

DOES MONEY ILLUSION MATTER ?

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Comment and reply

Agenda

- What is Money illusion
- Original Experimental design
- Comments on original design
- Reply on the comments
- Conclusion



What is Money illusion

What is money illusion

- If real trade-offs between various actions remain unchanged, an illusion-free individual's real decisions will also remain constant.

Veil of money

- idea of money illusion in the first paper :



The Experiment design

Total of 30 periods, price shock at 15th period
Four people in each treatment.

	Computer	Human
Real	RC	RH
Nominal	NC	NH

Results

RC

Price adjust instantaneously, ruling out irrationalities other than money illusion

NC

Adjustment is slower, providing the evidence for a low level of individual money illusion.

RH

Prices adjust to the equilibrium in the third period after the shock.

NH

Price adjust to the equilibrium in the
13th period after the shock.

Results

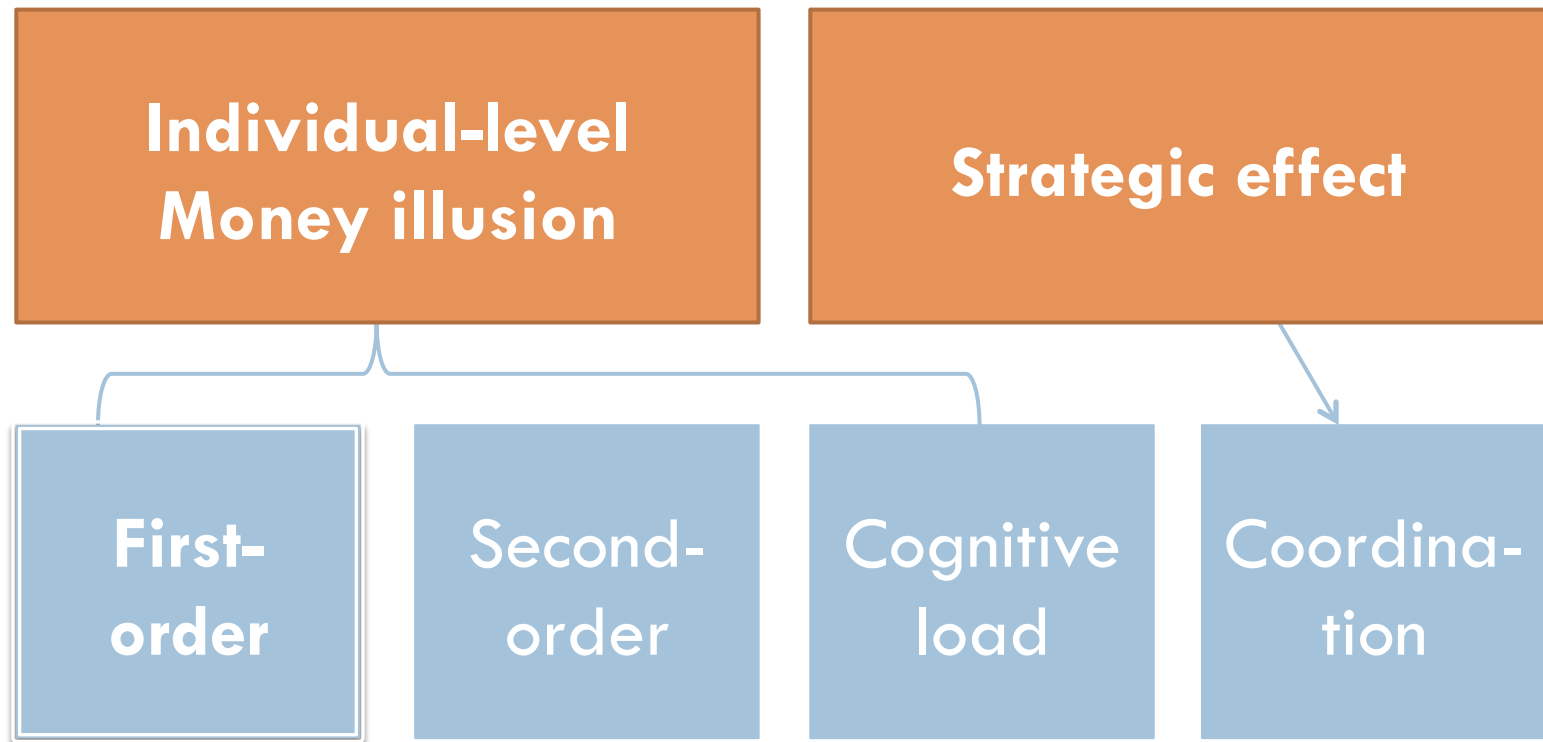
- When prices are strategic complements, even a small amount of money illusion at the individual level can lead to substantial downward price stickiness.



