CENTRO DE ECONOMÍA APLICADA

Abstract

We argue that US welfare would rise if unemployment insurance were to be increased for young workers and decreased for old. This is because young workers have little means to smooth consumption during unemployment, and want jobs to accumulate high-return human capital. So unemployment insurance is highly valuable to them while the induced moral hazard problem is mild. We consider a life cycle model with unemployment risk and endogenous search effort, that we calibrate to match US labor market institutions. We find that allowing unemployment replacement rates and other government transfers to decline with age yields sizeable welfare gains which amount to around two thirds of the gains attained under the constrained optimal scheme for unemployment insurance over the life cycle.