

ASSET BUILDING PROGRAM ISSUE BRIEF

POINT-OF-PURCHASE BANK CARD SURCHARGES:

The Economic Impact on Consumers

ALLEN ROSENFELD, PH.D.¹

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Credit and debit cards have taken the nation by storm. During the past two decades, the use of electronic payment cards to make retail purchases in the United States has increased at a phenomenal rate. Adjusted for inflation, the annual amount charged to credit cards in this country increased more than threefold between 1993 and 2007, from just over \$600 billion to more than \$1.9 trillion.² Debit card use is increasing even faster. The Federal Reserve estimates that debit card payments tripled in just six years – between 2000 and 2006 – growing at an average annual rate of almost 20 percent.³ According to estimates, card transactions accounted for 56 percent of all U.S. retail purchases in 2005.⁴ Further increases are expected.

As card purchases have increased, retailers have called on lawmakers to allow them to add point-of-sale surcharges. If these surcharges are allowed, retailers would be able to add a fee to the purchase price at the checkout counter when customers use credit or debit cards to pay for goods and services. For example, say that a retailer, such as a department store, at the point of purchase tacked on a fee to the price of each sale paid for with a credit card. Suppose also that the fee was equal to two percent of the value of the sale and was designed to cover what the retailer pays banks to process the transaction.⁵ (The fee paid by the retailer is known as a merchant discount fee, which will also be referred to as a bank card fee in this paper.) As a result, a product marked \$100 on the rack would be sold for \$102 plus any sales tax when a customer paid by credit card.

¹ Allen Rosenfeld is a Senior Vice President at M+R Strategic Services; he is based in California.

² U.S. General Accountability Office (2009).

³ Prager, Manuszak, Kiser, and Borzekowski (2009).

⁴ Prager, Manuszak, Kiser, and Borzekowski (2009).

⁵ Retailers pay their banks, known as “acquiring” banks, a “merchant discount rate” for every debit card and credit card transaction that is processed through the bank card system. For every purchase made using a bank card, the merchant discount rate has three components: 1) an “interchange fee,” which is paid by the acquiring bank to the bank that issued the credit or debit card and comprises the bulk of the merchant discount rate; 2) a portion of the merchant discount rate that is kept by the retailer’s bank, which credits the card transaction to the retailer’s bank account; and 3) a fee that is paid by the acquiring bank to the bank card network (e.g., Visa or MasterCard) that connects the pieces of the system, promotes the use of their brand of bank cards, and so on. Merchant discount rates in the United States average roughly 2 percent of the purchase price for credit cards and about 1 percent of the purchase price for debit card transactions. Bank card networks receive roughly one-tenth of 1 percent of the purchase price.

Consequently, surcharging has become controversial, especially among consumer advocates. First, there is concern that retail shoppers who use bank cards would not be able to obtain accurate information from on-product sticker prices or ticket prices on the rack. Second, the actual price of the purchase is not revealed until the customer is at the point-of-sale — the checkout counter. This makes informed shopping, often characterized by cost comparisons and household budget consideration, difficult. Third, perhaps more troubling for consumers, the actual price of goods or services would be higher than what they expected to pay.

Under the Federal Truth in Lending Act, such surcharges were banned by the federal government until 1984. However, Congress never renewed the part of the law forbidding surcharging, and the federal ban is no longer in place.⁶ Currently, ten states have laws on the books forbidding retailers from imposing credit card surcharges on consumers. Laws in four of them also prohibit surcharges on purchases made using debit cards.⁷ In addition, a number of other state legislatures are considering bills that would extend state bans on credit card surcharging to debit cards.⁸ Rules established by credit card networks, such as Visa and MasterCard, prohibit the use of consumer surcharges. Consequently, these fees have not yet appeared in the U.S.

Merchants have pricing options other than point-of-sale surcharges that avoid the problem of unannounced price increases at the checkout counter. They can build the out-of-pocket expenses associated with bank card expenses into the prices of their products, as they do with other business

expenses, thereby providing consumers with a single price and avoiding surprises at the point of sale. Also, bank card network rules and federal law allow retailers to offer discounts to customers who pay with cash.⁹ In that instance, retailers would post a single price for all customers and then make reductions in that price at the point of sale for customers who use cash.

