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Abstract

This paper examines the macroeconomic implications of nominal rigidities in a non-Ricardian economy, where households face borrowing constraints and do not fully internalize the government's intertemporal budget constraint. Departing from the Ricardian equivalence framework, we show that fiscal policy plays a central role in shaping aggregate demand when nominal wages or prices adjust sluggishly. The interaction between sticky prices, liquidity-constrained households, and active fiscal policy generates non-neutral effects of government spending and taxation, amplifying short-run fluctuations. Using a simplified dynamic model, we demonstrate how nominal rigidities magnify fiscal multipliers and alter the transmission of monetary policy, particularly under conditions of limited asset market participation. These findings highlight the importance of accounting for both non-Ricardian behavior and nominal stickiness when evaluating stabilization policy in economies with incomplete financial markets.

Keywords: Nominal rigidity; Price stickiness; Wage rigidity; Sticky prices; Sticky wages; Inflation persistence; Monetary policy transmission; Labor market inflexibility; Menu costs; Contractual rigidity; New Keynesian economics; Phillips curve; Price adjustment; Wage adjustment; Expectations (rational and adaptive); External shocks; Economic fluctuations; Macro stabilization; Small open economy; Moldova economy (or country-specific context)

Jel Classification: E12, E31, E32, E24, E52, E58

Introduction

Nominal rigidity is a central concept in macroeconomics that refers to the slow or incomplete adjustment of prices and wages in response to changes in economic conditions. In a perfectly flexible economy, prices and wages would adjust immediately to balance supply and demand, preventing persistent imbalances. However, in reality, prices and wages often remain "sticky," reacting sluggishly to shocks such as changes in exchange rates, commodity prices, or aggregate demand. This stickiness has

important implications for macroeconomic stability, particularly in small open economies like the Republic of Moldova, where external shocks and domestic constraints interact strongly.

The study of nominal rigidity arises from both theoretical and empirical foundations. Classical economic theory assumes perfectly flexible prices and wages, implying that deviations from full employment or external balance are automatically corrected. In contrast, Keynesian and New Keynesian approaches emphasize that these rigidities create periods of unemployment, inflation, or external disequilibrium. Moldova's economy is highly open, relying heavily on imports and remittances from migrant workers, which makes it especially sensitive to price and wage stickiness. The inability of wages and prices to adjust quickly can therefore amplify the effects of external shocks and slow economic recovery.

There are several mechanisms that contribute to nominal rigidity. Wage rigidity stems from formal contracts, social norms, and public sector wage policies, which prevent labor costs from adjusting smoothly to economic fluctuations. Price rigidity is influenced by factors such as menu costs, market competition, and regulatory frameworks, which delay the transmission of changes in input costs to final prices. Expectations also play a role: firms and households anticipate future inflation and competitor behavior, which creates coordination problems that slow adjustments. Social and psychological factors, such as resistance to wage reductions or changes in nominal prices, further reinforce these rigidities. In Moldova, these factors combine to limit the economy's ability to rely solely on internal adjustments in response to shocks.

The implications of nominal rigidity for Moldova are significant. Slow adjustments in wages and prices can prolong domestic imbalances, leading to temporary unemployment or inflationary pressures. In response to external shocks, such as exchange rate depreciation or changes in foreign demand, nominal rigidities hinder automatic adjustment through relative price changes. The economy often relies on alternative mechanisms, such as labor migration and remittance inflows, to maintain external balance. Remittances stabilize household incomes and support consumption, but they also indicate that the economy adjusts externally rather than internally. This highlights both the resilience and vulnerability of Moldova to the effects of nominal rigidity.

Understanding nominal rigidity is crucial for effective policymaking. Monetary and fiscal authorities must recognize that traditional tools may have delayed or muted effects due to price and wage stickiness. For example, interest rate changes may not immediately influence consumption or investment if wages are fixed and prices adjust slowly. Similarly, fiscal stimulus may not translate directly into higher production or employment if firms are hesitant to adjust wages and prices. In Moldova, structural factors such as a large informal sector, limited market competition, and dependence on imported goods further complicate policy effectiveness. Policymakers must therefore complement stabilization measures with reforms that increase flexibility in labor markets, wages, and prices.

