

Is There Deadweight Loss in Holiday Rewards?

As this is the
holiday season,
I'm undertaking
my annual holiday
reflection — are
holiday rewards to
employees really
worth it or could
organizations spend
those extra resources
in better ways?



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This annual reflection of mine started one year after receiving the sixth flyer in the mail about buying holiday hams for the staff in my organization. Phone messages followed. And it came to a head one unlucky day when I answered the phone to hear the salesperson start pitching me to buy hams for my staff. “I am not my organization’s ham guy!” I pleaded.

What form is best (cash or hams, for example) for employee bonuses or rewards? And how are these rewards related to other (nonwork-related) gifts we give to others near the holidays? Does it make more sense to give someone a gift card to a local restaurant or the cash equivalent?

The Deadweight Loss of Holiday Giving

An interesting and provocative study was conducted by Joel Waldfogel of the University of Minnesota some 20 years ago. He wrote “The Deadweight Loss of Christmas” (*The American Economic Review*, December 1993). Waldfogel was not only discussing Christmas but noted that the ideas could apply to “other holidays with gift-giving rituals.” To think about deadweight loss think about the costs to society of not perfectly allocating resources. There are many applications in economics including taxation and price controls (e.g., minimum wage or rent control).

The study noted that although gift giving is generally applauded by economists since it is a way to help the macro economy, there is another side to the story. A problem with gift giving (or nonmonetary rewards) is that the gift giver often does not perfectly know the preferences of the person receiving the gift. If one is considering giving a \$100 gift, then the best the giver can do is to buy exactly the item that the recipient would have bought with \$100. Any deviation from that and the receiver is worse off because he didn't get the \$100 item he would have preferred most. The difference between how happy he is with the gift vs. what he would have bought with the same amount of cash is what economists call deadweight loss.

Waldfoegel studied these issues theoretically (using mathematical models) and statistically analyzing data. Among other things, using a sample of undergraduate students, he found that “holiday gift giving destroys between 10 percent and one-third of the value of the gifts.” He also found that the probability of giving cash versus noncash gifts varies depending on the age difference between the giver and receiver and their relationship — in ways that make economic sense. For example, Waldfoegel found that gifts from friends or partners are the most efficient gifts since these types of individuals know each other well and can more closely match recipient interests.

Reasons to Give Noncash Gifts

There are at least four reasons why individuals (or organizations) give noncash gifts. The first is that there may be some sort of a “bulk” discount. Suppose that all of the staff like hams and intended to buy them anyway. If the company buys 1,000 hams, it can get the hams at a deep discount and can, therefore, buy more ham for each employee. There is certainly no problem here.

A second reason to give noncash gifts is that the receiver is not actually fully informed about his/her options. That is, the receiver does not know about some product or service

that he/she really does prefer until it's received as a gift. Also, sometimes gifts come with extraordinary sentimental value or are thoughtful in a highly valued way.


There may also be rewards that are not easily transferrable into cash. For example, although Nobel Prizes now come with a \$1.5-million cash award, if the recipient is a professor at the University of California at Berkeley, he or she also receives a parking space close to his or her building for life. This reward cannot be purchased.

An additional reason to give noncash gifts is that some people find it unseemly to give cash. The giver may actually find it more rewarding to give a noncash gift to another. In fact, the giver may actually suffer an extra “cost” of giving cash, rather than a noncash gift. The total societal gain from the gift exchange, therefore, must be considered, and that includes the gain to the receiver and the giver.

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The Next Generation

There is evidence that deadweight loss in holiday gift giving varies across individuals, generations and cultures. Do you know how your employees really feel about what's spent on the holiday party, cash vs. noncash holiday bonuses or even the employee-of-the-month awards?

My brother-in-law asks my kids at each holiday if they want a greeting card in the mail with a gift card (or cash) of a certain amount or no greeting card but a gift card with a slightly larger amount (say \$2.44 more than he would have otherwise put toward the greeting card and the postage). I am not sure what it means but, my kids always take the extra cash. 



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