Abstract

This paper studies unemployed workers' decisions to change occupations, and their impact on fluctuations in aggregate unemployment and its underlying duration distribution. We develop an analytically and computationally tractable stochastic equilibrium model with heterogeneous labour markets. In this model three different types of unemployment arise: search, rest and reallocation unemployment. We document new evidence on unemployed workers' gross occupational mobility and use it to calibrate the model.We show that rest unemployment is the main driver of unemployment fluctuations over the business cycle and causes cyclical
unemployment to be highly volatile. The resulting unemployment duration distribution generated by the model responds realistically to the business cycle, creating substantial longer-term unemployment in downturns. Finally, rest unemployment also makes our model simultaneously consistent with pro cyclical occupational mobility of the unemployed, countercyclical job separations into unemployment and a negatively-sloped Beveridge curve.