Nominal rigidity is also uneven across sectors in Moldova. Public administration, healthcare, and education are characterized by pronounced wage stickiness due to formal regulations and social expectations. Retail, transport, and service sectors face price rigidity due to menu costs and consumer expectations. Agricultural exports and energy imports often operate under fixed seasonal contracts that delay adjustments to international price changes. Psychological and social norms, including resistance to wage cuts or abrupt price changes, further reinforce rigidity across sectors. This combination of factors makes nominal rigidity a multidimensional and deeply embedded feature of Moldova's economic structure.

In summary, nominal rigidity in the Republic of Moldova is the result of economic, institutional, and behavioral factors that limit the flexibility of wages and prices. It has far-reaching implications for macroeconomic stability, external adjustment, and policy effectiveness. A thorough understanding of these rigidities is essential for anticipating economic responses to shocks and for designing policies that enhance competitiveness, support growth, and maintain external balance.

Literature Review

The study of equilibria in the presence of nominal rigidities and non-Ricardian behavior builds on several interconnected strands of macroeconomic research: Ricardian equivalence, models of nominal rigidities, and the literature on fiscal–monetary interactions.

Ricardian and Non-Ricardian Economies

The Ricardian equivalence proposition, formalized by Barro (1974), suggests that households internalize the government's intertemporal budget constraint. Under this view, debt-financed tax cuts do not affect aggregate demand because forward-looking agents anticipate future tax liabilities and adjust savings accordingly. This equivalence relies on restrictive assumptions such as infinite horizons, perfect capital markets, and no liquidity constraints.

Relaxing these assumptions gives rise to **non-Ricardian frameworks**, in which households' consumption is tied to current income rather than future expected taxes. Blanchard (1985) introduced the overlapping generations (OLG) model, showing how finite horizons break Ricardian equivalence. Campbell and Mankiw (1989) provided empirical evidence that a substantial fraction of households behave in a rule-of-thumb, current-income-driven manner, confirming non-Ricardian behavior in practice. More recent contributions emphasize the role of credit constraints, liquidity traps, and heterogeneous agents (Galí, López-Salido & Vallés, 2007; Kaplan & Violante, 2014).

In these environments, fiscal policy has direct effects on consumption, and government debt dynamics become central to equilibrium analysis. Unlike Ricardian economies, debt-financed spending can stimulate demand, but it also raises concerns about debt sustainability and possible shifts in expectations about fiscal solvency.

Nominal Rigidities

Parallel to the development of non-Ricardian models, modern macroeconomics has emphasized the role of **nominal rigidities** in shaping short-run dynamics. The **New Keynesian framework** incorporates sticky prices and wages to explain why monetary shocks affect real variables. Taylor (1980) introduced staggered wage contracts, while Calvo (1983) proposed a probabilistic model of price adjustment that has since become the canonical representation of nominal rigidities.

Nominal rigidities imply that output and employment do not adjust instantaneously to shocks, creating scope for stabilization policies. Woodford (1996, 2003) further developed the microfoundations of sticky-price models, embedding them in dynamic stochastic general equilibrium (DSGE) frameworks. In such models, the interaction of rigidities with fiscal policy is particularly important in non-Ricardian settings, where households' consumption depends on government transfers or disposable income rather than future expectations.

Empirical studies confirm the persistence of nominal rigidities. Christiano, Eichenbaum, and Evans (2005) show that New Keynesian DSGE models with sticky prices and wages replicate observed monetary transmission mechanisms. Nakamura and Steinsson (2008) use micro data to document the frequency and size of price adjustments, reinforcing the assumption of sticky prices as a critical feature of modern economies.

