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1997

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#### Recommended Citation

Eric Posner, "Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises," 1997 Wisconsin Law Review 567 (1997).

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# ALTRUISM, STATUS, AND TRUST IN THE LAW OF GIFTS AND GRATUITOUS PROMISES

ERIC A. POSNER\*

## I. INTRODUCTION

The law discriminates between gifts and exchanges in odd and interesting ways. A promisee can sue to enforce an ordinary commercial promise, but not a promise to give a gift. Creditors can force a donee to disgorge gifts received from insolvent debtors, but they cannot usually force a purchaser to disgorge goods purchased from insolvent debtors. In England and the United States, disinherited spouses can sometimes reverse inter vivos gifts that diminish their statutory share of the estate; in civil jurisdictions, disinherited spouses and children can do this routinely. But in none of these places can disinherited relatives reverse commercial exchanges that have diminished the value of the estate. What accounts for these differences?

To understand the law's treatment of gifts and gratuitous promises, one must recognize that people have many different motives for giving gifts. This article assumes that people give gifts to each other in order to (1) enhance the well-being of the donee, (2) increase the status of the donor, or (3) enter or enhance an exchange relationship. It concludes that much gift-giving is not as socially valuable as routine commercial exchange, and therefore legal protection of gift-giving is not as justifiable as legal protection of commercial exchange. However, failure to enforce gratuitous transfers is less justified than failure to enforce gratuitous promises because of differing problems of reliance in the two cases. Furthermore, much gift-giving that *is* socially valuable derives its value from its role in nonlegal relationships, and therefore efforts to regulate it with the law would reduce its value.

The argument differs both from the economic literature on gratuitous promises and from the doctrinal literature on gratuitous promises. The law and economics literature, almost exclusively, assumes that altruism

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\* Assistant Professor of Law, University of Pennsylvania. My thanks to Ian Ayres, Lucian Bebchuk, Stephen Coate, Richard Craswell, Jesse Fried, Louis Kaplow, Richard MeAdams, Richard Posner, Steven Shavell, Michael Trebilcock, participants at a seminar at Harvard Law School, and participants at the *Wisconsin Law Review* Symposium, for their helpful comments.

is the sole motive of gift-giving.<sup>1</sup> The article improves on this literature by considering other motives for gift-giving. In addition, the article criticizes the logic of some of the economic arguments that assume altruism.

The doctrinal literature on gratuitous promises generally relies on less narrow assumptions about motivation than does the economic literature.<sup>2</sup> The articles in this literature, however, are frequently unsystematic and their conclusions are, as a result, hard to evaluate. This article improves on the doctrinal literature by treating the motives of gift-giving in a more complete and systematic manner. The use of economic ideas, it is claimed, allows a more rigorous argument.

At a broader level, I hope to show that some simple economic ideas help us understand complex phenomena usually analyzed by sociologists, not by economists (in the legal literature)<sup>3</sup>—phenomena like status and trust. The article should be taken as an illustration of the thesis that “law and economics” rather than “law and sociology” provides a more promising methodology for investigating the law.

Part II discusses the meaning of gift-giving, the reciprocation norm, and the motives for gift-giving. It shows that the altruism assumption cannot by itself explain the pattern of gift-giving observed in everyday life, and it justifies the more complex assumptions regarding motivation. Part III discusses the social utility of gift-giving. Part IV examines the legal treatment of gift-giving.<sup>4</sup>

1. See, e.g., MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* 170-87 (1993); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 *YALE L.J.* 1261 (1980); Richard A. Posner, *Gratuitous Promises in Economics and Law*, 6 *J. LEGAL STUD.* 411 (1977); Steven Shavell, *An Economic Analysis of Altruism and Deferred Gifts*, 20 *J. LEGAL STUD.* 401 (1991).

2. See, e.g., Melvin Aron Eisenberg, *Donative Promises*, 47 *U. CHI. L. REV.* 1 (1979); E. Allan Farnsworth, *Promises to Make Gifts*, 43 *AM. J. COMP. L.* 359 (1995); James Gordley, *Enforcing Promises*, 83 *CAL. L. REV.* 547, 570-82 (1995); James D. Gordon III, *Consideration and the Commercial-Gift Dichotomy*, 44 *VAND. L. REV.* 283 (1991); Andrew Kull, *Reconsidering Gratuitous Promises*, 21 *J. LEGAL STUD.* 39 (1992).

3. Economists writing about gift-giving outside of contract law have frequently assumed nonaltruistic motives. For a recent survey, see Susan Rose-Ackerman, *Altruism, Nonprofits, and Economic Theory*, 34 *J. ECON. LITERATURE* 701 (1996).

4. For the most part, I ignore some important related issues, including the tax treatment of gifts, see, e.g., Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 *VA. L. REV.* 1393 (1988), and the role of nonprofits, see, e.g., *THE ECONOMICS OF NONPROFIT INSTITUTIONS* (Susan Rose-Ackerman ed., 1986).

## II. WHAT ARE GIFTS?

### A. Terminology

A “gift” is defined as a transfer of goods or services by a “donor” to a “donee,” where the donee is not required by agreement or convention to transfer something specific back to the donor in exchange. An anonymous donation to victims of a disaster or a toy for a small child are clearly gifts, because nothing is expected in return. Frequently, however, transfers that are called “gifts” do call for a return transfer, if only implicitly or by convention: a gift to a friend often calls for a return gift on a future occasion, or at least expressions of gratitude; a gift to a business associate frequently creates the expectation of future dealings; and a gift to a politician generally requires the politician to show some favoritism to the donor in return. The observation that almost all gifts are components of an implicit exchange has led some scholars, particularly those writing in the anthropological and sociological traditions, to collapse the categories of gift and exchange, and to claim instead that gift-giving is a form of exchange behavior.<sup>5</sup> This impulse also seems to lie behind some famous judicial decisions.<sup>6</sup>

It is more productive, however, to resist this impulse. While it is true that almost all gifts involve some form of reciprocation, it is also true that the significance of reciprocation varies considerably from context to context. To observe that there is a continuum in the degree of reciprocation required by transfers—from the anonymous gift or the bequest, which requires no reciprocation, through the political or intra-family contribution, which generates a nonspecific expectation of reciprocation, to the commercial exchange, which produces a powerful

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5. See, e.g., PETER M. BLAU, EXCHANGE AND POWER IN SOCIAL LIFE 88-112 (1964); MARCEL MAUSS, THE GIFT: THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES (W.D. Halls trans., 1990); WILLIAM MILLER, HUMILIATION 15-52 (1993); Jane B. Baron, *Gifts, Bargains, and Form*, 64 IND. L.J. 155 (1988-89); Carol M. Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295 (1992).

6. See, e.g., *Hamer v. Sidway*, 27 N.E. 256 (N.Y. 1891), in which the court enforced a man's promise to pay his nephew \$5000 on his 21st birthday if he gave up smoking, swearing, and gambling; *Allegheny College v. National Chautauqua County Bank*, 159 N.E. 173 (N.Y. 1927), which involved a charitable contribution. It is hard to know whether to classify the *Hamer* transaction as a gift or an exchange: it appears to have been altruistic, like most gifts, but there is a quid pro quo. The transaction in *Allegheny College* was clearly a gift, but the court characterizes it as an exchange (the donor sought memorialization) in order to justify enforcement under the consideration doctrine. The better analysis of both cases turns on an understanding of the motives, discussed *infra* part II.C, and the social effects of the transactions, discussed *infra* part III.

and well-defined expectation of reciprocation—is not to deny that it is useful to divide that continuum into two conceptual categories, gifts and exchanges. Scholars who take reciprocation as a primitive, something that explains other things but is not explained itself, cannot explain why reciprocation arises in some cases but not others.

One other terminological note will be helpful. A “gratuitous promise” is a promise to give a gift.<sup>7</sup> A “gratuitous transfer” is the actual giving of a gift. As we shall see, this distinction raises the question of why the state is more willing to strike down gratuitous promises than void gratuitous transfers. I shall use the term “gift” or “gift-giving” when the distinction between transfers and promises does not affect the analysis; otherwise, I shall refer to “gratuitous transfers” and “gratuitous promises.” Transfers that are not gifts will be called exchange, non-gratuitous, or commercial transfers; likewise for promises that are not gift promises.

### *B. Reciprocal Obligation*

The concept of reciprocity requires more explanation. It is often assumed that an actor who receives a benefit from a person usually feels a compulsion to provide a return benefit to him. This assumption can be interpreted in two ways. First, it can be interpreted psychologically to mean that people have an urge to reciprocate, and feel guilty if they do not. Second, it can be interpreted sociologically to mean that people feel social pressure to reciprocate. If they fail, they are sanctioned through criticism, gossip, or ostracism.

An example of the power of the reciprocity obligation comes from the social psychologist Robert Cialdini. He observed that in airports members of the Hare Krishna sect solicited donations more successfully when they first gave people flowers as “gifts” than when they simply asked for a donation.<sup>8</sup> People almost invariably gave a donation of a few dollars after receiving a flower which was virtually worthless.<sup>9</sup> So powerful is the reciprocity obligation that potential donees would go to great lengths to avoid receiving the flowers (by changing their routes or by not accepting the flowers) but would not simply refuse to pay after receiving the flower.<sup>10</sup> Manipulation of reciprocation norms appears in

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7. Courts often use the term “gratuitous promise” to refer to non-gift promises, such as promises to modify one’s performance. I adopt the narrower meaning for convenience, and context will make clear when I use the term in the broader sense.

8. ROBERT B. CIALDINI, *INFLUENCE* 34-35 (1984).

9. *Id.* at 35.

10. That no commercial exchange occurred is clear from the fact that the donors would immediately throw away the flowers, which would then be plucked from the

every imaginable context, and it is frequently discussed in sociological and anthropological studies.<sup>11</sup> This example and similar examples in the sociology literature provide evidence that reciprocation is a deep-rooted and powerful norm.

The reciprocity obligation is complex.<sup>12</sup> Some gifts forbid similar return gifts (for example, one would not give the Hare Krishna follower a flower in return for the flower, or a cake to a neighbor who welcomed one to the neighborhood with a cake). Some gifts require a return gift that is almost but not completely at the discretion of the recipient; in particular, gifts are almost never reciprocated with money (for example, a neighbor who lends you a tool would be offended if you gave him money but not if you lent him some other object on a different occasion). Some gifts are exchanged ceremoniously; other gifts are transferred informally. Gifts often cannot be reciprocated in a precise way, leaving a cloud of doubt around the transaction. Whereas a commercial contract specifies with precision how each party discharges his obligations, one rarely knows how much to spend on a gift that is intended to reciprocate for an earlier gift.

When a gift calls forth a determinate response, it begins to look like the consideration for an implicit promise—a promise understood by all from context but not articulated. In politics, the ambiguity between a gift and a non-gift is constantly exploited. If a politician promises to vote for a certain bill in return for a campaign contribution, the contribution is a bribe. When a politician does not make such an explicit promise in return for a contribution, no one really believes that the contribution is gratuitous, but the failure by the parties to make explicit the *quid pro quo* produces just enough doubt to defeat charges of vote-selling.

It is useful to distinguish between “formal” and “informal” gift-giving. Formal gifts include holiday cards, birthday gifts, and other ritualized transfers. Informal gifts are transfers of resources that are not clearly defined and signaled. Examples of donors of informal gifts include the purchasing agent who buys from Firm X because it employs a friend as a sales agent, the academic who gives comments on another’s work because that person has commented on his, and the insurance agent

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garbage can by members of the sect for reuse. *Id.* at 43.

11. See, e.g., JON ELSTER, *THE CEMENT OF SOCIETY: A STUDY OF SOCIAL ORDER* 111-14 (1989); MILLER, *supra* note 5, at 15-52.

12. Useful discussions can be found in BLAU, *supra* note 5, at 92-95, and MILLER, *supra* note 5, at 15-52. Empirical investigations of modern gift-giving can be found in Theodore Caplow, *Christmas Gifts and Kin Networks*, 47 *AM. SOC. REV.* 383 (1982); Theodore Caplow, *Rule Enforcement Without Visible Means: Christmas Gift Giving in Middletown*, 89 *AM. J. SOC.* 1306 (1984). Since these investigations mostly confirm intuitions, I will not report their results.

who violates some regulations on behalf of an old and trusted client. Formal gift-giving is puzzling in a way informal gift-giving is not. In formal gift-giving the transfers back and forth make the exchanges a wash, economically. Indeed, formal gifts often cost the donor more than they benefit the donee, resulting in a net loss. In contrast, exchange of informal gifts is jointly value-maximizing: when two academics cite each other, read each other's papers, or recommend each other for grants, both are made better off. The solution to the puzzle appears in Part II.E.

