

Submission

By

**THE
NEW ZEALAND
INITIATIVE**


to the Commerce Commission

on

**the Consultation Paper
Retail Payment System**

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1 INTRODUCTION AND SUMMARY

- 1.1 This submission in response to the Commerce Commission's Consultation Paper *Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand*¹ is made by The New Zealand Initiative (the **Initiative**), a think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.
- 1.2 The Initiative undertakes research that contributes to the development of sound public policies in New Zealand and the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.
- 1.3 The Initiative's members span the breadth of the New Zealand economy, including Mastercard, banks that issue credit and debit cards, and merchants that accept those cards. However, the views expressed in this submission are the views of the author, not those of our members.
- 1.4 In summary, we submit:
 - (a) New Zealand differs substantially from markets in which surcharges are prohibited. The ability to set surcharges for credit card acceptance materially affects results.
 - (b) Merchant inability to perfectly set surcharges does not make a case for banning surcharges above 0.7%. If a merchant were not perfectly able to apportion electricity costs across every customer and instead used rough-and-ready rules, we would not expect that to be sufficient basis for comprehensive price controls in the electricity sector.
 - (c) The Commission understates the value of ancillary services provided by card schemes, particularly the value of insurance on transactions. It is difficult to understand how the Commission would take a view that "there should be no difference between the interchange fees for credit and debit transaction" unless no value is placed on the extra services provided to the consumer when credit cards are used for transactions.
 - (d) The Commission's analysis needs to more seriously consider market dynamics where retailers can choose whether to accept credit cards (where EFTPOS cards are ubiquitous) and whether to set surcharges on credit card use (where customers can choose to use EFTPOS instead if they wish), where consumers can weigh the relative advantages of each payment method on a transaction-by-transaction basis, and where credit card companies can vary merchant fees across different merchants. If the value of ancillary services like insurance varies across retailers, we should expect fees to vary. In areas where chargeback risks are high, service fees will be higher.
 - (e) The Commission ought to worry about the harm it could inadvertently cause if it sets maximum interchange fees below the cost of delivering services that consumers and merchants find to provide net value. The cost of *payments* could reduce, but with increases in the overall cost of *transactions* where card services had been valuable (and if consumers seek secondary providers of services that had been bundled with credit card transactions) or with other reductions in overall welfare (if the transaction cost of arranging those previously-bundled services is prohibitive).

2 THE COMMISSION FAILS TO TAKE SURCHARGES SERIOUSLY

- 2.1 New Zealand allows retailers to set surcharges for credit card acceptance, or to refuse to accept credit cards and only accept EFTPOS. This liberal environment has resulted in a wide variety of retailer practices.
 - 2.1.1 Some retailers place a piece of black tape across the credit card option on their payments terminals. Customers in those places can choose cash or EFTPOS.

- 2.1.2 Some retailers accept credit cards but set surcharges on use. Customers in those places can choose to accept the surcharge and use their credit card, or to use EFTPOS instead.
- 2.1.3 Other retailers set differential surcharges for payWave. Customers can choose whether to swipe their credit card at one (or no) fee, to use payWave at a higher fee, or to use EFTPOS or cash without fee.
- 2.1.4 And still other retailers set no surcharge at all. Large supermarket chains do not apply surcharges.
- 2.2 Under ubiquitous surcharges, the Gans and King neutrality theorem applies; under non-universal surcharges, welfare effects are more ambiguous. But they are hardly presumptively inefficient.
- 2.3 Fletcher's literature review for the Commerce Commission notes the neutrality result and suggests that, in the absence of perfect surcharging, at least some of the interchange fee will be spread to non-card users – and that the fee will be set strategically to impose costs on non-users.
- 2.4 The theory of harm in that case is a consequence of undercharging. What then should we make of concerns that retailers set card surcharges above the cost they incur in accepting cards?²
- 2.5 Consumer and merchant choices in these contexts matter. The Commission asks, at 4.36, why the costs of credit and of card rewards and benefits should be borne by all consumers. Merchants setting surcharges for the use of credit cards have clearly asked, and answered, the same question.
- 2.6 The Commission asks whether larger merchants should be able to attract lower interchange fee rates. Surely a card scheme faces a fixed cost in dealing with any retailer as well as costs that vary with the number and value of transactions, as well as costs that vary by the type of retail transaction. The combination of fixed and variable (by transaction and by value) costs would automatically drive differences in interchange fees across merchants. We should not worry if larger retailers are able to secure volume discounts from suppliers in other contexts. It should not be a concern here.

