregate. Meanwhile, new premiums rates for the different regions of Chiriquí are now being developed in order to make insurance a more attractive proposition to producers in relatively low risk districts.

In contrast, the results for the Guararé district farms indicate that insurance has a substantial impact on the level and stability of farm income. The presence of insurance in this drought prone area accounts for a 50% income differential among insured maize and sorghum farmers. This beneficial effects of insurance is related to the high risk associated with droughts at the corn planting stages or excessive humidity in sorghum at harvest time. The high loss cost for sorghum during the first quarter of 1982 has prompted the development bank to revise its sorghum credit policy in response to ISA's advice. ISA will also be forced to revise its premiums for the district.

From these two interesting studies, we can draw tentative conclusions about both the utility of agricultural insurance and its administration. First, it is clear that agricultural insurance is not always a clearly indicated risk management tool. The farmers of Bugaba live in an ecological niche characterized by a very beningn climate. They are able to absorb the infrequent mild losses without insurance.

As premiums are lowered to reflect the continuing good experience of the district, it will most enlightening to see if insurance becomes more attractive. _A priori_ we suspect that it will not as the high yield variability required to trigger the insurance mechanism will continue to make the insurance unattractive.

This presents an administrative dilemma: On the one hand, the yield variability requirement could be lowered to make insurance more attractive to farmers but on the other hand, lowering the yield variability requirement would imply more frequent and costly inspections of small losses and consequently higher administrative costs which have to be borne by an administrative cost loading of the premium. The result is that the lowered premium must again be raised. One partial solution to this dilemma would be to permit self-reporting of losses until fraud costs exceed administrative costs. We are also "grading" clients and adjusting the frequency of inspections downward for the better clients while concentrating inspections on the more loss prone clients.

The impact of crop credit insurance on the credit delivery system is quite clear now. In terms of default rates, the Agricultural Development Bank (ADB) of Panama has received the full benefits of insurance for those cases involving climatic risk. However, preliminary studies have found that climatic risk accounts for only part of the total default risk by the bank. An analysis of 900 bank loans issued since 1974 reveal that non-insured loans have an actual maturity greater than the expected maturity, while the opposite is the case for insured loans. Hence in the later case, there is a lower administration cost for the banks as the insured loans stay on the books for a shorter period. Although bank officials concede that insurance has been beneficial to the bank, interinstitutional rivalries have precluded a more active cooperation between the bank and the insurance agency. It seems that present political conditions and the developmental nature of the bank have more effect on the supply of credit than the possibilities for loan default. The BDA, like many development banks was established to channel low interest loans to farmers. Much of the capital came from "soft" international loans. A very tight domestic budget and the higher interest rates charged by commercial lenders have begun to have an impact upon the bank. At present a substantial portion of the BDA's resources are obtained from commercial banks at LIBOR plus rates. This impact is seen in the tendency of the BDA to begin to consider diversified or multiple function banking to capture funds through checking and savings accounts; and hence act as a commercial bank. To the degree that this tendency continues, the default risk, and consequently credit insurance can be expected to play an increasing role in the BDA's loan portfolio management. Tighter credit funds from external sources and more interinstitutional cooperation are expected to improve the current situation and make insurance far more attractive to bankers.

Research activities at the level of the insurance agency were concentrated on the elaboration of technical inputs for premium rate making, and the implementation of ISA's portfolio selection model for the optimization of the financial outcome of insurance operations. The principal technical coefficients placed in the model were the loss cost (the ratio of indemnities to liabilities) per option in the portfolio, and the administrative cost per option. In addition, the province of Chiriquí, the most important province in the portfolio, was throughly mapped with respect to crop technologies, costs of production, crop zones and ecosystems. These coefficients will be used to define more adequate insurance coverages and premium rates. The results for the portfolio selection model indicate that, under current premium rates, crop credit insurance is not profitable on a commercial basis. The high premium rates required to justify a self sustaining mechanism are not acceptable to small farmers, financially or politically. However, the results also indicate that by lowering the administrative costs by about 60 percent it is possible to reach a break even point. This reduction could be produced, either by lowering actual costs or by expanding the number of insured. The latter appears the more likely.

The IICA/IFPRI conference held in San José in February gathered a selected group of professionals from several countries who work in interrelated aspects or risk, insurance and credit. The discussions centered around the costs and benefits of insurance and its justification. It could be asserted that small farm subsistence-oriented agriculture could benefit considerably more from policy instruments other than insurance. However, highly subsidized insurance could provide an important incentive for technology adoption as a way out of subsistence. Nevertheless, insurance subsidies could be more harmful than beneficial if extended beyond the infant industry or capital formation period of the insurer or if subsidies become permanent for farmers who have made the transition from subsistence to market-oriented production. The output of the conference as a procedings is now being prepared for publication.