COMMITTEE TO UNLEASH PROSPERITY

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The Durbin Credit Card Interchange Fee Caps Will Cost Consumers

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Executive Summary

Later this year, Senator Richard Durbin (D, IL) is planning to attach his credit card price control bill, the **Credit Card Competition Act of 2023**, as an amendment to the must-pass omnibus spending bill to fund the government for the upcoming year. This bill would cap the 1.5 to 2.5% "interchange fees" that Visa, Mastercard, Discovery and other credit card companies charge retail merchants for processing their transactions.

This comes at a time when the market is speaking loud and clear that consumers are using credit cards at all-time record levels. Each day there are more than 150 million credit card transactions on the more than 1 billion cards that have been issued. These cards are used to facilitate close to $5 trillion in consumer transactions in 2022. This study shows that the Durbin bill is misguided and harmful to consumers for several reasons:

- Consumers benefit from the convenience of credit cards and rewards to the tune of almost $300 billion a year.
- Where credit/debit cards have been tried in 47 countries, the evidence shows that consumers are harmed by lack of access to cards and a loss of benefits from credit cards, such as limitations of popular "reward programs."
- Credit card price controls limit the ability of lower income Americans to have access to credit cards – as firms respond to price controls by restricting cards issued to poorer and less creditworthy applicants.
- Credit card price controls will NOT lower prices for consumers. Studies have shown that when fees are restricted by government regulations, about 70% of the savings go to the merchants, while consumers get little benefit at the cash register. Some studies have found that 70 to 80% of retail merchants do not change their prices at all, after credit card interchange fee caps are implemented.

A much better solution to increase competition in the credit card industry is to allow retailers to establish their own banks, so they can issue their own credit cards for their customers.

Introduction

Credit cards are arguably the greatest consumer (and merchant) convenience tool for shopping in stores and on-line ever invented. There are now more credit cards issued in the United States than there are people.

Far from the "American Express Gold" status symbol of the wealthy that they once were, credit cards are a ubiquitous convenient and time-saving payment system that benefit tens of millions of American consumers daily.

Today with a mere tap on a plastic card (or a cell phone) Americans are able to order every possible consumer item from a new car to an iced latte to an airline or concert ticket without any cash being carried around or transacted. Consumers also rack up popular reward points that Americans use for vacation travel or special purchases they may not otherwise afford to buy.

But if lawmakers have their way, the benefits of credit cards may once more be cut off from lower income Americans.

A bipartisan group of congressmen led by Senator Dick Durbin (D-IL) recently put forward the **Credit Card Competition Act of 2023**, a piece of zombie legislation spawned from a **similar bill put forward in 2022** that aims to extend the Durbin Amendment of the Dodd Frank Act from debit cards to credit cards. Its specific purpose is to reduce interchange or "swipe" fees, the 1.5 to 2.5% fee credit card companies charge retailers for providing a host of financial services and protections.

In a recent **press release**, Durbin stated, "Credit card swipe fees inflate the prices that consumers pay for everyday purchases like groceries and gas. It's time to inject real competition into the credit card network market, which is dominated by the Visa-Mastercard duopoly." Senator Roger Marshall, a Republican from Kansas, and also an advocate of credit card price controls, says this will save the average family "$1,000 a year."

But Durbin and Marshall's claim that these regulations on credit card companies will help consumers is contradicted by evidence from other nations and past attempts in the U.S. An honest evaluation of the academic literature on the Durbin Amendment and similar caps on interchange fees in other countries shows little to no cost savings pass-through from merchants to consumers and a disproportionate cost on low-income and minority groups. The price controls are also likely to restrict availability of rewards programs that have proven to be popular with American consumers.

The Function and Benefit of Credit Cards in the Financial System

The extensive benefits of holding and accepting credit cards has made them ubiquitous in American life, with 77% of Americans owning at least one credit card (**Federal Reserve, 2023**). At the end of 2022, there were over **1.1 billion credit cards** in circulation for an adult population of over 333 million (**U.S. Census, 2022**). The average U.S. adult made almost 600 card purchases in 2022, making American consumers some of the most active card users in the world (**Verisk Financial 2022**). Additionally, credit cards were the leading card type, accounting for more than half of all active payment cards in circulation and over half of total payment cards' purchase volume (**Verisk Financial 2022**).

