Comment on Rochet and Tirole's

The Welfare Impact of Interchange Fees

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Possible distortions in CP market

- Usage externality
  - By using card, buyer imposes externality on retailer.
- Acceptance externality
- Under a variety of conditions, supercompetitive IF may correct these externalities.

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  - By accepting card, seller creates option for buyer.
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Market power distortions

- For simplicity, consider extreme case:
  - One platform
  - Acquiring and issuing are cartelized ("monopoly")
- Buyer heterogeneity. Under reasonable conditions,
- Seller heterogeneity. Under reasonable conditions,
- Assuming away buyer and seller heterogeneity eliminates a potentially important source of distortionary effects.

Market power distortions

- For simplicity, consider extreme case:
- Buyer heterogeneity. Under reasonable conditions,
  - Monopoly IF implies higher retail prices and foregone efficient sales w.r.t. competitive IF.
  - Monopoly IF greater than socially optimal IF.
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Market power distortions

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Example: buyer heterogeneity

- Willingness to pay:
  - u_H for half the buyers
  - u_L for half the buyers
- Benefit from card use:
- f = merchant fees − "subsidy" to buyers.
- Zero production and network costs.
- Assumption: $0 < u_H - 2\,u_L < b_B$.

Example: buyer heterogeneity

- Willingness to pay:
- Benefit from card use:
  - $b_B > 0$ for all buyers
  - $b_S = 0$ for sellers
- f = merchant fees – "subsidy" to buyers.
- Zero production and network costs.
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Buyer heterogeneity (cont)

	Competition	Monopoly
f	0	b_B
p	$u_L + b_B$	$u_H + b_B$
Welfare	$\frac{1}{2}(u_H + u_L + 2\,b_B)$	$\frac{1}{2}(u_H + b_B)$

Summary

- Two-sided networks are complex systems.
- IF is not simply a fee for a service; it also helps balancing externalities.
- But Econ 1 still applies: Harberger triangles exist.
- Simple-minded cost regulation would be simple minded; but there is rationale for regulation.

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- Give me the result and I'll give you the model.
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Summary (cont)

- Give me the result and I'll give you the model.
- Need for empirical analysis. But is there any hope?
  - Actual data: very little variation in prices
  - Survey data: very problematic