3 SURCHARGES AND SERVICES WILL BE INTERRELATED

- 3.1 The value and cost of insurance bundled with credit card transactions through ability to initiate chargeback procedures will vary considerably across types of transactions.
 - 3.1.1 It seems unlikely that many consumers would view transaction insurance as being important when buying groceries. If they have a problem with an item, they will bring it back to the store; the value of any particular item is unlikely to be large. Credit card schemes are unlikely to have to deal with chargebacks on groceries if a consumer discovers that they have been defrauded in the transaction weeks after the sale.
 - 3.1.2 It seems likely that many consumers would view transaction insurance as being important when purchasing higher value items that require shipping, or where there are other lags between payment and delivery, and where they worry about the merchant fulfilling their end of the bargain. While the Consumer Guarantees Act offers protections, those protections do little if the retailer has gone into liquidation before goods were delivered. EFTPOS and bank transfers do not come with insurance; credit cards do.
 - 3.1.3 In cases where that insurance is valuable to consumers, it is also likely to be valuable to merchants. A consumer who is only willing to deal with a new retailer or service provider in the presence of clear insurance against transaction risk will be lost if the transaction cost of obtaining that insurance is high and if that insurance is not bundled into the credit card transaction. Further, because cards will experience-rate merchants, merchants have incentive to avoid inducing chargeback scenarios: they will want to maintain lower credit card fees by delivering promised goods and services.³

- 3.2 Similarly, but from the reverse perspective, consider the merchant who worries that a consumer may fail to make instalment payments or may fail to pay an invoice. If a credit card user accumulates credit card debt and does not pay it back, merchants are secure. The credit card company eats the loss, selling the debt at a discount to companies specialising in debt collection. The ability to place a hold on a card against final payment and against determination of any losses, for example at rental car companies and at hotels, is a valuable service – with some risk transfer to the card issuer. And, again, the value of that facility will vary considerably across merchants.
- 3.3 The Commission, at 4.48, seems to have concluded that because some merchants are charged lower fees than others, all merchants could be charged that lowest fee. Would the Commission similarly conclude that the per-can cost of Coke in different volumes should be identical, regardless of whether it is sold as a single can from a grocer's cooler or as a containerload? Should life insurance for a 25-year-old draw the same annual premium as life insurance for an 80-year-old? Observing that a low price is possible hardly means that that price is appropriate in all contexts. And again, remember that merchants can and do pass those fees on to consumers through surcharges where they wish to do so – and often do. That also constrains the fees that cards may impose. If the consumer does not value the credit card service sufficiently, the consumer will push the EFTPOS button instead.
- 3.4 In the presence of merchant surcharges, credit card users face a two-part pricing regime. They (may) pay an annual fee for holding the card, and they pay a fee when using the card that is somewhat proportionate to the value they receive from using the card and obtaining its bundled services. In places where the scheme adds high value, like in transactions where there is greater perceived counterparty risk, consumers will choose the cards and pay the fees. If allowed fees were capped, the cost of providing those services would have to shift into the card's annual fee. Low-volume users may choose to drop cards providing larger bundles of services where the cost of those services is averaged across all users and choose EFTPOS instead, or new cards that come with fewer bundled services, *even in the case where on a per-transaction basis they would have preferred to have paid for those services through surcharges.*
- 3.5 We note a similarity to the approach taken by MBIE in its 2016 inquiry. There, MBIE suggested that credit card customers who pay off their cards in full each month and consequently do not benefit from the credit part of the service could have used EFTPOS without loss, other than loss of card loyalty scheme benefits – which MBIE viewed as constituting a transfer rather than net benefit. In essence, MBIE assumed that no other benefits existed and that there were consequent inefficiencies in charging a non-zero price for something deemed-by-officials to have zero value. Dispute resolution and chargeback services bundled with credit cards here ignored by the Commerce Commission were there ignored by MBIE.⁴
- 3.6 Let us take a very concrete recent case. In July 2024, Actura New Zealand was placed into liquidation by its creditors. Actura organised student trips to SpaceCamp in the United States. The cost of the trip was substantial: over \$10,000 per child for flights, accommodation, and camp fees in Houston and in Huntsville. Actura took initial deposits, then instalment payments, then payments for additional services at SpaceCamp like laundry, then went into liquidation before the scheduled trip. It seems likely that the company was knowingly trading while insolvent and defrauding parents. Parents who had paid for the trip through credit card payments, with a credit card surcharge imposed by Actura, were able to secure refunds through chargebacks because the service was never rendered. Parents who avoided the surcharges by using bank transfers are likely to receive nothing back at the end of the liquidation procedure. It seems odd to expect that EFTPOS and credit cards should have the same fees.⁵

