The Effect of Unemployment Insurance on Unemployment Duration and Subsequent Employment Stability

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The purpose of this paper is to empirically assess the effect of Unemployment Insurance Benefits (UIB) on unemployment duration and on the duration of the subsequent employment. Past research has mainly focused on the effect of UIB on the transition out of unemployment. The empirical literature has shown that benefits lead to longer unemployment spells. However, the effect of UI benefits is not limited only to the unemployment spell. Benefits can affect also the post-unemployment outcomes of the individuals and in particular the stability of the subsequent employment. In this paper, we study the effect of UI benefits on the post-unemployment stability by looking at the employment duration which incorporates job to job transitions. The main hypothesis addressed is that if benefits give time to the unemployed to obtain a better match this should imply a positive correlation between unemployment and subsequent employment duration for the recipients. Assuming that better matches in the labour market tend to last longer, identifying the effect of benefits on employment duration would provide information regarding the effect of UI benefits on the efficiency of the matching process and employment stability. This paper contributes to the limited literature on this issue by employing data from the European Community Household Panel (ECHP, 1994-2001) for 6 countries (France, Germany, Ireland, Portugal, Spain, and UK),for which sufficient information is available. For each country, we obtain an inflow sample of unemployed and their subsequent employment history allowing for multiple spells. The effect of UIB on unemployment duration is identified by comparing the exit rate of unemployed with and without benefits given unemployment duration and controlling for other individual characteristics. The identification of the effect of UIB on employment duration is obtained by comparing the effect of previous unemployment duration between recipients and non-recipients. The econometric analysis is based on a two-state mixed proportional hazard model allowing for flexible duration dependence and state specific unobserved heterogeneity. To control for endogeneity of previous unemployment duration on the subsequent employment duration, we estimate unemployment and employment durations jointly allowing the unobserved heterogeneity components to be correlated across the two states. We find that recipients, relative to non recipients, face lower exit rates from unemployment and this effect is significant in all countries. Concerning the effect of UI benefits on employment stability we find that those who exit unemployment receiving benefits in France, Germany, and Portugal, have significantly lower employment exit rates compared to the non-recipients. These results indicate that receiving benefits during an unemployment spell increases post-unemployment stability.