General Discussion:
Weiner-Wright

Chair: Hendrik J. Brouwer

Mr. Trifilidis: I find the Weiner and Wright paper very interesting and very well done. But I found a missing point, and a very important missing point—that is, entry has different consequences. The first consequence I call the "multilateral interchange fee" just to remember that it is a price-fixing agreement between banks. It could be a coercive or cooperative agreement, but for sure it is an agreement. Another consequence that was addressed in the paper, but not in the presentation of the conference, was about public authorities and looks at the central bank and antitrust authority as if they have the same job. They do not. The types of jobs they do are completely different. The consequence is the same. As an antitrust authority, and also as a commissioner for the Bank of Italy, I find agreements on an interchange fee to be like agreements that are restrictive of the competition. So, if I accept them and authorize them for a little while from a bank commissioner point of view, I may find them illegal from an antitrust point of view.

The final consequence is the main problem of collecting data. My results are proper if we should keep the interchange fee forever, or before a letter and antitrust authority will prohibit it, so we should see which way the system could work with that.

Ms. Tumpel-Gugerell: I found both presentations very interesting. The ability to change interchange fees depends very much on banks or issuers acting collectively. Would the more liberal licensing policy change anything in this situation or not? Or is it so expensive to set up a separate network that it will not happen?

Mr. Frankel: I guess I didn't understand the question. A separate new network?

Ms. Tumpel-Gugerell: Does the ability, for instance, to increase interchange fees here in the United States depend on issuers acting collectively?

Mr. Frankel: The interchange fee is set collectively. My view is that their ability to increase that profitably increases; as merchants and consumers get more dependent on cards, their market power increases.

Ms. Tumpel-Gugerell: But why are there no alternative suppliers of these services? Is it too expensive to set up a network in the country, or what is the reason for it?

Mr. Frankel: There are competing systems, but a good example is the difference between a PIN debit network here, which used to have no interchange fees—it was essentially a par collection system on PIN debit in the United States—versus signature debit. I am sure Lloyd Constantine will be telling you what happens in that environment, because consumers are getting an incentive to use their signature debit, which is a more expensive system to merchants and a less efficient system (most people would agree). They may be paying a fee to use their PIN debit card. It is giving consumers an incentive to choose the more expensive system.

So just having a cheaper or more efficient system isn't enough. The answer that I have heard from some is, "The answer is simple: The PIN debit networks should compete better by raising their interchange fees."

I suggest that is simply everyone moving toward the monopoly fee.

Mr. Weiner: I guess my view is somewhat different in the sense that the United States is a very dynamic market and there is a lot of change. Some would question whether the direction of interchange movements right now is consistent with this or that theory and this or that business model and who benefits. Alan Frankel obviously has one view.

I want to emphasize that Julian Wright and I, at the end of the paper, remain agnostic on exactly what is going on in the U.S. market, because frankly we don't feel we have sufficient information. But I appreciate Alan's insight, thoughts, and comments. This goes to the first gentleman's question as well. This whole notion of how fees are set is central to the interchange issue. It is very easy to look at what is called collective fee setting and say, "That's monopolistic."

That may or may not be true. One thought I would leave you with is that the market structure implications in two-sided markets aren't necessarily the same as the market structure implications in standard one-sided markets. When we see monopolistic and oligopolistic behavior in single-standard markets, we think we understand that. I would add also, we have ample empirical data to help us understand it.

In two-sided markets, I am not convinced that we know exactly what the implications of various market structures are. There is a much deeper, fundamental question here.

Mr. Rochet: I would like to respond briefly to Alan's comments, particularly since he kindly cited my work with Tirole. However, I think the citations should be qualified a little bit, in particular when you said that multiple networks simply might replicate the monopoly outcome. This is what you call dysfunctional competition. The word *might* is important, because the result, as you remember, holds only in a very peculiar case, in particular under the assumption that consumers hold only one type of card, which I don't think is relevant for the case of the United States.

The other remark is that what you call the monopoly platform outcome is not necessarily bad for social welfare. It would be true if we had a monopoly proprietary system. But, if you have even a unique association or a duopoly of associations, then the outcome is not necessarily bad because there is competition between the members of the association on both sides of the market.

The other citation of my work that you are using is, and I quote, "Privately optimal interchange fees are at the maximum level that is acceptable for merchants." Again, this is true under very peculiar assumptions. In particular, you need to have market power only on the issuer side, which is the assumption that we made initially in my paper with Tirole, and no competition between platforms. It is really a theoretical result, and it is probably not applicable as such in any country.

Mr. Frankel: If I didn't make it clear, when I was saying I am picking a particular scenario that I believe to be reflective of the way the markets actually work, I mean that I will extend on my selective citations of Mr. Rochet's work as well. I didn't mean to imply that those were the only possibilities he discussed. I happen to think, though, that with respect to consumers holding one card—the single-homing versus the multihoming point—merchants do behave as if consumers have one card. If you talk to merchants, I think they will tell you they can't afford to drop particular cards. This is especially true of Visa and MasterCard.