Recently, legislative proposals have appeared that would explicitly negate no-surcharge rules by preventing credit card companies from “inhibit[ing] the ability of any merchant to direct consumers to the merchant’s preferred form of payment.”¹⁰ Some of the nation’s largest retailers have expressed support for this approach and opposed additional state bans on bank card surcharges.¹¹

To inform this debate, this paper presents an economic analysis of point-of-sale surcharges and examines their potential effects on U.S. consumers.

Economic Impact of Bank Card Surcharging

Economists have focused a good deal of attention on our transition to a plastic retail economy. This research can be used to inform an analysis of the impact on consumers when merchants impose bank card surcharges. In the following sections of this paper, which has been written for the lay reader rather than economists, the claims made by supporters of consumer surcharges are examined in some detail – including assumptions about who stands to gain if consumer surcharges are imposed on bank card users. After analyzing the costs and benefits of bank cards to merchants and the likely impact of consumer surcharges

⁶ The Federal Truth in Lending Act defined surcharging as, “any means of increasing the regular price to a cardholder which is not imposed upon customers paying by cash, check, or similar means” and stated that, “no seller in any sales transaction may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means.” However, that prohibition was in effect only until February 26, 1984 and was not renewed by Congress.

⁷ The ten states are: California, Colorado, Connecticut, Florida, Kansas, Maine, Massachusetts, Oklahoma, New York, and Texas. Connecticut, Kansas, Maine and Oklahoma also have laws prohibiting surcharges on purchases made with debit cards. The latter three states enacted debit card surcharge bans this year.

⁸ Two examples include: SB933, introduced by California State Senator Oropeza, on February 2, 2010; and S7267, introduced by New York State Senators Schneiderman, Foley, Huntley, Krueger, Montgomery, Peralta on March 26, 2010.

⁹ For federal cash discounting regulations, see Truth in Lending Act Amendments, Fair Credit Billing Act 15 USC 1601 Section 167, July 1986. For an example of bank card network rules allowing cash discounting, see http://www.mastercard.com/us/merchant/pdf/BM-Entire_Manual_public.pdf.

¹⁰ Credit Card Interchange Fees Act of 2009 (H.R. 2382), Section 193(c).

¹¹ These include: The Food Marketing Institute, which represents supermarket chains; the National Association of Chain Drug Stores; the National Association of Convenience Stores (e.g., 7-Eleven); the Petroleum Marketers Association of America; and the Retail Industry Leaders Association, which touts itself as “the trade association of the world’s largest and most successful retail companies” and includes major corporations such as Home Depot, Target, Gap, Lowe’s, J.C. Penney, and Sears.

on these types of payments, this paper concludes that, contrary to the claims of surcharge proponents, those surcharges add unexpected and excessive costs to purchases that function as a tax or wealth transfer from consumers to retail merchants.

Retailers' Claims about Consumer Surcharges

Some retailer advocates argue that consumers would be better off if bank card users paid a surcharge. While this notion seems counterintuitive at first glance, it does have its own internal logic. This argument is based on three key assumptions, which are identified and examined below:

1. Accepting bank cards for payment represents a negative net cost to a merchant's business operations. Those net costs are thus passed on to all customers in the form of higher prices for goods and services sold;
2. Customers who pay with cash or check are disadvantaged relative to customers who pay with bank cards since they pay higher prices for goods and services without getting the benefits of credit cards, such as rewards from banks that issue the credit cards; and;
3. If merchants were allowed to impose surcharges on bank card users, they would then reduce prices by an amount equivalent to bank-card fees, leaving card-paying customers no worse off than they would have been had they not been surcharged, and customers who pay with cash or check better off.

The assumption that accepting bank cards represents a net cost to retailers and results in higher retail prices initially seems credible. After all, retailers do pay fees to banks whenever bank cards are used. However, a closer look at the economic impact of electronic payments on merchants undercuts the validity of this claim.

