

SUBMISSION TO RESERVE BANK OF AUSTRALIA

REFORM OF CARD PAYMENT SYSTEMS

A. PREAMBLE

THE COMMON GROUND

In the call for submissions about setting standards for interchange fees on EFTPOS transactions, there was a foreword of sorts noting some principles of the Bank's approach.

The Bank's acknowledgement of the 'public interest' and its apparent sense of purpose about regard for 'the totality of the payments system'; for 'how the system is likely to evolve over the medium to long term' and about ensuring 'interchange fee arrangements conducive to the efficiency of the overall payments system', would find broad support in the community, as they do with me.

THE DISAGREEMENT

-- the Bank's view

The Bank says the problem is the current arrangements resulting in the effective price of (lower-cost) EFTPOS purchase transactions being higher than the effective price for (higher-cost) credit card transactions. On this basis, the Bank says that a narrowing of the differential in effective prices would promote the use of EFTPOS and thus the efficiency of the overall payments system.

This formulation was similar to 'evidence' which the Bank put to the Australian Competition Tribunal (ACT) -- that removing EFTPOS interchange fees would lower the fees charged for EFTPOS transactions and encourage debit-card use relative to credit cards. This evidence suggested that, as a consequence, merchants would be better off: that even though merchant costs of accepting EFTPOS were likely to rise, for many merchants it will still be cheaper to accept EFTPOS transactions than to accept credit cards.

-- the opposing view

The Australian Competition Tribunal rejected this evidence from the Bank.

Removing the interchange fee from EFTPOS transactions may reduce the effective price differential favoring credit card transactions, however, the substantial remaining differential in effective prices would still leave the comparison favoring credit card transactions. Consumers will still prefer credit cards because they will still get 'free credit' and 'free transactions' (and

possibly additional ‘rewards’) when using credit cards while banks will still charge for EFTPOS transactions (beyond ‘free transactions’ limits). [Banks charge customers for their BPay payments even though their ‘paying’ bank takes a substantial interchange fee.]

In short, getting a little closer has never meant winning – and it won’t in this case either. I believe the Reserve Bank’s analysis is flawed.

-- on balance

The issues here are complex and, in the normal course, understanding them is beyond the reasonable reach of the community. The Reserve Bank has never spoken plainly to the people about the dirty mechanics of the way the retail payments system works. It is about time the Bank did so speak frankly to the community. This is an opportunity for the Bank to level with the community – but, will it take it?

The body of this submission is about, hopefully, extending the community’s reach: it is about an agenda of issues that should be openly addressed by the Reserve Bank when it explains to the community the detail of how the Bank does (or does not) pursue the apparent sense of the ‘overall’ purpose that the Bank says it has. Will the Bank do this, as it knows it should?

I have previously exposed the Bank’s inclination to first say the ‘right things’ about the principles of good payments policy making, and then not only do little, if anything, effective to practically implement those principles but to often do things that are absolutely inimical to setting policy soundly in the public interest. Good intentions are not only not enough, at some point, stating them becomes deception.

It astounds me that the Reserve Bank would now press on the community a view assessed as flawed by the Australian Competition Tribunal -- and do so without persuasively refuting the decision made by the Tribunal. Even if the Bank considers it has superior legislative authority, it would avoid an appearance of arrogance if it were to openly and persuasively plead its ‘appeal’ against the Tribunal decision.

B. THE WAY AHEAD

A basic familiarity with the characteristics of world best practice in the business of retail payment systems has a clear message for Australia.

In the world’s best-practice systems, neither ‘cheques’ or ‘credit cards’ have a role of significance and even the other ‘tangible’ instruments, currency notes and coin, are slated for displacement by an electronic, e-money, alternative.

In the light of this widely acknowledged consensus – one which even the RBA itself sometimes deceptively espouses – one wonders why we are still so dependent on ‘cheques’ (for small business banking); have no real prospect of a

widely used e-money alternative to currency and why credit cards are still dominant (and apparently have the status of a protected species with the RBA). The practical prospects for desirable reform are bleak.

At some point the RBA needs to take seriously the homilies it delivers about the importance of a properly working price system to achieving efficient resource allocation – payments system policy should be directed to ensuring that customers, choosing between payments instruments, have explicit cost-related price signals to drive those choices.

As things stand nothing could be further from this truth – and on current RBA plans the distance of the system from this truth is about to lengthen.

