Abstract:
In many principle-agent settings the principle can acquire noisy information that is otherwise observable only to the agent. I study this problem in the context of optimal unemployment insurance a la Hopenhayn and Nicolini (1997), where job-search effort is private information. In the optimal monitoring scheme, random monitoring, together with endogenous sanctions and rewards, create effective job-search incentives for the unemployed worker. For CRRA utility, the monitoring frequency increases and the spreads decrease with promised utility, if and only if the coefficient of risk aversion is greater than 0.5. Compared to optimal unemployment insurance, monitoring saves, at the balanced budget point, about eighty percent of the cost associated with moral hazard.