

Title: The Economic Effects of Interchange Fees

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Abstract

When a consumer uses a credit or debit card to purchase goods or services from a merchant, the consumer's bank typically collects an "interchange fee" from the merchant's bank, which obtains the funds from the merchant. The amount of the interchange fee is determined by the network, which may be controlled by its member banks. The interchange fee makes card transactions more profitable for card-issuing banks and raises merchant costs. This transfer of revenue may induce card issuers to incur additional costs or share some of the profits with card using consumers, while merchants typically recover their interchange fee costs from all consumers, not just card users, in part because of vertical restrictions imposed by networks. The question arises whether the collective imposition of interchange fees is anticompetitive. We describe alternatives to the existing interchange fee practices, and explain that the current arrangements lead banks and card networks to set interchange fees which tend to maximize the profits from their exercise of collective market power. We review various economic defenses offered for existing interchange fee practices, and compare testable implications of those defenses to available evidence. We see no persuasive case that interchange fees achieve economic efficiencies which overcome the usual presumption against collective price setting or offset their anticompetitive effects.