To understand the impact of bank card use on consumers and prices, we also have to understand the impact on retail

merchants, let's examine one of the fundamental questions at stake in determining those impacts, namely: *how do the net costs and retail prices for goods and services of a retailer that accepts bank cards compare with the net costs and retail prices of a similar retailer that does **not** accept bank cards?*¹²

Economists at the Federal Reserve Board developed a basic model to explain the relationship between the fees merchants pay to banks for processing credit card payments and retail pricing. They found that retailers set a price for an item purchased by credit card that is equal to:

(the retail price for a cash purchase) +
(credit card-related costs paid by the retailer, including bank fees) – (the benefits to the retailer from accepting the credit card rather than cash or check).¹³

In other words, the retail price for a credit card purchase is not simply the price that would be charged by the retailer in the absence of credit card use plus the cost of bank card fees. Rather, calculating the full *net* costs to the retailer of accepting credit cards, instead of cash, *after accounting for the benefits of the credit card transaction to the retailer*, is the key to the retail pricing.¹⁴ If the benefits of credit card acceptance for retailers are greater than the costs associated with the acceptance of the cards, then the credit card price should be *less than, not higher than*, the cash price. This outcome would overturn a key assumption that underlies arguments for allowing retailers to impose a customer surcharge.

To put it another way, if retailers incurred *lower, not higher*, net costs (i.e., benefits minus costs) when accepting

¹² Net costs equal the benefits associated with accepting bank cards minus the costs associated with accepting bank cards.

¹³ Prager et al. (2009). The model was developed for a section of the study devoted specifically to the effects of credit card use when retailers have the option of setting different retail prices for different payment methods.

¹⁴ Prager et al. (2009). The authors also stated that "competition among merchants should lead a merchant to incorporate any transactional savings (i.e., benefits) from card transactions in the card price." See also McAndrews and Wang (2008).

card payments instead of cash, and if card purchases dominate sales, the difference between those costs would represent the amount by which retailers in competitive markets could *lower, not raise*, prices to account for the savings produced by credit card use. Those price decreases should occur despite the fact that retailers are being charged bank-card fees. This would contradict the assumption that bank card use leads to higher retail prices, thereby undermining the claims of retailers advocating for the right to add surcharge fees to posted retail prices.

Benefits to Retail Merchants of Bank Card Acceptance

According to a review of the economic literature on retail payment methods by Wilko Bolt and Sujit Chakravorti of the Chicago Federal Reserve Bank, there have been few attempts to use data from retailers to estimate the benefits of bank card payment methods relative to cash or check transactions.¹⁵

However, the importance of incorporating the benefits of bank cards into the analysis of retail pricing is recognized widely by economists and other financial experts. The benefits of cards over cash or checks from the perspective of retailers are substantial. The failure to include these real benefits in theoretical models and empirical estimates of retail payments is bound to distort research findings and lead to unreliable policy recommendations about the advantages of surcharges.

A December 2008 study by James McAndrews and Zhu Wang (of the Federal Reserve Banks of New York and Kansas City, respectively) indicated that bank card use does not impose higher costs on retailers than cash purchases, especially when the unique benefits of bank cards have been considered. According to the authors, as “empirical evidence shows, electronic payments are more cost-efficient than paper payments.”

¹⁵ Bolt, Wilko and Chakravorti (2008).

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They conclude that “because the [bank card] adoption costs can be spread over a large volume of transactions [a major benefit of bank cards], and because the variable fees of card use are less than the variable costs of handling cash, large merchants who adopt cards can offer lower prices than cash-only specialized merchants.”¹⁶

Other economists have noted the importance of bank card acceptance to merchants in gaining and maintaining market share relative to their competitors. According to a study from the Federal Reserve of Kansas City, “as previous studies found, competing *merchants accept cards for strategic reasons*. Merchants initially hope that their card acceptance can lure customers away from their rivals, but later on they accept cards to keep their current customers. Even monopoly merchants accept cards when their transactional benefits are lower than the fees they pay if they face an elastic consumer demand. They do so not because they have a strategic reason but because card acceptance shifts their cardholder customers’ demand upward.”¹⁷

¹⁶McAndrews and Wang (2008). Variable costs are additional costs that change as the number of purchases increase; these are separate from fixed costs, such as the construction of a supermarket, which occur and remain constant regardless of the volume of sales.) This conclusion is particularly interesting given the increasing concentration of retailing in the hands of fewer and larger corporations, and the prominent role played by the trade associations who represent these large companies in the push for authority to impose consumer surcharges.

