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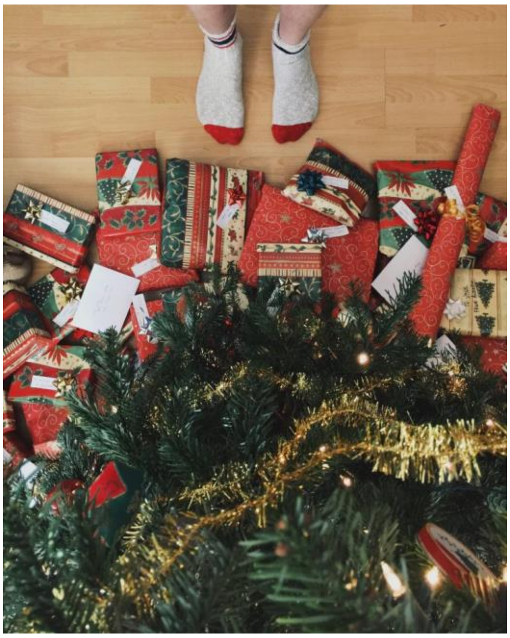
Behavioral Economics.

Scrooge Economics: The Behavioral Economics of Christmas

Serena Iacobucci

It is no exaggeration to say that some economists really seem to hate Christmas as they consider this a holiday that simply "destroys value." George Loewenstein and Cass Sunstein – two researchers who pioneered behavioral economics and neuroeconomics, affirm that the destruction of wealth in **Econoland** (an imaginary world where everyone behaves rationally and there's apparently no room for eggnog and carols) is indeed the greatest crime one can commit. In this article, we are going to destroy some of your Christmas spirit: we'll talk about the "**Scrooge**" spirit of some economists, we'll explain why we often make mistakes when choosing gifts, and finally we'll tell you why even the much-loved last-minute gift cards might not be the best choice.

The economists' Grinch



According to Loewenstein and Sunstein (Newrepublic, 2012), the gold medal for the economist most critical of Christmas should go to Joel Waldfogel. The author of "Scroogenomics: Why You Shouldn't Buy Presents for the Holidays," generated a great deal of discussion around the theory of the economic inefficiency of Christmas presents, defining such holiday "an orgy of wealth destruction," in tones worthy of the Dickensian character he is inspired by.

Not surprisingly, the popular article in which the economist expounds his theory is called "Better to give nothing." Surely this title will inspire no Christmas carols, but it is excellent food for thought because

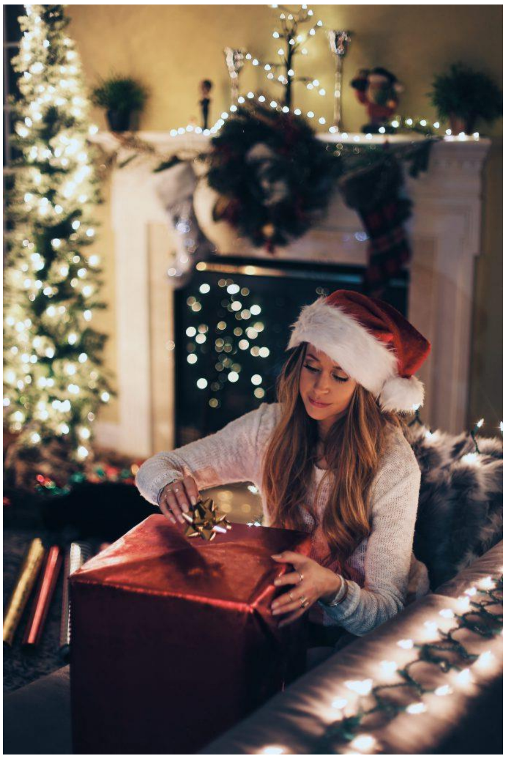
Waldfogel's criticism is well-justified in micro and macroeconomic terms.