Comments on the experiment

Comments on the experiment

Counfounds in the previous research:



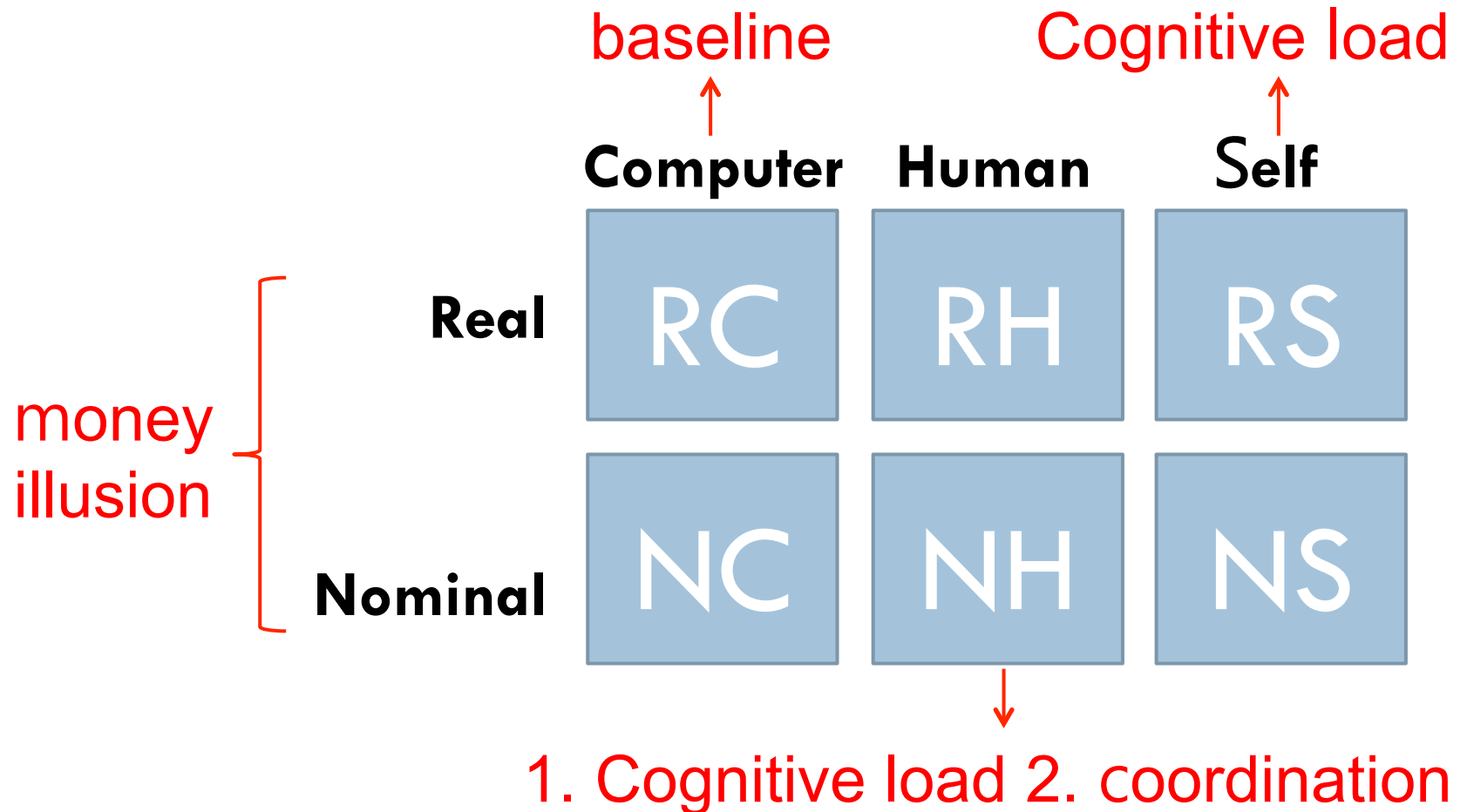
PW, 2014

Comments on the experiment

□ Money illusion

1. **First-order:** maximize nominal payoff
2. **Second-order:** rely on the underlying real payoffs but take some account of nominal payoffs

