Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

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From: Thomas Stratmann

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Your comment: More Political Giveaways to Chain Retailers Will Hurt Virginians Thomas Stratmann As a Virginia-based economist, I am concerned that a new rule proposed by the Federal Reserve will disproportionately impact residents of this commonwealth. The central bank recently proposed Regulation II, which would lower the maximum allowable "interchange fee"; the cost merchants pay to banks to process debit cards. The thought is that the central bank mandating banks charge smaller processing fees to corporations would help both consumers and the big chain retailers like Walmart that pushed the regulation. Unfortunately, however, anything but this would happen. We know this because history proves it. In 2011, the Fed implemented a similar policy. Big merchants benefited while consumers; especially minority Americans; got dealt the short end of the stick. Data from the Richmond Federal Reserve Bank found that, in response to the Fed limiting the amount banks could charge retailers, financial institutions increased the maintenance costs associated with consumers' checking accounts. They also raised the minimum balance for fee waivers, thereby preventing lower income individuals from accessing banking services, a requirement for transacting and succeeding in the modern economy. All told, 90 percent of merchants did not decrease their prices in response to this 2011 Fed price control on interchange, which allowed said merchants to increase their profits an additional $90 billion off our backs. Research from my school, George Mason University, found that the 2011 price control went so far as to increase the nation's unbanked population by 1 million. As Richmond-based education and equity advocate Taikein M. Cooper put it, Virginia felt this "unbanking" more than most in the country did because roughly 15 percent of Black and brown households already lacked access to a financial institution. This policy added further complications to an already complex problem in this commonwealth. The lesson here is clear: Price controls distort the market and result in less efficient transactions. Unfortunately, however, now the Fed has laid out a new proposal, Regulation II, to make this price cap even lower. That would again be a blessing for the Walmarts of the world, but it would hurt the rest of us. Regulation II wouldn't just lower the current interchange fee cap by over 30 percent. Under the new policy, the Fed would also gain the power to evaluate if technological innovations have allowed banks to lower their processing costs and if so, it would lower the maximum charge allowable. In other words, this proposed rule captures any gain that banks obtain and forces them to put it into reducing processing costs; even if that is not a feasible reality. Consequently, this proposed regulation provides the debit card issuers with little or no incentive to innovate or create cost-saving technology to lower transaction costs, increase their product offerings, or bolster the security of consumers' accounts. By preventing banks from competing in the transaction fee market, the policy will also negatively affect other services customers receive. It should not surprise us if this policy accelerates the trend of businesses and consumers using digital payments to avoid an over-regulated banking market. That would reduce Virginia and the larger government's tax revenue even further. Instead of moving policies that would disproportionately benefit chain retailers, the Fed should stick with enforcing its dual mandate of creating maximum employment and price stability. Those are two things that many Virginians don't feel they have enough of, and it is incumbent on the Fed to help make them more attainable. Stratmann is an economist and professor at George Mason University