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The Cost and Efficiency of Credit Card Schemes ——A Comparative Study on the Australian Regulatory Reform for Credit Card

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Abstract

This paper first outlines the Australian recently adopted regulatory framework for credit card scheme, highlighting the growing concerns over the possible anti-competitive effects of the setting of interchange fees and the "no-surcharge rule".The rate of the interchange fees applied to the credit card use nowadays raises the concerns of overcompensating the financial institution as well as the credit card schemes and also, the "no-surcharge rule" restricted the competition and suppressed price signals that guide the efficient allocation of resources.

In my opinion, the interchange fee should be decided at a cost-based benchmark. The cost to be included in calculating the formula should be confined within the related cost of processing and authorizing the transaction, of fraud and of the interest-free period. Furthermore, the regulatory authority should review the setting of the interchange fees regularly and related information should be disclosed to the public in the way that consumers can easily and conveniently access.

As to the no-surcharge rule, for consumers, when they purchase with credit cards, they don't have to bear additional cost, though credit card is among the most expensive payment instruments, but benefit from delayed-payment without

interest. On the other hand, the merchants are confronted with the customers' demand to accept credit card transactions even when VISA and MasterCard charge them high fees for using their services. Nowadays, the merchants don't have any option but to accept credit card transactions since majority of consumers enjoy the convenience of creditcard payments. Barred by the "no-surcharge" requirement from VISA and MasterCard, will the merchants passively shoulder the high service fee for accepting credit card transaction? Merchants will raise the price of every items slightly just enough to cover their cost without attracting consumers' complaints. Consequently, the general consumers in the economy bear the credit card transaction cost, resulting in the cross subsidization.

By abolishing the no-surcharge rule, merchants have the power to set different rules according to the payment instruments used. With additional fee charged, people will make payment decisions based on the cost and benefit analysis, but not simply using credit card as payment with every transaction. Confronted with downward sloping usage rate, VISA and MasterCard may be motivated to make the credit card scheme more efficient.

In long term, the credit card scheme will work in the way that best contributes to the efficiency and competition.

Keywords: credit card, no-surcharge rule, interchange fee, merchant service fee, cross subsidization, VISA and MasterCard