### *C. The Motive of Altruism*

Commentators influenced by law and economics have generally assumed that people give gifts altruistically, i.e., out of a desire to benefit the recipient of the gift. Of course, giving a gift is also costly to the donor. Thus, the donor gives a gift to a donee when the donee's increase in utility causes an increase in the donor's utility that exceeds the loss in the donor's utility resulting from the expenditure of time or money on the gift.<sup>13</sup>

I make three comments about the motive of altruism. First, it is an insufficient explanation for gift-giving behavior. Consider the donor who gives gifts to a charity because he cares about the well-being of the charity's beneficiaries. Assume that many people share the donor's concern about the well-being of the beneficiaries and make contributions, and that each person takes every other person's contributions as given. Then any donor would decrease his contribution to a charity when other people increase theirs. Because the well-being of the beneficiaries increases through the other donations, the donor in question has a stronger incentive to spend his money on something else. This result conflicts both with intuition and with evidence.<sup>14</sup>

Another phenomenon that cannot be explained by the motive of altruism is that of reciprocal formal gift-giving. If *X* and *Y* exchange presents of equal value at Christmas, then each ends up with a commodity rather than money, and this money would be worth no less and most likely more to him than the commodity. If the parties entered an agreement not to exchange gifts, then each party would gain from (1) *qua* egoist, the fact that he has cash rather than a commodity of equal value,

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13. For example, suppose that donor gives a painting to donee. If donor values the painting at \$100, donee values the painting at \$200, and donor obtains utility from the donee's happiness at, say, a 40% discount, then donor obtains \$120 worth of utility from donee's acquisition; subtracting the \$100 loss, the donor nets \$20. The donee, of course, gains \$200.

14. See Robert Sugden, *On the Economics of Philanthropy*, 92 *ECON. J.* 341 (1982).

and (2) qua altruist, the fact that the other party has cash rather than a commodity of equal value. But such agreements are rarely observed.<sup>15</sup>

Second, supposing for the moment that a reciprocation norm exists (I discuss it in more detail subsequently), such a norm complicates the analysis. If the donor is an altruist, he must take into account the fact that the donee may feel obligated to reciprocate any gift. If the donee has enough resources to reciprocate and does reciprocate, the gift will not necessarily increase the utility of the donee. Parents who give expensive gifts to independent-minded children learn this when the children reciprocate by giving expensive gifts to their parents. As I will discuss later, accepting a gift can also reduce the donee's status relative to the donor. To the extent that the donee cares about his status, this cost may offset the value to him of the gift.<sup>16</sup>

Sometimes, the cost of accepting a gift is low. The donee will not feel compelled to reciprocate if the context does not require reciprocation, as sometimes is the case with intergenerational transfers (especially wedding gifts and bequests); as often is the case when the donee is a charitable organization; and as almost always is the case during an emergency such as a natural disaster. The donee will not be able to reciprocate, and often will not feel compelled to reciprocate, if the gift is anonymous. (An anonymous gift, however, may give the donee the disagreeable sensation of feeling pitiable; and to add insult, he has no way of showing that this is not true by declining the gift to the donor's face.) An altruistic donor with sufficient self-consciousness will take into account all these possible costs to the donee when deciding whether and how to give a gift, and will give the gift only if the benefits to the donee exceed these costs.

Third, one should distinguish what is sometimes called "impure altruism," which refers to the attitude of a donor who cares not about the donee's utility but about the donee's consumption. For example, parents often pay a child's tuition rather than giving him cash which the child may squander. A Good Samaritan may offer food or clothing to a poor person, rather than money, for fear the recipient would use the money to purchase drugs.

It is important to mention that there is no reason to believe that any particular gift is the product of only one of the three motivations that are identified. Motivations are usually mixed. Many of the gifts conveyed

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15. For evidence that altruism is an insufficient explanation for gift-giving, see Donald Cox, *Motives for Private Income Transfers*, 95 J. POL. ECON. 508, 508-10, 540-41 (1987). Cox argues that a desire for exchange motivates most gift-giving. *Id.* For example, parents give gifts to their children in the hope that their children will later support them. This is similar to the trust explanation discussed *infra* part II.E.

16. See discussion *infra* part II.D.

between family members and between friends are motivated by altruism; but often other motivations are involved. The same is true of public contributions.

#### *D. Status-Enhancing Gifts*

Many generous gifts are given to prominent charities in a public fashion. Examples include the tycoon who endows a chair in his name or funds a building in his name. As mentioned earlier, altruism does not supply a satisfactory explanation of philanthropic giving. It does not explain why people do not decrease their giving as a charity becomes wealthier; it also does not explain why large gifts are conveyed in a highly public way.<sup>17</sup>

One might argue that public charitable gifts are actually disguised sales. The university sells its right to name a building after someone else to the "donor" in return for the latter's money. This description, however, does not capture what is special about the transaction. Universities resist the temptation to sell the right to name buildings to wealthy scoundrels out for a cheap way to repair their reputations. Like the politician who receives a campaign contribution, the university maintains a formal, even if rarely exercised, right of discretion. The reason that universities do not simply sell titles and positions is that their prestige would be destroyed if they were routinely sold, just as the prestige of the Nobel prize would be destroyed if it were auctioned to the highest bidder. The Reformation taught the Catholic Church a similar lesson about the difference between the price and the value of indulgences. In a phrase, people value reputations for generosity, ingenuity, and fair-mindedness; but if one could purchase such reputations, then they would cease to exist.<sup>18</sup>

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17. Charitable gifts are rarely made anonymously. Anonymous gifts accounted for 1.29% of the donations to the Pittsburgh Philharmonic, and for less than 1% of the donations to Yale Law School, Harvard Law School, and Carnegie Mellon University. Amihai Glazer & Kai A. Konrad, *A Signaling Explanation for Charity*, 86 AM. ECON. REV. 1019, 1021 (1996). Glazer and Konrad also point out that the motive of altruism cannot explain why people typically make gifts at the lowest value in the range by which donors are classified in published reports. *Id.* For example, 93% of those who contributed to the Harvard Law School Fund in the category of \$500-\$999 made contributions of \$500. *Id.* People motivated by altruism would presumably give gifts along a broader distribution.

18. This is not to say that universities can always resist skating close to the line. A recent article discussed the method of the University of California at Irvine:

"[The potential donor, Mr. Barclay] asked the magic question: What does it cost to put your name on something?" recalls Terry Jones, a former UCI development officer who handled the Barclay gift. . . . Mr. Jones says

To analyze this phenomenon, it is useful to introduce the concept of status. This concept, which refers to a person's rank in a hierarchy, can be modeled in various ways. Recent writings on the subject often assume that status is an index of one's wealth or conformity to important moral values, for example, honesty or generosity, but it can be a function of whatever is valued in a particular group—beauty, prowess as a warrior, strength, shrewdness, chess-playing talent, musical skill, piety, or any combination. One difficulty in discussions of status is that valued qualities differ from subculture to subculture. Sometimes one obtains status from having a distinguishing talent; sometimes one obtains status from always behaving in moderation.

The literature does not untangle these problems but it makes some progress. One approach assumes that people obtain status by being known to have great wealth.<sup>19</sup> Because one's wealth is not easily observable, to prove to others that one has wealth, one must take actions that only wealthy people can take. Such actions include conspicuous consumption and conspicuous donation.<sup>20</sup> Another approach assumes that people obtain status by being known to have good dispositions or talents—for example, the disposition of generosity.<sup>21</sup> The problem, again, is that one's generosity is not observable. To prove to others that one is generous, one must take actions that only generous people take, including lavish gift-giving.<sup>22</sup> Both approaches contain elements of the truth: people want others to think that they are wealthy *and* generous, not

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Mr. Barclay was pitched several "naming opportunities"—projects that would be named in his honor in exchange for a contribution—and "his eyes kind of lit up at the theater." After a series of negotiations, he agreed to the \$1 million, payable in \$200,000 installments over five years.

After that, the Barclays were treated more or less like royalty. Mrs. Barclay, for example, was "knighted" at an elaborate ceremony put on by the university's madrigal society. The couple was saluted at luncheons, cocktail parties and the gala review. And they were given other tokens of affection, including his-and-hers windbreakers bearing the university's Anteaters logo.

Richard B. Schmitt, *Uncharitable Acts: If Donors Fail To Give, More Nonprofit Groups Take Them To Court*, WALL ST. J., July 27, 1995, at A1.

19. Glazer & Konrad, *supra* note 17, at 1019-21.

20. *Id.* at 1020.

21. See B. Douglas Bernheim, *A Theory of Conformity*, 102 J. POL. ECON. 841, 842-46, 864-66 (1994).

22. See generally JAMES COLEMAN, FOUNDATIONS OF SOCIAL THEORY 129-31 (1990); ROBERT H. FRANK, CHOOSING THE RIGHT POND: HUMAN BEHAVIOR AND THE QUEST FOR STATUS (1985); Richard H. McAdams, *Relative Preferences*, 102 YALE L.J. 1 (1992) (and citations therein). Economic theories of status trace their origin to THORSTEIN VERLEN, THE THEORY OF THE LEISURE CLASS: AN ECONOMIC STUDY OF INSTITUTIONS (1953).

just because wealth signals talent and power and generosity signals virtue<sup>23</sup> (and also power), but because people with these qualities are demanded for their business and society.

There are two problems, however. First, as noted earlier, one cannot buy a reputation for generosity. Even if you paid people to acknowledge you as a generous person, no one would really think you were, precisely because it is clear that you demand something for your money. Second, reputation for generosity is a positional good. If everyone donates \$1000 per year, you cannot distinguish yourself as a generous person by donating \$1000 per year; you can only distinguish yourself by donating more than \$1000 per year.<sup>24</sup>

What sort of equilibria these assumptions produce depend on further assumptions and analysis that would take us too far afield. It is sufficient to mention that under both models, if people care sufficiently about their reputations (for being generous or for being wealthy), almost everyone will conform to a norm of gift-giving behavior; almost everyone will give more wealth than they would if they did not care about their reputations; and people's charitable contributions will not be as sensitive to the well-

23. Wealthy people who do not give, according to interviews of other wealthy people, are considered "warped," "revolting," and "looked upon with disdain, disfavor, and are highly criticized." FRANCIE OSTROWER, *WHY THE WEALTHY GIVE: THE CULTURE OF ELITE PHILANTHROPY* 14-16 (1995).

24. Consider:

The view was repeatedly expressed that New York philanthropy had changed during the past twenty to twenty-five years, so that one could now "buy in" to a position of prominence. One person said that there used to be a tight circle, but "what blew that apart were the [Xs] and people like that coming in who nobody knew . . . what we call nouvelle society. It did change things. All of a sudden these people started giving huge amounts of money. You had to notice. *But it also made people look bad who were moderate donors and they didn't like losing their position.*"

*Id.* at 43 (brackets and ellipsis in original, emphasis added). Ostrower describes in detail the role of philanthropic gift-giving in status competition among the social elite. *Id.* at 28-49.

Ostrower argues that elite philanthropy is mainly a system used by elites to preserve and enhance their status. She points out that altruism cannot be a sufficient explanation of elite philanthropy, because it does not explain the nature and the target of elite gift-giving. However, she does think that altruism plays some role; she points to the practice of allowing the nouvelle riche to "buy" trustee positions (a chief symbol of status, *see, e.g., id.* at 38), and argues that the incumbents permit this practice because they care about the charity. *Id.* at 141.

If, however, we broaden the perspective, and assume that status is not intrinsically desirable but matters as a method for distinguishing "good" types (wealthy and cooperative) from "bad" types, the reason for allowing newcomers is clear: it is to ensure that the elite class remains the elite, i.e., composed of people one would profit from interacting with. It is this argument that I pursue.

being of the donee as the altruism theory predicts. These arguments will be discussed in greater detail subsequently.

