Competition Policy in Card-based Payment Systems – Comments

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What we know so far

- **Important theme from this conference has been – what choice of policy instrument?**

- **Papers in this session:**
  1. Provide insights on concerns that can arise in card-based systems.
  2. Together with other contributions, highlight complexities and controversies around theory and evidence.

What we know so far

- **Some points of agreement;**
  1. Collective interchange fee (IF) setting more efficient (Simon);
  2. Socially efficient IFs depend on costs and demand elasticities;
  3. Actual IFs set differently from what social planner might choose (Simon and Frankel-Shampine);
  4. If interchange set too high, ‘no-surcharge’ rules may make distortion worse (Frankel-Shampine). BUT removing ‘no-surcharge’ may also permit free-riding; and
  5. ‘Honour all cards’ rule may make it attractive to set IFs too high. BUT rule can promote efficiency by reducing transaction costs.
- **However, by no means clear that there is market failure**

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Choice of policy instrument – what are the differences?

- **ECONOMIC REGULATION PRESCRIBES**
  - Specialist regulators
  - Greater powers of initiative
- **Greater institutional capability**
- **Long history of principal-agent problems**

- **COMPETITION POLICY PROSCRIBES**
  - Courts of law
  - Rules of evidence and procedure
- **Slower to adapt**

Cost of choosing regulation

- **Given principal-agent problems, desirability of regulation depends on meeting certain conditions:**

1. **Compelling grounds for believing markets will fail imposing material social costs.**
2. **Ability to objectively determine the right level of interchange.**
3. **Regulation may be quicker to adapt - BUT is on-going monitoring and adaptation required?**
4. **Effective means for curbing regulator's information rent, in particular, the potential for time-inconsistent behavior**

The Candidate: Card-based systems

- **Evidence of market failure far from conclusive, moreover there are formidable difficulties to determining ‘right’ IF.**

- **Regulator therefore would have little guidance - has even broader discretion and greater information rents.**

- **Particularly in jurisdictions where decisions not reviewed, perceived risk of time inconsistent decisions by regulator deters investment.**

The Candidate: Card-based systems

- **Costs of deterred investment large for card systems – greater scope for dynamic efficiency gains from investments.**

- **Given the information rents, is resulting lost efficiency greater than static gains from regulation?**

- **Guerin-Calvert/Ordover point out significant opportunity costs of benefits to merchant side – the results of long term investments by card systems**

Results: The Australian “experiment”

- Little guidance from economic analysis on method of IF setting so far – RBA has justified it on the basis that it was implementable (Simon).

- As theory predicts, RBA seems to have focused on transfers rather than any efficiency gains – some groups have gained while cardholders have lost.

- RBA now finds itself amidst expanding scope of regulation – different forms of debit, ATM cards and bill payment services.

- Clear competitive neutrality concerns exist with respect to the quasi-open schemes Amex and Diners.

Results: The Australian “experiment”

- **Competition policy may not be panacea, but many of Simon’s criticisms inaccurate.**
- **Valid questions about effectiveness of competition policy in this context**
- **No presumption that competition solves any of the major problems**
- **Significant issues about process:**
  1. Can *ex post* process of litigation create disincentive to abuse occurring?

  2. Is monitoring and enforcement/adaptation to changing circumstances important?

  3. How efficient are court decisions at providing wider guidance?

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Conclusions

- ***If* there was evidence of persistent market failure AND a clear standard to guide regulators then regulation *could* be superior.**

- **Standard prescription “First, do no harm.”**

- **Follow the lead of the NY Fed and pay close attention to the Australian “experiment.”**

- **…..and thank your Australian guinea pigs!**

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