

Dual hedge: Index insurance and crop diversification for small-plot farm holders

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This research investigates the optimal use of index insurance and crop diversification under various climatic and financial settings. Insurance and crop diversification are among strategies that farmers can use to hedge against uncertainty in climate. While a significant number of small plot farm holders in developing countries are practicing crop diversification, in various cases however, this hedging strategy alone is not sufficient to avoid costly adaptation and smooth consumption. Agricultural index insurance holds great promise in providing farmers with additional financial resilience when face with hardships: it avoids moral hazard and adverse selection that plague traditional crop damage-based insurance. Thereby theoretically, it allows farmers to take the full benefit of good agricultural practice as the index insurance's payoff is determined independently from the farm's performance, hence the solution to insurance – sustainability conundrum in which the adoption of insurance is found to be associated with the increase in unsustainable practice.