Two further points should be made. First, a donor may seek to signal his wealth or generosity to some people but not to other people. A person may give an anonymous donation in order to signal these qualities to a spouse. A person may give a donation to a charity in order to signal his wealth or generosity to friends and associates without caring about the opinions of the actual recipients of the gift. Note that to the extent that observers value status, the gift injures them by lowering their status relative to that of the donor, but to the extent that observers benefit from the donation—as is often the case when the donation benefits an institution like the opera—observers gain from the gift. Whether observers gain or lose more cannot be answered in the abstract, depending as it does on the extent to which they value status and the good being endowed.

Second, it should be emphasized that an individual *donee* suffers a loss of status. (Interestingly, an institutional donee does not suffer a loss of status; nor do its directors or officers.) The acceptance of an expensive gift, when no reciprocation is expected or occurs, signals that the donee does not have much wealth. If status is a function of perceived wealth, the donee will suffer a loss of status. This is why a person who wants to humiliate another person can do so by offering charity to the latter. In order to avoid losing status, even donees in great need will sometimes refuse to accept charity, or will insist that the charity be hidden, or will attempt to reciprocate after receiving charity—all of this a favorite subject of novelists.

### *E. Trust-Enhancing Gifts*

Why do people give each other Christmas presents rather than exchanging money or, better yet, representing gifts as bookkeeping entries? Part of the explanation is impure altruism: people give each other gifts in order to influence consumption. Part of the explanation has to do with status: donors give expensive gifts in order to obtain power and influence. But common sense suggests that the main reason for exchanging gifts is to create, enhance, or reaffirm relations of trust.

Initially, one should be careful about how one uses the word “trust.” *X* might trust *Y* to keep a promise because *X* knows that *Y* knows of the legal penalty for breach of contract. But in its fuller sense, “trust” means that *X* expects *Y* to keep a promise even if the law does not penalize *Y* for

breaking it.<sup>25</sup> Trust can, of course, be symmetrical, and we say that *X* and *Y* have a trust relationship if they cooperate for the purpose of obtaining some collective good and the threat of losing future cooperation from the other deters each from cheating.<sup>26</sup>

It has been increasingly recognized by academics that some nonlegal mechanism such as trust must account for long-term or "relational" contracts, in which significant value depends on one party acting in a way that cannot be verified by courts, frustrating legal enforcement. Examples include the relationships among family members, long-term supply contracts involving materials that require intensive investment by the supplier and are customized to the buyer's needs, employment relationships in which the employees develop valuable firm-specific expertise over time, and, in one view, the nonprofit corporate form which constrains the nonprofit's temptation to exploit the donors' inability to observe its services.<sup>27</sup> Although some argue that courts should try to enforce jointly maximizing behavior directly,<sup>28</sup> it seems more likely that the optimal judicial approach is passivity, because courts cannot verify the

25. Obviously, *X* might trust *Y* to do him a favor, not to stab him in the back, to say nice things about him, and so on, not just to keep a promise. My example should be viewed expansively.

26. Useful discussions of trust can be found in COLEMAN, *supra* note 22; TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS (Diego Gambetta ed., 1988); Richard Craswell, *On the Uses of "Trust": Comment on Williamson, "Calculativeness, Trust, and Economic Organization,"* 36 J. LAW & ECON. 487 (1993); Partha Dasgupta, *Trust as a Commodity*, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS, *supra*, at 49; P. Goran & T. Hagg, *The Economics of Trust, Trust-Sensitive Contracts, and Regulation*, 14 INT'L REV. LAW & ECON. 437 (1994); L.G. Telser, *A Theory of Self-Enforcing Agreements*, 53 J. BUS. 27 (1980); Robert L. Trivers, *The Evolution of Reciprocal Altruism*, 46 Q. REV. BIOLOGY 35, 45-54 (1971); Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J. LAW & ECON. 453 (1993).

Discussion of the incentives to cooperate in repeated prisoner's dilemmas can be found in *e.g.* DAVID M. KREPS, *GAME THEORY AND ECONOMIC MODELLING* 65-66 (1990). The connection between gift-giving and exchange is emphasized in the sociological and anthropological literatures. *E.g.*, GEORGE A. AKERLOF, *Labor Contracts as Partial Gift Exchanges*, in AN ECONOMIC THEORIST'S BOOK OF TALES 145 (1984); BLAU, *supra* note 5, at 88-114, 143-67; MAUSS, *supra* note 5. Blau, Mauss, and their followers, however, take the norm of reciprocity as a primitive, whereas this article uses a model that derives reciprocity from self-interested behavior. Akerlof also assumes a "fairness norm," which is similar to the reciprocity norm and creates the same problems. An economic theory of gift-giving can be found in JANET TAI LANDA, *TRUST, ETHNICITY, AND IDENTITY* 141-70 (1994).

27. See Henry B. Hannsman, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 846-48 (1980).

28. See Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, VA. L. REV. 1089, 1147-48 (1981).

actions of the parties and private mechanisms for resolving disputes and deterring opportunism often can.<sup>29</sup>

Less discussed is the possibility that an important element of relational contracting and similar forms of information-sensitive cooperation is the ability of parties to distinguish in advance of contracting more and less cooperative partners. A signaling model captures some aspects of this phenomenon. The following discussion is based on such a model developed by Camerer.<sup>30</sup>

Imagine that there are two kinds of relationships between universities and academics. In the "short-term" relationship, the university seeks no more than a year's worth of teaching from the academic and the academic wants no more than a year's worth of salary. In the "long-term" relationship, the university seeks an academic who will stay for a long time and during this time produce work that enhances the university's reputation; the academic prefers to stay at the university for a long time during which he expects to develop a productive relationship with his colleagues and to plunge roots in the community. Call the first kind of university a  $U_s$ , and the second kind a  $U_l$ ; the first kind of academic an  $A_s$ , and the second kind an  $A_l$ .<sup>31</sup> (We will also call a party that seeks long-term gains a "cooperator" and a party that seeks short-term gains an "opportunist.") Both a  $U_l$  and an  $A_l$  gain the most from a long-term relationship. When an  $A_l$  joins a  $U_s$ , under the misimpression that it is a  $U_l$ , he is exploited in the sense that he commits himself to investing in the university but receives inadequate support in return. When a  $U_l$  hires an  $A_s$ , the  $A_s$  exploits the  $U_l$  in the sense that the  $U_l$  commits itself to supporting the  $A_s$  (as with tenure) while the  $A_s$  declines to work hard enough to enhance the university's reputation. For these reasons, the  $A_s$  prefers being hired by a  $U_l$  to being hired by a  $U_s$ , since in the first case he obtains the exploitation gains; and the  $U_l$  prefers hiring an  $A_l$  to hiring an  $A_s$ , since it obtains the exploitation gains. Opportunists want to match up with cooperators, but cooperators prefer to avoid the opportunists and match up with each other.

Gift-giving serves as a signal that the cooperators use to distinguish themselves from the opportunists. Cooperators give gifts as a way of

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29. See Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 273-74, 313-18 (1992); see also Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133, 155-61 (1996).

30. Colin Camerer, *Gifts as Economic Signals and Social Symbols*, 94 AM. J. SOC. S180, S180-91 (1988); see also LANDA, *supra* note 26, at 161-68.

31. The differences between the types of academics and the types of universities refer only to differences in their opportunities outside the relationship and their discount rates. Some people care about their future wealth more than other people do.

showing that they expect a long-term relationship; if they expected only a short-term relationship, they would not obtain a sufficient return to offset the cost of the gifts. Opportunists cannot mimic this behavior, because the cost of the gifts exceeds the short-term gains. The ability of gift-giving to act as a signal assumes, first, that it is costly to give gifts, too costly for opportunists but not too costly for cooperators. Because the value of a gift is within the power of the donor, this assumption is plausible. The argument also assumes that there is some initial cost to entering the signaling game that all parties incur.<sup>32</sup> If there were no such cost, opportunists would enter the game merely to collect gifts. Given such a cost, the value of the gift must still be sufficiently low, so that the expected value of the gift alone does not exceed the cost of entering the game; but the cost of the gift must be sufficiently high, so that the giving of a gift performs its signaling role of distinguishing the cooperator from the opportunist. In sum, gifts are costly but not valuable. This suggests that cash gifts do not serve signaling functions, but that non-cash gifts typically do.

The argument also is valid only if the probabilities of being one type of partner or the other fall within a certain range. Most importantly, the probability that a potential partner is a cooperator must be sufficiently low; if it is high enough, then parties are willing to enter long-term contracts even without signaling. If it is too low, the signal is prohibitively costly. Other details we can safely ignore.<sup>33</sup>

Camerer's model does not explain why the best gifts surprise the recipient but at the same time please him and seem particularly suitable for him. Flowers and candy are hackneyed gifts, because everyone likes flowers and candy and no one is surprised to receive them. In contrast, clothes that look especially good on the recipient, art that appeals to his tastes, a book that interests him but that he has not read—all of these can be good gifts. The difference between good and bad gifts can be captured by a signaling explanation similar to Camerer's. A good gift shows that the donor has developed expertise about the donee's tastes, but only someone who intends to maintain a long-term relationship would invest in developing such an expertise, because the relationship must endure for a long time before he will recover the costs of that investment. So a good gift—one that reveals that the donor has a deep understanding of the donee—is a reliable signal that the donor is a cooperator. And money

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32. The interpretation of this assumption is puzzling. Camerer suggests that the entry costs "might include the costs of making a date or arranging an occasion for gift giving." Camerer, *supra* note 30, at S189.

33. For a formal model and further assumptions and qualifications, see *id.* at S184-87, S190-94.

could never be such a gift, since a gift of money requires no knowledge about the donee's tastes and personality.<sup>34</sup>

Once two cooperators match up, they form a relationship in which they produce and divide a cooperative surplus—even one that could not be specified in advance and enforced through a legally enforceable contract. Pursuant to this trust relationship, each party takes any action that produces more benefits to the other party than costs for the first, or at least any such action that the other party can observe and evaluate. Transfers and promises will often look gratuitous in the sense that each such action is not specifically determined in advance as part of a *quid pro quo* but are whatever action the actor believes will maximize the surplus. The apparent gratuitousness of trust-related behavior, however, should not conceal the fact that the parties enter the relationship solely for the purpose of obtaining personal (nonaltruistic) economic gains.

To return to our example, the university gives the prospective hire dinners, trips, meetings, flattering phone calls, and so on, which are not only costly to the university but fairly valueless to the academic. The high cost of these gifts signals that the university seeks a long-term relationship. Their low value deters prospective hires with no interest in academia from feigning an interest in order to receive some nice gifts. The academic's willingness to accept the gifts signals his interest in a long-term relationship. Universities offer much less valuable gifts—or none at all—to prospective lecturers, adjuncts, and others with short-term interests, because no long-term gains justify the costs. Once the long-term academic and university form a relationship, the academic engages in value-maximizing activity on behalf of the university (writes papers, serves on committees, even though he has tenure) and the university does the same on behalf of the academic (gives him regular raises and so on, even though he has sunk roots into the community and cannot easily leave). Notice that when the academic serves on a committee, this action is gift-like—a transfer that does not explicitly call for a reciprocal transfer—but it is really taken pursuant to a contract-like relationship that cannot be enforced legally because of information costs.

It is important to distinguish between gifts that are made for the purpose of signaling and gifts that occur as part of the loose *quid pro quo* in a trust relationship. The signaling gifts correspond to “formal” gifts discussed above—gifts that are ritualistic and not clearly value-maximizing, such as an exchange of fruitcakes at Christmas. These gifts are motivated by the desire to enter or continue a relationship of trust. The other sorts of gifts—call them oxymoronically but appropriately “exchange gifts”—are best understood as any transfer from one party in

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34. *Id.* at S193-94.

a trust relation to the other, which benefits the recipient by more than it costs the donor. These gifts are motivated by a desire to obey the terms of the relationship so as to continue to benefit from it.<sup>35</sup> Exchange gifts benefit the donee more than they cost the donor; signaling gifts do not necessarily do so, and frequently cost the donor more than they benefit the donee. Exchange gifts are transferred as the opportunity arises; signaling gifts are transferred in a highly ritualized fashion. In Part IV, we will see that the legal implications of each kind of gift diverge.

