

Georg Dürnecker, Frankfurt am Main

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Host: Zeno Enders

"Biased Expectations and Labor Market Outcomes: Evidence from German Survey Data and Implications for the East-West Wage Gap"

Abstract:

Using a large and representative panel survey of German households, we document sizable and persistent biases in workers' expectations regarding job stability and job finding. Workers in East Germany are substantially more pessimistic than workers in West Germany. Motivated by this evidence, we incorporate biased expectations into a frictional labor market model and analytically study their implications for wage bargaining, equilibrium unemployment and vacancies, and welfare. We explicitly model the duration of wage contracts and show that this contract length plays a crucial role in shaping how expectation biases affect wages and equilibrium outcomes. Using a calibrated version of the model, we show that expectation biases at West German levels would increase wages and expected lifetime income in East Germany and lead to a substantial reduction in the East-West German wage gap.