Abstract

I study a principal-agent problem in which the principal can obtain additional costly information about the agent's effort. I analyze this problem in the context of optimal unemployment insurance a la Hopenhayn and Nicolini (1997), where job-search effort is private information. I calibrate the model to the US economy and use it for two purposes. First, I show that for CRRA utility, the optimal contract dictates that monitoring frequency increases and the sanction decreases with promised utility, if and only if the coefficient of risk aversion is greater than 0.5. Second, I show that compared to optimal unemployment insurance and estimated at the balanced budget point, monitoring saves about eighty percent of the cost associated with moral hazard.