

CREDIT WHERE CREDIT'S DUE

REFORMS TO CREDIT CARD TRANSACTION FEES HAVE BEEN WORTH IT SO FAR, A PARLIAMENTARY COMMITTEE HAS CONCLUDED.
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The next time you whip out a piece of plastic at the shops, pause for a moment and consider just how much wizardry goes into making it work. How does your money eventually make its way into the account of the merchant? Who pays for all the gadgets and associated financial wibzbangery? Who pays for moving the money about? Who is the referee and is there a video ref? The answers are, as you might imagine, complex, and although we don't often think about what makes the system tick some people make a living out of it. It's just that they don't all agree on how it should work and there is a fairly serious argument raging about it at the moment.

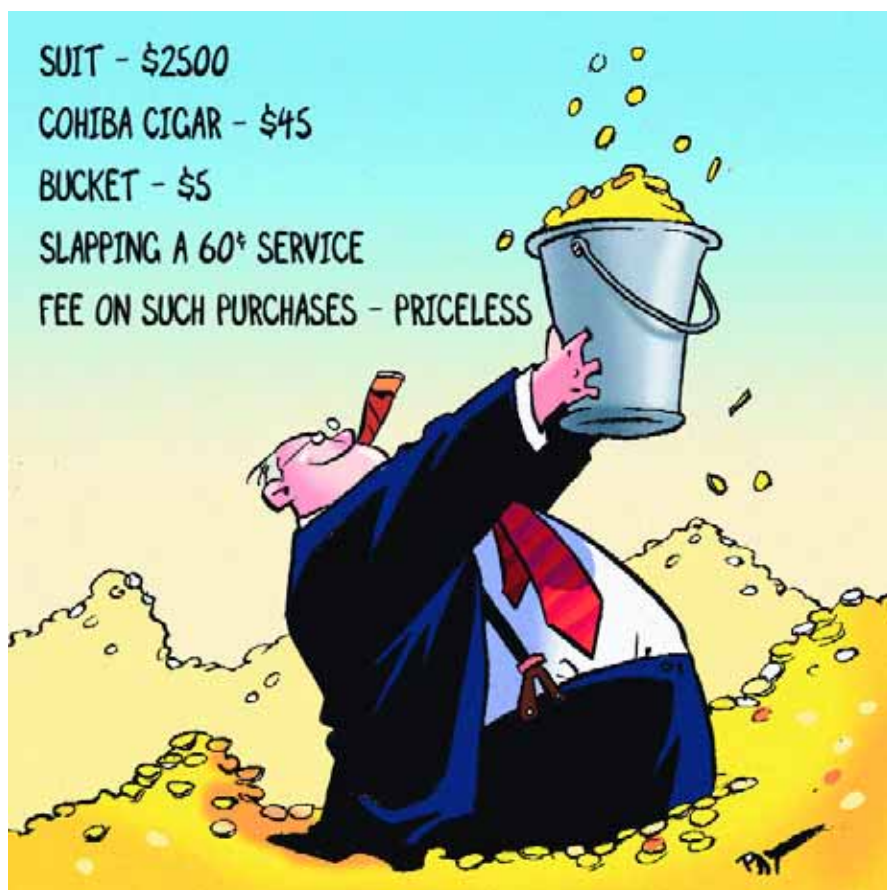
And so, the House of Representatives Economics Committee held an inquiry into the 2005 Annual Report of the Reserve Bank of Australia and the Payments System Board: because the bank, through the Payments Board, is the referee. Like all these things, at first blush the inquiry sounds boring and remote. Take a closer look and you learn that this inquiry is about your money and how it is being spent by those who run the credit and debit systems.

To start at the very beginning, there are basically two ways to pay for something: give someone cash; or give them something that instructs your bank to give them cash. Cheques were simply a way of verifying an instruction to move cash from one account to another. The arrival of plastic ushered in a much more complicated world of charge cards, credit cards, debit cards and a host of ways for paying for a good or service.