I have emphasized the importance of trust relationships in business, where they allow parties to exploit surpluses unobtainable through contractual mechanisms because of the cost of information. They are also important in family relations, where legal norms as well as information costs restrict the ability of family members to make and enforce marriage contracts pertaining to household production. The most vivid example of their importance, however, comes from the political arena. Law and public policy bar political bribery, so lobbyists give politicians gifts in the hope of influencing their votes. The initial gift is a signal from the lobbyist that future gifts will be forthcoming if the politician acts properly. Later gifts are rewards for earlier behavior and promises of more to come.<sup>36</sup>

#### *F. Gifts and Exchanges*

It might be useful to unify the analyses of the different motives. It is assumed that people maximize their utility. One way to increase one's utility is to make gifts or to promise to make gifts. Through gift-giving, one increases one's utility by increasing the well-being of someone one cares about (altruism), by increasing one's status, or by signaling one's desire to enter an exchange relationship or by benefiting the other pursuant to that relationship in anticipation that the other will reciprocate.<sup>37</sup> There are two sorts of people: cooperators and

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35. A trust relationship is not the only relationship in which profitable exchange of gifts can occur. For example, in Becker's "Rotten Kid" model a beneficiary gives gifts to another beneficiary because he thereby obtains contributions from the benefactor sufficient to offset the cost of the gifts. See GARY S. BECKER, *A TREATISE ON THE FAMILY* 288 (1991). The "Rotten Kid" model assumes an altruistic benefactor; the trust model does not assume altruism, and only assumes that parties gain from long-term trade.

36. A subtle example of this phenomenon is corporate donation to charity. In one instance, authorities enacted laws protecting local businesses from takeover threats at the request of managers. The authorities feared that a takeover by outsiders would end a large local business's periodic donations to local charities. See Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 121 (1987).

37. Another possible motive, discussed in the economic literature on "warm-glow" giving, is that people take pleasure from the act of giving itself. See, e.g., James

opportunists. Some or all people are altruistic with respect to some others. Many but probably not all people place a high value on status. Because gifts result from a variety of motives, and because motives are hidden, it is never entirely clear to recipients or observers why a donor is giving a gift. As a result, a recipient may turn down a gift for fear that it is a status-enhancing gift when it is not intended to be so (for example, an offer from a rich friend to stay at his fancy house over the summer). More precisely, whether or not the donee believes that the donor's motives are altruistic or even trust-enhancing, the donee may fear that *other* people will interpret his acceptance of the gift as evidence of relative poverty. Or a person may accept an altruistic gift as a signal of a desire to enter a trust relationship and, by reciprocating, defeat the altruist's purpose of benefiting the recipient. All of this is the stuff of etiquette books. At times, context clarifies motives. The victim of a disaster who receives donations from strangers knows that they act from altruism, not from a desire to enter a relationship of trust. The professor who receives comments from another academic will understand that a relationship of reciprocity has been created, and will not assume that the commenter acted from altruism.

To say that gift-giving is a useful mechanism for people who want to behave altruistically, enhance their status, or pursue trust relationships is not to say that such people can only use gift-giving to achieve these goals and cannot achieve the same goals by engaging in ordinary commercial transactions. As a matter of theory, people can; as a matter of practice, they usually do not, simply because gift-giving is the more effective mechanism. This can be shown as follows.

First, suppose an altruist wants to benefit *X*. He can do so by giving *X* cash or buying goods from *X*'s boutique. Imagine that the altruist is indifferent between giving up \$100 and giving up \$110 for some of *X*'s goods that he values at \$10. The altruist would benefit *X* more by giving the cash gift at the same cost to himself, since *X* obtains the full \$100 rather than just his profit margin on the sale.<sup>38</sup>

Second, suppose a tycoon wants to enhance his status. He can do so by giving \$100,000 to a university or by purchasing for \$110,000 a yacht that he values at \$10,000. To the extent that the tycoon seeks to enhance his status, the gift is superior. The problem with the purchase is that observers do not know whether it reflects the tycoon's wealth or the intensity of his enjoyment of yachting: the signal is fuzzy. Relatedly, people can cheaply mimic conspicuous consumption—for example, by

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Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 *ECON. J.*, June 1990, at 464.

38. See BECKER, *supra* note 35, at 299-300.

purchasing high-quality imitations of expensive jewelry, clothing, and so on, or renting the yacht rather than purchasing it.<sup>39</sup> But one cannot credibly pretend to have given a gift to an established charity. Because charities understand that people give them gifts in order to signal their status to others, charities take pains to publicize the names of donors. Your colleagues at work may never really believe your stories about your lavish vacations or about the value of your art collection, but they cannot question your entitlement to the label "Patron" when they see your name under that category in the program at the opera.<sup>40</sup> Finally, to the extent that status is a function of perceived generosity, rather than just of wealth, obviously a gift will enhance status more than a purchase.<sup>41</sup>

Third, suppose a person wishes to enter a relationship of trust. He can try to do so by purchasing goods from the subject. The problem is that the seller cannot easily distinguish a purchase that is made in order to obtain goods and a purchase that is supposed to signal a desire to enter a trust relationship. In order for some behavior to act as a signal of a desire to enter a relationship of trust, it must be costly, or at least look costly to the receiver of the signal. A purchase, however, does not look costly, the way a gift does, because the buyer's acquisition of the goods offset his out-of-pocket loss. A more effective way to signal an interest in a trust relationship is to buy the seller a drink or, if it is a big purchase, dinner.

These examples show that while an altruist, status-seeker, or trust-enhancer *could* try to achieve his ends through commercial transactions, he is likely to find them to be an inconvenient means. The converse point is also true. Suppose a person wants to buy a widget. He could try to give some flowers to the widget seller, but this would be an odd thing to do. The buyer, by hypothesis, wants the widget, not a trust relationship, and not an improvement in the seller's well-being, so there is no point in giving a gift. When people want some specific good, they do not try to obtain it through the indirect means of gift-giving. However, as noted before, when legal or moral norms prohibit the sale of desired goods or services, as is the case in politics, or there are severe information problems, gift-giving presents a method for circumventing these barriers.

In sum, giving allowance for the blurriness of lines, we can conclude that most commercial transactions are motivated by a desire for a specific thing, whereas most gift-giving is motivated by a desire to improve the

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39. See Glazer & Konrad, *supra* note 17, at 1019.

40. *Id.* at 1019-20.

41. Note, however, that the analyses of Veblen, Frank, McAdams, and others are intended to apply to the commercial context. Despite the theoretical objection contained in the text, the extent to which people generate status through consumption or production rather than donation is an empirical question not easily resolved.

well-being of others, to enhance one's status, or to enter or enhance a relationship of trust (or to satisfy obligations pursuant to such a relationship).

### III. SOCIAL UTILITY OF GIFTS

The economist Joel Waldfogel argues that in 1992 Christmas-giving produced a deadweight loss of between four and thirteen billion dollars in the United States.<sup>42</sup> The results are drawn from a survey in which respondents attached to gifts they had recently received a value that was lower than the purchase price of the gifts. One interpretation of this result is that people prefer money to goods, because money is fungible and can be used to buy whatever one wants the most. Thus, whenever a person gives goods (or services) as gifts, this produces a deadweight loss equal to the difference between the value the donee attaches to the goods and the value the donee would attach to the amount of money used to buy the goods. When this behavior occurs on a large scale, such as at Christmas, billions of dollars are lost.

Waldfogel's results raise the possibility that gift-giving generates enormous social costs. Is this at all plausible? To analyze this question, one should keep distinct the question of the value of gift-giving as a single social phenomenon and the value of various *kinds* of gift-giving. If relevant government actors can distinguish different kinds of gift-giving, they may want to discriminate among them; if they cannot, they may want to take a general approach to the phenomenon as a whole. For expository convenience, I discuss the social value of the different kinds of gift-giving separately, then discuss the phenomenon as a whole.

#### A. Altruistic Gifts

Some commentators argue that altruistic gifts are socially valuable. Gratuitous transfers make the donor and donee better off without making third parties worse off. They make the donee better off, because the donee prefers the gift to nothing; and they make the donor better off because the donor derives utility from the donee's increase in utility.<sup>43</sup>

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42. Joel Waldfogel, *The Deadweight Loss of Christmas*, 83 AM. ECON. REV. 1328 (1993).

43. I ignore two arguments associated with RICHARD M. TITMUSS, *THE GIFT RELATIONSHIP* (1971). First, I do not consider the argument that in certain markets the quality of the product depends heavily on nonobservable attributes and that only altruists will self-screen so as to produce products only with those attributes (Titmuss' example is blood). Second, Titmuss argues that the cultivation of altruistic tendencies produces social goods that are independent of the aggregation of the satisfaction of private preferences.

Gratuitous promises similarly make both parties better off without making third parties worse off. The donor might prefer making a gratuitous promise to making a gratuitous transfer, because in doing so he gives the donee a reliance interest that increases the value of the gift to the donee and himself time to use the goods prior to performance.<sup>44</sup>

Impure altruism is similarly straightforward. A gift from an impure altruist can be thought of as a conditional promise—"I promise to give you \$100 so long as you use it to buy food." Because the donee often cannot commit himself to satisfy the condition, the impure altruist uses a form of donation whose use is limited (for example, food or food stamps rather than cash to buy food). The donee has the option of declining the gift, and will do so if the gift would make him worse off than he would be without the gift. If he accepts the gift, then the gift must be in the joint interests of the parties.

There are several problems with these arguments. As Kaplow points out, the donor takes account of the donee's utility only as it is translated into his (the donor's) own utility function, and does not account for it separately as it would be in a social welfare function.<sup>45</sup> For example, suppose that the donor proposes to give the donee a painting worth \$100 to the donor and \$200 to the donee, and that the donor values the donee's well-being at a discount of 40%. The donor makes the gift because he gains \$120 worth of utility while losing \$100. In addition, the donee gains \$200 from the gift. The gift, which would result in a Pareto improvement, will occur. Now suppose that the donor values the donee's well-being at a discount of 60%. The donor does not make the gift because its cost (\$100) exceeds the benefit to him (\$80). However, if the donor did give the gift, the donee would gain \$200, which exceeds the donor's loss. The gift will not occur, but if it did, it would increase total utility, though it would not result in a Pareto improvement. Although it is theoretically possible that the donee would offer to pay the donor, say, \$21 to make the gift, thus making both the donor and the donee better off and enabling the "gift" to occur, this Coasean bargain rarely, if ever, happens.

A possible reason for this bargaining failure is that recipients are never quite sure whether a gift is intended for altruistic or for trust-enhancing reasons. Attempting to bargain over a trust-enhancing gift is terribly improper, as it suggests that the donee is neither a cooperator who seeks a relationship nor a cooperator who does not seek this

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44. See Shavell, *supra* note 1, at 402 (giving this and additional reasons).

45. See Louis Kaplow, *A Note on Subsidizing Gifts*, 58 J. PUB. ECON. 469 (1995). The general point about double counting is also made in David D. Friedman, *Does Altruism Produce Efficient Outcomes? Marshall Versus Kaldor*, 17 J. LEGAL STUD. 1 (1988).

particular relationship, but rather an opportunist seeking to get a signaling gift at no cost to himself—something that would be in the interest of no one to admit. Bargaining is appropriate when the donor is an altruist; but a pure altruist would give money, not goods, so the bargaining would not be necessary.<sup>46</sup>

Two other problems with altruistic behavior can be briefly mentioned. These problems are sometimes called “Samaritan’s dilemmas.” First, altruistic donors can be exploited by their donees. Suppose the donor consumes some of his own resources in time periods one and two, and makes a gift from his period one resources to the donee which the donee receives in period two. Because the donor cares about the donee’s well-being, the donor will give the donee more money when the donee is poor and less money when the donee is wealthy. To ensure the largest possible gift, the donee consumes all his resources in period one and saves none for period two, realizing that the donor will have to give him a large gift so that he can survive period two. Foreseeing the donee’s behavior, the donor has little choice: he can simply give the donee more wealth in period two than he would otherwise want to give, or he can commit himself not to by overconsuming in period one, thus limiting the amount he can give to the donee in period two. A Pareto improvement would occur if the donee could commit himself not to overconsume in period one, but there exists no such means of self-commitment.

