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Congress Should Repeal The Durbin Amendment, Not Expand It To Credit Cards

Norbert Michel

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Americans have been using credit to buy things for just about as long as America has existed, but the consumer goods market has undergone massive changes. So, it's very easy to forget how the plastic cards that we rely on became so prevalent.

Unfortunately, forgetfulness won the day in last week's Senate Judiciary Committee hearing.

Supposedly a fact-finding mission about the fees that retailers pay when customers swipe their cards to make a purchase, much of the discussion made it seem like Visa V +1.8% and MasterCard recently swooped into America and took over the card network business. Obviously, that's not what happened, and the way the industry has developed should inform public policy.

Nonetheless, the proceedings made it quite clear that Senator Dick Durbin (D-IL) wants to extend price controls and routing mandates to the credit card market. (For those who don't remember, Durbin was the author of Section 1075 of the 2010 Dodd-Frank Act, also known as the Durbin Amendment, which placed interchange caps and routing restrictions on *debit* card purchases. Durbin also argued, at the time, that 1 to 2 percent interchange fees for *credit* transactions were "understandable because there is risk associated with it.")

The Durbin Amendment has not worked out so well for consumers–and Congress should have repealed it in 2017–but Durbin and his acolytes are not about to admit defeat.

No matter how much evidence exists that the credit card network business is highly competitive, the Durbin gang wants the public to believe a completely different story. Namely, Visa and MasterCard dominate the industry and use their power to charge absurdly high prices. And, of course, only Congress can fix the problem. (There is a very long history of lawsuits in this industry, with both sides winning and losing at various times, but merchants did not want to take their chances in court when people started relying more heavily on debit cards. Hence, the Durbin Amendment and the new push to expand it.)

All sides in this debate are looking out for their best interests, but there's good reason to be skeptical of the Durbin gang's narrative.

First, when the credit card market–rather than the combined credit and debit card market–is viewed separately, Visa has about a 50 percent market share (by volume), while MasterCard and

American Express AXP +2.9% have roughly 20 percent each. This structure has been similar since at least 2016, with Discover (the fourth largest card network) growing slowly and steadily.

When viewed, instead, by the share of Americans that have particular cards, Visa has less than a 50 percent share, MasterCard has less than 40 percent, Discover has 18 percent, and American Express has 15 percent. Visa certainly is the larger company, but there is no doubt that the networks compete for volume. In 2021, Discover gained 2 percentage points market share, and multiple fintech firms continued to provide new competitive threats to the industry's traditional payment methods.

Put differently, Visa and MasterCard do not dominate the credit card market in any objective sense.

Regardless, if Visa and MasterCard really are ripping off merchants, then there's an obvious solution: Start a card network and undercut their fees, taking all their business away.

There are roughly 150,000 convenience stores in the United States, more than 20,000 independent supermarkets, and more than 1 million retail establishments. If the Durbin gang is right, and it's so easy to run a card network while charging dramatically lower prices, these store owners are leaving billions on the table. So why not start a payments association, much like banks did to form the Visa network in the 1970s, and provide a direct competitor to the existing networks?

They'd probably make so much money that they could even stop paying the National Association of Convenience Stores (NACS) to advocate for lower merchant fees.

Of course, they probably should talk to the folks at Discover first.

In 1986, when Sears launched the Discover credit card to compete with Visa and MasterCard, it had no annual fee, offered cash back rewards, and charged zero merchant fees. That zero-fee feature was why Discover was the only credit card accepted at Sam's Wholesale Club.

Eventually, Discover gained widespread acceptance, but only after multiple missteps, losing millions of dollars, and changing their strategy. Discover now charges interchange fees of approximately 1.5 percent to 3 percent, not incredibly different from the rates that Visa and MasterCard charge.

The retailers should also probably talk to someone over at American Express, a company that also charges interchange fees of approximately 1.5 percent to 3 percent. And, of course, they should consult with the people at Venmo, the upstart payments company that charges merchants 1.9 percent.

