



Interchange Fees, Antitrust and Consumer Welfare

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Interchange Fees: Antitrust Primer

- Setting IF by “associations” (Visa and MasterCard) is literally “price fixing” by competitors (i.e., issuers)
- Price fixing normally illegal (“cartelization”)
 - Heavy burden on assoc to justify conduct as beneficial
 - Burden heavier if assoc has market power
 - Constraints on *non-members*’ prices is highly suspect (no-surcharge rules)
- Justification must involve increasing “consumer welfare”
 - “Allocative efficiency” benefit is not enough
 - Subsidizing a monopolist to increase output and reduce price is *not* a “cognizable” antitrust justification
- Default is “no price-fix” -- defendant loses ties.



Interchange Fees and Price Discrimination

- Interchange fees raise merchants' costs
- Merchants do not/can not surcharge card users
- Result is higher merchandise prices
- Card users get a partial pass-back of IF
- But, non-users (including cash customers) pay higher prices and get no pass-back benefits
- Bottom Line
 - IF are a "tax" on non-users, especially cash consumers
 - This "tax" is a "consumer harm" under US antitrust laws



Justification: Internalizing Network Externalities

- Empirical evidence to support claim is lacking
 - Canada – Debit usage exceeds US, despite lack of IF
- Issuers control networks; incentive to maximize profits, not consumer welfare
- Issuers spend a significant amount on advertising
 - But, mainly cannibalize other cards
- Issuing is highly profitable, suggesting only partial pass-back of IF to card users
 - Cardholders likely not very price elastic; APRs very cost insensitive
- Size of collective value of additional card holders to merchants as a group is unclear
- Cost externalization onto cash customers distorts incentives of credit card networks in setting IFs



Two Analogous Illegal Agreements

- Auto companies fix price of hybrids, and justify p-fix by saying that higher prices and profits will drive additional advertising to popularize hybrids, making dealers, consumers and the environment better off.
- Auto Co's join together and require gas stations to pay them a "tax" on every gallon of gasoline for hybrids. Enforce agreement by jointly "certifying" gas stations that pay.



No-Surcharge Rules

- Merchant surcharges on card users would eliminate price discrimination against cash customers
- But surcharges are unusual
 - Card network rules
 - Transaction costs
- No-surcharge rules by assoc. cannot be justified under antitrust laws
- Note: Negative impact of surcharges on behavior of card users may be over-estimated
 - ATM surcharges called “death” to networks when proposed
 - But, ATM surcharges are now ubiquitous