

Georg Dürnecker, Frankfurt, Departmental Seminar 20.01.2025

Host: Zeno Enders

**"Biased expectations and labor market outcomes:
Evidence from German survey data and implications for the East-West wage gap".**

Abstract:

We study how biased expectations of workers about their labor market transitions affect labor market outcomes, in particular wages and wage differentials. We document significant pessimistic bias regarding job stability and optimistic bias about job finding in long panel data for Germany. East Germans are substantially more pessimistic than their West German counterparts. We incorporate biased expectations into the workhorse frictional labor market model and investigate their implications for wage bargaining and the labor market equilibrium. Biased expectations about job separation rates interact with the length of contracts for which a wage schedule is bargained. Our model implies that expectation biases at West German levels would increase wages and lifetime income in East Germany. Differences in biased expectations about labor market transition rates explain a substantial part of the East-West German wage gap.