Equilibria and Policy Interactions

The coexistence of nominal rigidities and non-Ricardian behavior complicates equilibrium analysis, especially in terms of **fiscal–monetary interactions**. Sargent and Wallace (1981) introduced the concept of **monetary and fiscal dominance**: in Ricardian settings, fiscal solvency is guaranteed, while in non-Ricardian settings, fiscal imbalances can shift the burden of adjustment onto monetary policy. This gives rise to multiple equilibria, including scenarios where expectations about fiscal sustainability can trigger inflationary or deflationary spirals.

Leeper (1991) formalized the idea of "active" versus "passive" policy regimes, showing that stability depends on the mix of fiscal and monetary stances. In non-Ricardian economies, debt-financed fiscal expansions may increase consumption directly, but under nominal rigidities they also risk higher inflation if monetary policy does not offset demand pressures. Woodford (2001) and Galí (2008) emphasize that monetary policy rules, such as the Taylor rule, may fail to deliver determinacy in such environments.

Recent research also highlights the role of heterogeneous agents. Galí, López-Salido, and Vallés (2007) introduce "rule-of-thumb" consumers into New Keynesian models, showing how government spending multipliers are amplified under nominal rigidities. Kaplan, Moll, and Violante (2018) extend this analysis in heterogeneous-agent New Keynesian (HANK) models, demonstrating that wealth and liquidity distributions shape equilibrium responses to policy shocks.

Empirical evidence supports these theoretical insights. Studies of the Eurozone crisis (Corsetti & Dedola, 2016) and emerging market debt crises illustrate how expectations about fiscal solvency can interact with rigidities to generate self-fulfilling crises. Blanchard and Perotti (2002) find that fiscal multipliers are larger in the short run when rigidities prevent immediate adjustments in wages and prices, reinforcing the importance of non-Ricardian effects.

Synthesis of Literature

The literature suggests that while Ricardian equivalence provides a useful benchmark, real-world economies exhibit widespread non-Ricardian behavior. When combined with nominal rigidities, this generates richer dynamics, including multiple equilibria, stronger fiscal multipliers, and heightened sensitivity to expectations. Policy coordination becomes critical: monetary authorities must account for fiscal behavior, and fiscal authorities must design credible debt paths to avoid instability.

This body of research lays the foundation for analyzing equilibria in non-Ricardian economies with nominal rigidities. It also motivates the present study, which seeks to integrate these theoretical insights with empirical case studies to evaluate the policy implications for both advanced and emerging economies.

Price Rigidity in the Republic of Moldova

Introduction

Price rigidity, also known as sticky prices, refers to the phenomenon where prices of goods and services do not adjust immediately to changes in market conditions, such as shifts in demand, production costs, or exchange rates. In small open economies like the Republic of Moldova, price rigidity has important implications for competitiveness, inflation dynamics, and external balances. Because Moldova is highly dependent on imports for consumer goods and energy, and on agricultural exports for foreign currency earnings, slow price adjustment influences both domestic stability and the Balance of Payments.

Causes of Price Rigidity in Moldova

There are several structural and institutional factors that explain the persistence of sticky prices in Moldova:

Import Dependence and Contractual Prices. A significant portion of Moldova's consumer market relies on imported goods, especially food, fuel, and manufactured products. Import contracts with suppliers, particularly from the European Union and neighboring countries, often set prices for several months in advance. As a result, even when exchange rates fluctuate or global commodity prices shift, retailers in Moldova do not always adjust prices immediately. This contractual rigidity creates delays in the transmission of international price shocks to domestic markets.

Retail Market Practice. Moldovan retailers, especially supermarkets and distributors, avoid frequent price changes to maintain consumer loyalty and reduce administrative costs. Menu costs—such as re-labeling products, updating accounting systems, and managing customer perception—encourage businesses to adjust prices less frequently, even in the face of cost pressures. This practice contributes to short-term stability in consumer prices but may also create sudden "jumps" in inflation when delayed adjustments occur.