Credit Card Facts and Figures

In 2022, U.S. credit card transactions totaled **54.8 billion** for an average of **150.15 million** per day, **6.25 million** per hour, **104,274** per minute. or **1,739** per second.

- The average U.S. cardholder makes **210** credit card transactions per year or one transaction every 1¾ days.
- American consumers use credit cards to pay for **4-in-10** in-store purchases.

Nationwide Transactions 2022

Increment	Transactions per
Second	1,738
Minute	104,274
Hour	6,256,411
Day	150,153,863
Year	54,806,159,895

Credit Card Transactions By Issuer

- The world's three (3) largest credit card processors facilitate over 600 billion transactions per year.
- The total number of transactions Visa processed reached 192.53 billion in their FY ending 2022.
- Visa, Inc. processed 226 billion global payment transactions in the 2021 calendar year.
- UnionPay processed an estimated 279 billion global transactions in 2022.
- Mastercard processed an estimated 164 billion transactions in 2022.
- Other credit card processors, including Discover and American Express, processed an estimated 16.8 billion transactions.

Credit Card Transaction Volume Statistics

Transaction volume refers to the transacted dollar value.

- Americans used credit cards for an estimated $4.98 trillion in purchases in 2022 for an average daily purchase rate of $13.6 billion.
- The average U.S. transaction is for $90.89.

Nationwide Transaction Values

Increment	Transaction Values per
Second	$157,965
Minute	$9,477,913
Hour	$568,674,781
Day	$13,648,194,737
Year	$4,981,591,079,161

Source: Number of Credit Card Transactions per Second & Year: 2023 Data (capitaloneshopping.com)

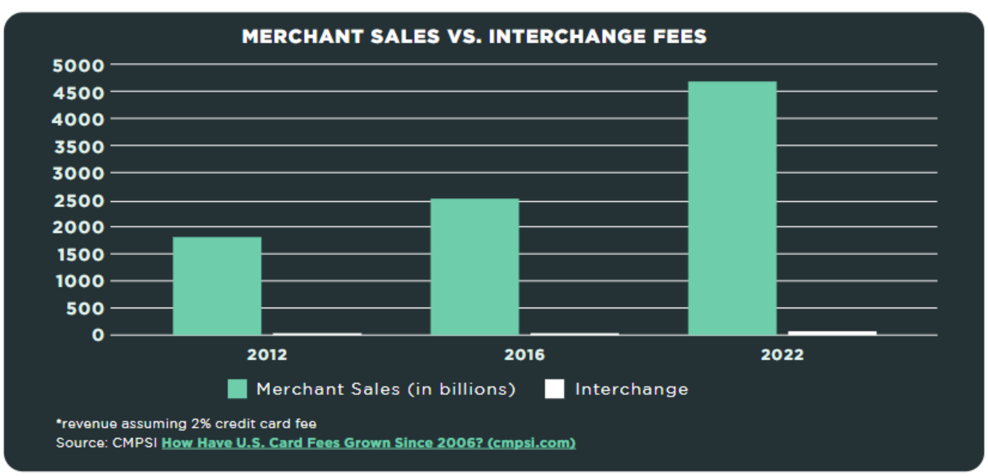
It is no wonder that credit cards have become so widely used in American life considering the incredible economic value they provide. In a **recent analysis** from financial specialist Peter Dunn it is estimated that U.S. credit cardholders reap aggregate benefits of $445 billion annually with aggregate costs of $150 billion annually. In other words, U.S. consumers get an average net benefit of $295 billion or $140.92 per month from holding a credit card. Dunn's analysis suggests that the largest benefit to U.S. consumers from holding a credit card is increased purchasing ability ($300 billion), followed by services ($70 billion), rewards ($45 billion), and avoiding cash expenses ($30 billion).

