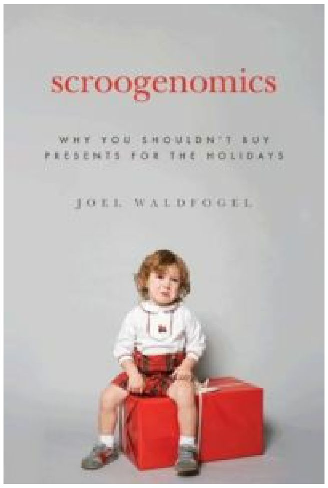

Book Scroogenomics

Why You Shouldn't Buy Presents for the Holidays

Joel Waldfogel
Princeton UP, 2009
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Recommendation

People are conditioned to think that holiday spending is good for the economy. Even fiscal analysts read seasonal retail spending as an indicator of good or bad times. However, University of Pennsylvania professor Joel Waldfogel takes an economist's look at gift giving and pronounces it wasteful. Every time you receive a gift that's not what you want, the item loses value. For example, you wouldn't pay more than $10 for the ugly orange teapot Aunt Bea bought you for $50. What's the solution? Cash, of course, but giving cash is often seen as being in bad taste. How about gift cards? A little bit better, theorizes Waldfogel, but people don't always redeem gift cards, which generates waste as well. *BooksInShort* recommends this grumpy professor's analysis of Christmas spending, which manages to be simultaneously fun and serious. Those with an interest in economics or a passion for looking at revered institutions from a fresh perspective will enjoy this little text. And, it makes a great stocking stuffer.

Take-Aways

- Gift giving does a poor job of matching an item with the appropriate recipient.
- This mismatch translates into millions, or even billions, of dollars of lost value.
- The U.S. ranks twelfth out of 26 developed countries in holiday spending.
- People obtain 18% more satisfaction from products they buy for themselves than they derive from unwanted gifts.
- The recipient's relationship to the gift giver influences the satisfaction rate.
- The three economic rationales for giving gifts are: "redistribution, paternalism and altruism."
- Cash is the most efficient gift, but people consider it tacky so it loses value.
- Easy access to credit lets shoppers splurge in December and pay later.
- The use of gift cards has grown steadily since the late 1990s.
- Donating to a charity on behalf of someone on your gift-buying list is a wonderful solution to Christmas waste.

Summary

Scroogenomics Think back to the last holiday season. Did you like all the presents you received? If you're like most people, you received many gifts that you never would have bought for yourself. From an economist's point of view, gift giving does a poor job of matching an item with the appropriate recipient. This mismatch translates into millions, or even billions, of dollars of lost value. If gift recipients would willingly pay only 25 cents per dollar of the retail price of a gift – had they bought it for themselves – that item has lost 75% of its value as a gift.

> [Christmas is] "a large and organized institution for value destruction, hiding in plain sight but obscured for most people by their warm childhood

memories."

People believe that spending more is good for the economy. Every year news reports compare this year's holiday spending to last year's, implying that more is better. Spending generates more employment for workers, more income for suppliers and higher returns for vendors – all pluses. Moreover, many business sectors rely heavily on Christmas spending. December sales account for more than a fifth of annual receipts for jewelry stores, and a seventh for clothing, sporting goods and bookstores. But is a lot of inefficient spending really good for the economy?

"Gift giving matches resources poorly with users, producing a meager amount of material satisfaction for the amount of money spent."

When people purchase a product for themselves, the benefit they receive exceeds the purchase price (or, rationally, they wouldn't buy it). For example, when you decide to buy a sweater for $50, you do so believing that it is worth $50 or more to you. Economists call the difference between your assessment of a product's value and the actual price the "consumer surplus." However, if your Aunt Martha buys you a sweater you don't like, its value to you is less than the purchase price. Maybe you deem the sweater to be worth $25. Then, society loses out by $25 or 50%. Your satisfaction is less than the purchase price, destroying value. Perhaps the sweater has sentimental value. You don't like Aunt Martha's $50 sweater, but you like Aunt Martha. This may increase the sweater's value to $75. Yet, if Aunt Martha gave you a sweater you liked, you would enjoy its full dollar value plus its sentimental value, making it worth at least $100.

"As an institution for 'allocating resources,' (getting stuff to the right people), holiday giving is a complete loser."

Imagine a government with $50 million to spend on either a bridge or a school. Both would create jobs. But, if the consumer benefit of a new school is $75 million and the benefit of a new bridge is $25 million, then erecting the bridge incurs $50 million in lost social benefits. Thus, the "opportunity cost" of building the bridge, the "true cost of a choice," shows how spending can damage the economy.

