



[Optimal Automatic Stabilizers](#)

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Should the generosity of unemployment benefits and the progressivity of income taxes depend on the presence of business cycles? This paper proposes a tractable model where there is a role for social insurance against uninsurable shocks to income and unemployment, as well as inefficient business cycles driven by aggregate shocks through matching frictions in labor markets and nominal rigidities in product markets. We derive a formula that, on top of the usual tradeoff between the redistribution benefits and moral hazard costs of unemployment insurance and income taxes, adds to the determination of the optimal generosity and progressivity a new macroeconomic stabilization term. Using a series of analytical examples, we show that this term typically pushes for an increase in generosity and progressivity as long as slack is more responsive to social programs in recessions. A calibration to the U.S. economy shows that taking concerns for macroeconomic stabilization into account raises the optimal unemployment benefits replacement rate by 13 percentage points but has a negligible impact on the optimal progressivity of the income tax. More generally, the role of social insurance programs as automatic stabilizers affects their optimal design