The use of credit cards is best characterized as a "two-sided" market of mutual benefit. In other words, cardholders would have no reason to use them if retailers didn't accept them, and retailers wouldn't accept them if cardholders chose not to use them. This implies that for this market to function smoothly, the incentives of card holders and the merchants that accept them need to align. In the U.S. credit card market this is overwhelmingly the case.

Both credit card users and the retailers that accept them, incur a host of valuable benefits. Using a credit card allows consumers to easily carry funds, receive rewards for transactions (i.e. delayed payments, cash back, special offers, and redeemable reward points), convenient checkout, the ability to build credit, and financial protection from theft and fraud. Reciprocally, accepting credit cards allows merchants to increase their sales, offer convenient checkout, receive prompt payment, and establish safer transactions.

In order to provide all of these benefits to consumers and merchants, credit networks charge a 1.5 - 2.5% interchange fee to merchants, amounting to mere pennies on many transactions. On average these fees **only rose 0.1%** from 2014 to 2020. And although the proponents of the Credit Card Competition Act claim that merchants pay more in interchange fees each year, this is only due to the rapid increase in the sales transacted through credit cards, rising to over $4.5 trillion in 2022 (See chart 1). Fees collected have lagged behind the volume of transactions.

1. The narrative that merchant interchange fees continue to increase leaves out the critical fact that it is impossible for "swipe fees" to increase if sales do not increase. The rate of interchange has remained flat for the past seven years, as sales have grown substantially.



What proponents of the Credit Card Competition Act fail to acknowledge is that credit card networks force retailers to compete for business by accepting credit and making transactions as convenient for customers as possible. In attempting to regulate credit card networks, merchants are colluding to reduce competition and cut cost at the expense of their customers.

Beyond the general convenience and financial service of credit cards that are covered by the cost of interchange fees, fraud protection and rewards points/cash back come at a significant cost to credit card companies. The Consumer Financial Protection Bureau **reports** that the rewards points and cash back enjoyed by American cardholders cost the largest U.S. banks almost $35 billion per year. This represents significant value for American consumers. Giving them points and cash to buy everything from gas and groceries to flights and hotels.

In addition to rewarding consumers with points and cash back, credit card companies use interchange fees to provide consumer and merchant protection from fraud and theft. Considering that the average U.S. retailer sees **1,740** fraudulent charges per month, this is an exceptionally valuable service. A recent **Nilson report** estimates that losses from fraud and theft cost credit card companies nearly $12 billion in 2021, up 18% from 2020. The report further estimates that U.S. fraud losses will cost $165 billion over the next ten years.

Interchange fees compensate credit card companies for providing a beneficial service to merchants and consumers, but it also pays for the significant costs associated with offering rewards and cashback as well as fraud and theft protection. If interchange fees are regulated to ensure an artificially low rate, credit companies will have to cut back on these valuable cardholder benefits.

How the Credit Card Competition Act Functions as a Price Control

In past iterations of the current Credit Card Competition Act a direct cap on credit card interchange fees was the proposed channel of regulation, but in the current proposed bill its authors have disguised the effective control on interchange fees in pro-competition rhetoric. If passed, the bill would mandate that all credit cards offer merchants the choice of at least two networks (one of which must be an alternative to Mastercard or Visa) through which to make the transaction. At first glance, this proposal might seem to be rooted in free market principles that would enhance competition and efficiently lower prices for consumers. In reality though, this would distort how credit card networks compete for customers and shift power to retailers at the expense of both consumers and credit card companies.

It is crucial to understand that offering an alternative network through which to make a transaction is far more complex than a simple flip of a switch or a push of a button. Every card would have to be reissued with new microchips capable of running transactions through two separate networks. This alone would cost credit card networks up to **$5 billion** and expose all card holders to potential fraud. More importantly though, it would require the credit card company that issued the card to provide the functional infrastructure, fraud protection, and customer rewards agreed upon with the card holder, but for its competitor. The issuing credit card company still bears all of the risk and cost, while the alternative network would reap the fee from the transaction. It is the equivalent of McDonalds being required by law to put Burger King Whoppers on its menu and sell them to their customers. Not exactly free market competition.