The first cards yoked the buyer and merchant to the same financial institution. As the organism evolved, a series of agreements between banks allowed the development of two systems: the credit and debit networks. When you present a card to a shop assistant you choose which system to use and the assistant directs your request through the appropriate network.

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To pay for all of this banks charge each other handling, or interchange, fees. With credit cards the fees flow from the merchant's institution to the cardholder's institution. With Electronic Funds Transfer Point of Sale (EFTPOS) or Automatic Teller Machine (ATM) withdrawals the flow of fees is reversed: it runs from the cardholder's institution to the merchant's institution.

There is always an exception to the rule and, in this case, it is the Visa debit card. Because of the way Visa is set up, when buyers use it the fees involved in the transaction are treated in the same way as a credit card.

So, although two people may buy the same good from the same store, the interchange charges for the transaction differ depending on whether they choose to pay through the debit or credit network. And the fee structure is significantly different. EFTPOS attracts a flat fee that averages around 20 cents a transaction. Credit cards and Visa debit cards fees are a percentage of the amount spent and that currently averages around 0.55 per cent across all transactions. In effect, the issuing bank stands to get 40 cents, on average, in interchange fees from each Visa debit or credit card transaction and pays 20 cents for each EFTPOS transaction, setting up a price difference between

the two systems of 60 cents a transaction.

The Reserve Bank watched the growth of credit and debit plastic through the 1990s with growing concerns about the largely invisible fees. The Reserve worried that interchange fees were not subject to normal competitive pressures and altered the direct link between costs and prices. Merchants were bearing the cost of the credit network and agreements with banks prevented them from charging card users a fee, so the cost of the system was buried in the price of goods and services. The effect was that everyone was subsidising the credit card system, a system which builds its profits on the undisciplined use of cards by some consumers.

The Reserve also worried that interchange fees were not aligned with costs of the two systems, so users of the cheaper system (EFTPOS) faced the highest prices.

After a joint study with the ACCC the Reserve Bank argued the fee structure as it then existed was not in the public interest and so used its powers to step in and regulate the market. The Reserve moved first on the credit system, introducing a maximum fee and allowing new players into the market.

The lower fees came into force in late 2003 and the effect can be measured by a drop in banks' income from

merchant service fees from \$1.837 billion in 2003 to \$1.522 billion in 2004. Don't feel too sorry for them though, bank fees charged to households grew by 196 per cent between 1997 and 2004, from \$1.162 billion to \$3.443 billion. Over the same time, fees on business increased by 93 per cent, from \$2.880 billion to \$5.562 billion.

But that was only part of the equation. Reform on debit cards lagged, so in April this year the Reserve intervened again designating a floor and a ceiling for interchange fees on EFTPOS transactions and capping the average fee in the Visa debit system. This would drop the average EFTPOS fee from around 20 cents to between four and five cents. It would also reduce the interchange price difference between EFTPOS and Visa from 60 cents to around 20 cents.

The Reserve has also ruled that merchants will be able to charge Visa debit card holders a surcharge for using the cards and that the credit and debit cards have to be made visually distinct. The changes are due to come into effect in November.

This, as you might imagine, caused a fight. So the video referee, the House Economics Committee, took a look at the tape. The commentary being provided on it by the major players is a fascinating study in how winners and losers see the same play.

In handing down its report, Committee Chairman Bruce Baird (Member for Cook, NSW) said, "The RBA has pursued what some have termed an 'aggressive' reform agenda, with the consequences of those reforms subject to considerable debate.

"The most contentious payments system reform issue has been reductions in credit card interchange fees," he said. "The RBA argues that its reduction of these fees has resulted in cardholders facing truer price signals when using their cards, while also saving merchants and ultimately consumers millions of dollars each year.

"Conversely, opponents of the reform—Visa and MasterCard, among others—argue that there is no evidence of savings being passed through to consumers. "While the committee was not wholly convinced by either argument, it concluded that the benefits of the reform, at this point, outweigh any alleged disadvantages." ■

The House Economics Committee report is available at www.aph.gov.au/committee/efpa or email efpa.reps@aph.gov.au or phone (02) 6277 4587.