"After the thrill of free stuff wears off, people realize that they do not have what they want."

If you apply economic theory to gift giving, its mandate is clear, though nonsentimental: give cash. Behavioral economists might disagree. Their arguments for "value-creating" gifts include:

- People don't always make the best decisions when they buy something for themselves. Someone else with better taste might do a better job.
- A person might not have all the information or accessibility available to make the best choice. If you are familiar with someone's passions, you can "search" for the perfect gift. You might find a rare book they've always wanted on the Internet.
- Perhaps you would really like a luxury item, such as HD TiVo, but you see it as lavish and unnecessary. If you receive it as a gift it comes with "permission" to enjoy it.

Spending in the U.S. and Around the World

In 2007, monthly spending in the U.S. was a steady $370 to $380 million for most of the year. In December, spending mushroomed to $430 million. This spike was "gift driven." Does the U.S. spend more at Christmastime than other countries? Organization of Economic Cooperation and Development (OECD) data from 26 nations shows that all European countries experience a spending increase in December. The only nations in the OECD report that didn't spike in December in 2007 were Israel, China and South Korea, "where Christians are rare." Japan experienced a 21% December sales bulge, because it treats Christmas as a "commercial event." Among wealthier countries with a large Christian population, the top spenders include Norway, the U.K., Italy, Finland and France. The U.S. comes in twelfth of 26 countries.

Does Santa Deliver Satisfaction?

How does the satisfaction that people feel when purchasing something for themselves compare to the satisfaction that a gift delivers? A 1993 Yale University survey discovered that "gift giving destroyed at least 13% of the value of the resources transferred." This is called a "deadweight loss," because the loss incurred by one person did not result in some other person's gain. A later study illustrated that the best way to compute the "value destruction" from gift giving would be to "compare the amount of satisfaction, per dollar spent, derived from items received as gifts with that provided by items people purchased for themselves." The gap between the perceived valuation of a gift and of a self-purchase measures the wastefulness of gift giving. The results over several years were consistent: Buying based on personal choice creates 18% more enjoyment than getting a gift.

"Every purchase we make reflects a decision that the value of an item to us – the buyers – exceeds its price."

However, other factors influence the satisfaction rate, such as the recipient's relationship to the gift giver, the amount of contact between them and the age of the participants in the transaction. Distant, older relatives delivered the lowest level of satisfaction, around 75 to 80 cents per dollar of the value of a retail item. Friends come in at 91 cents and parents at 97 cents. Siblings are at 99 cents, and significant others deliver almost 102 cents of satisfaction. These statistics show that the better the gift givers know the recipients, the more likely they are to appreciate their gift.

Cheese = Cash

Three economic rationales explain why people give gifts: "Redistribution, paternalism and altruism." Robin Hood was a redistributor: He stole from the rich and gave to the poor. Paternalism means giving gifts that benefit the recipient. A two-year-old might want an action figure, but he still needs a winter hat. Altruists wish to satisfy others as much as possible.

"If a dollar disappears from my pocket and reappears in yours, it's a loss to me, but it's not a deadweight loss to society. If you take my dollar and destroy it lighting your Cohiba, then it's a deadweight loss."

Through taxation, the U.S. government redistributes funds from the rich to the poor. Its giving programs usually take the paternalistic form of giving "in kind" goods or vouchers. For instance, the government distributes more than $30 billion per year in food stamps to promote healthier living among the poor – a kind of gift. Are in-kind transfers always efficient? If you give people $10 and they buy cheese with it, then giving them $10 worth of cheese vouchers is very efficient. However, if you give them a cheese voucher and they'd rather use the $10 value to buy cigarettes, the cheese voucher is worth less than $10. From an economist's point of view, a person can use cheese, a gift, as cash. If a family budgets $15 per week for cheese and receives $10 worth of cheese from the government, this frees up $10 they can spend on something else.

> "Under the stigma view, cash is a handicapped gift in that it certainly results in less value for the recipient than what I spend."

One would think that giving a cash gift is altruistic since the recipient gets exactly what he or she wants. So why not give cash? In a nutshell, cash gifts fall under a social taboo – with some exceptions. An older relative can give cash to a younger relative. Grandma can give her college-age grandchild $100 and make everyone happy. It's not okay for the grandchild, however, to hand grandma a $100 bill. The stigma is so large that it significantly decreases the perceived value of the money, which explains why cash is not a common gift. If people didn't have negative feelings about giving cash, Christmas spending would be more altruistic and efficient. People would give cash and recipients would buy whatever they desired.

