Efficiency and Competition Among Payment Instruments

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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