Unemployment Crises

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Abstract

A search and matching model, when calibrated to the mean and volatility of unemployment in the postwar sample, can potentially explain the large unemployment dynamics in the Great Depression. The limited response of wages to labor market conditions from credible bargaining and the congestion externality from matching frictions cause the unemployment rate to rise sharply in recessions but decline gradually in booms. The frequency, severity, and persistence of unemployment crises in the model are quantitatively consistent with U.S. historical time series. The welfare gain from eliminating business cycles fluctuations is large.

JEL Classification: E24, E32, J63, J64.

Keywords: Search and matching frictions, unemployment crises, the unemployment volatility puzzle, projection, nonlinear impulse response functions, the Great Depression

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