4 MARKET DYNAMICS AND POTENTIAL HARMS OF REGULATION

- 4.1 Retail payments reflect market choices. Merchants choose whether to accept credit cards, and whether to impose fees on card use. Large retailers, like supermarket chains, responsible for large volumes of transactions, and whose customers derive little benefit from bundled transaction insurance services, will be able to negotiate transaction charges low enough to not be worth surcharges. Smaller retailers that are more costly for issuers to deal with will be more likely to face higher charges – and even more so if their transactions face higher risk of chargebacks. If the retailer views the fee as exceeding the value that the retailer derives from the service, the retailer can set a surcharge. If the customer sees the surcharge as exceeding the value that the customer derives from using the card, rather than using EFTPOS, the customer will choose to use EFTPOS instead.
- 4.2 If the Commerce Commission is correct that cards provide no value sufficient to warrant charges above 0.7%, few card users would be willing to push the button accepting a 2% surcharge for credit card use. EFTPOS is readily available as alternative and carries no charge.
- 4.3 If the cost and value of services bundled with credit card transactions exceeds whatever cap the Commerce Commission would wish to set, it will force a presumably inefficient unbundling of those services. Customers wishing transaction insurance would need to find a provider of it, if one exists.
- 4.4 Similarly, Card schemes employing two-part tariff regimes would need to revise their tariff structures to rely far more heavily on annual charges. Perhaps they could innovate in developing annual charge schemes that vary with monthly average card turnover, so that low-volume users would not be disproportionately harmed by annual charges reflecting average cost of services across all cardholders.
- 4.5 It seems difficult to set a maximum interchange fee that constrains rents in cases where there may be rents, but that does not price out services that are costly to provide and that are difficult for the Commerce Commission to observe. Caution may be in order.
- 4.6 We suggest that if the Commission wishes to proceed with tight regulation of interchange fees, a comprehensive cost-benefit assessment may be in order. Forcing prices down is not costless. If costs are unchanged, they must be funded by other means.⁶ If costs are reduced by removing services, so too are benefits. Who will bear the burden, and whether there will be net benefits, seems worth knowing. Any tallying of costs should also include dynamic costs in innovation, where services that could only be sustained through service charges may fail to be developed or rolled-out in New Zealand if providers expect regulatory predation after having sunk those costs.
- 4.7 Our 2017 submission on MBIE's consultation follows directly, under its own heading.

¹ Commerce Commission. 2024. *Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper*. 23 July 2024. Available at https://comcom.govt.nz/data/assets/pdf_file/0031/359491/Retail-Payment-System-Costs-to-businesses-and-consumers-of-card-payments-in-Aotearoa-New-Zealand-Consultation-Paper-23-July-2024.pdf

² <https://www.rnz.co.nz/news/business/502580/consumer-nz-faults-businesses-over-excessive-card-surcharges>

³ See, for example, Stripe's discussion of chargebacks here: <https://stripe.com/nz/resources/more/chargeback-fraud-101>

⁴ Our submission to that process is appended to this submission.

⁵ See discussion in <https://www.stuff.co.nz/nz-news/350346375/actura-new-zealand-placed-liquidation> for example. While the piece does not note credit card chargebacks, it is common knowledge among affected parents that those who paid by credit card were able to effect refunds.

