

# Selective Hiring and Optimal Labor Market Policy

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## *Abstract*

Standard labor market models (e.g. search and matching) assume random hiring, i.e. workers are ex-ante identical and the individual job-finding probability is the same for all unemployed. In this paper, we develop a tractable model of selective hiring (with ex ante heterogeneous workers), which can be calibrated such that job-finding rate, unemployment and business cycle fluctuations are the same as in a random hiring model. However, our model implies starkly different welfare implications. Under selective hiring, unemployment delivers large welfare costs because the ex-ante heterogeneity makes some workers bear higher unemployment risks than others. Thus, optimal labor market policies look very different under random and selective hiring, with unemployment insurance being more generous in the latter case.