So what if banks push fancy cards? Give consumers the steak they want.

By Eric Grover

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The estimable Mallory Duncan, general counsel for the National Retail Federation, wants card-acceptances fees for merchants lower than they can get in the market. He criticizes banks pushing reward-rich credit cards over debit cards, declaring, “If someone has a choice between [pushing] steak and beef stew, they make more money on steak, so they’ll push the steak.”

But why shouldn’t consumers have steak — with a grace period, rich rewards, an option to draw down credit anywhere, anytime, and global acceptance and access to cash — if they prefer it? Government price controls of payment-network fees consign consumers to watery beef stew.

Duncan attacks banks for making “monopolistic fees on credit cards.” Consumers with a wallet chock full of credit and debit cards understand the charge is risible. Credit-card competition is fierce.

Networks Visa, MasterCard, American Express, PayPal, Discover, Star, NYCE, and Accel all directly or indirectly compete for consumers, as do a multitude of banks including Chase, Citibank, Bank of America, and Capital One for pride of place in our digital and leather wallets. From 2010 to 2016, America’s six largest credit-card issuers wooed cardholders with $110 billion worth of rewards.

For more than three decades a global war has raged over fees merchants pay to accept payment cards. Those believing payments should be regulated like public utilities have framed the issue and since its 1984 victory in the Nabanco case the payments industry has beat a slow retreat, managing restrictions on fees and practices.

The price controls under the Dodd-Frank Act's Durbin amendment permit interchange-recovering circumscribed debit-issuer costs — a public utility model to minimize merchant costs. However, politically sympathetic government benefit cards, general purpose prepaid cards used by the unbanked and underbanked, and small banks are exempt, showing Congress understood price controls were harmful.

European regulators also aim to reduce merchant payments costs, initially pushing an issuer-cost-recovery model employed in 2012 when they forced Visa to reduce interchange, before switching to the "tourist test," which posits the optimal card-acceptance price is where a merchant selling to a tourist would be indifferent between cash and a payment card.

Large banks' debit cards subject to interchange price controls aren't even "beef stew." Price controls reduced free checking, issuer innovation, and consumers' use of debit cards. Bankrate.com's 2009 survey reported 76 percent of banks offered free checking. By 2015, only 37 percent of banks surveyed offered free checking with no conditions.

The Federal Reserve reported from 2003 through 2006, debit-card payments increased at a 17.5 percent compound annual growth rate, while credit-card payments increased at a 4.6 percent rate. From 2012 through 2015 debit-card payments increased at a 7.1 percent compound annual growth rate, while credit-card payments increased at a 8.4 percent rate. The signal change between these two periods was debit-interchange price controls implemented in 2011.

Since 2015, when interchange price controls were approved in the European Union, 70 percent of card product changes made by 78 EU issuers were unfavorable in terms of increased fees or reduced rewards.

Recent rulings however have started looking at holistic value. The Second Circuit U.S. Court of Appeals in February 2015 ruled that American Express' practice of charging merchants higher fees than those of Visa, MasterCard, and other card companies violated the Sherman Antitrust Act. The judges wrote, "The District Court erred here in focusing entirely on the interests of merchants while discounting the interests of cardholders."

In addressing merchants' core beef that they pay too much, the judges wrote, "Though merchants may desire lower fees, those fees are necessary

to maintaining cardholder satisfaction." The judges recognized cardholders, merchants and each transaction rely on an "interdependent" "multitude of economic acts and actors."

Payment-system prices work best when set in the free market by the interplay and vast intelligence of billions of decisions by cardholders, merchants, banks, processors, and networks, all dynamically allocating resources to their optimal use.

What's to be done? While a majority in Congress in principle oppose price controls, the issue, unfortunately, has been framed as picking sides between retailers and banks, which lawmakers prefer to avoid. This framework is a loser. The right framework is pro- or anti-free market and pro- or anti-consumer.

Repealing debit-network-interchange price controls could attract Democrat support. In 2011, a dozen Democratic senators including Chuck Schumer (D-N.Y.) and Mark Warner (D-Va.) voted for the Debit Interchange Fee Study Act, which was a proxy for those not fully on board with the price controls in the Durbin amendment.

It's time for the payments industry to play to win rather than not to lose. It must make an affirmative case in the public arena to be free to compete, set prices in the free market to maximize value, and deliver filet mignon to Joe and Sally cardholders.

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