Payments Industry Should Lead the Charge in Interchange Wars

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Google fired the latest salvo in the interchange wars last week by filing an antitrust suit against MasterCard and Visa in Texas federal court. The move is doubly ironic. Google enjoys greater market share in search queries — 67% — than either MasterCard or Visa have in the general-purpose payment network market. And like MasterCard and Visa, Google serves a two-sided market and employs asymmetric pricing — charging advertisers but not search users — to maximize value and revenue. This last point sets Google apart from traditional Goliath retailers like Home Depot and Wal-Mart, which are implacably hostile to interchange.

Google's suit is but one engagement in a multi-front global war on interchange. Since Visa's 1984 victory in the NaBanco interchange antitrust case, retail payment networks have been beating a worldwide retreat. In the years since 2002, the European Commission, Reserve Bank of Australia and Bank of Mexico have all clamped down on interchange, along with the U.S.

It's high time the payment networks tried to retake ground and put advocates of regulating payment networks as public utilities on their heels. Repealing the Dodd-Frank Act's interchange price controls — also known as the Durbin Interchange Amendment — would be a good place to start.

The coming year presents an opportunity for the payments industry to do just that.

In December, as part of the omnibus spending bill, the lame-duck Congress repealed Dodd-Frank's swap push-out rule. The rule had banned swaps entities from receiving Federal Deposit Insurance Corp. insurance or having access to the Fed's discount window. It was the first brick removed from the enormously destructive Dodd-Frank law, which economist Robert Genetski estimates will cost the U.S. economy $200 billion annually.

In 2015, the Republican Congress will continue to try to chip away at Dodd-Frank. Their goals will likely include substituting a proven, transparent bankruptcy process for the FDIC's authority to liquidate — and de facto bail out — failed financial behemoths. They will also attempt to put limits on the Financial Stability Oversight Council's ability to designate any financial business as systemically important, and to rein in the unchecked Consumer Financial Protection Bureau. The payments industry should push to get Durbin repeal on the Republicans' target list.

Price controls harm businesses and consumers. They lead to misallocation of resources and product shortages. Moreover, prices allocate scarce resources to the places where they are most highly valued. That's why payment networks use interchange to balance participation by consumer and merchants on the spend and acceptance sides of the network respectively, thereby maximizing transactions and total value.

Congress understood that price controls were harmful back when it passed the Durbin amendment. That's why it exempted politically sympathetic small banks, government benefit cards and general-purpose-reloadable prepaid cards. During the run-up to the rule's passing, only regional debit issuer TCF made an effort to warn voters about its negative effects.

These negative effects are borne out in the market. Capping interchange puts a damper on innovation by eliminating funding for new business models and cardholder benefits. Interchange has fueled a number of advancements by traditional and nontraditional issuers, including Apple Pay, a raft of prepaid cards, Flexible Spending Account and Health Saving Account cards, and a host of reward programs that consumers love. Moreover, debit interchange price caps have forced banks to increase checking account fees, reducing the DDA availability for the less affluent.

Captains of the payments industry have had little appetite thus far for pushing back against the rule. Their efforts were limited to lobbying the Federal Reserve for an accommodating implementation of Dodd-Frank's interchange price controls and the requirement merchants have debit routing choice. Visa's chief executive Charlie Scharf said at a KBW Financial Services conference in February that the company has no affirmative strategy to repeal the rules. He noted that repealing legislation is difficult and that the company was working with regulators to mitigate the harm it might cause.

It's time for the payment industry to adopt a full-throated advocacy of free-market competition. Google, MasterCard and Visa enhance merchants' profitability, or else merchants wouldn't use them. All three companies therefore should be free to price their products and services as they see fit.

The payments industry should make a public, affirmative case for repealing interchange price controls and for the freedom to compete, innovate and serve its customers. The industry's best chance of success is to underscore the pro-consumer nature of the repeal. No one on either side of the political aisle wants to be perceived as anti-consumer.

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