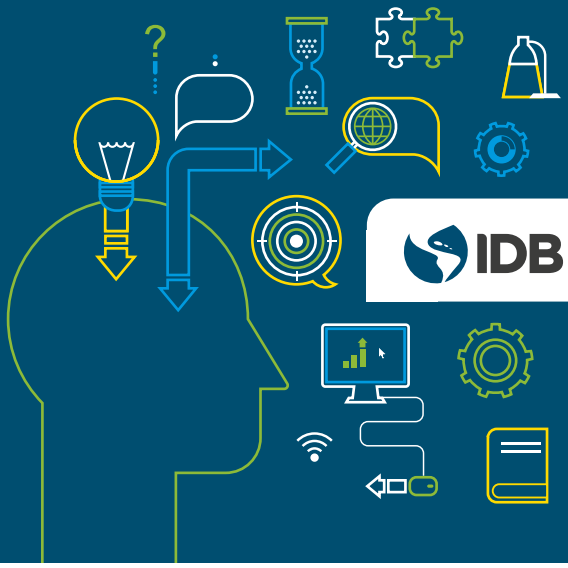
RESEARCH INSIGHTS

# How Can Unemployment Insurance Programs Balance Support, Job Quality, and Costs?



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- **Non-wage job attributes, such as effort and amenities, affect unemployment spells and UI costs, with unobservable features leading to inefficiencies and moral hazard.**
- **UI programs must balance the insurance provided to unemployed workers with incentives for re-employment.**
- **When workers search for jobs with different levels of quality, the use of distortionary taxation might help the government incentivize worker search.**

## CONTEXT

**Unemployment insurance (UI) provides financial support to workers during periods of joblessness, helping sustain their consumption and well-being.** However, the design of these programs must carefully balance the provision of adequate benefits with incentives for reemployment. One key challenge arises from the variety of job characteristics beyond wages, such as effort requirements, working conditions, and nonmonetary perks (i.e., amenities). Workers often prioritize these attributes, seeking positions that offer higher quality but are harder to find. This dynamic can lead to longer unemployment spells and higher public costs, making it essential for policymakers to consider job quality when designing UI systems.

## PROJECT

**This study investigates the role of job quality in shaping optimal UI policy.** Unlike traditional approaches that assume jobs are homogenous, our model incorporates these critical variations into job characteristics. We analyze a dynamic labor market where unemployed workers search for jobs and firms post vacancies with differences in job quality. Using a model calibrated to the U.S. labor market, we examine how the unobservability of these job features influences the structure and cost of UI programs. This framework sheds light on the trade-offs faced by policymakers when trying to balance the efficiency, equity, and fiscal sustainability of UI systems.

## RESULTS

**The research highlights the significant effects of unobservable job quality on the labor market.** Panel (a) in the figure 1 shows that unemployed workers who receive UI are less likely to find a job, which is a standard sign of moral hazard. Panel (b) shows that unemployed workers are more likely to find jobs that come with important amenities, such as unionized jobs or jobs that come with health insurance, a key amenity in the United States.

The results additionally shed light on the optimal design of UI programs. In such an optimal program, workers returning to employment would face taxes that increase with the duration of their unemployment spell. This policy incentivizes shorter unemployment periods by penalizing extended job searches.

Second, as government cannot observe job quality directly, optimal UI programs would have to allow for a degree of distortionary taxation. By taxing earnings, the government discourages workers from exclusively targeting high-quality jobs that indirectly increase the program's cost. Although these taxes create inefficiencies, they are necessary to manage moral hazard effectively.

Key Concept

### MORAL HAZARD

The idea that unemployment insurance might reduce the incentive for workers to actively seek employment because they are receiving benefits.

In a world with unobservable job contracts, UI systems are 10.5% more expensive than in a world in which the government could perfectly observe all the details of employment contracts. This additional cost stems from the need to address the complexities introduced by job quality considerations while maintaining comparable welfare levels.