⁶ Discussion on this issue from Geoffrey Manne, Joshua Wright, and Todd Zywicki is illuminating. See Manne et al, 2010. “Politically-mandated credit card interchange fees won’t create jobs (But they will hurt consumers and the economy)”. Available at https://truthonthemarket.com/2010/03/20/politically-mandated-credit-card-interchange-fees-wont-create-jobs-but-they-will-hurt-consumers-and-the-economy/?_gl=1*1pvj3ce*_ga*NDAXNzQxOTY5LjE3MjI4OTM2ODQ.*_ga_R1FRMJTK15*MTcyNDExNjExMC43LjAuMTcyNDExNjExNy4wLjAuMA

Retail payment systems in New Zealand

Submission to the Ministry for Business, Innovation and Employment

18 January 2017

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Introduction

- 1.1 Thank you for this opportunity to provide feedback on MBIE's Issues Paper, "Retail payment systems in New Zealand."
- 1.2 I am Head of Research with The New Zealand Initiative, a Wellington-based think-tank supported by New Zealand's leading businesses. The Initiative engages in public policy research for a free and prosperous New Zealand. Previously I served as Senior Lecturer in Economics at the University of Canterbury; I am currently Adjunct Senior Fellow with the Department. I can be reached at [REDACTED] and at [REDACTED]
- 1.3 I have reasonable background in cost-benefit assessment and market failure theory. At the University of Canterbury, I taught on the principles of cost-benefit analysis. I also occasionally taught the Department's intermediate microeconomics course, which provided a strong focus on defining market failure. I now teach Introduction to Public Finance at Victoria University's School of Government, which also covers cost-benefit assessment. With Tyler Cowen, I edited Market Failure or Success: The New Debate (Edward Elgar, 2002); I also wrote the entry on market failure for the Encyclopedia of Law & Society (Sage, 2007). I am not, however, expert in the economics of credit card interchange fees.

Market Failure and Problem Definition

- 2.1 "Retail payment systems in New Zealand" suggests broad inefficiency in New Zealand's payment regime.
- 2.2 The paper argues that customers have incentive to shift to cards providing larger rewards, and with higher associated merchant fees, and to shift from EFTPOS to reward-bearing cards.
- 2.3 The paper argues that the real resource costs associated with credit card use over EFTPOS are of the order of \$137 million per year. The paper notes that consumers receive benefits from credit cards over EFTPOS and that these benefits would need to be counted against the real resource costs of credit card use.
- 2.4 However, the paper also argues that where credit card users pay off their cards in full each month, those users have no need for the card's credit facility as they could have used EFTPOS (paragraph 193). These users are deemed by the authors to receive no benefit from using credit over EFTPOS other than rewards through card loyalty schemes. The authors view reward schemes as constituting a transfer (from merchants, from users of lower fee cards, and from non-card users) rather than a net benefit.
- 2.5 The paper then argues that card loyalty schemes increase the cost of payment processing by some \$45 million per year: the value of the extra real resources used to process credit transactions among those deemed to receive no benefit from the credit transaction other than card loyalty rewards. The authors go on to conclude this constitutes a market failure.
- 2.6 This key finding is fundamentally erroneous in two key respects. First, the conclusion itself is dependent on an *assumption* that that users of credit cards derive no benefit, when this is both

unproven and unlikely. Secondly, simply deciding that some class of transaction has no benefit to the people involved does not constitute a market failure.