Waldfogel presents us with a very familiar scenario: Every year, in the months between Halloween and New Year's Eve, the newscasts predict a (more or less) positive economic trend based on the "spending" factor. Are we spending enough during these holidays to stimulate the economy? Are we in line with last year's figures?

Certainly, the Christmas period is a panacea for retailers and, even though it is concentrated in the last month of the year, it guarantees many sectors, such as jewelry stores, about one-sixth of their annual revenue.

But is it the same for the economy as a whole? The author seems to have clear ideas and does not leave much choice: the answer is between "maybe" and "not really." The reason for this drastic statement is very simple and is based on a fundamental concept in economics. Every economic transaction takes place between two parties: a seller and a buyer. The seller decides on a selling price that allows them to cover the costs and have a surplus (which will be the profit). In a normal transaction, i.e., not a gift, the consumer also generally gets a surplus from their purchase. Let's say we are willing to spend $50 if we believe the product or service purchased will give us a satisfaction worth at least $50. (Let's not forget that marketing experts know these mechanisms very well, constantly leveraging psychological value).

What about when we choose a gift?

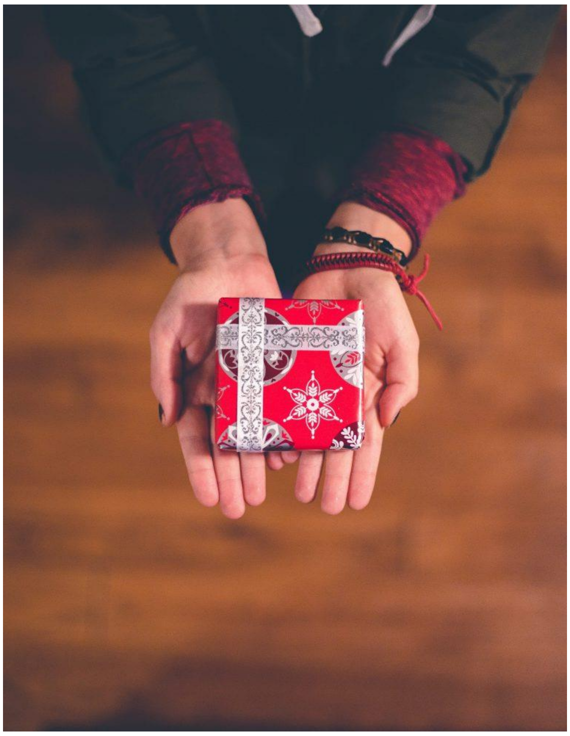


This is the typical scenario when we purchase something for ourselves. But let's now compare it to what happens when we give a gift instead. We take the exact same $50 but this time you want to buy me a gift. First, the starting disadvantage is obvious: you don't know exactly what I like. Sure, you may have a vague idea of what my tastes are, but it is possible that – if I had a spare $50 – I'd rather spend it on something different from product that you have gifted me for the same price. When buying for ourselves, we are sure that the expense will produce a satisfaction worth **at least** $50. When spending the same amount to make a gift, we cannot be sure that the recipient will get the same level of satisfaction. What does this mean? Any deviation from the **optimum satisfaction** becomes a loss of value that amounts to the difference between what the gift was paid for and what it is valued by the recipient.

Why are we such bad donors?

Among economists, however, it's not just Waldfogel who has been receiving too many red-and-green-checkered socks, teddy-bear pajamas or funny smelling aftershaves. Many other researchers in the field seem to hold the same grudge against the holly-jolly gift exchange tradition.

In an article published in the *Journal of Experimental Psychology*, researchers from the National University of Singapore and the Chicago Booth School of Business have also recently attempted to explain another dynamic that is triggered when we are asked to gift something. According to the researchers, what prevents us from giving useful gifts, at times, is a decidedly unexpected element: selfishness.