¹⁷ Hayashi (2004).

Another team of analysts concluded that “benefits that extend beyond pure transactional or processing efficiencies from card acceptance include broader operating efficiencies, payment guarantees, reduced risks of theft of cash, elimination of the risk of uncollectible checks, the gains from efficient resolution of customer disputes through the credit card network chargeback processes, access to (and benefits from) network marketing programs, and improvements in merchants’ cash flow.

For example, in a credit card transaction, the merchant will be paid well before the card issuer receives payment from the card holder, which reduces operating cash balances that a merchant needs to have on hand. If, instead of accepting a credit card, the merchant were to extend credit to the customer, the merchant would have to incur the cost of a credit check, wait for payment and bear the risk that the customer might not pay. By accepting the credit card, the merchant gets the benefit of prompt payment, while the card issuer bears the cardholder credit and fraud risk.”^{18,19}

Bank Card Use and Higher Sales

To further illustrate the important benefits of accepting bank cards, let’s consider a hypothetical example using supermarket industry cost data. Assume that a supermarket in a competitive local market decides to stop accepting bank card payments. Its competitors in that local market, which are owned by other chains, continue to accept bank cards.

Assume further that the supermarket that stops accepting cards immediately reduces its costs for 50 percent of its transactions by the average merchant discount rate, which is roughly two percent per dollar of sales.²⁰ Because its competitors continue to accept cards and offer competitive

prices and similar products, however, assume that 10 percent of the store’s customers decide that they would rather continue having the convenience of using bank cards to pay for groceries than be forced to pay by cash or check. As a result, they switch to the competition.

Now imagine that each supermarket sells 1,000 packages of a certain food product per month and each charge a retail price of \$5.00 per package. The supermarket that stops accepting bank cards will save an average of 3.8 cents per package (i.e., the average amount per package of the merchant discount fees for credit and debit cards) as a result of accepting only cash and checks as payments.²¹ On the other hand, given the supermarket’s cost structure,²² the ten percent drop in sales will drive up the average cost of a package by 12.8 cents.²³ That’s nine cents per package more than, or 2.4 times the amount of, the reduction in costs due to the elimination of merchant discount fees.²⁴ In other words, without even considering the other benefits to merchants of bank card acceptance described above or the costs associated with handling cash or checks, such as theft and fraud, this example shows how the benefits to merchants of accepting bank cards can substantially exceed the costs.

²¹ That’s 10 cents per previous bank card sale spread across 50 percent of the purchases. Given that credit and debit card purchases each account for about 50 percent of the value of bank card purchases, in this example, the average bankcard merchant discount fee is assumed to equal 1.5 percent of the purchase price.

²² According to the Food Marketing Institute (FMI), the trade association of the supermarket industry, average fixed costs for the industry account for about 25 percent of total costs.

²³ Average product costs increase for the store that stops accepting bank cards because fixed costs such as interest payments and insurance, which do not decrease and account for about 25 percent of total costs, still need to be covered. However, there is now lower sales volume across which to spread those costs. As a result, the total costs per package increase. Conversely, if the store had continued to accept bank cards, the higher level of sales attributable to bank card acceptance would have resulted in 13 cents less in average costs, which would have more than compensated the merchant for the five cents per package in average merchant discount fees.

²⁴ Even if only five percent of the customers of the store (i.e., 10 percent of bank card users) that stopped accepting bank cards switched to the competition, the increase in average fixed costs per package (6.1 cents) would exceed the average value of the eliminated merchant discount fees per package (3.8 cents).

¹⁸Guerin-Calvert and Ordover (2005).