- 2.6.1 A market failure obtains where one of the conditions underlying the First Welfare Theorem fails. Externalities are a very common form of market failure – for example, dumping effluent in a river to the detriment of downstream users. In that case, the marginal cost facing the decision maker diverges from the marginal social cost and too much dumping is expected relative to an optimum. But the market failure case advanced in this paper is tenuous at best. Normally, parties linked by a contractual nexus are not seen as imposing externalities on one another. To take a classic example, a baby crying on an airplane *inconveniences* other passengers and imposes cost on them, but does not impose any kind of policy-relevant externality. If consumer willingness to pay for baby-free flights were high enough, airlines would provide them. The baby, and other passengers, are linked through a contractual nexus via the airplane ticket which does not guarantee a baby-free experience.
- 2.6.2 In this case, users of credit cards, merchants, and EFTPOS users are similarly linked through contractual nexus. Card users decide whether or not to subscribe to different types of cards with different fees; merchants decide whether to accept credit cards and whether to apply a surcharge if they do; and, shoppers decide whether to shop at establishments accepting cards.
- 2.6.3 Consider again an airline analogy. The MBIE paper asserts that credit card users impose costs on non-users and, because those users do not consider the costs of their decision on others, an externality obtains. When you fly internationally, the airline typically provides free alcohol. Do passengers who partake in free drinks impose an externality on tea-totalling passengers by slightly increasing the average cost of tickets? Hardly. Airlines decide what is included in an airfare, and customers choose across airlines and ticket classes. They are linked through that contractual nexus, and competitive pressures across airlines for passengers provides far stronger incentive to get the right mix than would any MBIE-led regulatory intervention.
- 2.6.4 MBIE's position here on the irrelevance of contracts in determining whether an externality obtains is worrying.
- 2.6.5 Finally, simply proving the existence of a market failure, which MBIE has failed to do, would be insufficient basis for intervention. Intervention to address market failure is only warranted where that intervention is supported by cost-benefit assessment. Harold Demsetz's 1969 classic "Information and Efficiency" explains that we need comparative institutional analysis: markets fail, but government intervention does not automatically bring about Nirvana. Interventions consequently need to be backed up by a case demonstrating that outcomes under real-world interventions, taking account of implementation costs and unintended consequences, improve welfare as compared to real-world market outcomes. Cost-benefit assessment is needed.

Benefits of credit card use for those who pay off balances in full

- 3.1 It is highly likely that consumers using credit cards who pay their cards off in full each month receive valuable benefits from card use, over EFTPOS, other than simply reward schemes.
- 3.2 Credit cards are considerably simpler in use in online transactions than EFTPOS.

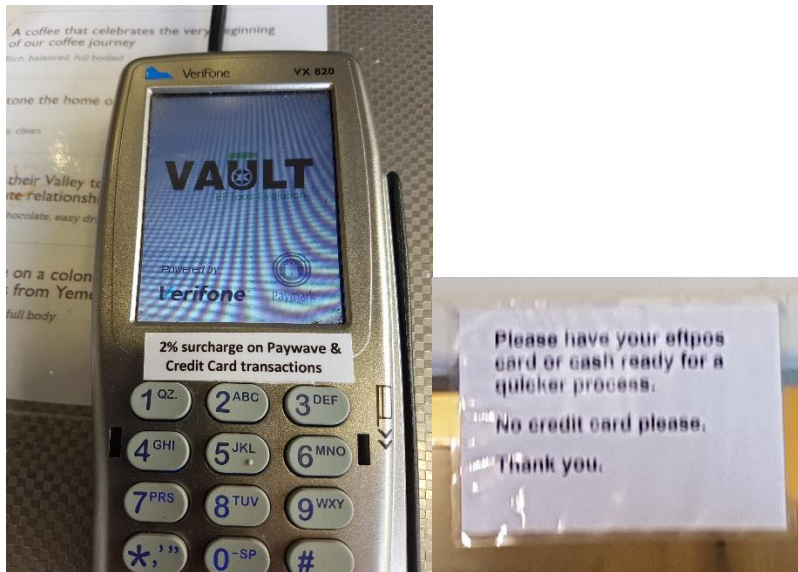
- 3.3 Credit cards come with dispute resolution facilities in case of disputed transactions. Similarly, credit cards can provide extended warranties, fraud protection, and simplicity in transactions when travelling abroad.
- 3.4 Credit card users enjoy an interest-free period on all purchases equal to the distance between the purchase and the next credit card payment due date, multiplied by the customer's relevant interest rate. For those consumers on a line-of-credit mortgage that acts as their transaction account for EFTPOS purchases, EFTPOS purchases immediately draw interest at the consumer's home mortgage rate. Credit card purchases allow a deferring of that interest. This is a transfer rather than a net benefit (from the bank to the card user via forgone interest), but is a plausible reason for using a card while paying it in full each month.
- 3.4.1 Question 3 of the Report asks why the revolve fee has declined. The mechanism above may prove part of the answer. Customers with the type of mortgage described above will have reasonable incentive to use credit cards, and to shift their balances in full each month to their lower interest mortgage. The authors of the study should at the very least investigate the uptake of this type of mortgage.
- 3.5 Where consumers do draw benefits like those described in 3.1 and 3.2, those have to be set against the real resource costs of credit card use over EFTPOS. Failing to do so is inconsistent with sound cost-benefit assessment. I consequently disagree materially with the logic underpinning the assessment of inefficiency in the credit card market.
- 3.6 Even if it were the case that these benefits were inframarginal to any customer's decision, and even if it were the case that many of these customers decided to use credit over EFTPOS because of the rewards schemes, sound cost-benefit assessment would *still* require the tallying of the benefits listed above. Those benefits would be forgone in any counterfactual shift to EFTPOS, and their value would need to be assessed.
- 3.7 I also have some reservations about the analysis undertaken by Treasury in its feedback to MBIE on this paper.
- 3.7.1 I have been provided Treasury's advice to MBIE on this paper under the Official Information Act in the form of an earlier draft of the paper where Treasury's comments were included. Treasury's analysis did not question the \$44 million then-listed as additional cost but rather only requested that the introduction outline how this was calculated. If sufficient detail were provided in the earlier draft to make clear that the \$44 million rested on an assumption that consumers paying their balance in full received zero benefit from use of credit card (as compared to EFTPOS) other than scheme rewards, Treasury should have advised MBIE of the error in its cost-benefit assessment. Those sections of the report provided to me were redacted, so I cannot tell whether Treasury's comments caused MBIE to demonstrate their workings, which showed that they simply rely on an assumption that credit card users receive no benefit from that use if they pay off their balance in full, or whether those workings were provided and Treasury failed to point out the inadequacy of that analysis.
- 3.7.2 At draft paragraph 236 (draft Chapter 5, first section), where MBIE then noted that government intervention was likely to be necessary, Treasury's advice was "Would be good to go further here and link to the cost-benefit case for acting. MoF's office have been vocal that market failure alone does not justify intervention, there has to be the case that regulation will increase the net social benefit too. Some level of government intervention would decrease the inefficiencies and save consumers money? Or similar...". A second Treasury commenter noted that MBIE's wording that "some level of government