-- go back, you are going the wrong way

It seems fair to say that the way ahead for Australia's retail payment system would ideally take a very different track to the one that the RBA seems committed to tread.

Giving a proper sense of direction to the 'totality of the system' as it 'evolves' and to 'the efficiency of the overall payments system' seems to require a very different perspective to the Reserve Bank's piecemeal reforms of very closely related elements.

Having 'done' credit cards first – but having done it so very badly – it makes the underlying problems worse if other related elements – EFTPOS, VisaDebit, BPay etc – are now to be force fitted into a flawed framework constrained to validate the flawed credit card model.

The RBA needs to go back to laws – to go back to the big picture and rearrange the elements to better fit the long-term public interest. This, rather than pandering to the major banks and their 'international' credit-card schemes which are so clearly a contrivance against the public interests of Australians and the world community more generally. Would our Reserve Bank tell Iraq that the Visa/MasterCard racket is likely to be good for its people? – Implicitly it is, and that is a disgrace.

-- no interchange fees at all

In the difficult situation now contrived, one sensible step would proscribe 'interchange fees' for all established retail payments networks

Without interchange fees, participants in payments networks would recover costs from network users – merchants and customers -- without the distorting distractions of either gimmicks like 'free credit' or the predatory practice of 'reward schemes' funded from over-pricing the services in the first place. No responsible competition authority would ever have allowed its major banks to first extort the customers with a price-fixing agreement and then use the

proceeds to relegate the competition (the credit unions and former building societies now dependent on the VisaDebit ‘credit card’). Talk about a disgrace.

The plan for ATM services is the correct one – ATM owners will recover directly from ATM users a pre-disclosed fee for the service. It should also be the plan for the credit card, EFTPOS, VisaDebit and BPay schemes.

A no-interchange-fee rule would quickly resolve problems associated with all transaction card facilities and related accounts – including VisaDebit and BPay as well as credit cards and EFTPOS.

[If, in future, there is a case for an interchange fee to assist the establishment of a new retail payments network, that could be a specific short term concession – not a fundamental ‘forever’ concession to exploit the customers and distort the incentives to competition and efficiency. The credit card ‘sell out’ is a continuing disgrace.]

-- decide and rule

Much of the confusion about interchange fees arises in the question of whether the use of a transaction card facility is a banking service to the bank customer-purchaser or to the retailer (and its purchasing customer).

It seems sensible for the RBA to assess the best prospects for ensuring efficiency in the retail payments system, and answer the question in a way that best promotes that end.

Given banks proclivity to charge more than once for the same service, it seems sensible to now say that the banks should recover from their customers the costs of the ‘customer’ side of a purchase transaction – and recover from retailers the banks costs of servicing the retailer.

By ‘dividing and ruling’ in this way the RBA would avoid the emerging prospect of more bank costs being ‘buried’ in the retail prices paid by customers to retailers (but banks still charging customers separately, either explicitly or by imposing ‘minimum balance’ requirements).

Burying the costs of the retail payments system in retailer’s retail prices is hardly likely to bring to the market the disciplines of cost related (explicit) prices which bear on customer choices among alternative payment instruments.

-- restore common sense

The ideal of properly regulating the transaction card payments system was dealt a body blow in August 2002 when the RBA, without explanation, reneged on its undertaking, properly given only months earlier, to exclude any allowance for ‘free credit’ from the eligible costs included in any calculation of an ‘interchange fee’ for credit card schemes.

If banks want to give ‘free credit’ they can, but they should not expect the authorities to agree to a price-fixing agreement between banks whereby retailers pay the costs of the ‘gift’ from banks). In August 2002 the RBA did so agree and sold out the Australian community to the international credit card cartel: it now needs to fit the rest of the system to this flawed, rip-off model. It is truly a disgrace that the RBA caved in to the banking cartel to allow this – ‘ordinary’ staff at the RBA knows this, and they are ashamed.

This fundamental mistake should now be acknowledged and fixed. It is simply unjust to allow banks to claim a cost at a value higher than the ‘beneficiary’ would place on their ‘gain’. Who would want the ‘free credit’ if it were assessed as taxable income at the rates of interest banks charge on credit card loans, or even at the ‘cash rate’ banks claim as the cost?