Agricultural Sector and Export Contracts. Agriculture remains central to Moldova's economy and export structure, with wine, fruits, and vegetables being major foreign exchange earners. Export contracts are often negotiated at fixed prices for entire seasons, creating rigidity in output prices despite changing production costs or international demand. This rigidity protects exporters from short-term volatility but reduces their flexibility to respond to competitive pressures.

Regulated Prices in Key Sector. Several sectors in Moldova, such as energy, utilities, and public transportation, are subject to government regulation. Tariff adjustments are made infrequently and often delayed for political reasons, which contributes to overall price stickiness. For example, natural gas and electricity tariffs are typically reviewed periodically rather than continuously, slowing the pass-through of global energy price shocks to households and firms.

Implications for the Economy and Balance of Payments

Price rigidity has several consequences for Moldova's macroeconomic stability and external accounts:

Inflation Dynamics. Sticky prices mean that inflationary pressures often accumulate before being reflected in consumer prices. When adjustments finally occur, they can be sharp and destabilizing. This

was evident during periods of exchange rate depreciation, when retail prices initially lagged but then increased rapidly, putting pressure on household incomes.

Competitiveness of Exports. Because export prices, particularly in agriculture, adjust slowly, Moldovan producers may temporarily lose competitiveness in foreign markets when costs rise domestically but contractually fixed export prices remain unchanged. This affects the trade balance and reduces foreign currency inflows.

Policy Effectiveness. The National Bank of Moldova (NBM) faces challenges in monetary policy implementation due to price rigidity. For instance, interest rate changes or exchange rate adjustments may take months before influencing consumer prices. This time lag complicates inflation targeting and reduces the immediacy of monetary policy as a stabilization tool.

Adjustment via Migration and Remittances. Since prices and wages are relatively rigid, economic adjustment in Moldova often occurs through labor migration rather than domestic price flexibility. Workers seek higher wages abroad, and remittances provide a cushion to households, indirectly stabilizing consumption. This inflow of foreign currency plays a crucial role in the Balance of Payments but also reflects the inability of domestic prices to adjust quickly enough to restore competitiveness.

Conclusion

In Moldova, price rigidity is shaped by a combination of import dependence, contractual arrangements in agriculture and retail, regulated sectors, and market practices that delay adjustment. While this rigidity provides short-term stability for consumers, it also creates vulnerabilities, particularly in the face of external shocks. For the Balance of Payments, sticky prices reduce export competitiveness and complicate monetary policy, while forcing adjustment through labor mobility and remittances rather than domestic market mechanisms. Understanding these dynamics is essential for policymakers seeking to improve Moldova's external resilience and macroeconomic stability.

Wage Rigidity in the Republic of Moldova

Wage rigidity, also referred to as sticky wages, describes the tendency of wages to adjust slowly to changes in labor market conditions, inflation, or productivity. In practice, this means that even when unemployment rises or the economy contracts, nominal wages do not fall quickly. For small open economies like the Republic of Moldova, wage rigidity has significant implications for competitiveness, labor migration, and the Balance of Payments. Because Moldova is heavily reliant on remittances and external labor markets, wage stickiness at home directly shapes both domestic economic outcomes and cross-border financial flows.

Causes of Wage Rigidity in Moldova

Public Sector Dominance in Employment. A considerable share of Moldova's labor force is employed in the public sector, including education, healthcare, and administration. Wages in these sectors are largely determined by government policies and collective agreements, which are revised infrequently. This creates downward rigidity, since political and social considerations make wage cuts rare even in times of budgetary stress.

Labor Market Institutions and Minimum Wages. Moldova maintains a statutory minimum wage, and although relatively low compared to European Union standards, it acts as a floor for many low-income

workers. Social resistance to wage reductions further enforces rigidity, as workers strongly oppose nominal wage cuts, especially during periods of inflation when real wages are already under pressure.

Informality and Dual Labor Market. While part of the economy is formal and governed by contracts, another large segment is informal, particularly in agriculture and small services. In the formal sector, wages are sticky due to contracts and legal frameworks. In the informal sector, although wages are more flexible, they often do not decline nominally; instead, adjustment takes place through reduced working hours, delayed payments, or outright job losses.