Second, altruism interferes with cooperation. Suppose *A* and *B* embark on a cooperative endeavor, and *A* has altruistic feelings toward *B*. Assuming no third-party-enforcement mechanism, *A* and *B* can cooperate only if their discount rates are sufficiently low and *A* and *B* can credibly punish each other should cheating occur. If *A* is sufficiently altruistic, however, *A* will not punish *B*; foreseeing this, *B* will cheat. Foreseeing this, *A* will not enter the relationship and the cooperative surplus is lost.<sup>47</sup>

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46. Kaplow points out that a Coasean bargain will not occur because an altruist would not gain from a return payment. A gift plus a return payment is equivalent to a smaller gift; but if that gift would not be made, then neither would the donor accept the bargain. See Kaplow, *supra* note 45. This argument does not hold, however, when the donor is an impure altruist and has the choice between giving or not giving a “lumpy” gift, like a family heirloom.

47. See B. Douglas Bernheim & Oded Stark, *Altruism Within the Family Reconsidered: Do Nice Guys Finish Last?*, 78 AM. ECON. REV. 1034 (1988). Further discussions can be found in ODED STARK, *ALTRUISM AND BEYOND* (1995). The first argument is also made by James M. Buchanan, *The Samaritan’s Dilemma*, in *ALTRUISM, MORALITY, AND ECONOMIC THEORY* 71 (Edmund S. Phelps ed., 1975); Shavell, *supra* note 1.

These arguments reveal inefficiencies even when the donation does not harm third parties. An additional inefficiency arises when donations do harm third parties. As we shall see, a theme in legal history is the problem of heads of families who give away or bequeath much of their wealth to people who do not belong to their family, rather than providing for the support of their families. Many countries and some of the United States have put restrictions on inheritance and inter vivos gift-giving in order to deter this behavior.<sup>48</sup>

I will discuss this phenomenon at greater length shortly. For now, it is worth pointing out that such extra-family gifts are more likely to injure family members than ordinary commercial transactions. When the head of a household gives gifts to a paramour or to a charity, he reduces the pool of family assets. In contrast, when he buys goods, he does not necessarily reduce the value of the family assets and may augment them (although not if he consumes the goods or if he makes bad investments). As we shall see in Part IV, this distinction may justify different legal treatments of gifts and exchanges.<sup>49</sup>

### *B. Status-Enhancing Gifts*

To analyze the social utility of status-enhancing gifts, I distinguish the effects of such gifts on the donor, the donee, and observers of the gifts.

*The donee.* When a tycoon endows a university building or chair in his name, clearly the university benefits. Interestingly, the university does not suffer a loss of status or if it does, the loss is presumably less than the gain.<sup>50</sup> When an individual accepts a donation from a wealthy person, that individual often loses status. As noted earlier, the reason is probably that the person signals his poverty when he accepts a gift. The observer might regard him contemptuously as a "retainer," or, if such is the case, a "poor relation." It seems appropriate to assume, however, that the donee believes that the benefit of increased wealth exceeds the costs resulting from a loss of status.

*The observers.* Observers both gain and lose from donations. On the one hand, they gain to the extent they share in the consumption of a public good supported by the donations. On the other hand, they lose to

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48. See JOHN P. DAWSON, *GIFTS AND PROMISES* (1980).

49. For another critique of altruistic gift-giving, see Jeffrey E. Stake, *Darwin, Donations, and the Illusion of Dead Hand Control*, 64 *TUL. L. REV.* 705 (1990).

50. Ostrower notes that wealthy individuals solicit donations from each other for the benefit of the institutions on which they serve as board members. See OSTROWER, *supra* note 23. If these institutions did not exist, who would get the money? The act of donating is more important than the well-being of the recipient.

the extent that they care about their own status, and to the extent that status is a function of the relative size of one's contributions. When a large donation is made, status-conscious observers must dig into their pockets just to maintain their rank.<sup>51</sup> The balance of these costs and benefits cannot be determined in the abstract.

*The donor.* At first sight, one would argue that the donor gains by making the gift—he gains status. As discussed earlier, however, status is a peculiar good. A large gift to a university does not raise the donor's status unless the act is unusual. If everyone routinely gives such gifts, the donor's gift does not distinguish him for his generosity and wealth. Thus, the utility of the gift to the donor depends on the behavior of others. If enough people seek to enhance their own status by giving gifts, then the cost of any particular gift necessary to enhance the status of the donor must rise.<sup>52</sup>

The competition for status is a prisoner's dilemma. Each potential donor faces a choice between making a gift, in order to assert his status, and not making a gift. If he expects other people to give gifts, he should give a gift, because otherwise he will lose status. If he expects the others not to give gifts, he should give a gift, because by doing so he gains status at the expense of the others. Therefore, each potential donor will give the gift. But because everyone gives a gift, no one gains status (because giving a gift does not distinguish one from the others); and this outcome is inferior to the case where no one gives a gift. In the latter outcome, no one gains status; but at least no one incurs the expense of the gift.<sup>53</sup>

It might be argued that status competition is socially beneficial, because it leads to the provision of public goods.<sup>54</sup> The external value of donors' contributions to the public good exceeds the cost to themselves. The problem with this argument is that there is no reason to believe that the equilibrium at which the donors give gifts matches the socially beneficial level of gift-giving. It might be lower or higher.

In addition, the equilibrium will favor some charities at the expense of others in a way that bears no relation to their social utility. The amount of money raised by a charity from status-seekers is a function not of its social value, but of the extent to which its purpose justifies

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51. OSTROWER, *supra* note 23, at 43; *see also* BLAU, *supra* note 5, at 318.

52. *See* FRANK, *supra* note 22; McAdams, *supra* note 22; *cf.* BLAU, *supra* note 5.

53. *See* FRANK, *supra* note 22.

54. *See* McAdams, *supra* note 22. For a general discussion, *see* JOHN D. COLOMBO & MARK A. HALL, *THE CHARITABLE TAX EXEMPTION* (1995).

expenditures on media that widely disseminate its list of donors.<sup>55</sup> Status-enhancement is most likely to occur when the donor's generosity can be prominently memorialized, as when a building or chair is named after him, or when names are listed on plaques or in programs that are widely seen. Many charities, such as anti-poverty charities, cannot offer these services or can do so only by distorting their mission (constructing buildings, for example, rather than providing services), or simply by providing donors with a means of publicity. Hence the common but incongruous sight of catered black-tie balls held for the purpose of raising money for poverty relief.<sup>56</sup> Because there is no relation between the public prominence of a charity, or the prominence of its activities, or the ease with which its mission justifies the production of buildings or permanent institutions, and its social value, status-driven philanthropy cannot be expected to maximize social welfare.<sup>57</sup>

Evidence for the social disutility of status-enhancing gift-giving may be found in a wide range of contexts. In many societies, especially highly stratified ones, people sometimes ruin themselves in an effort to meet gift-giving obligations. The dowry system in India, for example, leads to far too much mayhem to have a plausible claim as an efficient institution.<sup>58</sup> The dysfunctional nature of some forms of gift-giving can be seen in the social and legal responses to them. Many subcultures feature social norms against "too much" gift-giving. For example, elite New York society frowns upon wealthy social climbers who in making extravagant gifts to establish their status humiliate old families who cannot match them.<sup>59</sup> And one even finds attempts to outlaw certain kinds of gift-giving. India, for example, has laws against dowry; and, to take a trivial but telling example, when the practice of tipping came to the United

55. Cf. Glazer & Konrad, *supra* note 17. For an example of the way a donee will engage in elaborate techniques for publicizing the gift, see *supra* note 18 (discussing the Barclay gift).

56. These events always stir a strange mix of emotions: envy, at the members of high society from which one is ostentatiously excluded; disgust, at their hypocrisy—they obviously don't care about poverty enough to go without their lobster bisque; gratitude, at their generosity, as they could have spent all their money on themselves.

57. Charitable giving, especially by the wealthy, is skewed toward high-profile gifts to cultural institutions. See OSTROWER, *supra* note 23; WHO BENEFITS FROM THE NONPROFIT SECTOR? (Charles T. Clotfelter ed., 1992). The exception is contribution to religious organizations.

58. For descriptions, see Marguerite Roulet, *Dowry and Prestige in Northern India*, 30 CONTRIBUTIONS INDIAN SOC. 89 (1996); MOHINDERJIT KAUR TEJA, *DOWRY: A STUDY IN ATTITUDES AND PRACTICES* (1993).

59. See OSTROWER, *supra* note 23; see also Roger D. Congleton, *Efficient Status Seeking: Externalities, and the Evolution of Status Games*, 11 J. ECON. BEHAV. & ORGANIZATION 175 (1989) (discussing other ways in which inefficient status-seeking competitions are discouraged).

States in the beginning of the twentieth century, many states prohibited it by law.<sup>60</sup>

### C. Trust-Enhancing Gifts

Trust relationships allow parties to exploit gains from trade that cannot be exploited through legal contracting. At first sight, one might conclude that therefore the use of gifts to enter and maintain trust relationships is a socially valuable practice. On reflection, this conclusion must be qualified. The problem arises from the struggle between opportunists, who attempt to mimic cooperators, and cooperators, who attempt to distinguish themselves from opportunists. Suppose, for example, that everyone—both opportunists and cooperators—conveys signaling gifts. If the opportunists would lose more by being identified, and thus avoided, than they would gain by saving on the cost of gift-giving, then they will not deviate from the equilibrium; but neither would the cooperators, for then they would be mistaken as opportunists and lose the gains from the trust relationship. Both types would be better off if they could enter a binding commitment never to give gifts, since they would then save on the costs of gift-giving without losing any other benefit. But there is no mechanism by which such a commitment could occur. Now, suppose that only cooperators give gifts and opportunists do not give gifts. It may be the case that all cooperators would be better off if none of them gave gifts (the cost of giving gifts exceeds the gains from cooperative relationships when opportunists and cooperators cannot be distinguished), while at the same time no single cooperator would deviate from the equilibrium (the cost of giving gifts is less than the cost of being mistaken for an opportunist and avoided). Both examples show that one cannot say in the abstract whether trust-enhancing gift-giving equilibria are efficient.<sup>61</sup>

### D. The Social Value of Gift-Giving

One possible conclusion about the relative value of gifts and exchanges is that it is more difficult to determine whether gift-giving in general or one particular instance of gift-giving maximizes social welfare, than it is to determine whether commercial exchange maximizes social welfare. Economic theories specify the conditions under which

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60. See VIVIANA A. ZELIZER, *THE SOCIAL MEANING OF MONEY* 94-99 (1994).

61. The ambiguity of the welfare implications of signaling models is well-known. For a discussion, see ANDREU MAS-COLELL ET AL., *MICROECONOMIC THEORY* 455-57 (1995).

commercial markets maximize social welfare and conditions under which they do not. These conditions can be said to obtain, in a rough and ready way, in most routine market transactions. In contrast, because analysis of gift-giving requires complicated and hard-to-test assumptions about interdependent utility, information costs, and strategic behavior, theories of gift-giving produce no analogous theorems. It might be argued that similar complications undermine the general theories about the market. I have supplied one response to this objection—theoretical reasons for believing that parties will exercise altruism, pursue status, and signal trust outside the market—but at bottom the plausibility of this response depends on the answers to difficult empirical questions. Thus, although the analysis of the social value of gift-giving reveals interesting inefficiencies often overlooked in the literature, it does not provide a firm basis for evaluating the law. A more promising approach is to ask whether specific forms of legal restrictions on or protections for gift-giving are likely to promote welfare. This is the subject of the next section.

#### IV. LEGAL IMPLICATIONS

This Part uses the preceding analysis to shed light on the legal regulation of gift-giving. Section A examines the preliminary issue of whether gratuitous promises and gratuitous transfers should be treated identically by the law, and concludes that they should not. Sections B-D analyze the optimal legal treatment of gifts and gratuitous promises relative to the legal treatment of exchanges. Section E discusses fraudulent conveyance law.

##### *A. Transfers and Promises*

Commentators have pointed out that one problem with the literature on gifts is that it does not adequately account for the law's seemingly oddly different attitude toward gratuitous promises and gratuitous transfers. One might think that one way to rationalize the law is to show that gifts are socially costly, while commercial exchanges are valuable; thus the refusal to enforce gratuitous promises is justified. But this argument would explain too much. If gifts are bad, why don't courts refuse to enforce gratuitous transfers—for example, by allowing transferors the right to revoke the transfers?<sup>62</sup> An adequate explanation

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62. This point is emphasized by both Eisenberg and Kull. Eisenberg, *supra* note 2; Kull, *supra* note 2. Eisenberg argues that transfers are harder than promises for a putative donee to fake, and that transfers are more likely than promises to have been a subject of deliberation on the part of the donor.

for the law's treatment of gift-giving must show (1) why gratuitous promises are given less protection than non-gratuitous promises, while (2) gratuitous transfers are given the same level of protection that non-gratuitous transfers receive.