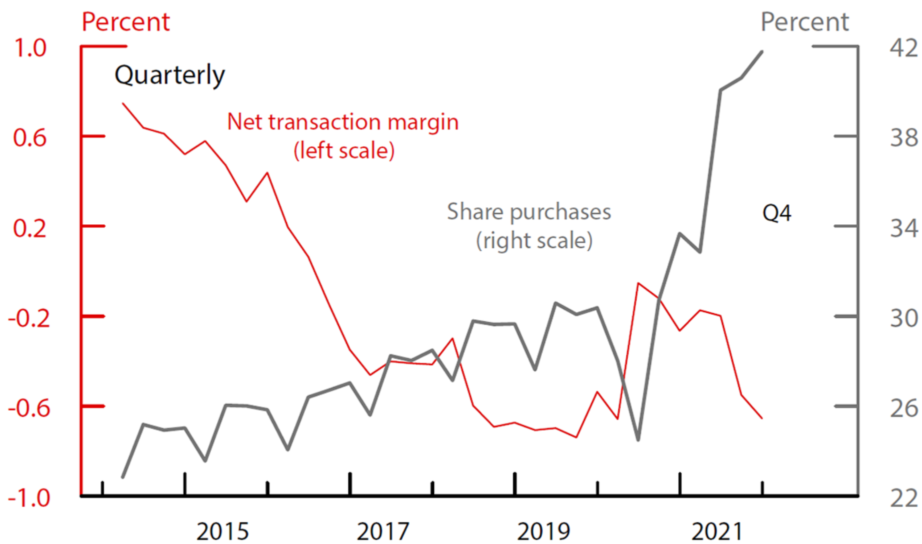
If the issuing company bears all of the risk and cost, then the alternative network chosen by the merchant (not the consumer) can offer to service the transaction at a lower cost. Additionally, the alternative network provider likely wouldn't be able to provide the same data security and transaction speed that Mastercard and Visa are able to provide due to the substantial investment in infrastructure and software. Under these conditions, issuing companies could no longer offer the same rewards and fraud protections currently provided to customers. These factors would effectively drive interchange fees down, but at the cost of so many of the benefits that Americans depend on – including easy access to credit cards and availability of rewards programs that lower purchasing costs for consumers.

No Lack of Competition in the Credit Card Market

The claim that there is a detrimental lack of competition in the credit card transactions market lies at the core of Durbin's stated purpose for proposing the Credit Card Competition Act. The logic goes that because Visa and Mastercard process a majority of U.S. credit card transactions, they constitute a duopoly in the market, and are guilty of fixing prices above competitive levels. A brief review of recent credit card transaction profitability and simple economic theory, vividly illustrates the intense competition that exists in the credit card transaction market.

In a **recent note**, economists at the Federal Reserve analyze the drivers of credit card profitability. Using granular data from the FR Y-14M Capital Assessments and Stress Testing Report with data from January 2014 to December 2021, they decompose credit card profitability into its three primary components: the credit function, the transaction function, and associated fees. The credit function encompasses all profit derived from interest earned on outstanding credit balances, the transaction function captures the profitability of the interchange fees collected less the rewards, cashback, and losses due to fraud, and the associated fees component is the catch all for usage fees, late fees, over-limit fees, and foreign exchange fees.

Using this profit decomposition framework, they find that over the studied period, 80% of profit was derived from the credit function, and 16% was from associated fees. What might come as a surprise to Durbin and those of his ilk is that the transaction function comprised approximately negative 4 percent of aggregate credit card profitability. Specifically, the net transaction margin (NTM) declined significantly from 2014 to 2019, dropping from 0.6% to less than negative 0.6% in five years. The steady decline in NTM is due in large part to an increase in rewards expenses, which rose from a quarterly average of 3.5% in 2015 to around 4.4% in 2020, an increase of about 25%. (See chart 2)



These findings beg an obvious question, why would credit card companies continue to offer such significant rewards to consumers if they are losing money on their transaction services? The answer is competition.

