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Can Christmas Gift Giving Be the "Waste" Economists Claim?

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New York Times columnist Josh Barro took obvious pleasure last Christmas reporting on one of modern economics' most settled arguments: that in-kind gift-giving, especially at Christmas, involves a lot of "waste," or, more formally, "deadweight loss."[1]

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Barro defers to economist Joel Waldfogel, who reported in his 1993 *American Economic Review* article that "between a tenth and a third of the value of holiday gifts is destroyed by gift-giving," which means that of the total estimated Christmas gift-giving in 1992 of $38 billion, $4 billion to $13 billion of the gifts amounted to the type of deadweight loss that emerges from income taxes. Waldfogel summarizes his (and the profession's) argument:

> "While it is possible for a giver to choose a gift which the recipient ultimately values above its price – for example, if the giver is not perfectly informed – it is more likely that the gift will leave the recipient worse off than if she had made her own consumption choice with an equal amount of cash."[2]

How could Santa Claus (and so many others) get the Christmas spirit so wrong for billions of children (and adults) around the world? Could the "dismal science" be more dismal?

Problems with the Christmas Gift-giving Theory and Evidence

Barro's column, as well as Waldfogel's journal article, is fundamentally flawed in several regards, meaning Waldfogel's reported econometric evidence on gift-giving waste is of dubious value.

The Survival of Gift-giving. Granted, in an imperfect world, giving traditions can be burdensome for some — especially for buyers who don't like crowded malls. However, with giving traditions, we need a full accounting of the costs and benefits, not just the supposed "waste" considered in isolation from the value of the process of giving over time.

Christmas giving has been prevalent for at least 2,000 years, since three kings made their trek across the desert with in-kind gifts, in search of the newborn Messiah. The tradition of Santa Claus (or other fatherly old men) distributing gifts to children has been around for a millennium, or more. Could a giving tradition with systemic waste of a third have persisted without some redeeming, maybe unnoticed, offsetting benefit? Surely Christmas gift-giving has admirably passed the survival test.

Yes, people often buy wrong gifts, but they also make mistakes everywhere. Gift mistakes can be nothing more than an economic and personal problem to be mitigated. The (thought-to-be) waste from giving can be mitigated, with time, by the waste itself. Failed gifts can reveal the recipients' preferences and can lead to a subsequent reduction of failed gifts

and an increase in the net gain from giving over time (much as business failures can increase entrepreneurs' income and wealth).[3] An econometric study, like Waldfogel's, that estimates the "waste" for a point in time can miss the various beneficial "feedback loops" from the giving process.

Barro and Waldfogel (and economists generally) treat cash and in-kind gifts as totally separated gift options for givers, when givers often employ them in various combinations to maximize their own and recipients' gains from gifts. Across recipients, givers will likely adjust their cash gifts to accommodate their personal knowledge of recipients' preferences, as Waldfogel deduces. But that deduction is hardly universal, because some givers — bosses — might decide to reduce their search costs by giving all employees the same in-kind gift, with the bosses using their cost savings to increase and individualize employees' bonuses.

Cash and in-kind gifts are obviously seen by many givers as complements, with each enhancing the value of the other. Some parents give their daughters bracelets along with cash, which their daughters can use to buy charms. Besides the *process* of giving can have value that can compensate for (expected) gift mistakes.

> *"Some economsts claim in-kind gift-giving is a waste because gift-givers make mistakes."*

Gift-giving as a Portfolio Problem. From Barro and Waldfogel's perspective on gift-giving, the extent of waste from gifts will likely be positively related to the volume of in-kind gifts given: Any increase in people's spending on in-kind gifts (at Christmas or for birthdays) will likely lead to more gift errors and more waste. However, they could have posited the opposite relationship (as least for some givers), if they had considered gift giving as a "portfolio" problem, one of expanding the range of gifts for a range of recipients. While it may be true that the more gifts shoppers give to more people, the greater the likelihood of "mistakes," it could also be argued that the greater the giving, the more likely giving can result in more big "winners" and higher odds of their gift collections "paying," *on balance.*

The common gifting strategy of multiple gifts for multiple recipients is simply an extension of investors' common-sense strategy of avoiding "putting all your eggs in one basket," which can maximize investment risks. Instead, savvy investors typically devise portfolios of investments to spread and reduce investment risks (which can cause investors to take on some riskier investments with greater returns). Using the Barro/Waldfogel perspective on in-kind gift-giving, investors expanding their portfolios to include more risky assets, with more "mistakes," would be condemned for increasing investment "waste" — as their return (net of risk) rises.

The portfolio approach to gift-giving unsettles (if not damns) the theoretical and empirical foundations of Barro's and Waldfogel's conclusions.

