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An Economic Guide To Giving the Perfect Gift

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> "The manner of giving is worth more than the gift."
> —Pierre Corneille

The goal of giving a gift during the holidays is to show love to friends and family, and to be generous and joyful in the process. But how can a gift giver ensure the gift they buy is valued by the recipient? Well, we can apply some economics. Economists make it their business to measure the value that buyers, sellers, and society receive from goods and services, to maximize these benefits.

Measuring Value

Economists use **consumer surplus** to measure the benefit, or value, that consumers receive from buying goods and services; this is the amount of money a buyer is willing to pay for a good minus the amount they actually pay. For example, imagine you go to the store willing to pay $50 for a new gadget, but when you get there, you find the price is $40. An economist would tell you that you've gained $10 in consumer surplus—a good buy.

Of course, people are pretty good at estimating how much they value goods and services for themselves. In gift giving, you need to estimate how much *someone else* will value the goods or services you buy them. Now that's tricky! Say you bought that same gadget as a gift for your friend at the same $40 price. If they valued it at only $30, their consumer surplus would be negative $10—not an efficient use of your funds. So, how can economics make you a better gift giver?

Economically Efficient Gift Giving

First, let's discuss a few different categories of gifts you may exchange. *Perfectly efficient gifts* are those the recipient values at a price that is equal to the price the giver paid. In this case, consumer surplus is equal to zero; it is like a "breakeven" gift. For example, if you buy your friend a necklace for $150 and they value it at $150, your gift generates zero surplus and is a perfectly efficient gift. Of course, you'd rather generate some surplus for the recipient; that's part of the joy of the holidays after all.

Inefficient gifts are those the recipient values at a price that is lower than the price the giver paid. In this case, consumer surplus is negative; it is called **deadweight loss**, which is a decrease in total economic surplus when compared with an efficient outcome. In our necklace example, if you buy your friend the necklace that costs $150 but they value it at only $100, the consumer surplus is a negative $50, or put differently, there is a deadweight loss of $50. Generating less value than what you paid is likely not your gift-giving goal. Economists believe a large number of gifts exchanged during the holiday season fall into this category.

Value-generating gifts are those the recipient values at a price that is higher than the price the giver paid. In this case, consumer surplus is positive. According to the *American Economic Review* article "The Deadweight Loss of Christmas," this type of gift "makes the recipient better off than the cash amount equal to the cost of the gift" (p. 1330). In our necklace example, you paid $150 but your friend values it at $200, generating $50 of consumer surplus and zero deadweight loss. These gifts are rare but special. Think of a gift you received, like a trip or experience, that created a priceless memory. You may have put a much higher value on that gift than what the giver paid.

Is Cash the Answer?

Economists have long studied the deadweight loss of holiday gift giving. That same *American Economic Review* article suggests that between 10% and 33% of value is lost during holiday gift exchanges. That is, on average, a gift recipient values their gift 10%-33% less than what the giver paid for the item, putting these exchanges in the *inefficient gifts* category. This finding is why many economists support a simple cash gift exchange, which retains value and prevents a deadweight loss from occurring. In other words, when you give someone cash, they can spend it on exactly what they value most and you are guaranteed to provide a perfectly efficient gift: You "paid" $150 for the for the cash, check, or money transfer, and the recipient receives the full $150 value of the gift.

In fact, the same journal article suggests that the more likely a person is to give an inefficient gift—such as grandparents who are a bit out of touch with what their grandchild is interested in—the more likely they are to simply gift cash. If you've ever received cash as a gift, it was likely from someone other than your best friend or significant other. That's because the closer your relationship with someone is, the more likely you are to exchange efficient noncash gifts that you know the other will enjoy.

Some behavioral economists support the risk of giving an "inefficient" gift because of the utility created outside of monetary value: Fond memories, laughter, sentimental value, and stronger relationships can be created through gift exchanges where a recipient would not have paid the same monetary value for their gift but still have gained *genuine social utility* from receiving it. White Elephant gift exchanges are a good example. Most people leave with a gift they never would have purchased for themselves, but they're also leaving the party with fond memories of laughter and quality time spent with family and friends. Have you ever received a gift that generated genuine social utility?