Credit card companies use rewards and cash back programs to build customer loyalty and expand their share of cardholders. They are willing to take a loss on their transaction services if they can expand their credit services that account for the bulk of their profitability. But they would have no need to offer such rich rewards to consumers if they weren't trying to bid them away from their competitors. The negative profitability margin that credit card companies incur from keeping interchange fees stable and increasing rewards to their customers is robust evidence of fierce competition in the credit card market.

What Durbin and his constituents fail to understand about market competition is that even when there is a high degree of concentration in a market, this doesn't mean companies have monopoly power or collude to artificially raise prices. The great free market economist, Harold Demsetz identified this principle in his famous 1968 paper, **"Why regulate utilities?"**. Using the utilities market as an example, a clear case of a natural monopoly, Demsetz showed that so long as there are low barriers to entry, competition for a market is as effective in keeping prices down as competition within a market. In other words, it doesn't matter if Visa and Mastercard process 80% of credit transactions. As long as consumers have the ability to switch to American Express, Discover, or the host of other competitors, Visa and Mastercard will keep interchange fees low and continue to offer rewards and benefits to their cardholder.

Considering that nearly **half of all credit card holders** say they use their credit card for the sole purpose of getting rewards and cash back, credit card companies will continue to compete for customers by keeping interchange fees stable and rewards high, even if it comes at a loss in their transaction profitability margin. But if the Credit Card Competition Act is implemented and interchange fees are capped at artificially low rates, credit card companies will be forced to start cutting the rewards and cash back benefits that millions of Americans use every day.

The Costly History of Interchange Fee Caps

We have at least 47 historical examples of countries across the globe that have tried to reduce consumer costs by implementing interchange price controls, according to a **report** from the Kansas City Fed that tracks government involvement in regulating credit and debit interchange fees. In most cases they have not worked to help consumers and have led to unintended consequences.

United States: Durbin Amendment

The Durbin amendment took effect in October of 2011, capping interchange fees on debit card transactions and effectively dropping them from an average of $.50 to $0.24 per transaction. A **study** by Zywicki et al. finds that this reduced average annual interchange fee revenue for banks by $6 billion to $8 billion. In response, banks recouped this loss in a number of distinct ways. They reduced the availability of fee-free accounts, pushing the total number of banks offering free current accounts down 50% between 2009 and 2013. Notably, smaller banks that were left untouched by the Durbin amendment saw an increase in fee-free banking. Banks also tripled the average minimum holding requirement on fee-free accounts from $250 to $750. These changes contributed to an increase of approximately a million unbanked people, the majority of which were low-income families. Zywicki et al. also estimate that the Durbin amendment caused a transfer of $1-3 billion annually from low-income households to large retailers and merchants.

And any idea of retailers passing cost savings through to consumers in the form of lower prices was a delusional fiction. An assessment by **Wang et al.** finds that 77% of retailers failed to change prices at all following the implementation of the Durbin amendment and 21-25% even had to raise prices due to the new regulation. The retailers that were forced to increase prices were likely small businesses. Prior to the Durbin amendment small businesses received small ticket discounts on low cost items, but due to the cost of the new regulation, banks eliminated this discount. An **analysis** from the Federal Reserve Bank of Richmond, estimates that this doubled or even tripled the cost of accepting debit cards for small businesses.

European Union: Regulation 751

In April 2015, the European Union introduced the Interchange Fee Regulation (IFR), capping interchange fees for debit cards at 0.2% and credit cards at 0.3% of the transaction value. As a regulation, the caps applied throughout the EU with direct effect. In other words, there was no room for member states to implement enabling legislation and no allowance for interpretation. The caps came into force in December 2015.

The results were unsurprisingly similar to the impact of the Durbin amendment in the United States. Based on an analysis from **Morris et al**, credit and debit card issuing banks compensated for the losses on interchange-fee revenue following the implementation of regulation 751 through a combination of increased interest, late-payment fees, and overdraft fees, which rose by nearly 38%, as well as from increased international-transaction fees, which rose by 22%. Additionally, pass-through rates from merchants to consumers were little better than in the U.S. with EU consumers receiving approximately 30% of the reduction in interchange fees in the form of lower prices. To put this in context though, pass-through rates of increased costs are generally in the range of 90%.

