Discussion of Consumer Payment Choices: Trends and Policy Implications
By Guerin-Calvert and Ordover

Sujit “Bob” Chakravorti
Federal Reserve Bank of Chicago

Consumer Behavior and Payment Choice Research Conference
Federal Reserve Bank of Boston
July 2006

The views expressed are the author’s and are not necessarily those of the Federal Reserve Bank of Chicago or the Federal Reserve System.
Key Points of Paper

• Summarizes current trends in consumer payments—shift to card payments and new technologies, e.g. aggregators and wands

• Policy debate over fee structure and levels should use two-sided market analysis

• Shift to card payments may reduce variable costs in the long run

• Government regulation of fees is not warranted
General Observations

• Current draft is a work in progress

• No new model or empirical investigation in current draft to support conclusions

• As existing literature highlights, assumptions matter

• Difficult to do merchant welfare calculations when merchants are competitive

• One payment method not ideal for all situations
Two-Sided Markets

- Two necessary conditions (Rochet and Tirole)
  - Price-ratio between end-users affects adoption
  - End-users are not able to negotiate prices
Price Based on Payment Instrument

- Merchants often restricted by card network
- Not common to see different prices in jurisdictions where allowed
- Payment pricing occurs in markets that are highly competitive or where little competition exists
- Assuming competitive issuers, acquirers, merchants and networks, Chakravorti and Emmons find that existence of different prices is first best
Examples of Surcharges and Discounts

- Some U.S. gas stations offered cash discounts in the 80s

- German department store offered credit card discounts after the introduction of the Euro

- Some online merchants impose surcharges on checks

- Some merchants surcharge PIN debit transactions

- Generally, observe only one price (Frankel)
Why Merchants Accept Credit Cards?

• Allow merchants to make sales to illiquid consumers

• Issuer extends long-term credit to consumers that may be costly to extend directly by merchants

• Useful for remote payments such as bill payment, Internet purchases, pay at the pump, and car rentals

• Authors claim increase transaction speed (may have amount caps)
Are Merchants Better Off?

• Simple Answer: Most likely, but may argue over pricing of services

• However, under certain conditions merchants may be worse off (Chakravorti and To)
  – No repeat purchasers
  – No bargaining power
  – Only one issuer/acquirer/network

• Need data to find out more
Network Competition

• Chakravorti and Roson find competition improves merchant and consumer welfare unambiguously

• Price level falls but price ratio may be less optimal with two networks than one

• Considers competition and cartel between two different types of networks
Innovation

• Alternative solutions to card-based products are becoming available, e.g. ACH-based products

• Payment networks are offering a diverse set of payment options e.g. credit, debit, and prepaid

• Merchants continue to challenge existing paradigm
Conclusion

• Look forward to reading completed paper

• Assumptions matter!

• Need data for empirical studies