UNEMPLOYMENT INSURANCE AND UNEMPLOYMENT ACCOUNTS: THE BEST OF BOTH WORLDS

Ofer Setty
Tel Aviv University

Abstract
Unemployment accounts are mandatory individual savings accounts that can be used only during unemployment or retirement. Unlike unemployment insurance, unemployment accounts solve the moral hazard problem but provide no public insurance to workers. I study a hybrid system that borrows from concepts of both unemployment insurance and unemployment accounts, in which workers are mandated to save when employed and can withdraw from the account when unemployed. Once the account is exhausted, the unemployed worker receives unemployment benefits. This hybrid policy provides insurance to workers more efficiently than an unemployment insurance system because it provides government benefits selectively. As a consequence, young workers can reduce their precautionary savings and better smooth their consumption over the life cycle. Calibrating the model to the US economy, I find that, relative to an optimal unemployment insurance system, the optimal hybrid policy leads to a welfare gain of 2.4%, measured as consumption equivalent variation. (JEL: E24, E61, J64, J65)

The editor in charge of this paper was Dirk Krueger.

Acknowledgments: Previously titled: Unemployment Accounts. This paper is based on the third chapter of my PhD dissertation. I am grateful for the invaluable guidance of my adviser, Gianluca Violante. I thank Dirk Krueger, the editor, and three anonymous referees for numerous useful comments and suggestions. I also thank Moshe Hazan, Iris Kashman, Lars Ljungqvist, Virgiliu Midrigan, Ariell Reshef, Thomas Sargent, Roine Vestman, Yaniv Yedid-Levi and seminar participants in numerous locations for their very helpful comments. Correspondence: Ofer Setty, Department of Economics, Tel Aviv University.

E-mail: ofer.setty@gmail.com