¹⁹ For additional discussion of benefits of acceptance of cards by retailers (e.g., adding value to their operations through payment guarantees; reduced risks of theft relative to cash; elimination of risks of unredeemable checks; faster transactions and improvements in cash flow; and marketing endeavors at lower costs than retailers can provide on their own due to the card network’s economies of scale), see Litan and Pollock (2006).

²⁰ In 2005, bank card payments were estimated to account for more than 50 percent of all retail sales in the nation. Prager et al. (2009).

In summary, a host of benefits gained by merchants from accepting bank cards – including increase in total sales – makes bank card acceptance a profitable enterprise for merchants and places downward pressure on customer prices. Expenses to merchants associated with bank card acceptance are real and, all other things constant, place upward pressure on prices. However, as this supermarket industry example illustrates, the benefits of bank cards can easily exceed their costs, thereby making up for associated expenses. From a retail pricing perspective, therefore, bank card use should have a net downward effect on retail prices.

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Surcharges Will Not Level the Consumer Playing Field

The findings in the preceding section about costs and benefits to merchants call into question the third assumption of surcharge advocates, namely that cash customers are disadvantaged relative to those using bank cards as a result of bank card fees. If net costs to retailers from credit card purchases are less than the net cost of cash purchases, then credit card purchases level the playing field *in favor of, not against*, consumers who pay with cash. As McAndrews and Wang put it, “cash users are subsidized by card users because they [cash users] use less efficient payments.”²⁵

²⁵ McAndrews and Wang (2008). Also, in their 2008 study of debit card surcharging, Bolt, Jonker and van Renselaar observed that, “Nowadays, surcharging debit card payments is not as self-evident as it used to be, since cash payments are often more costly to businesses than debit card payments. Hence surcharging cash usage or giving discounts for the usage of the debit card may provide consumers incentives that enhance the cost

Attracting credit card users, and thereby protecting market share, is especially important in this regard since it translates directly into cost reductions because retailers are then able to spread bank card fees over a larger volume of transactions.²⁶ On the other hand, suppose that some retailers decided to impose surcharges despite lower costs associated with bank card payments. These merchants would likely *increase* their costs by losing market share to competitors and having fewer customers among which they can spread fees associated with accepting bank cards. The end result could be a losing proposition for both retailers and consumers. Retailers that imposed a surcharge would lose market share as price-conscious and offended customers shifted loyalties to retailers that did not.

Consumers who continued to shop at surcharging stores could face a worst-case scenario, especially if they are less price-conscious, unaware of the imposition of an additional fee, or simply caught off-guard and trapped at the checkout counter when trying to complete their purchase. All customers – regardless of chosen payment method – would now encounter higher retail prices due to avoidably increased costs, while the bank card users among them would pay surcharges on top of the inflated retail prices. This raises one of the primary concerns about the acceptance of point-of-sale surcharging: that it is an unfair business practice that takes advantage of consumer behavior that is motivated more by inertia than small price sensitivity. It is a concern that has been raised by consumer advocates with respect to the business practices of many firms in the alternative banking sector, where payday lenders and check cashers provide a financial service but with a high fee structure that can trap customers into debt over the long haul.²⁷

efficiency of the POS payment system more than surcharging debit card payments.”

²⁶ McAndrews and Wang (2008).

²⁷ Parrish and King (2007).

Surcharge Revenues Will Not Likely Be Passed Back to Consumers

The previous analysis has undermined the first two assumptions underlying the claims that retailer surcharges would benefit consumers. Recall that the third assumption is that once surcharges can be assessed, retailers would reduce prices by an amount equivalent to bank card fees, leaving card-paying customers no worse off and customers who pay with cash or check better off since both would no longer have to pay inflated prices. Despite the tenuousness of the first two assumptions, let's examine whether imposing a surcharge on bank card users is likely to result in eventual consumer savings. Representatives of many of the nation's largest retailing industries seem to think so. Their beliefs cannot simply be dismissed on the grounds that they have a strong interest in the outcome of the debate.

To unpack the assumption that retailers who impose surcharges will reduce prices, this section reviews recent data on price movements within the supermarket industry, which has been in the forefront of current debates and is often described as a sector of the economy that is heavily affected by bank card fees.

