

**Should Unemployment Insurance Vary with the Unemployment Rate?**  
**Theory and Evidence**

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**Abstract**

We study how optimal unemployment insurance (UI) benefits vary over the business cycle by estimating how the moral hazard cost and the consumption smoothing benefit of UI vary with the unemployment rate. We find that the moral hazard cost is procyclical, greater when the unemployment rate is relatively low. By contrast, our evidence suggests that the consumption smoothing benefit of UI is acyclical. Using these estimates to calibrate our job search model, we find that a one standard deviation increase in the unemployment rate leads to a roughly 14 to 27 percentage point increase in the optimal wage replacement rate. We also conduct a model-based estimation of the structural parameters of the model, and we find that virtually all of the cyclical variation in the moral hazard cost and consumption smoothing benefit of UI is due to variation in the responsiveness of search effort as opposed to reservation wages.

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