Financing Santa

Older people often decry the "commercialization of Christmas," but is it something new? An analysis of U.S. spending patterns shows that today's adults spend much the same way that their parents and grandparents did. The December peak has remained fairly consistent since consumer records began being kept in 1935 (earlier information even indicates some evidence of pre-1935 December peaks) with down years during recessions and small spikes during boom times. Although the total amount people spend in December has tripled in the past century, "holiday spending's share of GDP fell by almost half."

> "Not only do high-income households in the United States give absolutely more to charity than do their lower-income counterparts; the rich actually give a much higher percentage of their income."

The way people pay for Christmas expenditures also has changed. Consumers used to budget for Christmas, putting away a little money each week or month to pay for holiday generosity. "Christmas clubs" and "layaway" programs were important ways to save all year to finance holiday spending. Now, easy access to credit lets shoppers splurge in December and pay for it later. Two-thirds of annual holiday spending is charged to credit cards.

Tiny Tim's Point of View

Many people protest against the idea that Christmas spending is wasteful. One counterargument poses that people give gifts voluntarily, so it can't be harmful to do so. They demonstrate Milton Friedman's theory that their choices reflect their own best interests. Economists agree with the "freedom to choose" but social behaviorists might take another tack. If you violate a social norm, such as refusing to exchange gifts, you will suffer the consequences. Your mom may not speak to you for months or your family may not invite you to the next gathering.

> "The idealized Christmas gift is a carefully chosen item that delights the recipient, opening his eyes to a new consumption possibility and at the same time functions as a conduit of warm feeling between giver and recipient."

Economists refer to the value lost through gift giving as a "principal-agent problem," involving "misaligned incentives." The downside to giving an unwanted gift is remote. For example, Grandma wants to buy little Tommy a Christmas present. Tommy wants Grand Theft Auto for his Xbox, but Grandma buys him a kaleidoscope. When Tommy opens the box on Christmas morning, he thanks Grandma for the gift, although he feels very disappointed. Grandma thinks she's made Tommy happy, so she has no incentive to change and the waste goes on.

Santa's Secret Weapon: Gift Cards

In the U.S., gift card sales were $12 billion in 1998. They increased to $63 billion in 2005 and have grown steadily since. The negative stigma attached to giving cash does not affect giving gift cards, which people rate near the top of their holiday gift wish lists. Some 80% of gift card recipients redeem their cards in January, so giving cards has the added benefit of increasing retail foot traffic in a traditionally slow sales month. Around 10% are cashed in at a later date and, unfortunately, around 10% of all gift cards issued are never used. This amounts to an approximate $8 billion annual waste in the U.S. alone. Retailers initially view the sale of gift cards as a liability, since it means that they owe the card's owner goods that are worth the value of the card. However, most retailers account for unused gift cards as revenue after four years. The money isn't a deadweight loss as it ends up in the retailer's pocket where it benefits shareholders as well.

The Robin Hood Effect

When someone has enough or too much of something, they tire of it. Economists call this the principle of "declining marginal utility." It is easy to understand how this can happen with something such as food. Once you are sated, you lose your immediate desire for more food. At this point, you are perfectly willing to donate your leftovers to someone who is hungry. Does the same principle apply to money?

> "Advanced decadence is supposed to be a clue that the End is near...We are awful gluttons hastening Armageddon."

The world's wealth is not distributed equally. The poorest nations, or those in the bottom 20%, have only around 2% of the world's wealth. The wealthiest nations, or the top 20%, have 80% of the world's wealth. One could easily argue that redistributing money from the rich to the poor would make the world a better place. However, forced redistribution in countries with established property rights is "a kind of theft." Perhaps "private giving" is the answer. In 2005, private giving in the U.S. amounted to $261 billion. The U.S. government also donates billions of dollars in foreign aid annually.

> "Do not despair completely. Value-creating gift giving is tough, but it's not impossible."

Is there a way to use the generous spirit of holiday giving to improve the condition of people around the world? Some nonprofit organizations offer the opportunity to purchase charity gift cards. Donating to a charity on behalf of someone on your gift-buying list is a wonderful solution to Christmas waste. Another answer is to adjust the gift card system so that retailers donate the unredeemed portion after a designated amount of time. By giving thoughtfully, you can diminish the waste from unwanted gifts while raising money for deserving causes.

About the Author

Joel Waldfogel chairs Business and Public Policy at the Wharton School of Business, University of Pennsylvania. He wrote *The Tyranny of the Market* and the article that sparked this book, *The Deadweight Loss of Christmas*.