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The Profitability of the U.S. Supermarket Industry

Supermarkets depend on high volume rather than on high profit margins for each dollar of sales to generate a return to their owners and investors. In fiscal year 2006-2007, the

industry's after-tax net profit was only 1.46 percent or, \$1.46 for every \$100 in sales.²⁸ Supporters of legislation that would end surcharge bans often cite such low-margin industries as examples of sectors of the economy that cannot afford to pay bank-card fees. They argue that credit card interchange fees, which in the U.S. have recently averaged about 1.7 percent, are higher than the average net profit per dollar of sales in the supermarket industry.

A closer look at the industry's profits, however, reveals a dramatically different picture. First, the 1.46 percent after-tax net profit estimate reflects "net income from sales that remains *after paying all expenses*," including bank card fees.²⁹ In addition, the standard for measuring profitability performance in our economy is the return on investors' equity investment, not the return on a company's or an industry's sales.

According to FMI, the rate of return on equity for the supermarket industry in the most recent fiscal year for which data were available (2006-2007) was 16.8 percent, well above the economy-wide average. The previous year's return on equity was 14.7 percent.³⁰ By comparison, the U.S. corporate average rate of return on equity was 15.4 percent in 2006 and 14.6 percent in 2007.³¹ Despite having to pay bank-card fees, the supermarket industry is, by any reasonable standard, performing well and delivering average to above-average returns to its investors. This means that despite a low profit margin per unit of sales, retail industries can be profitable.

The Failure of Grocery Retailers to Pass Through Cost Reductions to Consumers

The past three years' experience with retail food pricing in the U.S. offers an empirical example that can help us evaluate the likelihood that retailers will pass potential reductions in net costs produced by payment card surcharges onto consumers.

²⁸ Food Marketing Institute (2008).

²⁹ Food Marketing Institute (2008).

³⁰ Food Marketing Institute (2008).

³¹ Stern School of Business (2010).

In 2007, the prices of many key farm commodities surged to record levels on world markets. Those commodity price increases were translated into rapid and substantial increases in retail food prices throughout the nation. Since then, farm commodity prices have softened considerably, returning to near their pre-surge levels. In the case of wheat, a U.S. staple, prices dropped from highs well above \$10.00 to about \$5.00 a bushel in 2009.

One would expect, in the competitive market conditions required for the pass-through of cost reductions, that the ups and downs of farm commodity prices would be followed by similar ups and downs in retail food prices. In particular, given the combination of energy cost decreases, a weak labor market, and a deep recession, steep drops in farm commodity prices would be expected to lead to at least some reductions in retail food prices.³² This was not the case.

The caveat here is that if the food processing industry inexplicably raised its prices under similar conditions, retailers would likely pass those price increases on to consumers. In fact, as demonstrated by data in Table 1, prices paid to food manufacturing companies by retailers dropped between 2008 and 2009, ostensibly in response to reductions in the cost of the raw materials they purchased from farmers and the cost of energy. Despite declines in prices paid to processors and other costs, retail food prices increased, indicating that the retail food industry failed to pass its cost savings to consumers.³³

³² Since the cost of farm commodities comprises only roughly 20 cents of each retail food dollar, reductions in retail prices are not expected to be as large as commodity price reductions.

³³ Labor costs represent nearly 40 percent of the retail price of food according to the U.S. Department of Agriculture (USDA). Total retail trade employee compensation, according to the U.S. Bureau of Labor Statistics (USBLS), increased by one percent between 2008 and 2009. The grocery industry provides about three million jobs, or roughly two-thirds of the jobs in the non-farm food industry. The combination of these factors leads to the conclusion that labor cost increases from 2008 to 2009 should account for only a two-tenths of one percent increase in the price of food. That increase is roughly equal to the amount of decrease in food prices expected when the net decline in the costs of fresh fruits, vegetables and nuts are factored into the retail food price change equation.