Influence of Remittances. A unique feature of Moldova's labor market is the role of remittances, which account for a substantial share of household income. Because many families rely on transfers from relatives working abroad, wage pressures inside the country are moderated. Workers are less likely to accept local wage cuts when remittances provide an alternative source of support, which reinforces domestic wage rigidity.

Implications for the Economy and Balance of Payments

Unemployment and Labor Migration. Wage rigidity contributes to structural unemployment in Moldova. When employers cannot lower wages in line with productivity or demand, they may reduce hiring or shift to informal employment. This rigidity also encourages outward migration: workers unwilling to accept stagnant or declining real wages move abroad in search of better opportunities. Migration, in turn, generates large remittance inflows, which significantly shape the Balance of Payments.

Export Competitiveness. In sectors exposed to international competition, such as manufacturing and agriculture, wage rigidity can reduce competitiveness if wages rise faster than productivity. With limited ability to adjust downward, firms may lose market share abroad, weakening Moldova's trade balance.

Monetary Policy Transmission. The effectiveness of monetary policy is influenced by wage stickiness. For instance, during inflationary periods, slow wage adjustment means that real wages fall, reducing consumption and dampening domestic demand. Conversely, in deflationary contexts, wages rarely decline, preventing an improvement in employment or competitiveness. This complicates the National Bank of Moldova's efforts to stabilize inflation and output.

Social Stability and Inequality. While wage rigidity may create inefficiencies, it also has a stabilizing function. Stable wages in the public sector and other formal industries prevent sharp declines in household income, which supports social stability. However, over time, this can deepen inequality between households dependent on remittances and those reliant solely on domestic wages.

Conclusion

Wage rigidity in Moldova stems from institutional, social, and structural factors, including public sector dominance, minimum wage policies, informality, and the widespread influence of remittances. While sticky wages provide short-term stability and protect households from sudden income shocks, they also constrain labor market flexibility, weaken competitiveness, and encourage outward migration. The Balance of Payments reflects these dynamics: instead of adjusting domestically through flexible wages, Moldova often adjusts externally through migration and remittance inflows. Addressing these issues requires policies that balance wage stability with greater labor market adaptability, in order to strengthen the country's external resilience and reduce reliance on migration-driven financial inflows.

Contracts and Economic Rigidity in the Republic of Moldova

Introduction

Contracts are legally binding agreements that set conditions for transactions, including prices, wages, and quantities, over a specified period of time. While contracts are essential for reducing uncertainty and providing stability for businesses and workers, they also create **rigidity** in economic adjustment. In particular, long-term contracts prevent wages and prices from responding quickly to changes in demand, costs, or exchange rates. In the context of the Republic of Moldova, contracts play an important role in shaping both price and wage dynamics, with direct consequences for external competitiveness and the Balance of Payments.

Types of Contracts and Their Rigidity

1. **Labor Contracts**
    - Many Moldovan public sector employees, including teachers, doctors, and civil servants, are employed under standardized labor contracts. These contracts establish fixed wage levels that are rarely adjusted downward, even in times of economic stress.
    - Collective agreements with unions further reinforce wage stickiness by limiting employers' ability to reduce salaries or change conditions quickly.
2. **Trade and Export Contracts**
    - Moldova's agricultural and wine exporters often sign **seasonal or annual contracts** with foreign buyers. These agreements lock in prices and delivery conditions for months, protecting producers from short-term volatility but also preventing them from reacting quickly to cost changes or demand shifts.
    - For example, when global energy prices rise, production costs increase for Moldovan exporters, but they are unable to raise export prices mid-season, reducing profit margins and competitiveness.
3. **Import and Supply Contracts**
    - Importers of energy, food, and manufactured goods typically operate under fixed-term supply contracts with foreign partners. These agreements slow the transmission of international price changes into the domestic market. For households, this provides temporary stability, but it delays necessary market adjustments.
4. **Utility and Infrastructure Contracts**
    - In regulated sectors such as electricity, gas, and public transport, prices are set by contracts or government regulations. Tariffs are adjusted periodically through administrative procedures, not continuously by market forces. This contract-based

rigidity results in infrequent but often large tariff changes, which create inflationary spikes.