As an initial matter, the legal premises of the previous argument are not correct. The law actually gives gratuitous transfers less protection than non-gratuitous transfers. In fraudulent conveyance law and in law relating to forced heirship, there are standard conditions under which gratuitous transfers can be revoked routinely (regardless of motive), whereas non-gratuitous transfers can be revoked only upon proof of fraud. Still, the argument is important, because it forces one to keep separate different legal phenomena and not to provide overly general explanations.

To address this argument, we imagine two rules that could be used to govern attempts by promisors to revoke promises and transferors to revoke transfers. For expository convenience, define a "sender" as a general term that refers to transferors and to promisors, and a "receiver" as a term that refers to transferees and to promisees. Under the "sender-protection rule" the sender has the right to revoke a promise or transfer without compensating the receiver. Under the "receiver-protection rule" the sender may not revoke a promise or transfer or may only do so upon providing compensation. The question is whether it is possible that the sender-protection rule is more appropriate for promises while the receiver-protection rule is more appropriate for transfers.

Under a receiver-protection rule a promisee will "rely" on the promise in the sense of investing in equipment and so forth in anticipation of acquiring the goods in order to increase their value to himself. This reliance by the promisee benefits the promisor either because the promisor is an altruist and gains from the promisee's increase in utility or the promisor is a nonaltruist and gains from the higher price the promisee is willing to pay for goods that he (the promisee) can rely on prospectively. Of course, the promisor faces a cost. If the promisor decides after the promise that he values the goods by more than what he gains from the promisee, he will wish to break the promise. A receiver-protection rule forces the promisor to protect himself either by not making the promise or by making a conditional promise—both of which are costly.

Similarly, under a receiver-protection rule a transferee will rely on the transfer in the sense of investing in the goods in order to increase their value. The transferee's reliance benefits the transferor either because the transferor is an altruist and gains from the transferee's increase in utility or the transferor is a nonaltruist and gains from the higher price for the goods. But if the transferor decides after the transfer that he values the goods by more than what he gains from the transferee, he will wish to revoke the transfer. A receiver-protection rule forces the

transferor to protect himself by either not making the transfer or making a conditional transfer (such as with a lease). Again, this is costly.

Now consider a sender-protection rule. Under a sender-protection rule, the sender incurs no risk should events change his valuation of the promise or transfer. But now the receiver bears all the risk. If he relies on the promise or transfer in order to increase its value, he bears the full loss of the investment upon breach or revocation. To protect himself, either the receiver will not accept the promise or transfer, or will do so only if the sender can in some way commit himself not to break the promise or revoke the transfer. Since the law provides the sender with no means for doing this, it will be costly, perhaps prohibitively costly, to make promises or transfers. As a result, the receiver will not engage in value-maximizing reliance, and the sender will not obtain any portion of the gains that would be generated through such reliance.

Thus, the proper rule must, first, force the sender to internalize the receiver's costs in reliance on the transfer. However, such a rule would also cause the receiver to overrely, since under this rule the receiver would bear none of the costs of his reliance. Thus, second, the rule must discount damages to some extent in order to discourage overreliance when overreliance is likely to be a problem. The standard result is that the damages must be invariant with respect to reliance and, ideally, set at the level that causes the sender to behave efficiently.<sup>63</sup>

The efficient amount of reliance is probably on average higher for transfers than for promises. The reason is that on average the transferee possesses the goods for a longer period of time than does the promisee. While the promisee awaits delivery, the comparable transferee already has possession. Generally speaking, the possessor of a good can exploit it more effectively than a non-possessor. The promisee, to be sure, as prospective possessor, can make investments that increase the value of the goods once they reach his hands, but because he does not obtain a return on the goods immediately and because he has only second-hand information about them and no control over them, his investment is likely to produce lower returns than the comparable transferee's investments. Put another way, the transferee would have to protect himself from revocation under a sender-protection rule by hedging over the useful life of the goods; the promisee needs to protect himself only during the period prior to performance. Thus, the law should grant the transferee more protection than the promisee—as it does.<sup>64</sup>

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63. The analysis up to this point follows and generalizes the discussion in Goetz and Scott, *supra* note 1; the latter discusses only promises, whereas this analysis refers both to promises and to transfers.

64. In fact, the law protects the transferee with a property rule and the promisee usually with a liability rule. The property rule ensures that any surplus generated by the

This discussion does not explain the legal treatment of gratuitous promises and transfers,<sup>65</sup> but it sets the stage for such an explanation. It does so by showing that the law could sensibly provide more protection for transferees than for promisees. But there remains the task of showing why the non-gratuitous promisee receives more protection than the gratuitous promisee.

### B. Altruistic Gifts

#### 1. TRANSFERS

In the absence of third-party effects, transferors should not have the right to revoke transfers. Altruistic transfers are not always efficient, but refusing to enforce them would not improve their efficiency. Kaplow's argument, for example, suggests not that altruistic transfers should be discouraged but that they should be subsidized. The implications of the Samaritan's dilemmas are ambiguous, but they suggest that under certain conditions restrictions on altruistic transfers would make donors and donees better off: if the donor cannot commit to transferring goods, the donee will not be able to exploit him. But then either the donor will not be able to satisfy his altruistic impulses or he will invest in expensive nonlegal self-commitment mechanisms that not only increase the cost of his altruism but recreate the donee's opportunity to exploit him!

When altruistic behavior injures a third party, judicial intervention may be justified. This is true both for commercial transactions and for gift-giving, but, as I suggested earlier, third-party effects are likely to be more serious for at least some gratuitous transfers than for commercial exchanges. In the case of commercial exchange, the desire for material gain leads one to the market, where mechanisms arise to internalize third-party effects. In the case of gift-giving, however, markets rarely exist. Indeed, a historically important source of litigation arises from the practice of wealthy patriarchs giving gifts to paramours and to charities,

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breach will go to the transferee, whereas the liability rule gives the promisee some lesser amount. For a discussion, see Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713 (1996).

65. The discussion has also not explained whether gratuitous transfers should receive the same amount of protection or less protection than non-gratuitous transfers. It seems likely that protection for both transfers should be in the form of a property rule, and thus protection for each is the same. Both kinds of transferee are likely to value the transferred goods more than both kinds of transferor, the common value of the goods is likely to be high, and judicial evaluation of transferred goods, whether or not they are gifts, is likely to be poor, because once used by transferees they are not susceptible to market evaluation. *See id.*

at the expense of their relatives. The problem is that children and, to a lesser extent, spouses cannot protect themselves in advance from this kind of behavior with contractual mechanisms. This probably explains why in some countries courts will reverse the transfer or some fraction of it at the demand of disinherited family members.<sup>66</sup> If the family members depend on the donor for their well-being, and thus have given up opportunities to support themselves, the transfer may injure them by a greater amount than it benefits the donor and donee. One can conceptualize the donation as a violation of a long-term contract between the donor and his family for support. The court voids the transfer because it violates the donor's obligations to his family.

The problem with this policy is that it interferes with the donee's reliance on gratuitous transfers. In a regime in which gratuitous transfers are often reversed, donees take costly precautions to protect themselves, especially when the value of the transfer is equal to a large fraction of their wealth.<sup>67</sup> An evaluation of the policy requires weighing this cost against the cost to the family members, and it is easy to see that different rules could evolve in different countries.

## 2. PROMISES

When analyzing contract rules, one must take account of the various incentives parties have to engage in suboptimal behavior. These include incentives to make gratuitous promises, to breach them, to take precautions, and to rely on promises.<sup>68</sup> For example, when a donor thinks about promising to buy the donee a car, the level of damages will (in theory) affect (1) whether the donor makes the promise in the first place and how carefully he states the conditions under which he may revoke the promise; (2) whether the donor breaks the promise; (3) whether the donor takes steps to ensure that it will not later be in his interest to break the promise (for example, putting the money in the bank rather than anticipating a rise in the value of his stock portfolio); and (4) whether the donee incurs costs in reliance on the promise (for example, renting out garage space in anticipation of receiving the car). I also will discuss an argument made by Shavell concerning the promisor's

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66. See DAWSON, *supra* note 48.

67. See discussion *infra*.

68. For a discussion of the economic analysis of contract damages, see Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 630 (1988). The literature is too vast to cite; excerpts and citations can be found in FOUNDATIONS OF CONTRACT LAW 41-138 (Richard Craswell & Alan Schwartz eds., 1994).

incentives to “masquerade,” which refers to the donor’s incentive to promise to convey the car even when he has no intention of doing so.

**Making promises.** When a promisor makes a promise, he conveys valuable information to the promisee, namely, that the promisor plans to convey resources to the promisee at some future time. The promisee can increase the value of the transfer to himself by shifting his position in anticipation of the conveyance (i.e., incurring “reliance costs”). If the promise is altruistic and gratuitous, this shift in position benefits the promisor, because it allows him to convey value to the promisee at less cost than if the promisee did not shift his position. At the same time, when the promisor makes a promise, he takes a risk that at the time of performance he will prefer to break the promise—as when the value of the goods unexpectedly increases or the promisee shows ingratitude. If promisors can breach at no cost, then they do not bear the risk, but then the promisee bears the risk that his reliance costs will be wasted. If the promisor cannot breach or is punished for breaching, then the promisee does not bear any risk, but the promisor does. The proper level of damages would give the promisor an incentive to make promises only when doing so maximizes the gains to him (from the promisee’s gain) and the gains to the promisee (from performance) net of the costs incurred by either when the risk materializes. As Goetz and Scott show, this level of damages should roughly equal the promisee’s opportunity costs. The reason is that this level of damages forces the promisor to internalize the costs he imposes on the promisee, with the result that he will take “precautions” (by not making promises or by adding conditions to the promises that warn the promisee of contingencies under which the promisor reserves the right not to perform) that minimize the risk that the promise will lead either the promisor or the promisee to incur a loss.<sup>69</sup>

In the commercial context, the promisee’s opportunity cost is usually the market value of the promise, which is the same as expectation damages. It is true that if breach occurs immediately after the promise, the promisee’s reliance is sometimes minimal; but it will at least include the opportunity cost of not obtaining an identical promise from someone else. In the case of gratuitous promises, however, the promisee’s opportunity cost is likely to be considerably lower than the market value of the gift. The reason is that a promisee usually does not give up some other promise by accepting a gratuitous promise; and while he may shift

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69. Two qualifications should be mentioned. First, the optimal level of damages is the donee’s reliance costs discounted by a variable reflecting potential beneficial reliance that results from gratuitous promises. This variable can be ignored because it does not change the analysis in the text. Second, the optimal level of damages is the donee’s efficient reliance, not his actual reliance. See Goetz and Scott, *supra* note 1. Donee’s reliance incentives are discussed subsequently.

his position to some extent in anticipation of performance, this shift is unlikely to approach the value of the gift, unless the value of the gift is large relative to the donee's wealth.<sup>70</sup> Accordingly, everything else being equal, the victim of a breach of a gratuitous promise should receive lower damages than a victim of a breach of a non-gratuitous promise. In particular, the proper level of damages for the gratuitous promisee should be less—sometimes considerably less—than the market value of the gift.<sup>71</sup>

*Breach.* A standard result is that the expectation measure deters inefficient breach. Under the efficient breach theory the promisor should breach only if he values the promised goods more than the promisee does. If the promisor is required to pay damages equal to the difference between the contract price and the value the promisee attaches to the performance, then the promisor will breach only if he values the promise more than the promisee does. This amount is equal to expectation damages.