According to the study, we prefer a gift that has an instant "wow" effect on the recipient and very often we do it even at the expense of actual usefulness. To test their "smile seeking hypothesis," the researchers asked a group of participants to imagine that they had to give a gift and choose between two types of mugs with the exact same price. The difference lay in the fact that one mug was customizable, and, therefore, of greater emotional value, while the other was an ergonomic mug, more comfortable to hold and, fundamentally, more useful. Donors had no doubts when it came to expressing their preference. Most of them opted for the personalized mug. The scenario changed dramatically when subjects were asked which mug they'd like to receive as a gift. In that case, the majority opted for the ergonomic option, which was more useful than the "emotional" one.

The researchers then repeated the experiment, but this time the donors were told that they should choose the gift knowing that they would not be present at the time of delivery, so they would not see the recipient's reaction. The results confirmed the "smile search" hypothesis: when the donor knows that they will not see the reaction of the gift recipient, they opt for the most practical choice, that is the **ergonomic cup**.

The researchers' conclusion comes very close to Waldfogel's claims: in the decision-making process leading to the choice of a gift, the **interpersonal value** of a good comes into play, which significantly differs from the **intrapersonal value**.

And the gift cards?

The option that apparently could make everyone happy, then, could be the gift card.
If we all exchanged a card of the same value, no wealth destruction should occur.

However, there's a big risk: giving a gift card to those consumers that Kivetz and Simonson call "overly forward-thinking," who, living almost exclusively in a future-oriented manner, would procrastinate using the gift card, spending it only when they needed to. A time that, according to Marketwatch, may never come, causing many gift cards to expire and generate a loss of around $1 billion/year (Marketwatch, 2018).

In short, in rational **Econoland**, we are left with one choice, if we really want to maximize the economic efficiency of the

Christmas season: exchange money. On the one hand, we could use it to buy what we like or need most, thus reaching the **optimum satisfaction** and maximizing our **surplus**; on the other hand, even our most thrifty friends could at best keep it aside, creating savings, rather than letting the gift card expire, causing all that wealth to be destroyed. This would also save us the trouble of wandering around stores looking for a balance between interpersonal and intrapersonal value.

But, of course, even the driest-hearted economists would object to this scenario. **Loewenstein** and **Sunstein** remind us that a very important component that contributes to the value of the gift is the investment in terms of the **time** we spend on it. If we "destroy value" and uneconomically purchase an overpriced gift, we are simultaneously affirming the importance of our relationship with the recipient. In short, behavioral economics, thanks to the joined forces of economists and psychologists, has very many lessons to give us in the field of gifts. The same creators of the smile seeking hypothesis conclude their article reminding us of an important thing.

After all, whereas the receiver walks away with a gift, the giver walks away with the receiver's smile.

And perhaps – at least at Christmas - we could squeeze out some of the *bah-humbug* from all economists: when faced with emotions - there is no rationality that holds.

References:

1. **Waldfogel, J.** The Deadweight Loss of Christmas, *The American Economic Review,* Issue 83, 5 December 1993; pag. 1328;
2. **Kivetz, R. & Simonson I.**, Self-Control for the Righteous: Toward a Theory of Precommitment to Indulgence, *Journal of Consumer Research*, Volume 29, Issue 2, 1 September 2002, pag 199;
3. **Yang, A.X. & Urminsky, O.**, Smile-Seeking Givers and Value-Seeking Recipients: Why Gift Choices and Recipient Preferences Diverge (2015);

From the Web:

1. The Behavioural Economics of Christmas (di George Loewenstein e Cass R. Sunstein)
2. Better to give nothing (di Joel Waldfogel)
3. Why you're lousy at choosing gifts (di Alex Verkhivker)
4. The Behavioral Economics of Gift Cards over Cash (di Bruce Wydick)

Recommended Reading:

Scroogenomics: Why You Shouldn't Buy Presents for the Holidays (ENG)
Il libro che Babbo Natale non vi farebbe mai leggere (ITA)