

**ASK AN ECONOMIST**

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(now with his son) and enjoys grilling for family and friends. To read more of his work, see <http://research.stlouisfed.org/econ/sanchez/>

*Q. What are the pros and cons of unemployment benefits?*

**A. In short, the answer is insurance and incentives.**

Unemployment insurance benefits help individuals who have lost their job to sustain a desirable consumption level. An MIT economist, Jonathan Gruber, argues that private insurance or savings are not enough to prevent a large drop in the consumption of the unemployed. In particular, he estimated that in the absence of unemployment insurance, the consumption of the unemployed would fall by 22 percent. This drop would be more than three times the average fall in the presence of this program.<sup>1</sup>

Perhaps the most important disadvantage is that unemployed individuals may be discouraged from searching for a job (or taking certain jobs) if unemployment benefits are too generous. In a recent paper, Alan Krueger from Princeton University and Andreas Mueller from the Institute for International Economic Studies at Stockholm University found that across the 50 states and District of Columbia, job searches are inversely related to the generosity of unemployment benefits. In particular, the time devoted to job search drops by about 16 percent when unemployment benefits increase by 10 percent. The two economists also found that job search intensity increases prior to the exhaustion of benefits.<sup>2</sup>

The current programs in the U.S. and in most of the developed countries involve two or three levels of benefits that often decrease over the unemployment spell; the benefits are provided for a restricted period of time. This design resembles prescriptions in the seminal work of the economists Hugo Hopenhayn from UCLA and Juan Pablo Nicolini from the Federal Reserve Bank of Minneapolis and Universidad Torcuato Di Tella in Buenos Aires. They found that the best way to design an unemployment insurance program involves payments that decrease throughout the unemployment spell. They also prescribe a tax on each individual after re-employment—a tax that increases with the length of the previous unemployment spell.<sup>3</sup> The entire program can be implemented with unemployment insurance accounts for each individual. Individuals who use their benefits for a longer period of time would have to contribute more after re-employment to balance their account.

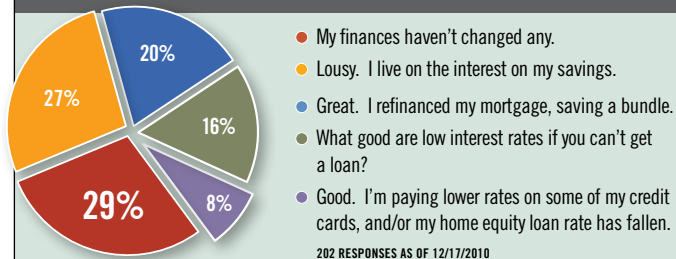
<sup>1</sup> Gruber, Jonathan. "The Consumption Smoothing Benefits of Unemployment Insurance," *The American Economic Review*, Vol. 87, No. 1, March 1997, pp. 192-205.  
<sup>2</sup> Krueger, Alan; and Mueller, Andreas. "Job Search and Unemployment Insurance: New Evidence from Time Use Data," *Journal of Public Economics*, Vol. 94, No. 3-4, April 2010, pp. 298-307.  
<sup>3</sup> Hopenhayn, Hope A.; and Nicolini, Juan Pablo. "Optimal Unemployment Insurance," *Journal of Political Economy*, Vol. 105, No. 2, April 1997, pp. 412-38

**Submit your question in a letter to the editor. (See Page 2.)  
 One question will be answered by the appropriate economist in each issue.**

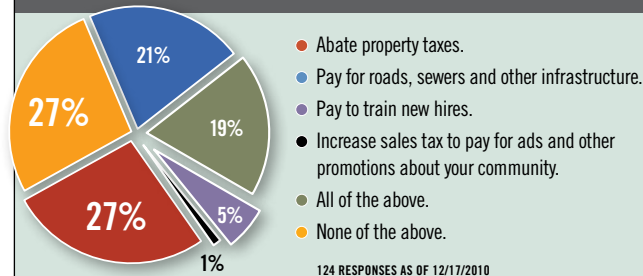
**FED FLASH POLL RESULTS**

When a new issue of *The Regional Economist* is published, at least one new poll is posted on our web site. The poll questions are always related to articles in that quarter's issue. Here are the results of the two polls that went with the October issue. The first stemmed from the article *Low Interest Rates Have Benefits ... and Costs*. The second stemmed from *Factory Closings Shock Community into Opening Wallets for Economic Development*.

**WHAT IMPACT, IF ANY, HAVE THE UNUSUALLY LOW INTEREST RATES OF THE PAST COUPLE OF YEARS HAD ON YOU?**



**IF YOUR COMMUNITY IS STARVED FOR JOBS, HOW FAR WOULD YOU AND YOUR FELLOW TAXPAYERS GO TO ATTRACT NEW EMPLOYERS?**



**THIS ISSUE'S POLL QUESTION:**

*Was the assistance provided by the Treasury, Fed and FDIC during the financial crisis a good idea?*

1. Yes, regardless of cost, the recession would have been much worse if not for the aid.
2. Yes, but only if taxpayers are paid back in full.
3. No, the assistance bailed out banks but didn't help ordinary citizens.
4. No, the assistance only encourages a repeat of the behavior that got us into this mess.

After reading *A Closer Look: Assistance Programs in the Wake of the Crisis* on pp. 4-10, go to [www.stlouisfed.org/publications](http://www.stlouisfed.org/publications) to vote. (This is not a scientific poll.)

**NEW VIDEOS PROVIDE INSIGHT ON KEY ECONOMIC TOPICS**

Want to find out how the experts would fix Fannie, Freddie and the other government-sponsored enterprises? Interested in how the new Dodd-Frank rules will affect financial institutions, consumers and regulators? Our cameras recorded recent discussions at the St. Louis Fed on these topics, and you can watch the videos by going to the multimedia section of our web site: [www.stlouisfed.org/newsroom/multimedia/video.cfm](http://www.stlouisfed.org/newsroom/multimedia/video.cfm). The videos range in length from a few minutes to more than an hour. While there, check out the scores of other videos and audiocasts that feature St. Louis Fed President James Bullard and other key leaders from the Bank.