I looked at your slides, to jump way ahead now. You cite Reisen's statistical work. I looked at that last night. It was very interesting. If you look at the probability that a consumer who has a Visa or MasterCard in the United States will also have a Discover card or American Express card, as I recall, it is in the range of 35 to 40 percent. If you look in the other direction, if a consumer has an American Express card or Discover card, the probability they'll also have a Visa or MasterCard is over 90 percent. Right now, even if a merchant might be able to afford to drop an American Express card or Discover card, I don't think they can afford to drop a Visa or MasterCard in the same way.

Ms. Litan: I thought the Weiner and Wright paper was really instrumental in educating me. As you point out, Stu, the weakness is that you didn't have enough data. As a researcher, data are critical to what I do too. Can you talk about why it was so difficult for you to get the data? I just don't quite understand that. And how do you propose to resolve that?

Mr. Weiner: I don't have a proposal to resolve it necessarily. There are actually two levels of data that we needed to generate for this paper. One was simply to construct what is going on in these countries. That is what appears in the tables, basically. It is kind of a snapshot of the various interchange fee arrangements, how they are set, who the networks are, what instruments there are, and what various network rules are in place. Where possible, we tried to get a sense of whether interchange fees, consumer fees, and merchant service charges have been declining, rising, and so on.

That in itself was somewhat ambitious because the data are not in any one place. It is difficult to even get that snapshot information. Many of you who work in this industry know how complex pricing tiers are and things like that. We felt we were fairly successful that, again with the assistance of many people in this room, we were at least able to get a sense of where these countries are.

I would argue the real data needs are at the second level, that is, when doing serious econometric work. There, one is going to need significant time series data on interchange fees, consumer fees, merchant service charge fees, degree of pass-through, all of these kinds of things that are in these models and that need to be rigorously measured. Those data, we believe, are out there. We have to believe that merchants have some of those data. Clearly, the networks know what fees they are charging. How one gathers that, I don't know. Nor would you expect a firm to release proprietary information that could somehow damage their competitive standing, but there are a lot of economic data in a lot of other sectors of this nature that is made available.

One of Julian and my pleas is to somehow start thinking about sharing this information, where feasible, and it will better inform all of us. Ultimately, we think it will lead to better public policy. It is a difficult question, Avivah. As a researcher, you know when one is in a position of being asked to make policy recommendations, you want to be relying not just on theory but on hard empirical work. Without the data, that is very difficult to do.

Mr. Frankel: If I could, I would like to add that even where some regulators have issued reports—such as the European Commission—they have often redacted as sensitive business secrets some of Visa's information about the level of their fees or costs, or the process by which fees are determined.

Mr. Brouwer: Maybe, if we are sharing all this information with institutions all over the world, you need to structure for interchange fees as well.

Mr. Orenbuch: I was wondering, primarily of Alan, if you could, in the context of the U.S. experience, discuss a couple of issues, as it doesn't seem that anyone really has discussed them.

It really seems to me that there are two separate issues. One is the level of the discount that merchants are being charged. The other is the form at which and way in which the interchange piece is set. You also have two other examples. You have stand-alone issuers that are now developing as networks in the United States—American Express and Discover—which are not discussed in virtually any of the literature about the United States or elsewhere. American Express has the highest level of that discount. Discover, recently in a discussion that we had with them, indicated they were raising it (they believed, anyway) faster than any of the other networks. Both of them have signed network agreements in the United States recently. Layering on the point you made about cardholders in the United States who have an American Express card and virtually all of them having a Visa or MasterCard, why is that a tenable proposition? And why isn't the solution just for merchants to say, "No mas?"

Mr. Frankel: That is a great question. Let me answer that in two ways. One, AmEx is often held out by interchange fee defenders as a prototypical, competitive player that they should be able to emulate. I suggest that AmEx, instead, has unilateral market power and a collective of all the banks in the country should not emulate that structure.

In terms of what merchants can do today, I think one reason why AmEx's fees are constrained as much as they are by Visa and MasterCard is because AmEx wanted to get penetration throughout a broader merchant sector, and because of the situation in which merchants are a little bit more comfortable throwing out AmEx if the fees get too high. You see in Australia where even AmEx had to cut its fee—not a lot, but a little bit—in response to the Visa and MasterCard fee reductions. What will happen as a result of the Department of Justice case is there will be potentially less and less distinction among these three- and four-party systems, so that maybe at some point in the future, I won't be able to say with as much confidence that a merchant could throw out AmEx and not lose as many sales as they will today by dropping MasterCard or Visa.

Even today, they find they really can't throw out AmEx. There is a public discussion of Walgreens temporarily canceling AmEx. It would be really interesting to know what their experience was, if they are willing to share. In the future, it will be harder and harder if AmEx continues to increase its penetration among cardholders and merchants. More consumers will rely exclusively on their AmEx card.