These findings underline the challenges of designing efficient UI systems when workers and firms prioritize non-wage job characteristics.

## POLICY IMPLICATIONS

**The study suggests several policy recommendations for improving the effectiveness and efficiency of UI systems.** First, policymakers should improve monitoring mechanisms to track job seekers' efforts and collect detailed data on job characteristics. This information can help tailor UI programs to account for non-wage factors influencing worker decisions.

Key Concept

### DISTORTIONARY TAXATION

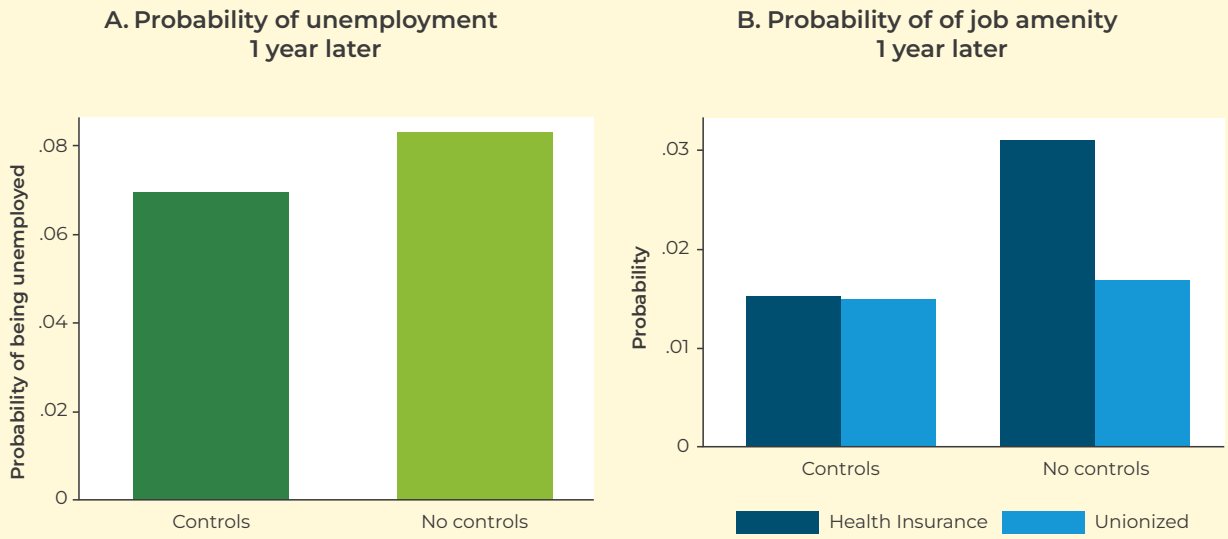
Taxes that change people's behavior, such as discouraging workers from only pursuing high-quality jobs.

Second, policy should include dynamic benefit adjustments. In particular, gradually reducing UI benefits over time can strengthen incentives for reemployment without severely compromising workers' financial security. This approach aligns benefits with the observed trade-offs in job search behavior. Likewise, to incentivize quicker reemployment, UI systems should reduce benefits more steeply over time when job quality is unobservable. This approach discourages prolonged searches for high-quality jobs, which are harder to secure and more expensive for the system.

Third, policy should encourage increased transparency in labor markets. For example, promoting clearer disclosure of effort and amenities in job contracts can reduce the information asymmetry that drives up UI costs. Transparency also enables more efficient matching between workers and jobs.

**By addressing these dimensions, policymakers can create UI systems that better reflect the complexities of modern labor markets while controlling costs and preserving equity.** These considerations are particularly important in countries in Latin America and the Caribbean, where a high number of workers face vulnerabilities in their labor market experiences.

## FIGURE 1. Difference in Outcomes between Unemployed Workers with UI versus those Without




*Notes:* Panel (a): Difference in the probability of being unemployed one year later for the unemployed today that receive UI versus those that do not. Panel (b): Difference in the probability of having a job with certain amenities one year later for the unemployed today who receive UI versus those who do not. Controls: age, gender, and education.