There is reason to believe that even this meager savings pass-through may be overestimated. Another long-term modeled **analysis** indicates that a 1% reduction in interchange fees results in only a 0.1716% decrease in retail prices from the merchant's perspective. However, it leads to a slight increase of 0.0048% in prices for cardholders. The net estimated effect translates to only a 0.1668% reduction in retail prices over the long run.

An Ernst & Young and Copenhagen Economics (EY/CE) **study** also finds that the EU cap on interchange fees led to stricter limits on who credit cards were issued to. The number of credit cards issued in the EU fell between 2015-2017 following the introduction of interchange fee regulation, while the number of debit cards grew only slightly.

Impacts on Consumers of Different Incomes, Races/Ethnicities, and Credit Scores

A cap on interchange fees has significant implications for consumers of different incomes, races/ethnicities, and credit scores. This section explores the effects of interchange fees on these diverse consumer groups, highlighting the potential disparities in the impact of implementing the Credit Card Competition Act.

In order to understand the disparate impact of this proposed policy change on different consumer groups, it is necessary to understand the current demographic makeup of U.S. cardholders. Approximately 34% of credit cardholders in the United States have an annual income below $75,000, compared to the median household income of $70,784 (**U.S. Census Bureau, 2021**). Within this group, 15% have an income below $50,000. It is notable that lower-income credit cardholders are more likely to be African American and/or Hispanic, and they also tend to have lower credit scores.

Additionally, 45% of African American credit cardholders have an income below $75,000, compared to 39% of Hispanic and 33% of White credit cardholders. Furthermore, 6% of cardholders with low credit scores (below 680) are African American, whereas only 3% of high-score cardholders (above 760) belong to this group. In contrast, 77% of low-score cardholders are White, while White consumers make up 83% of high-score cardholders. For Hispanic cardholders, the figures are 13% and 9%, respectively. So any policy that would disproportionately impact low-income and low credit score card holders would disproportionately impact racial minorities that are over-represented in these categories (**Viceisza, 2022**).

There are two significant implications for lower-income and lower-credit score consumers resulting from interchange fee regulation. The first is simply a relative budget constraint. The average loss in credit card benefits, regardless of the precise amount, is likely to have a more substantial impact on lower-income households compared to higher-income households due to the fact that it will constitute a larger proportional share of value for low-income cardholders.

The second and more subtle implication is reduced access to credit. Lower-income and lower-credit score consumers are more likely to experience an increase in the cost of credit, including fees and interest rates, due to the proposed regulation. Consequently, they might face challenges in accessing credit at all.

A **recent study** utilizing a demographic-specific model built with proprietary data from Verisk Financial and Nielson shows that while higher-income and high-credit score credit cardholders may experience an average loss of $11.50 per card, the loss is expected to be closer to $21.21 per card for lower-income and lower-credit score cardholders. This implies that lower-income and lower-credit score households could collectively incur a loss of $434 million. Although this consumer group constitutes 11.73% of the credit card population, they would bear approximately 21.64% of the consumer surplus loss to credit cardholders, in contrast to higher-income households who would experience much less severe losses.

These findings highlight the potential disproportionate impact of interchange fee regulation on different consumer segments, particularly those with lower incomes and credit scores. It is crucial to consider these disparities when evaluating the implications of capping interchange fees.

A Better Way for Retailers to Reduce Interchange Fees

In the period from the 1960s through the end of the 1990s, big retailers reduced their interchange fees by issuing their own credit cards. This was true of Marshall Fields, J.C. Penny, Montgomery Wards, Macy's, and even gas service stations. This was a way for companies to avoid having to pay transaction fees to the credit card companies. Some merchants, such as Airlines, also issue credit cards today.

If retailers like 7-Eleven, believe that the interchange fees are too high – or that they are not getting their money's worth by paying the 2 to 3 percent fees - then they are free to issue their own cards and avoid the Visa, Mastercard, Discover "middle man" fees altogether. The fact that so few do this, or that consumers are more attracted to using more standard credit cards, appears to be prima facie marketplace evidence that these major retailers get a substantial benefit from using the major credit cards for managing their transactions.