At the very least, they'll get some extremely useful information about building and running a payments network in the United States.

It may seem as though I'm being unfair to the retailers, or maybe even naïve about Visa and MasterCard. But I'm being neither. There's no doubt that both sides are advocating for their own interests, and there is nothing inherently wrong with the NACS advocating for their clients.

Still, it's critical to keep in mind that the NACS is asking Congress to play judge and jury in the market rather than testing their ideas in the market. The card networks, on the other hand, are relying on the market to be their judge and jury.

They constantly test their price in the market, trying to balance the interests of all parties to determine how much they can charge, at the risk of losing business when they charge too much. That's as objective as we humans are going to get, and it is a primary reason that a free market is superior to a heavily regulated economy with government-imposed price controls and mandates. It does not mean that everyone will be thrilled with the price that they pay the card networks, but that's irrelevant.

I also have a hard time taking the NACS's position at face value for two reasons. First, their general counsel, Doug Kantor, asked Congress to consider getting rid of the networks' ability to force merchants to take all cards in their network. This request lays the naked self-interest completely bare–the NACS simply wants to get leverage; they do not care about saving consumers money.

If Congress takes away the networks' ability to force merchants to take all cards in their network, it will directly harm consumers and potentially threaten retailers. One of the main reasons that retail stores accept Visa and MasterCard for payment is because *any* consumer with a credit card in the Visa or MasterCard network can use it to buy something. The NACS is asking Congress to consider taking that advantage away from the networks and, therefore, consumers.

It is a basically a threat to make the Visa and MasterCard networks smaller and more local rather than larger and national. It would be interesting to know how many NACS members–especially those who sell gasoline along interstate highways–truly want that outcome.

My other problem with the NACS's position is that Kantor's written testimony twists the facts regarding a Kansas City Fed research paper. According to Kantor (see page 5):

Economists with the Kansas City Federal Reserve Bank have studied these fees and found that, in light of the central fee-setting structure and the competitiveness of U.S. retail, swipe fees will increase to the point that retailers may go out of business.

It is charitable to call this statement a mischaracterization. The research paper that Kantor cites unequivocally does not say that swipe fees will increase "to the point that retailers may go out of business." The paper simply presents a theoretical model that tries to "explain why merchants accept payment cards even when the fees they face exceed the transactional benefits they receive from a card transaction."

And here's what the paper comes up with:

Even monopoly merchants accept cards when their transactional benefits are lower than the fees they pay if they face an elastic consumer demand. They do so not because they have a strategic reason but because card acceptance shifts their cardholder customers' demand upward and thus brings in incremental sales.

The paper literally explains why it might be in merchants' best interest to accept these cards for payment even when the fees appear to be too high. It also predicts the following welfare outcomes:

In comparison with the equilibrium without cards, if the network charges the highest merchant fee then cardholders are better off (or at least indifferent), non-cardholders are worse off, and merchants are either better off or indifferent. The total of the consumers' and merchants' surplus depends on price elasticity of the market aggregate consumer demand. In markets where the *aggregate consumer demand is inelastic, the total of the consumers' and merchants' surplus with and without cards are the same.*

In the case of *elastic* aggregate consumer demand, the model predicts that:

In the long run, the merchant fee will converge to the highest possible level and the product prices will also converge accordingly. Under such merchant fee and product prices, the merchant's profit with cards becomes the same as the equilibrium profit without cards.

It is bizarre that Kantor's testimony cites this paper at all–the model provides a theoretical justification for the very situation that the NACS is attributing to anti-competitive behavior. The model also suggests that the current situation is economically efficient and, at worst, welfare neutral.

Hopefully, enough members of Congress will stick to this basic truth: price controls make more people worse off than they help. If members do that, they'll see that the Durbin Amendment is a terrible public policy, and they'll repeal it rather than extend it to the credit card market.

Norbert Michel is Vice President and Director of the Cato Institute's Center for Monetary and Financial Alternatives.