## FULL STUDY

Da Costa, Carlos, Lucas Maestri, and Cezar Santos. "Job Quality, Search, and Optimal Unemployment Contracts." IDB Working Paper No. 1667. Washington, DC: Inter-American Development Bank. http://dx.doi.org/10.18235/0013396.

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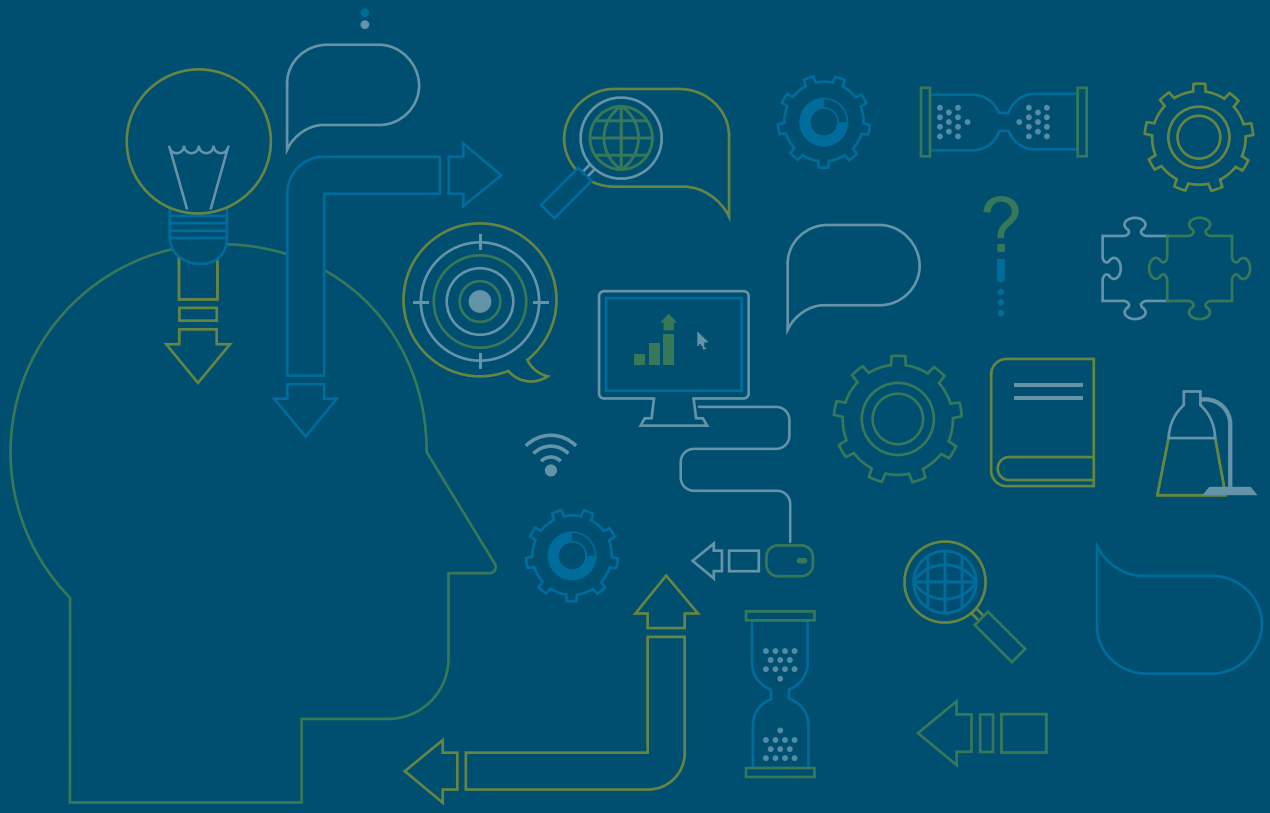




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