Asset Based Unemployment Insurance

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Abstract. This paper studies a model of consumption, savings and job-search in which a borrowing constraint limits self-insurance. The government provides unemployment insurance which may condition on an individual’s asset position, but not on her efforts of finding a job. In the model, wealth provides a sufficient statistic for an individual’s entire history of unemployment spells, and the optimal insurance policy does not display any duration dependence. To compensate for the impediments to self-insurance, benefit payments are optimally higher at lower wealth levels and peak for borrowing constrained individuals with zero liquid assets. A quantitative exercise reveals that the US unemployment insurance program is surprisingly close to optimal for the asset poor, but far too generous for wealthier individuals, resulting in significant efficiency costs. In contrast, a policy design which exclusively - but generously - insures the very poorest in the economy appears close to optimal, giving merit to asset-based means tested policies in a second-best world.

JEL-classification: D82, H21, J64 and J65.

Keywords: Unemployment insurance; Moral hazard; Self-insurance; Asset-based means test.

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