Are Cash and In-kind Gifts Likely to be Equal? Barro and Waldfogel rely on conventional microeconomic theory of consumer demand for what they presume is their clinching argument for consequential Christmas gift-giving waste. But their supposed clinching argument is as flawed as it is straightforward: Gift recipients (supposedly) prefer money of a given amount to in-kind gifts of an equal monetary value. Recipients of cash can always buy the in-kind gifts with an equivalent cash gift, but many recipients could buy other things they prefer more than particular in-kind gifts.[4]

Thus, in-kind gifts, supposedly, undercut recipients' potential utility, construed as a form of waste. Givers can improve their recipients' welfare at the same time they reduce their giving budgets by offering cash instead of in-kind gifts — supposedly.

Exceptions to Rules. The core problem with this line of argument is twofold. First, the argument is hardly universally applicable to givers and recipients under their varied circumstances. Indeed, there are instances in which the deduction doesn't pass the "smell test."

- Parents of young children might rightfully feel strongly that they can make better choices on toys and clothes than their small children.
- Many (of course, not all) brides-to-be might understandably be miffed if their suitors, on bended knee, were to offer the cash value of an engagement ring.
- There are also times when cash gifts would be deemed inappropriate relative to in-kind gifts, for example, when employees offer gifts to their bosses, precisely because of the presumed greater relative value of cash.

Second, conventional analyses of gifts also make no allowance for the considerable pleasure many shoppers get from searching out in-kind gifts and from watching each other open wrapped packages.

The Money Equivalence of In-kind and Cash Gifts. An even more debilitating problem with standard gift-giving analyses is the presumption that in-kind gifts will actually equal the money value of cash gifts (say, $100 in

chocolate versus $100 in cash). Unnoticed is the simple fact that cash and in-kind gifts are distinctly different for many givers, with cash loaded with worrisome connotations, not the least of which is that cash can speak to givers' crassness and laziness.

Are the two dollar amounts always likely to be equal? Not if the givers get a variety of added pleasures from making in-kind gifts. If that is the case (as must be the case, given givers' heavy reliance on in-kind gifts at Christmas and birthdays, for example), many givers would likely be willing to give more money value in kind than in cash, which could be the case when givers have to worry about the recipients' (children's) future decision making. In short, givers might give, say, $150 in kind versus $100 in cash, with the higher level of the in-kind gifts leaving in-kind recipients better off.

Understandably, gift recipients (especially children) might want to play along with the Christmas tradition of receiving predominantly in-kind gifts because their *expected* value of in-kind gifts (say, $125) exceeds the cash they would otherwise have expected to receive ($100).

Gift Cards versus In-kind Gifts. Barro (quoting his father Robert Barro, a prominent Harvard University economist) suggests that gift cards reduce giving waste: "It seems clear to me that a gift certificate [or gift card] is inferior to money," which implies that the spread of gift cards lowers gift-giving waste. Maybe so for Professor Barro in his own gift giving, but for all others? His deduction *only* applies if givers don't lower the dollar amount loaded on the gift cards from what they would have spent on in-kind gifts.

"Increased giving may lead to more 'mistakes,' but it may also lead to more big 'winners.'"

Givers who give gift cards are better off, obviously. But the recipients? Hard to say. Many gift-card-givers might capture some of the recipients' gains from cards by loading less money on the cards. But, card givers don't have to incur the costs of searching for in-kind gifts, perhaps causing some givers to add a portion of their gains to the gift cards. Economic theory and econometrics can't provide an *a priori* resolution.

Moreover, gift cards can be, effectively, a form of in-kind gifts. Many Christmas shoppers realize that they are competent in identifying their recipients' preference for gift categories (clothing and smartphones, for example). However, they might lack confidence in pinpointing recipients' preferences for attributes of any particular gift (for example, the style, size and color of a suit). Givers and retailers have found ways of handling the potential in-kind mistakes. Retailers have developed liberal return policies, while shoppers search out such stores frequented by their recipients. The givers can pick something off the racks that they *think* their recipients will like, confident that their recipients can exchange their gifts for something of greater value within the same price range. Such gifts are effectively "in-kind gift cards," which many recipients might value more highly than plastic cards that can be used anywhere (which make them close to a form of cash) because the store-specific cards suggest that the giver has at least considered where the recipient shops.[5]

Problems with the Data on Which Economists' Claims Are Based

Waldfogel's empirical findings must be assessed partially by the database, especially since he suggests conclusions can be generalized to a wide swath of the shopping population. Amazingly, Waldfogel generated his "data" by surveying only 86 undergraduate students in January 1992 and even fewer undergraduates, 58, later in March, all in his Yale University microeconomics class. He treats his "data points" as if they were hard facts, on par with measures of chemicals in moon rocks. However, his data points are very "soft," the students' *estimates* of the total amount paid (by the givers) for the holiday gifts they received in 1992 (which required them to rely on their flawed memory as well as their limited knowledge of the actual prices of the gifts they received), as compared with their *estimates* of how much they would have paid for their gifts. The so-called deadweight loss from gifts is nothing more than the difference between the two *estimates*, with both estimates likely subject to memory and recall flaws in the human brain, as well as by students' limited knowledge of the gifts' actual prices and usefulness over time.[6]