Table 1: Comparison of Changes in Prices Paid and Charged by Food Retailers

Time Period	Change in Retail Food Prices ³⁴	Change in Prices Paid by Retailers to Food Manufacturers ³⁵
2006-2007	+3.68%	+8.04%
2007-2008	+5.17%	+9.58%
2008-2009	+1.40%	-2.47%

The index of prices paid to food manufacturers is a good indicator of what retailers pay for the food products they sell since processed foods account for nearly 85 percent of consumer spending on food and includes both the costs of farm commodities purchased by processors and the costs of processing and distribution to retailers. Fresh fruits and nuts account for about another six percent and fresh vegetables account for about seven percent.³⁶ Between 2008 and 2009, the producer price indices for “fresh and dry vegetables” and “fresh fruit and melons” *declined* by 10 percent and 5 percent respectively.^{37, 38}

In other words, the increase in retail food prices between 2008 and 2009 cannot be accounted for by changes in the wholesale prices of fruits and vegetables.

These findings – that retail food price movements during the past three years failed to reflect changes in the grocery industry’s costs – suggest that the industry cannot be counted on to pass back to consumers, in the form of lower prices, revenues obtained by imposing surcharges on bank card purchases.

³⁴ USBLS. Consumer Price Index for Food at Home: U.S. City Average (2010).

³⁵ USBLS. Producer Price Index for the Food Manufacturing Industry (2010). The producer price index reflects changes in prices received by U.S. food processors.

³⁶ Blisard and Stewart (2007).

³⁷ USBLS. *Producer Price Index for Fresh Fruits and Vegetables* (2010).

³⁸ Data from USDA’s Economic Research Service, reported in various issues of *Fruit and Tree Nuts Outlook*, show that when tree nuts are included, the index of prices paid to growers declined about 7% between 2008 and 2009.

Conclusion: Bank Card Surcharges Are Unfair to Consumers

Advocates of allowing merchants to impose surcharges on customers who pay with credit and debit cards have argued that the practice would be in the best interests of consumers. This report has demonstrated that the assumptions underlying a case for bank card surcharging in the U.S. lack credibility.

First, from a consumer-information standpoint, shoppers who use bank cards to make retail purchases would not obtain accurate information from prices posted on products, on shelves, and on racks since those prices would be lower than the actual prices at checkout. Given the potential deception implied by surcharging, it could represent, in effect, a form of bait-and-switch pricing, leading to unfair treatment of unaware consumers who make purchases with bank cards.

Second, an analysis of the economic impact of surcharging found that when the benefits of bank cards to merchants are accounted for – benefits which are conveniently ignored by advocates of surcharging – accepting card payments more than pays for itself. Retailers should not need surcharges to cover bank-card related costs since retailers who accept bank cards as a means of customer payment enjoy a net value gain.

Third, the net value gain from bank card acceptance and the resulting net downward pressure it exerts on retail prices means that bank card users subsidize consumers who pay with cash and by check, rather than vice versa.

Fourth, even if the costs of bank card acceptance did exceed the benefits, merchants have better options than surcharges, from the perspective of consumers' overall well being, such as offering cash discounts at the point of sale.

Fifth, even if surcharges were needed to offset the costs of accepting bank cards, there is little, if any, reason to believe retailers would return all or part of that benefit to

consumers in the form of lower prices. The recent movements in retail food prices appear to bear this out.

Participants in future policy discussions should take these considerations into account as they deliberate over the appropriate rules to govern financial transactions in a world which will increasingly be dominated by electronic payments. These rules will have to work for retailers and consumers alike.

Any surcharging under those conditions, therefore, would amount to a needless transfer of income from consumers to retailers that are already covering their costs related to bank card acceptance without a surcharge.

Consumers would transfer income to retailers in two forms. First, customers who paid with credit or debit cards would pay an unnecessary sales tax in the amount of the surcharge. Second, retailers who imposed surcharges would lose some customers to competitors. Remaining customers of those retailers would pay higher-than-pre-surcharge prices, since the net costs of bank cards to those merchants would increase with the decline in sales.

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MAIN OFFICE
1899 L Street, NW
Suite 400
Washington, DC 20036
Phone 202 986 2700
Fax 202 986 3696

CALIFORNIA OFFICE
921 11th Street
Suite 901
Sacramento, CA 95814
Phone 916 448 5189



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