In the commercial context, the promisee is likely to value the performance more than the cost of performance or the market price. The reason is, of course, that the promisor paid at least that amount. In contrast, the gratuitous promisee will not value the performance more

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70. See Eisenberg, *supra* note 2, at 3. To see why, imagine the indifference curves of a donee, with present consumption on one axis and future consumption on the other. Assume the donee has wealth of \$100. In the absence of a gift, and assuming away interest rates and the like, he will likely consume \$50 in the present period and \$50 in the future period. Now suppose that donor promises to give donee \$50 in the future period. Donee would adjust by consuming \$75 in the present period, in anticipation of spending \$25 of savings plus the \$50 gift in the future period. If donor breaches, donee's reliance costs are less than \$50. The reason is that while donee gets \$50 less in period two than he would have in the absence of the breach, he also spent \$25 more in period one than he would have in the absence of the promise. Although donee would prefer spending \$50/\$50 to \$75/\$25, he also would prefer \$75/\$75 to \$50/\$50—thus a \$50 award overcompensates donee for his shift in position. The reliance cost is somewhere between \$0 and \$50, depending on the shape of donee's indifference curves. For a more detailed discussion, see Goetz & Scott, *supra* note 1. An illustration of this point is *Mills v. Wyman*, 20 Mass. 207 (1825), where the court refused to enforce a man's promise to a Good Samaritan to repay the latter for his expenses in caring for the man's son. The promisee did not, as far as the opinion reveals, incur any costs as a result of the promise, since the good deed had occurred prior to the promise, nor did he give up the opportunity to accept some other promise as a result of the man's promise: thus, the promisee's opportunity cost was likely zero.

71. For example, suppose parents promise to give their wealthy child \$1000. By accepting this promise, the child does not give up an opportunity to obtain gifts from other people, nor is it likely that the child would adjust his position in a disadvantageous way by taking on more debt or otherwise shifting his finances. So a breach would cause virtually zero reliance costs. See Goetz and Scott, *supra* note 1.

than its market price and likely will value it less than its market price.<sup>72</sup> Because the gratuitous promisee has not offered to pay for the performance, there is no reason to believe that he values it at its market price. Accordingly, although expectation damages is the correct measure to deter inefficient breach of both gratuitous and non-gratuitous promises, this damages measure should on average produce a lower award for gratuitous promisees than for non-gratuitous promisees.<sup>73</sup>

*Taking precautions.* The standard analysis also indicates that expectation damages ensure that the promisor will take the efficient level of precaution. If, for example, breach of promise will cost donee \$1000, the chance that a decline in the value of donor's stock portfolio will prevent him from keeping his promise is 10%, and moving money from the portfolio to a bank account would cost the promisor less than \$100 in foregone returns while reducing the chance of breach to zero, then the promisor should move the money to the bank account. The reason is that the cost of the precaution is less than the expected loss. Expectation damages will cause the promisor to take such a precaution, since he would rather incur the cost of the precaution when it is less than the expected value of compensation.<sup>74</sup>

Although expectation damages are necessary to ensure efficient precaution for both gratuitous and non-gratuitous promises, the resulting award should on average be higher for breach of non-gratuitous promise than for breach of gratuitous promise. The reasoning is the same as that in the discussion of breach. Because gratuitous promisees value gifts less than non-gratuitous promisees value performances they pay for, the amount of money necessary to compensate the gratuitous promisees for breach is less than the price of the gift, whereas the amount of money necessary to compensate the non-gratuitous promisees equals the price of the commodity (minus, of course, the consideration if not yet issued).

*Reliance.* The commercial promisee has an incentive to overrely if he expects to receive damages that compensate him for actual reliance costs. The reason is that such a damages rule externalizes all of the

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72. Trebilcock makes the general point that the efficient breach analysis changes when applied to gratuitous promises. See TREBILCOCK, *supra* note 1, at 186. However, the problem is not, as he seems to imply, that opportunity costs differ.

73. Some commentators point out that if parties can renegotiate at low cost, the choice of damage remedies for breach does not matter. See Craswell, *supra* note 68 (for a discussion and critique). It is odd to think of an altruistic donor and donee engaging in such renegotiations after the donor threatens to breach the promise (e.g., the donee offering to pay some minimal sum in order to induce the donor to change his mind). Whatever the reason for this (one possibility is discussed above), it suggests that renegotiation costs are higher for gratuitous promises than for non-gratuitous promises.

74. See *id.* at 646 (and cites therein).

downside risk of reliance on the promisor. One solution to this problem is a rule of zero damages, which forces the promisee to internalize the costs of reliance, but because a zero damages rule gives the *promisor* the wrong incentives, it is generally thought that the optimal damages rule would compensate the promisee only for the losses that he would incur from breach if he had engaged in the efficient level of reliance. This amount could, of course, be high or low, depending on circumstances. In contrast, the gratuitous promisee has an incentive to overrely under any damages rule, even a zero damages rule. The reason is that the altruistic promisor cannot credibly commit himself not to convey a promised gift.<sup>75</sup> Everything else being equal, then, damages for breach of an altruistic gratuitous promise should be as low as possible, whereas damages for breach of a commercial promise will frequently be relatively high.

*Masquerading.* Recall that because gift-giving is often taken as a signal of an intention to create a trust relationship, opportunists have an incentive to mimic this signal even if they have no such intention. Similarly, they have an incentive to promise to give a gift even if they have no intention to keep the promise. Shavell argues that if the donor who breaches a gratuitous promise does not have to pay damages, then donors generally have no way of distinguishing themselves, through promising, from a person who makes a gratuitous promise with the intention of violating it (a "masquerader"). As a result, donees will not rely adequately on gratuitous promises (for fear of losing their investment should a breach occur), and they will gain less than they would if they did rely adequately. In response, altruistic gratuitous promisors will make fewer promises because donees gain less from the promises. To prevent this suboptimal result, contract law should award damages to victims of breaches of gratuitous promises.<sup>76</sup>

Shavell's analysis does not show that expectation damages are necessary to deter masquerading. It shows just that some level of damages is necessary, the precise level depending on the proportion of masqueraders in the population. A low level of damages or even just the chance of a low level of damages may be sufficient to deter masqueraders. Thus, to the extent any adjustment in contract damages may be necessary, it would not be different in the two contexts, and it does not affect the conclusion that damages should on average be higher for breach of contract than for breach of (altruistic) gratuitous promise.

*Summary.* Two conclusions have been reached. First, the transferee deserves more legal protection than does the promisee in the cases of both

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75. See Shavell, *supra* note 1, at 404.

76. See Shavell, *supra* note 1.

gratuitous and non-gratuitous transactions. Gratuitous transferees might deserve slightly less protection than do non-gratuitous transferees, because of the danger to family welfare posed by extra-family altruism. Second, the non-gratuitous promisee should on average receive more damages for breach of contract than the gratuitous promisee should receive for breach of promise.

These conclusions are reflected by American law in a rough way. (1) Gratuitous transferees do receive more protection than gratuitous promisees. (2) Gratuitous promises are not enforced as routinely as non-gratuitous promises. Sometimes, courts simply refuse to enforce gratuitous promises. Often they enforce gratuitous promises only if the promisor satisfies formalities that are unnecessary for the enforcement of non-gratuitous promises. (3) It is not so clear how one should characterize damages. For non-gratuitous promises, the usual level of damages is expectation damages—the difference between the value of promise to the promisee and his position as a result of breach. For gratuitous promises, courts sometimes award the market value or the cost of the promise, and sometimes instead the costs the promisee incurs in anticipation of receiving the gift. The value of the promise is likely to overstate the gratuitous promisee's expectation, since the promisee will value the goods at less than their market price. The costs incurred in anticipation will usually understate expectation. At any rate, taking (2) and (3) together, it seems accurate to say that the expected value of the gratuitous promisee's remedy for breach is less than the expected value of performance.<sup>77</sup>

### C. Status-Enhancing Gifts

To analyze the legal treatment of status-enhancing gifts, we must make a series of assumptions about their social utility and the problem of distinguishing different kinds of gifts.

Begin by assuming that courts and parties can perfectly distinguish status-enhancing gifts and other kinds of gifts. If status-enhancing gifts are unambiguously socially harmful, then it might appear that courts should not enforce them, instead striking down gratuitous promises and

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77. Kull claims that gratuitous promises are generally enforced. Kull, *supra* note 2, at 40-46. It is clear from his discussion, however, that they are not enforced as routinely as are commercial promises. For example, courts are more reluctant to enforce gratuitous promises when they are oral and not specific. See, e.g., *Congregation Kadimah Toras-Moshe v. Deleo*, 540 N.E.2d 691 (Mass. 1989). The same is true in continental European countries, in which gratuitous promises are enforced so long as costly formalities are satisfied and so long as certain substantive requirements are met (the donee may not act with ingratitude). See DAWSON, *supra* note 48.

allowing transferors to revoke gratuitous transfers.<sup>78</sup> Such a policy would not injure promisees or transferees of altruistic gifts, because knowing in advance whether a proposed gift is status-enhancing, they would refuse to accept it and thus would not incur costs in reliance.

There are several problems with the policy, however. First, the social value of status-enhancing gifts is ambiguous, because they may contribute to the creation of public goods. Second, the refusal to enforce them may cause donors to substitute equally or more valueless behavior, such as conspicuous consumption, that cannot be so easily deterred. Conspicuous consumption recreates the prisoner's dilemma faced by the status seeker in the context of donation. Third, although it would be relatively costless for courts to refuse to enforce gratuitous promises, it may be costly for them to order and supervise the re-conveyance of property that has been transferred. In sum, although the argument in favor of discouraging status-related gift-giving is not decisive, the various inefficiencies associated with this phenomenon suggest that the state has less of an interest in protecting status-related gift-giving than in protecting ordinary commercial exchanges. Moreover, the state has a greater interest in refusing to enforce gratuitous promises than in forcing the re-conveyance of transferred goods.<sup>79</sup>

Now relax the assumption that courts can perfectly distinguish status-enhancing gifts and other kinds of gifts. If courts declined to enforce status-enhancing gifts but enforced altruistic gifts, they would occasionally err and enforce or strike down the wrong kind of gift. Thus, a hard line against status-enhancing gifts would reduce social utility by interfering with altruistic gifts—both discouraging donors from making them and discouraging donees from relying on them. Still, because some status-enhancing gifts are clearly socially costly and even some altruistic gifts are socially costly, the state has less of an interest in protecting gifts generally than in protecting exchanges, so the conclusion remains valid that the state should give less protection to gratuitous promises than to commercial promises. In addition, because interference with reliance by transferees of altruistic gifts is more costly than interference with reliance by promisees of altruistic gifts, the conclusion remains valid that the state should give more protection to gratuitous transfers than to gratuitous promises.

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78. For a discussion of the use of taxation to discourage status-seeking behavior, see Norman J. Ireland, *On Limiting the Market for Status Signals*, 53 J. PUB. ECON. 91 (1994); McAdams, *supra* note 22, at 83-91.

79. It is possible that a policy of strict enforcement of gratuitous promises would discourage gift-giving: if donors knew that they could not retract gratuitous promises despite changes in circumstances, they might be more reluctant to make them. See *infra* note 87.

#### D. Trust-Enhancing Gifts

The proper legal approach to a trust-enhancing gift depends on whether the gift is meant to signal a desire to enter or enhance a relationship of trust or is made to benefit the donee pursuant to a relationship of trust. For example, the recruiter for a university may take an applicant for a teaching position out to dinner in order to signal his interest in a long-term relationship; university officials may continue to treat even an employed professor to meals and other gratuitous benefits over time to signal their interest in continuing the long-term relationship. These “signaling” or “formal” gifts are distinguished by the fact that usually they cost the donor more than they benefit the donee. In contrast, the university gives the professor regular raises even though he has become locked into the community and cannot leave except at high cost; and the professor continues to produce work that enhances the university’s reputation even though he would prefer to substitute leisure. In both cases, each party’s action can be considered an “exchange” or “informal” gift that is jointly maximizing. These gifts are distinguished by the fact that they cost the donor less than they benefit the donee. Although they are perhaps not properly thought of as gifts at all, in the sense that each party implicitly agrees *ex ante* to engage in all jointly-maximizing actions, these actions look like gifts because the *quid pro quo* is invisible. The academic is not paid when he publishes a new article; nor is the academic explicitly obligated to publish a new article after the university gives him a raise. The looseness of the arrangement, however, should not conceal the definite economic value of this relationship to both parties.

*Signaling Gifts.* At first sight, one might believe that because signaling gifts perform the socially valuable function of allowing cooperative people to match up with each other, the state should not discourage them. If a donor could always revoke a gift, the transfer of a gift is not costly to the donor, and therefore the gift does not signal the donor’s interest in a long-term relationship. A rule denying promisees protection from breach of gratuitous promise would also interfere with signaling gifts, because the ability to make a binding gratuitous promise allows the promisor to commit to incurring greater costs than he can currently afford.

