

EFFICACY OF INDEX INSURANCE UNDER ALTERNATIVE POLICY SCENARIOS

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Abstract

The projected WTO and CAP policy scenarios has created an awareness amongst farmers and policy makers of the need to quantify the altered risk exposure, some of which being catastrophic and disruptive, and to study the scope for better risk management opportunities. It is argued that index-based insurance might be an interesting risk transfer tool. With such contracts, the premiums and payouts are based on the weather records of the locality in which the contract is sold. In general, it will be impossible to say whether the net effect of the introduction of such a new risk management instrument will increase or reduce either the mean or the variance of net returns. It depends on how the interactions with other risks on the farm and with other risk management instruments work out (e.g., diversification). Therefore, a whole-farm model is developed which provides insight into these innovative risk transfer instruments its efficacy to reduce farm exposure. Results of a qualitative analysis with respect to policy developments, including possible outcomes of Doha round of the WTO negotiations, have been converted into quantitative values which were a basis for Monte-Carlo simulations of farm incomes. The simulation results are subsequently used as inputs in a whole-farm model to provide insight into the impact of (new) instruments on farm income volatility.

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