Rather than imposing government price controls on the credit card industry, a much better solution would be to allow retailers, such as Walmart, Target, and Walgreens to eliminate barriers to entry by allowing merchants to set up their own banks so they can compete with Visa, Mastercard and American Express

Conclusion

Credit cards and their many benefits are a part of everyday life for millions of Americans. Now legislators and big retail lobbyists are threatening to extend already damaging regulation to cripple the thriving and vigorously competitive credit transaction market. The proposal to impose a cap on credit card interchange fees, as outlined in the Credit Card Competition Act of 2023, fails to consider the significant benefits that credit cards provide to consumers and merchants alike. The evidence presented highlights the lack of cost savings and potential harm associated with such a policy.

Credit cards play a crucial role in the financial system, offering convenience, financial services, rewards, and fraud protection to consumers, services which collectively cost billions of dollars annually. These benefits derived from credit card usage far outweigh the costs, with consumers enjoying an average net benefit of $140.92 per month.

Contrary to claims of a lack of competition, the credit card market exhibits fierce competition, as evidenced by credit card companies' willingness to offer substantial rewards to attract and retain customers. Even going so far as to take a loss on their net transaction margins in order to keep their customers from going to one of their competitors. Contrary to what Dick Durbin might say, high levels of concentration in the market do not equate to monopolistic pricing. Imposing a cap on interchange fees would push interchange fees to unsustainable levels, inevitably forcing credit card companies to cut the rewards and benefits American consumers have come to count on.

Examining the history of interchange fee caps in the United States and the European Union, reveals the costly consequences of such regulations. The Durbin Amendment led to reduced fee-free accounts, increased costs for small businesses, and a transfer of wealth from low-income households to large retailers. Similarly, in the European Union, caps on interchange fees resulted in increased interest and fees for consumers, limited pass-through savings, and stricter limits on credit card issuance.

Furthermore, the impact of interchange fee caps on consumers of different incomes, races/ethnicities, and credit scores cannot be ignored. Lower-income consumers, particularly African Americans and Hispanics, are more likely to be affected by the proposed policy change. With a significant portion of credit cardholders falling into the lower-income bracket, implementing a cap on interchange fees would disproportionately harm these minority groups.

The evidence presented strongly suggests that imposing a cap on credit card interchange fees, as proposed in the Credit Card Competition Act, would have adverse effects on American consumers and the economy more broadly . The benefits of credit cards, including convenience, rewards, and fraud protection, would dissipate, while the costs of this policy would be shifted to lower-income individuals and minority groups. It is crucial for policymakers to consider these implications and seek alternative solutions that preserve the benefits of credit cards that truly promote competition and consumer welfare.

About the Author

Stephen Moore is an economist and author, serving as a senior fellow at the Heritage Foundation and a co-founder of The Committee to Unleash Prosperity. He is a frequent lecturer to audiences around the world on the U.S. economic and political outlook, and is the author of 6 books, including "Trumponomics: Inside the America First Plan to Revive our Economy." Moore is a graduate of the University of Illinois and holds a Master of Arts in Economics from George Mason University.

From 1999-2004, Moore served as founder and president of the Club for Growth, an organization dedicated to helping elect free market candidates to Congress. In his tenure as president, the Club for Growth became one of the most influential and respected political organizations in the nation. From 2005-2014, Moore served as the senior economics writer for The Wall Street Journal editorial page and as a member of the WSJ editorial board. He remains a regular contributor to the publication. Moore served as a senior economic advisor to President Trump's 2016 campaign, drafting tax, budget, and energy policy plans.

In 2007, Moore received the Ronald Reagan "Great Communicator" award from the Republican party for his advancement of economic understanding. In 2010, he was awarded the University of Illinois Alumni of the Year. His book "Return to Prosperity: How America Can Regain its Economic Superpower Status" was a finalist for the F.A. Hayek Award for Advancing Economic Understanding. In 2018, Worth Magazine named Stephen Moore one of the 75 Most Influential People in the World Dealing with Economics and Finance.

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