

[Unemployment Insurance and Labour Productivity over the Business Cycle](#)

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This paper quantifies the effects of the increasing maximum unemployment insurance (UI) duration during recessions on the drop in the correlation between output and labour productivity in the U.S. since the early 1980's - the so-called productivity puzzle. Using a general equilibrium search and matching model with stochastic UI duration, heterogeneous match quality, variable search intensity and on-the-job search, I demonstrate that the observed countercyclical UI extensions in the U.S. can explain over 40 percent of the drop in this correlation (28 percent when the Great Moderation is taken into account).

More generous UI extensions during recent recessions cause workers to (1) be more selective with respect to the quality of job offers and (2) lower job search effort and, in effect, job finding prospects. The former channel raises the overall productivity in bad times. The latter prolongs UI extensions since in the U.S. these extensions are triggered by high unemployment. As a result, the observed increase in the UI extension generosity creates a sustained upward pressure on labour productivity whilst output is still affected by negative shocks during recessionary periods. This leads to a weaker correlation between output and labour productivity. Finally, I show that both channels are equally important in explaining a fall in the procyclicality of labour productivity.