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Poverty Traps and Climate Risk: Limitations and Opportunities of Index-Based Risk Financing

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Abstract

The objective of this paper is to frame the key issues and summarize the current state of knowledge about and innovations in index-based risk transfer products (IBRTPs) as they relate to the management of climate risk for poverty reduction, especially of chronic or persistent poverty. In the past several years, interest in and experimentation with weather index insurance and other IBRTPs has grown rapidly. Though no one should expect that these innovations alone can solve the problem of chronic poverty, index-based financing opens up a range of intriguing possibilities.

The remainder of this paper is comprised of five major sections that discuss: 1) how weather risks and climate shocks impact the poor in developing countries; 2) the concept of poverty traps, highlighting how conventional risk management strategies typically do not work well for managing covariate weather risk; 3) the limitations and opportunities of financial innovations using index-based risk transfer products (IBRTPs) for reducing or transferring weather risks and climate shocks; 4) a poverty traps-based typology of IBRTPs; 5) key remaining challenges in developing and implementing index-based risk financing for use in the global struggle to end chronic poverty.

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