

Economics focus

Is Santa a deadweight loss?

Are all those Christmas gifts just a waste of resources?

Dec 20th 2001 | From the print edition

ECONOMICS has long been known as the dismal science. But is any economist so dreary as to criticise Christmas? At first glance, the holiday season in western economies seems a treat for those concerned with such vagaries as GDP growth. After all, everyone is spending; in America, retailers make 25% of their yearly sales and 60% of their profits between Thanksgiving and Christmas. Even so, economists find something to worry about in the nature of the purchases being made.

Much of the holiday spending is on gifts for others. At the simplest level, giving gifts involves the giver thinking of something that the recipient would like—he tries to guess her preferences, as economists say—and then buying the gift and delivering it. Yet this guessing of preferences is no mean feat; indeed, it is often done badly. Every year, ties go unworn and books unread. And even if a gift is enjoyed, it may not be what the recipient would have bought had they spent the money themselves.

Intrigued by this mismatch between wants and gifts, in 1993 Joel Waldfogel, then an economist at Yale University, sought to estimate the disparity in dollar terms. In a paper* (#footnote1) that has proved seminal in the literature on the issue, he asked students two questions at the end of a holiday season: first, estimate the total amount paid (by the givers) for all the holiday gifts you received; second, apart from the sentimental value of the items, if you did not have them, how much would you be willing to pay to get them? His results were gloomy: on average, a gift was valued by the recipient well below the price paid by the giver.

The most conservative estimate put the average receiver's valuation at 90% of the buying price. The missing 10% is what economists call a deadweight loss: a waste of resources that could be averted without making anyone worse off. In other words, if the giver gave the cash value of the purchase instead of the gift itself, the recipient could then buy what she really wants, and be better off for no extra cost.

Non-cash gifts from extended family were found to be least efficient

Perhaps not surprisingly, the most efficient gifts (those with the smallest deadweight loss) were

those from close friends and relations, while non-cash gifts from extended family were the least efficient. As the age difference between giver and recipient grew, so did the inefficiency. All of which suggests what many grandparents know: when buying gifts for someone with largely unknown preferences, the best present is one that is totally flexible (cash) or very flexible (gift vouchers).

If the results are generalised, a waste of one dollar in ten represents a huge aggregate loss to society. It suggests that in America, where givers spend \$40 billion on Christmas gifts, \$4 billion is being lost annually in the process of gift-giving. Add in birthdays, weddings and non-Christian occasions, and the figure would balloon. So should economists advocate an end to gift-giving, or at least press for money to become the gift of choice?

Sentimental value

There are a number of reasons to think not. First, recipients may not know their own preferences very well. Some of the best gifts, after all, are the unexpected items that you would never have thought of buying, but which turn out to be especially well picked. And preferences can change. So by giving a jazz CD, for example, the giver may be encouraging the recipient to enjoy something that was shunned before. This, and a desire to build skills, is presumably the hope held by the many parents who ignore their children's pleas for video games and buy them books instead.

Second, the giver may have access to items—because of travel or an employee discount, for example—that the recipient does not know existed, cannot buy, or can only buy at a higher price. Finally, there are items that a recipient would like to receive but not purchase. If someone else buys them, however, they can be enjoyed guilt-free. This might explain the high volume of chocolate that changes hands over the holidays.

The thought actually does count

But there is a more powerful argument for gift-giving, deliberately ignored by most surveys. Gift-giving, some economists think, is a process that adds value to an item over and above what it would otherwise be worth to the recipient. Intuition backs this up, of course. A gift's worth is not only a function of its price, but also of the giver and the circumstances in which it is given.

Hence a wedding ring is more valuable to its owner than to a jeweller, and the imprint of a child's hand on dried clay is priceless to a loving grandparent. Moreover, not only can gift-giving add value for the recipient, but it can be fun for the giver too. It is good, in other words, to give as well as to receive.

The lesson, then, for gift-givers? Try hard to guess the preferences of each person on your list and

then choose a gift that will have a high sentimental value. As economists have studied hard to tell you, it's the thought that counts.

* “[The Deadweight Loss of Christmas](http://graphics8.nytimes.com/images/blogs/freakonomics/pdf/WaldfoegelDeadweightLossXmas.pdf) (<http://graphics8.nytimes.com/images/blogs/freakonomics/pdf/WaldfoegelDeadweightLossXmas.pdf>) ”. *American Economic Review*, December 1993, vol 83, no 5.

From the print edition: Christmas Specials