Biden Will Seek Credit Card Fee Price Controls. Just Say No.

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When people pay for goods and services with credit cards, merchants incur fees. With the Joe Biden sworn in, and Democrats in control of Congress, tom toms to impose price controls on credit card companies have started beating. In“Banks keep piling credit card fees on retailers. Congress must act.” an opinion piece published in the *American Banker,* Alex Ellwood urges Congress to enact legislation regulating card-acceptance fees.

Consumers take for granted the enormous convenience, security, value, and innovation provided by America's payments industry. This has been all the more true during the Covid-19 pandemic, when critical electronic payment systems have worked without a hitch. It would be put at risk.

The payments industry is fiercely competitive. Nevertheless, efforts to regulate it like a public utility aren't new. In 2008, Senator Dick Durbin and Congressman John Conyers proposed capping card-acceptance fees. In 2010 Durbin managed to include price controls on large, politically-unsympathetic banks' debit-card fees in the Dodd-Frank Act.

Advocates of payment price controls make a straightforward case. Merchants will benefit if reduced fees are mandated by government. They'll pass their savings on to consumers. Everyone but the dastardly payments industry wins. It's not so simple.

The argument focuses on a single stage in the value chain: transaction costs at the point of sale. But, as the great French political economist Frédéric Bastiat observed, actions have seen and unseen consequences. Retailers' immediate windfall would be seen. There would be unseen harmful effects as well.

Market prices dynamically allocate resources to where they're most highly valued. They harness the vast intelligence of billions of decisions by hundreds of millions of US consumers, millions of merchants, thousands of banks and processors, and more than half a dozen major networks like Visa, Mastercard, American Express, Discover, PayPal, Star, and NYCE. It's beyond the ken of the cleverest and best-intentioned central planners. Price controls cause shortages and misallocate resources, thereby hurting consumers, always.

Charges merchants pay to accept credit and debit cards have three principal components: interchange paid to banks issuing credit and debit cards, processing and licensing fees paid to networks like Mastercard and Visa, and fees paid to their processors.

In the US, interchange is often the largest portion. It's used by two-sided payment networks to balance participation on both sides, of spend and acceptance, to maximize holistic value. More cardholder spending, begets more merchant acceptance, begetting more cardholder spending.

Retailers are more willing to pay for electronic payments generating sales, than consumers are willing to pay for paying to purchase. Consequently, interchange fees are collected from merchants and passed to financial institutions, issuing credit, debit, and prepay cards, funding issuer innovation, fee-free accounts, and a host of cardholder benefits.

The asymmetry of merchants paying more than consumers strikes some as unfair. However, many two-sided markets employ asymmetric pricing to maximize total value. Google, Bing, and Yahoo charge advertisers, not consumers searching. Bars sometimes offer women, but not men, free drinks. Interchange is paid by merchants to issuers and then, to a large degree passed on to consumers in benefits. That is so because consumers' payment preferences trump merchants'.

Suppose, however, consumers were indifferent, that they would happily defer to merchants' payment preferences. Interchange would plunge, as wooing merchants would be a path to capturing greater payments share. But ours is a world where Joe and Sally Sixpack's payment preferences count for more than Walmart's and Amazon's.

The empirical evidence of payment price controls' harm is strong.

In 2003 the Reserve Bank of Australia slashed credit-card interchange roughly 50%. CRA International observed, consequently, Australian cardholders' annual fees increased AUD 480 million, and the value of reward points decreased 23%, primarily in 2003 and 2004.

EU central planners imposed price ceilings of 30 and 20 basis points on credit and debit interchange, respectively, in 2015. Accenture (First Annapolis) surveyed changes EU bank issuers made from 2015 through 2017. Seventy percent of 275 card-product changes made by 78 issuers tracked were unfavorable in terms of increased fees and/or reduced rewards.

US debit-interchange price controls were implemented in 2011. Exempting community banks popular with Democrats and Republicans, they were more political in design than the EU's and RBA's interventions. In response to lost revenue, banks reduced free checking. Bankrate.com's 2009 survey reported 76% of banks offered free checking. By 2015 only 38% of larger banks surveyed offered free checking with no conditions.

Interchange has fueled a raft of issuer innovation including prepaid cards for the un- and underbanked, virtual cards turning payables into a profit center, healthcare cards, and neobanks. Capping it would suppress innovation. Imposing price controls on the entire merchant discount fee would stifle processor innovation and the supply of payment-acceptance to small merchants, which retailer Goliaths might not mind.

Advocates of government intervention to reduce card fees are trying to curry favor with merchants, a special interest, albeit a big one. Many also suffer the conceit that their guidance from on-high would be superior to the seemingly messy and chaotic market, with each party – consumer, merchant, bank, network, and processor, pursuing its own interest by its compass.

In his seminal Economics in One Lesson Henry Hazlitt warned it is a "sophism…to concentrate on the short-run effects of policies on special groups and to ignore or belittle the long-run effects on the community as a whole." The debate over regulating payment fees has done just that. Consumers have been ignored and banks, networks, and processors belittled.

Making the payments industry a public utility would put a damper on innovation and consumer value.

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