

“Wait” Unemployment as a Real-Options Problem

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Abstract: Building on the theory of the optimal timing of investment under uncertainty; that is, the theory of real options, this paper proposes a highly stylized model to study the optimal time for an unemployed individual to exit from a so-called waiting state and start a new job. It is shown that as a result of the individual’s exercising the optimal timing strategy, there is a duration of “waiting” and that this duration is affected by a number of economic factors, prominent among them are uncertainty on the part of the unemployed individual and the attitude of this individual toward risk.

Keywords: Unemployment insurance, income, utility function, Brownian motions, search, waiting, exit, continuation region.

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