Finally, gifts serve an important purpose—to send signals and convey information about relationships, as discussed in "Gifts as Economic Signals and Social Symbols" in the *American Journal of Sociology*. Think of them as a way to show investment in a relationship, as demonstrated by a long-standing tradition of giving your date flowers to signal your affection. Another finding is that parents sometimes use gifting as a means of rewarding or compelling children's good behavior, such as warning a child they'll receive a lump of coal for the holidays if they behave badly. The goal is to incentivize children to behave and avoid possible penalties.

So, should you gift cash this holiday season? Well, if you're giving a gift to your economist friend, yes, just Venmo them. But there are lots of reasons why you might want to buy something special. Whether you want to create a memory, make someone laugh, or signal to someone that they are special to you, cash is likely not the best option. Consider how well you know the person and determine how efficient your gift may be, as well as what you are trying to signal, and make your choice accordingly.

Happy Holidays!

Glossary

Consumer surplus: The difference between the highest amount a consumer is willing to pay and what they actually pay.

Deadweight loss: The decrease in total economic surplus when compared with an economically efficient outcome.

References

Camerer, C. "Gifts as Economic Signals and Social Symbols." *American Journal of Sociology*, 1988, *94*(1), pp. S180–S214.

Waldfogel, J. "The Deadweight Loss of Christmas." *American Economic Review*, 1993, *83*(5), pp. 1328–36.

Name______________________________________ **Period**________

Reading Q&A

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After reading the article, complete the following:

1. What is deadweight loss?
   a. A decrease in total economic surplus when compared with an economically efficient outcome
   b. The value generated from gift giving between people who fully understand each other's preferences
   c. A drop in wages due to economic slowdown
   d. Money businesses lose when they drop prices

2. Why do economists say gift giving results in deadweight loss?
   a. Gift giving increases government spending and inflation.
   b. People usually give gifts that cost too little to be useful.
   c. Most people save gift cards instead of spending them, which hurts the economy.
   d. The recipient may value the gift at a lower price than what it actually cost, leading to wasted value.

3. Based on one of the studies cited in the article, what percentage of monetary value is lost during holiday gift exchanges?
   a. 10%-33%
   b. 50%-70%
   c. 1%-10%
   d. none

4. Why do economists generally consider cash an efficient gift?
   a. It reduces the total amount of cash in circulation.
   b. It forces the recipient to save money instead of spending money.
   c. It allows the recipient to spend the cash on whatever they value most.
   d. It prevents emotional attachment to material goods.

5. Which of the following is an example of an inefficient gift?
   a. Your partner proposes to you with a ring that cost them $2,500 but that you would value at $3,000.
   b. Your mother buys you a sweater for $30 from a store link you sent her that you would value at $30.
   c. Your aunt buys you a scarf for $50 that you would value at $20.
   d. Your employer gives you a $100 holiday bonus in your paycheck.

6. Which of the following is an example of a value-generating gift?
    a. Your partner proposes to you with a ring that cost them $2,500 but that you would value at $3,000.
    b. Your mother buys you a sweater for $30 from a store link you sent her that you would value at $30.
    c. Your aunt buys you a scarf for $50 that you would value at $20.
    d. Your employer gives you a $100 holiday bonus in your paycheck.

7. What are the reasons that some behavioral economists support "inefficient" gift giving?
    a. Behavioral economists acknowledge the utility created outside of monetary value, including memories, sentimental value, laughter, and relationship building.
    b. Behavioral economists think people always make rational decisions when shopping and therefore no deadweight loss is actually occurring.
    c. Behavioral economists don't believe in deadweight loss.
    d. Behavioral economists know that gift giving helps control inflation during the holidays and is therefore worth all the deadweight loss caused to society.

8. Based on one of the studies cited in the article, who is most likely to give you cash this holiday season?
    a. Your significant other who you talk to every day
    b. Your parents who know you well and understand your unique preferences
    c. Your great-aunt who you see once a year during the holidays
    d. Your best friend who you have known since kindergarten

9. Which of the following is an example of a gift serving as a signal in a relationship?
    a. Re-gifting an item you didn't want
    b. Donating to a charity in your name to reduce your taxes
    c. Buying yourself a new purse as a gift for making it through another semester
    d. Buying your significant other an expensive watch to show commitment and effort

10. Based on the information in the article, when should you buy a gift for someone and not exchange cash?
    a. When the recipient already has too much cash
    b. When you know them well enough to give them a gift they would value as much as or more than what you spent on the gift
    c. When the recipient never carries cash in their wallet
    d. When you don't want the recipient to spend the cash on more clothes because they always buy clothes and have too many items