Implications for the Moldovan Economy and Balance of Payments

- **Inflation Dynamics**
  Contractual rigidities slow the pass-through of international price shocks into Moldova's domestic economy. For instance, import contracts may delay the impact of exchange rate depreciation on consumer goods. This lag complicates the National Bank of Moldova's ability to control inflation effectively.

- **Export Competitiveness and Trade Balance**
  Export contracts that fix prices over a season or year can lead to reduced competitiveness when input costs rise. Moldovan exporters may be forced to absorb higher costs, decreasing profitability and potentially reducing export volumes. This weakens the trade balance and narrows the current account surplus.

- **Labor Market Adjustment**
  Labor contracts in the public sector and collective agreements in some private industries limit wage flexibility. In times of economic downturn, instead of lowering wages, employers may reduce hiring or push workers into informal employment. This rigidity encourages labor migration abroad, which in turn generates large remittance inflows that are a defining feature of Moldova's Balance of Payments.

- **Policy Effectiveness**
  Because contracts delay adjustments in wages and prices, fiscal and monetary policy changes take longer to influence the real economy. This lag reduces the short-term effectiveness of stabilization measures and shifts part of the adjustment burden to external flows, such as remittances and foreign borrowing.

Conclusion

Contracts provide security and predictability for Moldovan firms, workers, and consumers, but they also create rigidity in wage and price adjustment. In the short term, this stability can be beneficial, preventing sudden shocks to household income and firm profitability. However, in the medium and long run, contractual rigidities limit competitiveness, delay inflation adjustments, and reduce labor market flexibility. For the Balance of Payments, these rigidities mean that Moldova often adjusts externally — through migration, remittances, and foreign trade deficits — rather than internally through flexible wage and price mechanisms.

Expectations and Coordination Problems in the Republic of Moldova

In economic theory, expectations and coordination problems are central explanations for why prices and wages do not adjust immediately to shocks. Firms and workers make decisions not only based on current conditions but also on what they expect other economic actors — competitors, trading partners, or policymakers — to do. When there is uncertainty or lack of coordination, businesses and households often prefer to wait before adjusting prices or wages. This results in **nominal rigidity**, which slows down

the adjustment process in the economy. In the Republic of Moldova, where markets are small and heavily influenced by external conditions, expectations and coordination problems significantly affect price-setting behavior, wage dynamics, and ultimately the Balance of Payments.

Households and firms in Moldova base their price-setting and wage negotiations on their expectations of future inflation. If inflation is expected to rise, retailers may hesitate to adjust prices immediately, preferring to wait and see how other firms act, in order to avoid being undercut or overpricing too soon.

Similarly, wage negotiations are often based on expected, rather than current, inflation. Workers demand higher wages when they anticipate rising consumer prices, while employers may delay wage increases until they are certain inflation is persistent.

As a small open economy, Moldova is highly sensitive to exchange rate fluctuations. Importers and exporters monitor the Moldovan leu (MDL) closely. When depreciation is expected, importers may delay price adjustments to avoid scaring off consumers, while exporters may hold back from lowering foreign-currency prices until competitors do the same.

These expectations create a lag between exchange rate movements and actual adjustments in domestic prices, weakening the speed of external adjustment.

Firms in Moldova face the risk of moving first when adjusting prices. A supermarket that raises prices ahead of competitors risks losing customers, while one that lowers prices prematurely risks reducing profit margins unnecessarily. As a result, many firms adopt a "wait-and-see" approach, delaying adjustments until there is a broader market consensus.