However, the conclusions reached earlier suggest that the story is a great deal more complicated. The signaling function of gifts implies the possibility of inefficient equilibria—too many people give gifts, or very expensive gifts, in order to avoid the risk of being thought untrustworthy. The extravagant treatment of summer associates by law firms during the late 1980s may illustrate this phenomenon.

It is doubtful that the law can do much about this problem. The conditions under which signaling equilibria are efficient or inefficient are

too difficult for courts to identify. If judicial intervention produces no value, then it is reasonable for courts to resist appeals for help. Courts' refusal to enforce gratuitous promises and refusal to revoke gratuitous transfers seems, in this context, to be sensible. And the desirability of this stance is supported by the fact, noted earlier, that optimal reliance is higher for transferees than for promisees.

*Exchange Gifts.* Transfers and promises made pursuant to a trust relationship are economically valuable and should not be discouraged. That courts should not interfere with these transactions, however, does not mean that they should enforce them. If the trust relationship deters opportunistic behavior, courts should not intervene at all. Courts should neither intervene to allow a transferor to revoke a transfer nor intervene to allow a promisee to compel performance.<sup>80</sup>

If trust relationships worked perfectly, however, parties would never sue each other. Because the parties have better information than courts, and adequate nonlegal sanctions, they would always prefer to resolve disputes outside court. Either people in trust relationships never sue each other or trust relationships do not work perfectly. The latter is more consistent with observed behavior.

One way to explain why parties that appear to be in trust relationships might sue each other is to note that two parties in a single long-term relationship are likely to obtain the largest gains by exchanging a mix of legally enforceable and legally unenforceable promises. For example, the tenured academic can successfully sue the university for violating its promise never to fire him, but the academic probably cannot successfully sue the university for failing to give him regular salary increases or for giving him onerous committee assignments. This mix of enforceable and unenforceable promises reflects the judgment of the parties that a court, with its superior sanctions but inferior information, could do a better job of deterring extreme cases of opportunism but not minor cases of opportunism.<sup>81</sup>

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80. TREBILCOCK, *supra* note 1, at 178, and Goetz & Scott, *supra* note 1, both discuss the importance of nonlegal sanctions in exchange relationships. However, both discussions appear to assume that trust is important only for intra-family transactions, whereas I claim that it is important in business transactions. Moreover (and relatedly), both articles appear to assume that nonlegal sanctions are effective only when parties are connected by ties of altruism, whereas I claim that nonlegal sanctions play an important role even in the absence of altruism. An alternative approach sees trust as not related to exchange, so much as an aspect of affective relationships, which would be destroyed if subject to legal oversight. See Melvin Eisenberg, *The World of Contract and the World of Gift* (1997) (unpublished manuscript, on file with the author).

81. To be more precise, parties can generally observe more information about performance and surrounding conditions than can be verified by courts. Accordingly, so long as nonlegal sanctions are effective, parties can allocate obligations among future

When the parties sue each other, the value-maximizing court must distinguish between intended legal and nonlegal promises. To be sure, parties can facilitate this judgment by stating clearly in the contract which promises are meant to be legally enforceable and disclaiming those that are not. The costs of anticipating contingencies and accounting for them, however, prevent the parties from describing all enforceable and nonenforceable promises in the contract. Accordingly, a default rule is necessary for the purpose of determining the enforceability of promises about whose enforceability the contract is silent.

One candidate for such a default rule is the consideration doctrine. Although often understood today to mean that gratuitous promises are not enforceable, the consideration doctrine has historically had a different meaning. Under the consideration doctrine, a promise was enforceable only if motivated by a *specific*, or bargained for, performance or return promise. A promise might be unenforceable under the consideration doctrine just because it was a gift promise; but it also could be unenforceable because the return performance or promise could not be clearly identified. Thus, the consideration doctrine forbade the enforcement not only of gift promises, but also of requirements and output contracts, firm offers, contract modifications, and other promises made in return for something that was too vague. Courts might have resisted enforcing such promises because of the difficulty of proof. More likely they resisted enforcement because they feared that if they did enforce such promises, it would be too easy for people to make a fraudulent claim that someone had made a promise that never in fact occurred (in this respect, the consideration doctrine is a contract formality like the Statute of Frauds).<sup>82</sup> But it is also possible that courts understood that for complex and indefinite contracts parties could deter opportunism through nonlegal mechanisms more effectively than the courts could. Doctrines that prevent judicial enforcement are justified on the grounds that judicial enforcement would interfere with trust relationships.

In this respect, we see the convergence of the idea that a gift is part of an indefinite exchange and of the idea that the consideration doctrine prohibits the enforcement of indefinite exchanges. The consideration doctrine prohibits the enforcement of gift promises not because of a policy against gift-giving—not because gift-giving is “sterile” or socially undesirable—but because courts want to encourage parties to be specific

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states of the world more discriminately if they rely on nonlegal enforcement than if they rely on legal enforcement, and thus can obtain greater gains from trade.

82. See Eric A. Posner, *Norms, Formalities, and the Statute of Frauds: A Comment*, 144 U. PA. L. REV. 1971 (1996).

about the content of their exchanges in order to ease the judicial burden of interpretation. Similarly, courts resisted enforcing firm offers and requirement contracts not because they were socially undesirable, but because, like gift exchanges, they were vague. But judicial convenience had to give way to commercial exigency. It was gradually realized—or, at least, believed—that parties would prefer the uncertainty of judicial enforcement of vague terms, to the certainty of nonenforcement. Thus over time courts yielded to entreaties to enforce vague contracts. Whether courts will treat gift promises in a similar way remains to be seen—but clearly whether they should do so depends on how valuable these gift promises would be if they were enforced.

The disadvantage of any contract formality is that it creates transaction costs, discouraging value-maximizing contracting. When parties must comply with legal requirements, they may no longer find a contract desirable. Formalities, like all legal rules, suppress socially valuable behavior as well as socially costly behavior. The consideration doctrine's historical prohibition on the enforcement of all "gratuitous" or indefinite promises, including gift promises, contract modifications, firm offers, and so on, was rational if these sorts of promises were rare and of little value, and contract fraud was a serious problem. The progressive narrowing of the consideration doctrine over the years, so that it no longer bars firm offers and modifications, may have resulted from the perception that the value generated by enforcing these transactions in fact exceeded the losses resulting from the fraud and error routine enforcement would permit. Whether the consideration doctrine should be narrowed further so as to permit judicial enforcement of informal gift promises is a difficult, empirical question.<sup>83</sup> My analysis suggests that gift promises are sufficiently different from commercial transactions generally, and sufficiently problematic, that further narrowing should occur only with circumspection.

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83. This question has consumed the attention of many commentators such as Eisenberg, *supra* note 2; Lon Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 799-800 (1941); and Gordley, *supra* note 2. These commentators also believe that the consideration doctrine serves the important purpose of ensuring that the donor has engaged in sufficient deliberation.

*E. A Note on Gifts and Fraudulent Conveyances*

Stylized facts, drawn from a recent case,<sup>84</sup> raise an interesting question about fraudulent conveyance law. Donor runs a Ponzi scheme from which he earns \$20,000. He spends \$10,000 on various goods and services and he donates another \$10,000 to a church of which he is not a member. The issue is whether the donation to the church is a fraudulent conveyance.

Fraudulent conveyance law makes a distinction between conveyances for which the debtor receives a fair consideration and conveyances for which he receives little or nothing. If the debtor buys a car for \$20,000 without any intention of defrauding his creditors, the sale is not reversed under fraudulent conveyance law, although the car can be recovered by the creditors. If he gives \$20,000 to his best friend without any intention to defraud his creditors, then the gift is reversed. The purpose of fraudulent conveyance law is to prevent debtors from hiding assets with friends or relatives, and then obtaining them after creditors have given up the chase.<sup>85</sup> This purpose follows from the plausible theory that most debtors would give up their ability to hide assets in anticipation of default in return for a lower interest rate.<sup>86</sup>

Fraudulent conveyance law thus assumes that the average donor (the debtor) and donee have a trust relationship. If they did not, the donor could not expect to recover the goods after the creditors gave up the chase. But in our hypothetical case the donor and the church do not have a trust relationship. The motivation of the donor was altruism or, possibly, status-enhancement. In either case, the donor will not be able to obtain his funds from the church after he gets out of prison. The policy of fraudulent conveyance law does not justify revocation of the gift.

One might respond that the policy of fraudulent conveyance law is, on the contrary, simply to maximize the value of the debtor's estate. But

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84. See *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995). A similar case is *Christians v. Crystal Evangelical Free Church*, 82 F.3d 1407 (8th Cir. 1996), where the court held that donations (based on tithing) to a church were a (constructive) fraudulent conveyance. The court pointed out that while the donor may have gotten benefits from the church, they would have gotten them whether or not they donated. *Id.* at 1415. There was no quid pro quo (motive was something akin to altruism). *Id.* However, the court held that application of fraudulent conveyance law violated the Religious Freedom Restoration Act. *Id.* at 1420.

85. This was apparently the purpose of the original fraudulent conveyance law, the Statute of Fraudulent Conveyances, 13 Eliz., ch.5 (1571) (Eng.).

86. See Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985); a critique can be found in David Gray Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. 643 (1987).

if the debtor purchased and consumed a plane ticket with the \$10,000, the airline does not have to repay the creditors. Perhaps this is so because it is cheaper for the creditors to screen against fraud or, more specifically, take precautions to ensure that they do not lend to people who are likely to commit fraud, than it is for airlines to screen against payments out of funds tainted by fraud. But if this is true about airlines, it is also true about charitable organizations.

## V. CONCLUSION

So maybe Waldfogel is right. It is possible that people would be better off if they did not give each other gifts, or, at least, did not give each other gifts in certain narrow contexts. But it is also the case that in other contexts the giving of gifts serves important personal, economic, and social functions. The distinction between these contexts is so subtle that the legal implications of the analysis must be drawn with great care.

Taken together, the arguments in their strongest form suggest that courts should not enforce gratuitous promises as routinely as they enforce commercial promises. This conclusion is based on the following propositions: (1) that status-enhancing and "exchange gift" promises should not be enforced, even if altruistic and "signaling" promises should sometimes (but not always) be enforced; (2) that altruistic and signaling promises, when they are enforced, should result in lower levels of damages than should non-gratuitous promises; (3) that courts cannot reliably distinguish the different kinds of gratuitous promises; (4) that given a set of commercial promises and gratuitous promises that do not violate standard policy restrictions, such as the policy against price-fixing or against coercion, the commercial promises are likely to be more socially valuable than are the gratuitous promises. The arguments also suggest that gratuitous and commercial transfers should be treated roughly similarly. It should be emphasized, however, that the arguments rely on a large number of empirical assumptions, as noted in the text, which some may find plausible but others may not.<sup>87</sup> If these assumptions are doubted, the arguments are nevertheless useful for providing a framework to guide future empirical investigation.

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87. In particular, if gift promises are on average socially undesirable, a policy of fully enforcing gratuitous promises might be justified, on the grounds that people would be reluctant to make gratuitous promises if they expected courts to award full expectation damages in case of breach. My thanks to Louis Kaplow for pointing this out to me. But this argument is another way of saying that if gifts are undesirable, they should be taxed—either through the imposition of overcompensatory damages for breach of contract, or, more plausibly, through the tax system.

I hope to have shown that one can analyze legal issues adequately only by taking account of “soft” phenomena, such as altruism, trust, status, and, as I have argued in other work, social norms and group solidarity.<sup>88</sup> In the past, doctrinal and sociological scholars have taken these phenomena more seriously than economists have, but this is not because anything about the economic methodology disables economists from analyzing them. On the contrary, much recent economic work outside of law and economics deals with these phenomena. If it is now apparent how this work can be used to shed light on legal issues, this article will have achieved its main goal.

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88. See Posner, *supra* note 29; Eric A. Posner, *Efficient Norms*, THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS AND THE LAW (Peter Newman ed. forthcoming 1998); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1647 (1996); Eric A. Posner, *Symbols, Signals, and Social Norms in Politics and the Law*, 27 J. LEGAL STUD. (forthcoming 1998).

