

# Fee change gets too much credit

By Joshua Gans  
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A REPORT (Business, 15/3) on the conference on payment systems at the Melbourne Business School this week gave the impression the Reserve Bank was under fire over credit card changes.

I spoke at the conference and that wasn't my impression. In 2003, Australia dramatically changed the regulation of the credit card system. Prohibitions on surcharges for transactions were removed, access to card schemes opened up and, most critically, the interchange fee — the fee banks pay each other to settle card transactions — was cut by half.

The last change was significant. Not only was the industry subject to price regulation, but it was a sharp change in a key price. Central banks make sharp changes all the time to interest rates, but for regulatory price-setting (for example, by the Australian Competition and Consumer Commission), it is unheard of.

The article gave the impression the predicted massive disruption to the industry happened. But that is hardly the case. According to Reserve Bank figures, credit card use has continued to grow, credit card debt has grown with it and the share of credit card use to Eftpos use has remained roughly constant.

The article suggested Eftpos was rising at the expense of credit cards. But this has only occurred in the past quarter, three years after the changes.

The most that might be said for dramatic change is that it is still to come. Professor Jean-Charles Rochet (speaking at the conference, and an influential academic in this area) raised this possibility, and the long-term effects on investment.

What the changes have potentially done is shift profits from card issuers (who deal with cardholders) to card acquirers (who deal with merchants). In this case, issuers will have a reduced incentive to invest in the system, while acquirers will have a greater incentive. Rochet's point is that we don't know if this is a good thing and should have been more cautious about regulatory intervention.

There is less to be concerned about in the long run than industry participants are making out. Specifically, the interchange fee is only one means banks might use to share costs of mutually beneficial investments. They could agree to alternative arrangements. These would not be built into the cost of transactions and be based on forecast profits, just as other businesses do. This should not deter investment that would assist the credit card system.

The main risk comes from taking regulatory intervention too seriously. There are so many alternatives that this one price doesn't matter. Regulatory uncertainty matters. Every time the price changes, there are costs on market participants. Some of this uncertainty comes from continuing RBA reviews. It would be better if regulators and participants could regulate the fee and move on.

For 20 years, the banks practised this. They then didn't do anything until the RBA and ACCC started sniffing around. The rigidity tells me the fee is not important as an instrument for changing circumstances; large-scale change occurred anyway. What we want to do is return to rigidity.

*Joshua Gans is professor of management (information economics) at the Melbourne Business School, University of Melbourne.*