Comments on the experiment



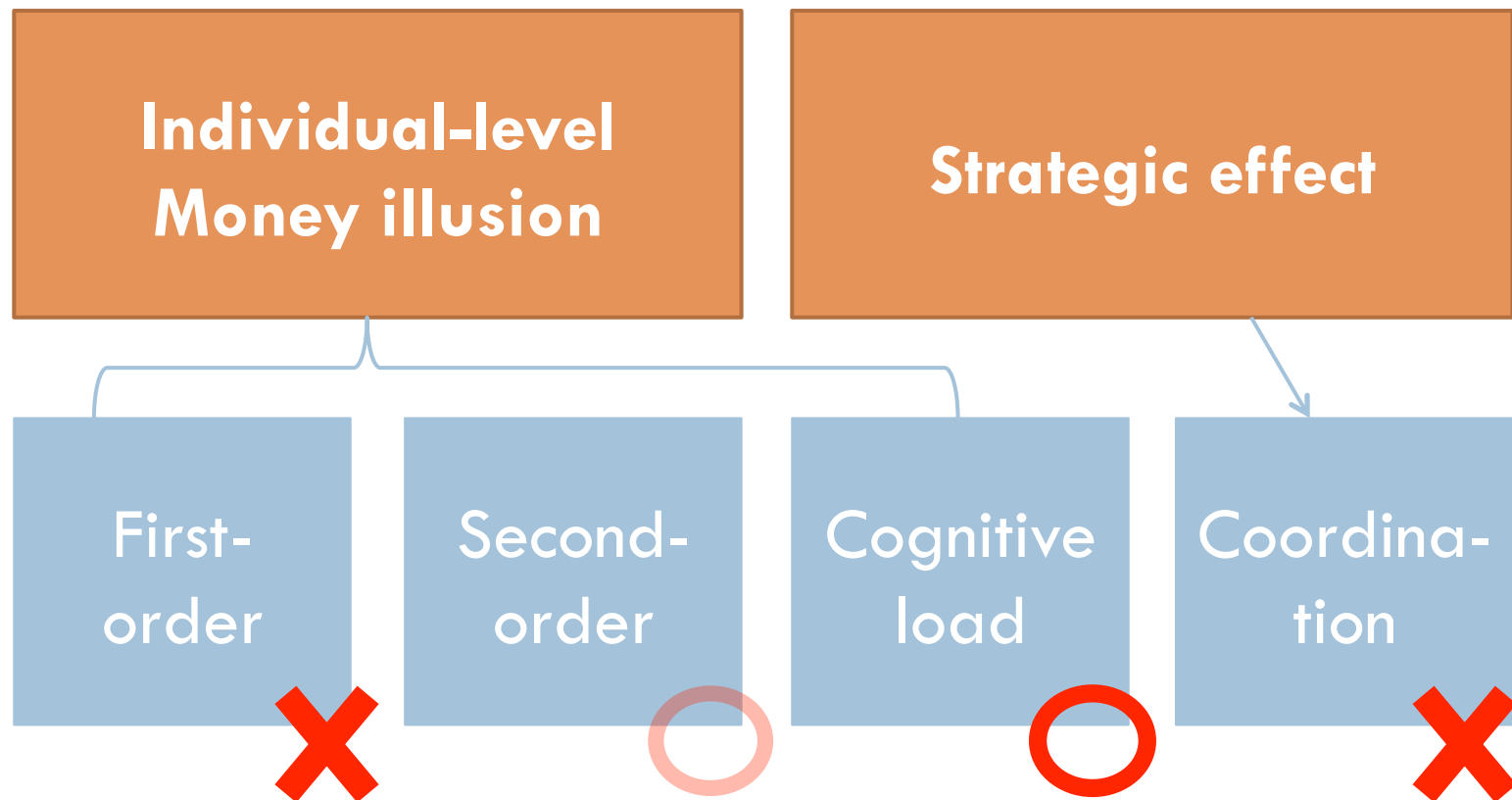
Comments on the experiment

Results:

- **RC&NC**: no nominal inertia
- **NS > NS⁺ ≈ RS**: cognitive load + second-order effect
- **NH > NH⁺ ≈ RH**: cognitive load + second-order effect
- **RH ≈ RS, NH ≈ NS, NH⁺ ≈ NS⁺**: no strategic effect

Results of experiments (PW, 2014)

Conclusions:





Reply on the comments

Reply on the comments

**You provide a misleading
interpretation both on
your own and my data !!!**

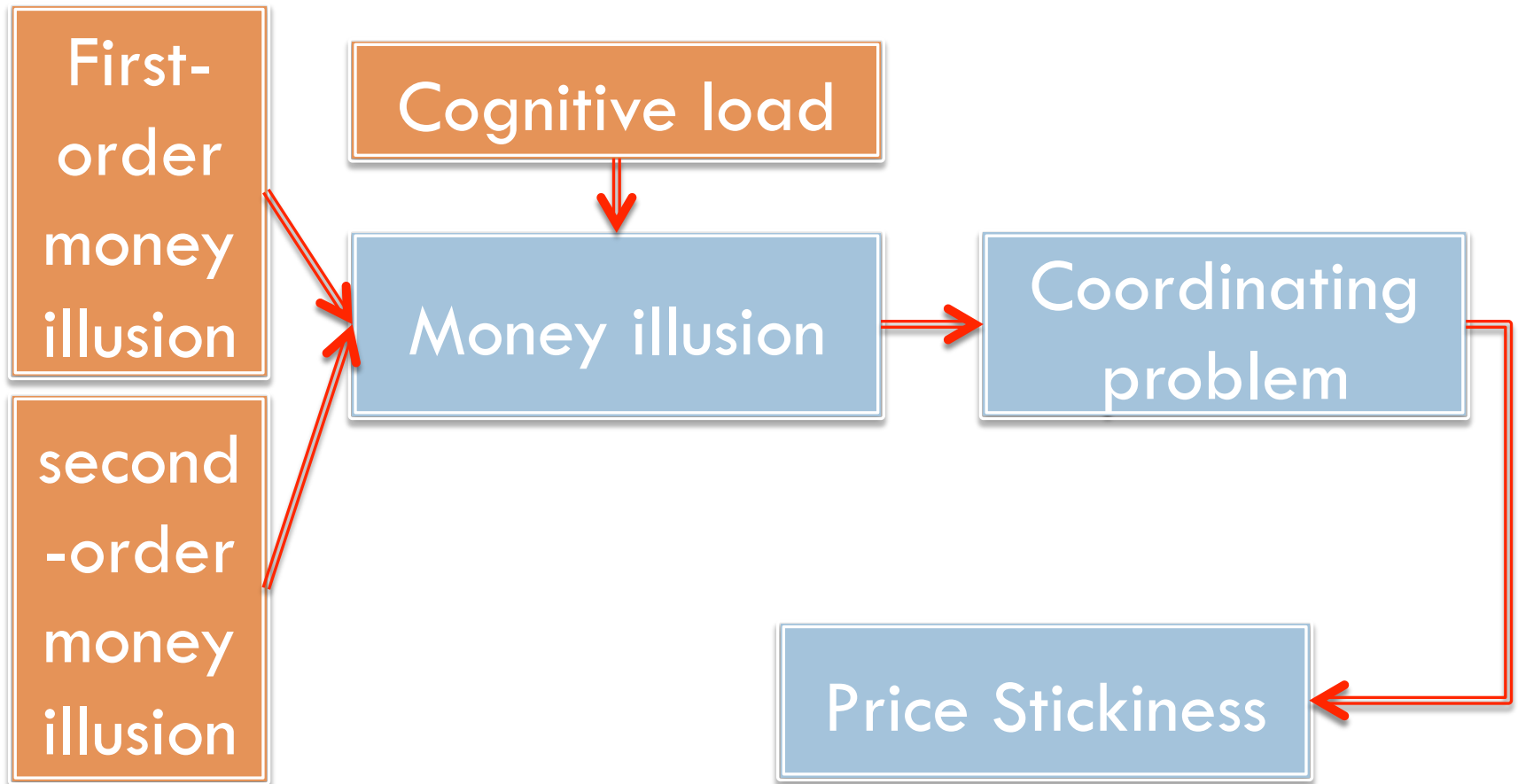
Veil of money

- My idea of money illusion:



Veil of money

Your MISLEADING idea of money illusion:



Veil of money

Remember the definition

- Define money illusion in terms of behavior and not in terms of specific psychological mechanisms (maximizing nominal payoff).
- The examination of a single mechanism behind money illusion should not induce the mistake of neglecting the many other potential mechanisms and treating them as something DIFFERENT from money illusion.

Conclusion of Reply

- Just because you don't find evidence for one particular psychological mechanism behind money illusion (the unconditional maximization of nominal income), it is **MISLEADING** to conclude that money illusion plays no or little role in our experiments



Conclusion



Conclusion

- Your equation, parameters and settings DOES matter !! The devil lies in the detail !!
- Be careful with your definition ! Be even more careful with what you're true goal is !!

THANK YOU