The study is based only on estimates from Yale *undergraduates* whose families had average annual incomes of $240,000 (in late 2014 dollars), close to the income threshold for the top 2 percent of all households.[7] Waldfogel also did not report the reliability of the students' estimates, which opens questions about the reliability of his findings.[8]

In addition, Waldfogel reports his estimate for the deadweight loss of *Christmas* gifts, but he asked the surveyed students about *holiday* gifts, which is not a trivial concern. Undoubtedly, some unknown number of the students equated "holiday" with "Christmas," but some might have included Thanksgiving and birthday gifts in their estimates. They could have forgotten about "holiday gifts" given early, or the gifts had not been received (or even opened) at the time of the first survey.

Waldfogel's waste estimates do not account for returns and exchanges (some for cash), which means his waste estimates are surely overstated (again!).[9]

Conclusion

The Barro/Waldfogel argument that Christmas giving is fraught with waste fails on even more fundamental grounds: With Barro's and Waldfogel's attention to the measured "waste" and "deadweight loss" of gifts, their argument intimates that givers can't (and maybe shouldn't) be trusted with giving decisions in whatever form they deem desirable. Granted, givers are mistake prone, which is hardly a news alert, but are detached observers (journalists and economists) likely to make better gift-giving decisions (with less "waste") than hordes of givers drawing on local information unavailable to detached observers? Would detached observers (dubbed "choice architects" by Richard Thaler and Cass Sunstein) likely decrease gift-giving waste?[10] The questions answer themselves.[11] Fortunately for them, Barro and Waldfogel don't even try to tender policy proposals for reducing the deadweight loss of Christmas. If they had, they would have revealed how empty their analyses are.

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Notes

1. Josh Barro, "An Economist Goes Christmas Shopping." *New York Times*, December 19, 2014. Available at http://www.nytimes.com/2014/12/21/upshot/an-economist-goes-christmas-shopping.html?smprod=nytcore-ipad&smid=nytcore-ipad-share&_r=0.

2. Joel Waldfogel, "The deadweight Loss of Christmas." *American Economic Review*, Vol. 80, No. 5, December, 1993, pages 1,328-1,336. Available at https://www.amherst.edu/media/view/104699/original/christmas.pdf.

3. Dwight R. Lee and Richard B. McKenzie, *Failure and Progress: The Bright Side of the Dismal Science* (Washington, D.C.: Cato Institute, 1993).

4. Joel Waldfogel, "The Deadweight Loss of Christmas," page 1,328.

5. The late Milton Friedman advocated giving people on welfare the income equivalent of the various in-kind transfers (rent, education, health care and so forth) on grounds that welfare recipients could be made better off at the same time taxpayers could face a lower tax burden. Friedman also made the mistake of presuming that the cash transfer would be equal to the money value of the in-kind transfers which, as noted, need not be the case, so long as taxpayers have an interest in structuring the consumption of welfare recipients (see Milton Friedman and Rose Friedman, *Free to Choose* (New York City: Harcourt Brace Jovanovich, 1980), chapter 4. However, notice that Friedman's argument applies to a category of givers and recipients (welfare beneficiaries) who stand distinctly apart from Christmas gift recipients. Taxpayers have little knowledge of the preferences of welfare recipients and their decisions are collective. Christmas gift-givers have far more information on the preferences of their recipients. This suggests that the "waste" from in-kind welfare benefits can be a far more serious problem than the waste from gift-giving at the individual (or family) level.

6. Joel Waldfogel, "The Deadweight Loss of Christmas," pages 1,330-1,331.

7. Waldfogel reported that only half, 43, of responding students estimated of their family income for 1992, which then averaged $143,000 (Waldfogel, "The Deadweight Loss of Christmas," page 1,332).

8. Richard Thaler, "Toward a Positive Theory of Consumer Choice," *Journal of Economic Behavior and Organization*, Vol. 1, 1980, pages 39-60.

9. The income threshold for the top 2 percent of married U.S. couples was $250,000 in 2013. See Hope Yen, "Who's the biggest barrier to income inequality? The '2 percent'." *NBC News*, December 9, 2013. Available at http://www.nbcnews.com/business/economy/whos-biggest-barrier-income-inequality-2-percent-f2D11708457.

10. Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (New Haven, Conn.: Yale University Press, 2008).

11. Supporters of granting gift-giving authority to "choice architects" should consider Friedrich Hayek's 1945 classic "The Use of Knowledge in Society," *American Economic Review*, Vol. 65, No. 44, September 1945, pages 519-530. Available at http://www.econlib.org/library/Essays/hykKnw1.html.