Mr. Posner: Mr. Weiner, in your paper, you conclude that you are agnostic, not having sufficient theory or data to prove one hypothesis or another. Of course, no theory or no amount of data will even allow any of us to prove anything conclusively, so we must approach this interesting controversial subject with conjectures.

Alan has outlined a conjecture that the fact pattern in the United States of increasing interchange rates is consistent with a race to the monopoly price. My question is, what is the most credible counterhypothesis to Alan's to explain what is going on in the United States?

Mr. Weiner: I am uncomfortable getting into the most likely counterproposal. On my part, it would be conjecture. Julian and I were comfortable raising that as a possibility. Certainly, it is one scenario that, even if we don't agree with it, we were comfortable enough at least with suggesting it in the paper. We suggested others as well, none of which we are going to hang our hat on.

You pointed out that we really are never going to have a conclusive answer. That is absolutely true. I would argue that we are never going to have it clearly on theory alone. Theories can spin out all kinds of implications and scenarios. They are very, very useful. But the way real policy and real action are taken, of course, is to take that theory and then apply the data to it. I admire

Alan and thank him for taking this one scenario and pushing it, because I think it is one we are hearing a lot of in the United States. I anticipate we are going to hear a lot more of it over the next day and a half of this conference. Maybe by the end of the next day and a half, I, in fact, will be more convinced myself with more information and with more data. At this point, that is as far as I am willing to go, but it is exactly this kind of dialogue that we need. In the end—and I hate to keep saying it—we are going to need to know from both ends of the market with all the different players where exactly the numbers are and what is driving some of this behavior. Again, I want to take issue with this language that is appearing about the drive toward the monopolistic price. It is not at all clear, from a theoretical standpoint, that is what is happening in U.S. markets or any other markets. I would be very uncomfortable saying it is a drive to monopolistic price. We don't know enough about two-sided markets, even theoretically, to know necessarily what a monopolistic price looks like.

Mr. Roylance: A question for Stu Weiner. In your paper, you haven't made any discussion about access issues. I raise that because in our Australian situation, as you know, the payments system board, which is also represented here, has placed some significant emphasis on opening up access to our credit card associations. And now they are working on opening access to our PIN debit system as well, the objective being to allow new competitors entrance into the market, particularly in the acquiring side; to allow new acquirers to enter the market; and to allow organizations to be specialist acquirers—not issuers—to bring some more balance into the internal operations of the associations that are typically issuer-denominated. Also, it will allow large merchants to function within the payments environment as self-acquirers. I wondered if you think that is of interest to you or if it could be important in the U.S. context?

Mr. Weiner: Yes, it is absolutely important and thank you for raising it. It was something that Julian and I really could not get our arms around, certainly for all the countries at which we looked. Our view—and I know I can speak for Julian—is that clearly nonbank participation in the various areas of the payments system, all else equal, should enhance competition. Whether it is a one-sided or two-sided market, the more competitors you have, all else equal, that should be a good thing for efficiency and competition. In some countries, and the United States is among them, we have a fair number of nonbank participants as acquirers and throughout the payments process. We will probably get into this in later sessions, but there are several ways to think about regulation and pricing caps and so on. Perhaps the simplest way to enhance competition where you think it is lacking is, in fact, to relax restrictive rules and/or ease barriers to entry. This is one area where nonbanks can clearly do both. That is a very good point.

Mr. Burns: I'll echo Stu's comment that it is probably best to be somewhat agnostic, even when we are talking about saints (this is getting to be a very religious discussion, as I think about it). I want to make a comment that hopefully may be helpful to discussions throughout the next day and a half. I was listening to this discussion and reading the literature, and I find that we get to this particular focus on an aspect of this business called interchange of pricing mechanism. It is also useful to keep in mind the larger context of what is going on in these payments instruments. For example, in the United States, if we look at the tremendous growth of electronic payments—debit, credit, and so forth—the much broader access of various population segments to credit and electronic payment mechanisms, innovations have taken place. Everybody is talking about prepaid and what not. Somehow it seems to me that all of those industry characteristics have to be taken into account when we start talking about the business end. We run a little bit of a danger getting too narrowly focused on one aspect. Having said that, it is important work, an important discussion, and certainly relevant, but there are other aspects that we ought to take into consideration as well. My point is that I don't know where interchange fits into all the rest of the stuff or not. I just know that you observe the growth, sophistication, and complexity of the industry. That is an important aspect and a social good.

Mr. Brouwer: As Stu already pointed out, even to understand interchange fees, you must understand the wider fields and the other instruments.

Mr. Frankel: What occurs to me is the Fed economists and officials are being very diplomatic. In 1914, the Fed began a long effort to quash interchange fees on checks. They were absolutely certain that was a noble effort for a long time. I think at some point, it makes sense for the Fed to reach conclusions on this point. It will be very helpful.

Mr. Weiner: I think I will remain diplomatic.