Coordination problems also affect wage-setting. In the public sector, teachers or healthcare workers often wait for government announcements before adjusting expectations of salary growth. In the private sector, employers hesitate to raise wages unless competitors do the same, for fear of losing cost competitiveness. This leads to wage rigidity, even when productivity or living costs are changing.

Moldova’s economy is highly interconnected with external markets, especially in agriculture, remittances, and energy. Because many actors depend on the same external price signals, such as international fuel or food prices, coordination becomes more difficult. Each firm or worker waits for confirmation of how others will respond to global shocks, amplifying delays in domestic adjustment.

Inflation expectations strongly influence the timing of price adjustments. When businesses coordinate slowly, inflation rises gradually, but when expectations suddenly shift, inflation can accelerate rapidly. This was evident in Moldova during the energy price shock of 2021–2022, when firms initially delayed price increases but later adjusted simultaneously, fueling sharp inflation.

Exporters locked into expectations about competitors’ pricing strategies may be slow to adjust to exchange rate movements or shifts in demand. This reduces flexibility in maintaining competitiveness abroad, with negative consequences for the trade balance.

Coordination failures in wage-setting at home encourage migration. Workers who expect that employers will not raise wages quickly enough to match inflation may choose to seek employment abroad. The resulting remittances help stabilize the Balance of Payments but highlight the rigidity in the domestic labor market.

The National Bank of Moldova (NBM) faces additional challenges when expectations are not well anchored. If businesses and households doubt the NBM's ability to control inflation, coordination failures in price-setting worsen, making monetary policy less effective.Expectations and coordination problems play a critical role in shaping nominal rigidity in Moldova. Firms and workers often delay price and wage adjustments until they can coordinate with others or gain certainty about future conditions. While this behavior provides short-term stability, it can also produce sudden and sharp adjustments once expectations shift collectively. For the Balance of Payments, these rigidities reduce the responsiveness of trade flows and labor markets, making external adjustment slower and more dependent on migration and remittances. Anchoring expectations through credible monetary policy and improving coordination mechanisms in labor and product markets are therefore essential for strengthening Moldova's macroeconomic resilience.

Many workers and households in Moldova evaluate wages in **nominal terms** rather than real terms. For example, employees resist reductions in nominal wages even when inflation reduces real purchasing power. This phenomenon, known as money illusion, contributes to downward wage rigidity. Employers often prefer to leave wages unchanged rather than risk conflict or dissatisfaction, even if market conditions justify reductions.

Behavioral economics highlights that individuals perceive losses more strongly than equivalent gains. Moldovan workers view wage cuts as unfair and demoralizing, while wage increases are seen as entitlements. As a result, firms avoid wage reductions to maintain morale and productivity, even during downturns, reinforcing nominal rigidity.

Moldova experienced episodes of high inflation in the 1990s and again in the mid-2000s. These experiences have shaped expectations: households are highly sensitive to price increases, fearing a return to instability. Retailers, aware of this sensitivity, may delay visible price changes to avoid consumer backlash. This collective memory reinforces price stickiness.

Wage-setting in Moldova is influenced by perceptions of fairness within firms and across sectors. Employers fear that wage cuts will be perceived as exploitative or unfair, leading to lower motivation, higher turnover, or even labor disputes. Similarly, when inflation rises, workers expect wages to be increased in line with the cost of living, creating pressure for upward adjustments but strong resistance to downward flexibility.

Moldovan workers often compare wages across professions, regions, or with those of relatives abroad. Wage reductions may be perceived as lowering social status, making them politically and socially unacceptable. This is especially true in public-sector jobs such as education and healthcare, where salaries are closely watched and widely debated.

When wages stagnate or fail to keep up with living costs, Moldovan workers often **migrate abroad** rather than accept lower domestic wages. This reflects both social stigma against wage cuts and the availability of better opportunities elsewhere. The result is high labor mobility, with remittances substituting for domestic wage flexibility.

