Twin Concerns

• Low cardholder-side fees can boost demand even given high overall fees
  – Not just given high merchant fees

• High merchant-side fees harm consumers using other payment instruments
  – Under price coherence, prices to them rise
  – This externality also “raises rivals’ costs” in payment-instrument competition
One Methodological Plea

• Raising rivals’ costs and thus restoring allocative efficiency harmed by exercise of market power is worrying…

• Instead, implement customer sovereignty in two-sided market:
  – Help demand to respond to a payment instrument’s joint value (net of *prices*) to merchant and consumer
One Technical Result

• Roughly, merchant resistance will be based on joint value, not narrowly merchant-side value
  – Merchant internalizes customers’ net benefits
  – Doesn’t depend on merchant competition
  – More general but less complete than RT
  – How rivals’ prices change
Bias Implication

• If cardholder bases choice on one-sided value, no countervailing merchant side
  – CH benefits count twice, M benefits once

• Bias likely
  – A’s fees 4% on M, 2% on CH
  – B’s fees 7% on M, 0 on CH
  – M slightly prefers A, reflecting joint payoff; CH strongly prefers B
No bias if...

- CH also has incentive to maximize joint value
  - M is indifferent
- When transaction fees such that M is indifferent, both M and CH seek best joint deal
- When M prefers A, CH has excessive incentive to choose B over A
- CH bias toward instruments that are inefficient
  - Not same as saying CH prefers those
The Externality

• Given price coherence, increasing M-side fee for instrument A raises prices to those using other instruments
  – Negative externality on non-participants
    • Roughly equal to gain to participants in short-run
    • Contrast externalities on participants?
  – Raises rivals’ costs

• Also vanishes if M is indifferent
Policy Conclusion

Control of fee structures may help ensure competing systems comparable in M-side costs

Freedom to charge CH whatever seems appropriate

Relationship to cost-based interchange?
Antitrust Thoughts

• Above concerns relate to competition/spillovers between payment instruments
  – Not coordinated “price” setting within one JV

• JV typically analyzed relative to but-for competition involving members
  – Bilateral interchange? EFTPOS

• Perhaps laxer standard: JV does no harm on balance to nonparticipants
  – Bring down interchange where it causes above-average merchant acceptance costs