intervention is required” was too strong, as the risks of intervening needed to be weighed against any identified inefficiencies of existing arrangements. Both point to the need for cost-benefit assessment to underpin any intervention, but the draft version of the issues paper suggests that MBIE has already decided that some level of intervention is required. Treasury was correct in its advice in this section. The final draft incorporates too little of this advice, and does disservice to the cost-benefit assessment framework by assuming that a class of transactions is of no benefit to the consumer.

- 3.8 The mechanism described in 3.3 is a transfer rather than a net gain, but muddies some of the welfare analysis. Simultaneous to any transfer that might obtain from one customer to another – which again is not necessarily any kind of market failure given the existence of a contractual nexus among parties – is a transfer from banks to those customers with mortgages able to reduce their interest charges in this way.
- 3.9 Even leaving aside the substantial error inherent in assuming zero benefit to those consumers who pay off their balances in full each month, there are other problems.

Credit card fees, retailer choice, and surcharges

- 4.1 There is a neutrality theorem that applies where merchants impose fees for use of credit cards (Gans and King, 2003). In that case, credit card fees simply do not matter.
- 4.2 “Retail payment systems in New Zealand” notes high penetration rates of credit cards (para 161) and the relative infrequency of surcharging (cited as less than 10% of transactions weighted by turnover at paragraph 158). Both of these are presented as suggestion that merchant uptake of credit cards is less than voluntary, and that merchants are constrained against using surcharges because of consumer objections.
- 4.2.1 Walking around Wellington, it is *easy* to find retailers who either do not accept credit, or who only accept it with a surcharge.
- 4.2.1.1 Moore Wilson targets high end shoppers – the kind MBIE would expect only care about reward scheme points and who MBIE would expect would pressure retailers to accept credit. Until recently, Moore Wilson did not accept credit at all. Now it accepts credit with a surcharge.
- 4.2.1.2 Little pieces of black electrical tape over the credit card button on the EFTPOS machine are very common. Just walk around town, pop into cafés, small restaurants, and dairies, and look!
- 4.2.1.3 My unscientific survey of 18 January 2017 encompassed all cafés and restaurants I visited that day. N is equal to 2 for that day. I have attached below pictures from both venues. The first reads “2% surcharge on Paywave & Credit Card transactions”. The second reads “Please have your eftpos card or cash ready for a quicker process. No credit card please. Thank you.”



