Copyright © 2012
Competition Policy International, Inc.

For more articles and information, visit
www.competitionpolicyinternational.com

# The consumer, once king, is missing in the EU interchange fee debate

David S. Evans
*University of Chicago & University College London*

When the European General Court's MasterCard Judgment came down my wife and I were celebrating a significant wedding anniversary with a long-planned trip to Sicily. Even though I was curious, and EU court decisions are most riveting, I decided to stick with a Nesbo mystery novel for my beach reading. Recently, the OECD asked me to attend a gathering of competition authorities to discuss developments in the payments industry. The time for procrastination was over. I ploughed my way through the Court's 336 paragraphs and refreshed my memory of the European Commission's decision.

I discovered there was a mystery here too: the European consumer, once the King served by EU competition authorities, has disappeared. Before I get to the consumer's curious disappearance, I'll provide a review of the Commission's decision and the Court's judgment.

## Commission's Decision

The Commission claimed that MasterCard was an association even after it became a publicly traded company, because it was found to have a "commonality of interest" with the banks. Based on this, the Commission could claim that MasterCard had violated the EU laws (Article 101 TFEU) concerning coordination among competitors.

The Commission then argued that payment cards consist of three separate markets—systems, issuing, and acquiring. It concluded that the interchange fee sets a floor on the price that acquirers charge to merchants. By having an interchange fee, MasterCard restrained competition in the acquiring market to the detriment of merchants.

That restriction might be acceptable if having an interchange fee was essential to operating a payment card system. But the Commission concluded that payment-card systems wouldn't collapse without an interchange fee. According to the Commission, they knew that interchange fees weren't essential because five countries still have payment card systems even though they don't have interchange

fees and because the Australian payment card system didn't crumble when interchange fees were reduced in that country.

MasterCard could still win if it could show that it satisfied all four conditions of Article 101(3). In principle Article 101(3) allows companies to show there are pro-competitive benefits that outweigh the anti-competitive concerns. But this is an escape clause that requires Houdini-like skills in practice. MasterCard had the burden of proof to show it met each of the conditions. The Commission concluded it hadn't.

Having found MasterCard's setting of interchange fees unlawful, the Commission decided that MasterCard had to withdraw its interchange fee and could have one, but only if it could prove that it had met the conditions of Article 101(3). Since it is not clear that would be possible—and the Commission provides no real guidance on how to do it—it leaves interchange fees at either zero (since the absence of an interchange fee is essentially a zero one) or whatever the Commission would like them to be.

What's notable about the Commission's decision is the absence of any analysis of the impact of its decision on the consumer. It rejects every argument MasterCard makes concerning balancing consumer and merchant welfare. But it contains no analysis whatsoever of whether the Commission's decision would benefit or harm consumers.

**The Appeal**

MasterCard's appeal presented an array of arguments. Several of them directly or indirectly tried to get the court to consider the fact that consumers would lose as a result of the elimination of interchange fees. I'm going to just focus on those because they are really at the heart of MasterCard's substantive response.

The first way to get consumers into the picture would be to recognize that because payments is a multi-sided platform it is not possible to consider the acquiring market separately from the issuing market from the standpoint of assessing the

impact on public welfare. If you considered the multi-sided nature of the payments business then you could bring in the consumer. The court rejected this point.

MasterCard also tried to argue that eliminating interchange fees would increase prices to consumers. The Court concluded this was "entirely irrelevant" since all the Commission had to show was that competition was restricted in the merchant acquiring market. As the Court further emphasized:

"Moreover, it must be pointed out that inasmuch as the present complaint seems to criticize the Commission for having failed to take into account the economic arguments that demonstrate the advantages of the MIF for the MasterCard system, cardholders or consumers in general, it is of no relevance in the context of a plea relating to an infringement of Article 81(1) EC." (Article 101 TFEU was previously numbered Art. 81 EC and the Court used the old numbers.)

There is a final way to bring the consumer in under Article 101(3). As mentioned above, that is a very high hurdle for any company because it has to prove each of four conditions. Doing so involves marshaling economic evidence. The Commission can then reject that evidence after conducting its own assessment. The European General Court insisted that it had to defer to the Commission for complex economic assessments. That eliminated any serious analysis of MasterCard's evidence by the Court.

The European General Court affirmed the Commission's decision. That shouldn't be a surprise. Outside of merger cases, and cartel fines, the Commission hardly ever loses an appeal.

**The Irrelevant Consumer**

The European consumer clearly didn't have his day in court. In fact he was "entirely irrelevant". That is unfortunate as a matter of public policy. The

evidence is overwhelming now that reductions in interchange fees result in higher costs for consumers. That's what the evidence has shown in Australia where fees went up and rewards went down after the credit-card interchange fee regulations. It is what happened in Spain. And it is what happened in the United States even before the ink was dry on the final Federal Reserve Board regulations. There is really no serious debate at this point that reducing the interchange fee revenue to banks will increase the fees that consumers pay.

That isn't the end of the story though. Merchants are paying less interchange fees given the Commission's decision. They could reduce prices or improve services in ways that benefit consumers. The critical question is whether the benefits that consumers get from merchants passing on savings, if they do, outweigh the higher prices they are paying to banks. Last year, Abel Mateus, former head of the Portuguese Competition Authority, and I did a study of this question. We reviewed likely pass-through of changes in costs in revenue for merchants and banks. We concluded that merchants would not give enough back to consumers to offset the higher fees from banks.

Of course, one could debate our analysis. Unfortunately, the European General Court and the European Commission approached interchange fees in a way that deflected the questions that any sensible policymaker would want to know the answers to: Is reducing the interchange fee benefitting competition and ultimately consumers? Or is it enabling merchants to shift their costs of supporting the payment system onto consumers?

You won't find any serious analysis of these questions in the Commission's Decision or in the European General Court's judgment. For all intents and purposes, the Commission said, forget about consumers, let's focus on merchants, and the Court said OK!

**The King Has Vanished**

For more than a decade, the European Commission has been talking about the importance of the consumer in competition policy. In June 2000, Mario Monti,

then serving as Commissioner for competition policy, said in Lisbon, "[C]ompetition policy puts markets at the service of consumers…. After all we say the consumer is king!" In 2009, his successor, Commissioner Kroes said, "[T]he Commission has made an important choice in putting consumer interests at the centre of our competition work." A year later Commissioner Almunia said, "All of us here today know very well what our ultimate objective is: competition policy is a tool at the service of consumers."

If that is so, it is very hard to see how the European Commission could be proposing the elimination of interchange fees (or the sharp reduction of those fees) with no serious analysis of its own that could establish how consumers will come out in the end. Nor is it easy to understand why the Commission would pursue a legal analysis—under Article 101—that essentially prevented a balanced consideration of whether consumers would end up better or worse off from its approach.

One can have a legitimate debate about whether payment card interchange fees are too high, whether regulators should reduce them, and even whether they should be eliminated entirely. But no policymaker concerned about the welfare of consumers would do that without carefully analyzing whether interchange fee regulation is simply crony capitalism for merchants, or whether it is truly in the interest of consumers.

There is indeed a mystery in Brussels and Luxembourg: how has the EU consumer, the King, vanished?