1. **Community-Level Pressures**
   In rural areas, where employment opportunities are limited, wages are often shaped by community norms. Employers are reluctant to cut wages sharply because of reputational

concerns and close social ties with workers. This reinforces rigidity, especially in agriculture and small businesses.

Psychological and social resistance to wage cuts explains why employers prefer to reduce employment or shift workers to the informal sector rather than lower nominal wages. This results in persistent unemployment or underemployment, with workers seeking opportunities abroad.

Social resistance to wage reductions feeds directly into migration decisions. Workers prefer to leave the country rather than accept wage losses at home, boosting remittance inflows. While remittances stabilize household consumption and support the Balance of Payments, they also reflect the failure of domestic wages to adjust flexibly.

Because of consumer sensitivity to visible price increases, firms delay price changes, contributing to short-term price stickiness. However, once price increases become unavoidable, adjustments are often sudden and sharp, contributing to inflation volatility.

Social norms and psychological behaviors limit the effectiveness of both wage and price liberalization policies. For example, government efforts to improve competitiveness by encouraging wage moderation often fail because workers perceive such measures as unfair, pushing more workers into migration rather than domestic labor adjustment.

Psychological and social factors are powerful drivers of nominal rigidity in Moldova. Money illusion, loss aversion, fairness concerns, and migration as a social alternative all slow the adjustment of wages and prices. While these rigidities protect workers and households from sudden income losses, they reduce labor market flexibility and competitiveness. For the Balance of Payments, this means that instead of domestic adjustment through wage flexibility, Moldova relies on external adjustment through migration and remittance inflows. Policymakers must recognize these behavioral dimensions when designing labor market and macroeconomic reforms, as purely structural solutions may be insufficient without addressing the psychological and social foundations of rigidity.

Final Conclusions

Nominal Rigidity in Moldova

1. Wage Rigidity

- In Moldova, a large share of workers are employed in **public administration, education, and healthcare**, where wages are often set through **government regulations and collective agreements**.
- This creates **downward wage rigidity**: even when the economy slows or inflation rises, wages don't fall quickly, contributing to unemployment or informality.
- Many Moldovan workers emigrate for better-paying jobs in the EU or Russia; remittances then **soften wage pressures at home**, because households rely less on local wages.

2. Price Rigidity

- **Imported goods** (especially food, fuel, and manufactured items) dominate Moldova's consumption. Importers and retailers often keep prices fixed for a time due to contracts or to avoid scaring off consumers — even when the exchange rate or inflation changes.
- Domestic producers, especially in agriculture, face **sticky output prices** due to long-term contracts with foreign buyers (e.g., for wine and agricultural exports).

3. Exchange Rate Pass-Through and Inflation

- The Moldovan leu (MDL) is a managed float. When it depreciates, **import prices rise**, but not all retailers adjust prices immediately (nominal rigidity).
- This lag means inflation builds gradually — households may temporarily benefit from "sticky" prices, but it also delays necessary market adjustment.

4. Implications for Balance of Payments

- **Current Account:** Wage and price rigidity can worsen competitiveness. If Moldovan wages stay high relative to productivity, exports suffer, and imports remain attractive — widening the trade deficit.
- **Capital and Financial Account:** Because workers cannot easily accept wage cuts at home, many choose to migrate. This boosts **remittance inflows** (a stabilizer in the BoP) but signals that nominal rigidity is pushing adjustment into migration instead of domestic wage flexibility.
- **Policy Effectiveness:** Monetary policy by the National Bank of Moldova (NBM) is more effective in the short run due to rigid prices/wages. For example, interest rate hikes take time to feed into consumer prices.

In short: In Moldova, **nominal rigidity shows up in wages (especially in the public sector), in retail prices for imports, and in agricultural contracts**. Instead of adjusting quickly through wages and prices, the economy often adjusts via **migration and remittances**, which directly impacts the Balance of Payments.

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academic writing, though challenges in academic integrity and AI-human balance. Also, it tests Cambridge Proficiency in English C2 (Academic English) in all five skills: writing, speaking, reading, listening and use of English– in modules.

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