- 4.2.1.4 The picture on the left comes from a small coffee shop tucked into a little nook at the corner of Featherston and Brandon Street, my local. A debit scheme card using Paywave that carries higher fees to merchants than standard EFTPOS there would come under the same surcharge as applies to credit card users. The picture on the right is from Chef's Palette on Woodward Street. This kind of thing really is not uncommon – though the café's surcharge for Paywave is the first I have seen.
- 4.2.2 MBIE's contention of market power, or consumer backlash, preventing retailers from using the little black piece of electrical tape or a surcharge simply does not reflect reality. It does not survive a casual stroll through Wellington retail shops, cafés and restaurants.
- 4.2.2.1 While MBIE cites relatively large numbers of retailers that accept credit, weighted on a transactions volume basis, as evidence of some kind of market power forcing people to accept credit cards, isn't the simpler explanation that a lot of retailers and customers find it beneficial to run transactions via credit, and that other retailers and their customers do not find it worth the higher cost? Advancing a "they're forced to accept it" argument surely would require some more systematic analysis of the types of retailers that accept credit with no surcharge, those who accept only with a surcharge, and those who accept with no surcharge, and seeing whether there really is some power argument that applies to one class of retailers but not the others.
- 4.3 If we go back to first principles, and accept for the moment MBIE's contention that many customers select high-fee high-end cards solely for the rewards schemes, we should expect that retail markets will segment. Some outlets will provide lower prices and refuse credit cards entirely, or accept them only with a surcharge – they will focus on more value-conscious customers. Other outlets will focus on higher end customers. The greatest potential for transfers, either from consumers using EFTPOS to those using credit, or from those using lower fee cards to those on reward schemes, will be in places where lower and higher end consumers do not segment but rather pool.
- 4.3.1 The greatest potential for such a pooling equilibrium is in grocery outlets serving diverse communities. Groceries will be a fairly large fraction of families' regular expenditures. But, the MBIE paper also complains that large grocers have been able to negotiate very low transaction fees relative to other retailers. The place where there is greatest potential for transfers from poorer to richer customers via credit card fees is also the place where MBIE

tells us that it isn't happening, because the fees have been negotiated down to levels where it wouldn't be happening. It is odd that the MBIE paper does not recognise the tension between its argument of widespread transfers and its complaint that large grocery chains have negotiated lower fees. The latter would mitigate the former.

- 4.4 If MBIE wanted to make a case for inefficiency despite many retailers choosing either not to accept credit, or to accept it only with a surcharge, it could point to that the neutrality theorem found by Gans and King applies where *all* retailers use surcharges. When only some retailers use surcharges, welfare implications are more ambiguous. But one does begin to get the feeling that MBIE is searching for reasons to deem credit card markets inefficient in order to justify promulgating new regulations.

Alternative payment systems

- 5.1 MBIE asks if there are any emerging payment methods the paper has missed. Snapper is reasonably important in the Wellington market and shows growth potential. Starting as the payment scheme for busses, it can also be used for parking meters, the cable car, and taxis.

Summary and conclusion

- 6.1 There is little basis for the paper's finding of widespread inefficiency. The paper provides no substantial evidence of market failure. And the critical finding of \$45 million in efficiency losses rests on an unwarranted and unsupported assumption that users paying off their balances in full each month derive no benefit from using credit over EFTPOS.
- 6.2 The paper's suggestion of large transfers to users of high end credit cards requires greater support than is provided in the paper. In particular, it needs to wrestle with market segmentation, where outlets catering to customers unlikely to use rewards-laden cards may be less likely to accept credit without a surcharge. It needs also to think harder about implications where the grocery market, where the greatest pooling potential seems to exist, is also the one where retailers have negotiated relatively low credit card fees.