

AMBIGUITY AVERSION DECREASES THE IMPACT OF PARTIAL INSURANCE: EVIDENCE FROM AFRICAN FARMERS

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Abstract

Indemnifying smallholder farmers against crop loss is thought to play an important role in encouraging the adoption of new technologies and facilitating productivity growth, but to be infeasible due to information problems. Consequently there is interest in developing alternative, partial, insurance products. Examples include rainfall insurance and the limited liability inherent in credit contracts. I argue that while these products may reduce information asymmetry, ambiguity averse farmers struggle to assess whether the contracts reduce risk. This problem is most pronounced when the production technology is ambiguous, as is likely the case for new technologies. I formalize this argument and test the theory using data from two RCTs, conducted in Malawi and Kenya. Comparative statics from the theory are consistent with both sets of data, and I argue that income losses from ambiguity aversion may be substantial (JEL: D03 D81 G22 O12 O16 Q12 Q14)

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