Proscribing an interchange fee, of any substance, in bank credit card schemes would so change the retail payments landscape as to make almost irrelevant the present dispute about EFTPOS.

-- fix the tax distortions

The RBA is inclined to say that ‘no one else is asking them to assess how distortions in the tax system are impacting on the efficiency of the retail payments system’ – so we won’t. That is a cop out, the assessment needs to be made by the Bank and widely publicized.

It is to Australia’s shame that for years ‘no one’ wanted to know how the housing market was being distorted by inappropriate tax policy settings – only after the mess was beyond repair did the RBA speak up and say how the tax rules were a major problem. The average home now costs ten-times average annual earnings – and it is a disgrace.

It is the same in the retail payment system. Bad tax policy is the major factor denying both competition and efficiency in the retail payment system.

Inappropriate tax policy settings allow tax-avoiding barter in the swapping of ‘free transactions’ for ‘interest free’ deposits -- and in respect of credit cards they allow the tax-deductible business expense of ‘free credit’ to be converted to an untaxed personal income (the value of the ‘free credit’). This is a ‘known disgrace’ but no one wants to acknowledge it – or fix it.

Simply correcting these tax distortions would be a most effective step to promote competition and efficiency in the retail payments system.

The Reserve Bank should say this clearly, and explain it in terms the community will both understand and accept. Will it?

-- demand fair trade practices

One can only wonder why banks have not developed the debit-card/EFTPOS product to provide all the features of the credit card, including 'remote' purchase transactions and (user-pays) access to a line of credit for customers wanting it. On the face of it there is a de facto agreement among banks to not offer such a facility – and one might ask why the authorities do not call the banks to account.

Banks agree with gay abandon to exploit their customers with credit card price-fixing schemes, among others, but there is no public policy counterweight ensuring the banks' capacity to 'agree' is used to give the customers a better deal.

The RBA stays real quiet when it comes to speaking up on matters of appropriate trade practices. No submission was made to the Dawson Committee. No comment was made to encourage the Government to act on the inclinations of the Dawson Report to moderate 'price fixing' in joint ventures such as the banks card schemes and retail payment networks.

It will be interesting to read the RBA's defence if a recent proposal put to the Treasurer were to see a challenge issued to the RBA's present ineffective role in 'promoting' competition and efficiency in retail banking.

C. IT SIMPLY BEGGARS BELIEF

It is beyond comprehension that any respected international panel of experts on retail payments systems would assess favorably either the way our retail payments system is, or how it is likely to develop, if the RBA presses ahead with its plans to regulate the EFTPOS system and hide even more payment system costs in retail prices for unrelated goods and services. The RBA plan for EFTPOS is a play of naked bureaucratic power that is contrary to the public interest.

It is simply perverse to now envisage this hiding of more bank costs in other retail prices without any real prospect of overturning the market dominance of credit cards – a product which the RBA agrees is both inferior and a source of market confusion.

The apocryphal 'Blind Freddy' can see that the public policy case against credit cards is substantial and will not go away – because credit card schemes are so obviously a contrivance against the public interest. This apocryphal one can similarly see the banks maneuvering to eventually agree to displace credit card schemes only if they can then impose an interchange fee (payable to card issuers).

Those with little time for apocryphal stories might see the same portents in both the proposal of NAB for a (initially modest) positive interchange fee to be

substituted, and in the reluctance of the ANZ to agree to fix the interchange fee at zero 'forever'.

All the talk about setting 'zero' interchange fees for EFTPOS is of little consequence if a 'done deal' can be unwound later when it suits the RBA and its bank 'mates' – and the banks are skilled at playing 'tag' in these public policy debates, presenting a confusing melee of some in the ring, and some out, but eventually all pushing a predictable common view.

I suggest the most credible policy position for the RBA is one that defacto proscribes interchange fees in all established retail payments networks by setting all such fees to 'zero'. With that position taken, the public has less risk of being held to ransom at a later stage.

Coincidentally that single step would deal with most current issues posed by price-fixing posing as 'interchange fees' – for credit cards, debit cards, EFTPOS, VisaDebit and BPay.

One single, credible decision would work wonders – and free some resources at the RBA to get to work on assessing the distortions arising in bad settings of tax policy.

I believe the foregoing is consistent with my earlier submission of 9 July 2004 and with related commentaries I circulated as the issues about EFTPOS regulation unfolded subsequently.

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