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BY ERIC ZORN

Monday, March 01, 2010

## 'Swipe fees' a hidden tax on the poor, most of all

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It's a small purchase — under \$30, say — at a small business.

"Cash or charge?" the clerk asks.

You have the cash on you. But you also have a credit card that rewards you with airline miles, say, or money back for every dollar spent.

You hesitate. You're dimly aware that, if you use plastic, the store is going to have to pay a processing fee and will make a bit less money on the transaction than if you pay with cash.

But, you figure, the store has added the cost of doing business with credit cards to its prices. So your choice is really whether to use cash and, in effect, subsidize those who use credit cards at the store, or use the card and, in effect, get a discount via the rewards program.

Help the small businessperson? Or help yourself?

And try not to think about the next person in line. That person may not have that choice because he or she is among the roughly half of low-income Americans who can't pay with credit or debit cards. That estimate comes from "The Costs of 'Charging It' in America," a report released last month by Consumers for Competitive Choice, a group connected to retailers that are exercised about the size of these so-called "swipe fees."

"These fees are a hidden tax on all of us, and they hit the poor especially hard," said the study's author, Robert Shapiro, who was undersecretary of commerce for economic affairs in the Clinton administration.

To pay for the rewards programs, which are heavily skewed toward the higher-income brackets, the card companies have boosted the processing fees retailers pay. "The result is massive transfer of wealth from poor to rich" in the checkout line, said Shapiro.

His study, which relies heavily on a 2009 U.S. Government Accountability Office report on the issue, says businesses pay about \$50 billion a year in what are called "merchant discount fees," even though there's nothing discount about it.

No one disputes the need for such fees, which average about 2 percent of the purchase amount. Banks and card issuers handle the verification, the billing, the payment and so on, and they have to pay their employees and overhead as well as earn returns for their shareholders.

But Shapiro's report contends that about 80 percent of these fees are pure profit for the credit industry. He estimates that excessive fees cost each American household an average of \$230 a year in higher retail prices, and that lowering these costs could result in the creation of nearly a quarter million jobs.

The credit industry, represented by the Electronic Payments Coalition, disputes most of Shapiro's assertions and maintains that the "discount fees" are reasonable. Coalition spokeswoman Trish Wexler points out that retailers are free to offer discounts for cash purchases, but that, aside from certain gas stations, few do.

Most retailers, Wexler said, realize that accepting credit cards vastly increases the number of purchases and reduces bookkeeping hassles.

That's true. But when she says that these fees are "no secret," she's on shakier ground. They're hidden from consumers, like gasoline taxes. So, for instance, most people don't know that the merchants, not the credit-card behemoths, pay for our bonus rewards.

Shapiro offers a big-government solution — have the Federal Trade Commission set "swipe fees" as was done in Australia — and a free-market solution — shift the costs of credit to those who use credit, encourage rate competition in the now take-it-or-leave-it credit-card industry and make sure consumers know exactly where their money is going and why when they use their cards.

Alas, neither solution was part of the new credit laws that went into effect last week. Legislation to limit "discount fees" was recently shelved in the U.S. House when House Financial Services Committee Chairman Barney Frank, D-Mass, said on Wednesday that legislation to limit or regulate such fees "is not on our agenda this year."

But, on Thursday, Sen. Arlen Specter, D-Pa., said he's "seriously considering" reviving the idea in the Senate.

So "cash or charge?" will remain a complicated question for the foreseeable future.

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To read Shapiro's report and many other articles, studies and position papers on this topic, check out [this Change of Subject weblibliography of online sources](#)

Posted at 10:28:16 PM

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## Comments



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Does EVERYTHING have to be spun into a class-warfare issue? Give me a break!

Posted by: Pete | Monday, March 01, 2010 at 11:42 PM

Wow people are just finding out that taxes almost always hurt the poor the most. Eric it must be a whole new world out there for you today.

Posted by: jfsp | Tuesday, March 02, 2010 at 06:00 AM

Charge perpetrated at Macy's -- women and minorities and the poor hardest hit.

Posted by: Jake Braekes | Tuesday, March 02, 2010 at 07:02 AM

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I didn't know that Link Cards have hidden fees. I love seeing people use them on junk food. Can we just blame Senator Bunning too?

Posted by: Sodd Troger | Tuesday, March 02, 2010 at 07:41 AM

So what's your point? I'm supposed to pay for cash because it might hurt someone else who doesn't use credit? Ummm, no. I always pay my bills on time and get rewards anyway, so I'm actually coming out ahead of the credit card companies, so using credit is a no-brainer.

The business doesn't have to accept credit cards, although they know they would make a lot less money if they didn't.

Finally, even if everyone stopped using credit cards and used cash, do you think the swipe fees would go away? Of course not.

All of this is moot, anyway, since we are moving towards a cashless society.

Posted by: Tom Blackford | Tuesday, March 02, 2010 at 07:52 AM

From a merchant's POV, the easiest way to do everything would be to offer discounts for using cash, but no discounts for plastic. (I know that merchants are forbidden by their contracts from upcharging for the use of a credit or debit card, but I don't think their merchant agreement forbids discounting on cash.) This way the merchant can raise prices to compensate for the fees, but charges cash customers the "real" price. (Note: to do this successfully, you would need to list both the "regular" price and the cash discount price.) Unfortunately, most people just don't carry around large amounts of currency anymore.

Posted by: SRM-LRM | Tuesday, March 02, 2010 at 07:53 AM

I have direct deposit, to give the merchants a break, I have to use an ATM to withdraw cash, for a fee. Is my sacrifice really going to help them? Merchants have the option to refuse fees by refusing credit, if they wish. But why reduce your bottom line, when card carriers make vastly larger purchases? And I'm sure this extra cost is passed along to consumers, anyway.

The poor always end up paying more. They're charged high interest rates, have to pay service charges and debit fees on checking and savings accounts, but if your combined balance is over, say, 10,000 dollars, all fees are dropped and you're allowed to draw interest on your deposits.

Class warfare? You betcha.

Posted by: Wendy C | Tuesday, March 02, 2010 at 08:14 AM

A tax? No. A tax is money collected by the government. The lottery - now there's a tax on the poor. It's an ignorance tax; if you don't know that paying 500 to 1 on a 1000 to 1 shot is a long-term loser, or you can't recognize that continuing rollovers in the Lotto and Mega-Millions games are just indications of how bleeping hard it is to win, you pay that tax.

Cash transactions are not without cost, either. It has to be carried to the bank, unlike credit card transactions, which are carried out electronically. It has to be safeguarded; having cash in the store makes it a robbery target, and it's subject to "shrinkage," as the Tollway found out with "Quarters" Boyle, whom your friend John Kass loves to write about. Our local grocery store was always happy to give us a couple of hundred dollars extra on a debit card transaction, just because it got the cash out of the store and replaced it with a more secure electronic credit.

Posted by: DaveB | Tuesday, March 02, 2010 at 08:25 AM

Why waste time nit picking on swipe fees? Look at all the taxes the poor pay because of the high taxes businesses pay, taxes on gas, heating bill, phone bill, electric bill, groceries and all other sales taxes especially in Cook County. Oh, and the State Lottery, that is a tax on the vulnerable! The above pales in comparison to your subject. I guess if you believe in big government it does not concern you.

But it is government greed we need to reign in, then the poor will pay much less in taxes.

Posted by: DCW | Tuesday, March 02, 2010 at 08:30 AM

I look forward to your column against the double taxation on corporate income, which costs the economy millions of jobs.

Posted by: MCN | Tuesday, March 02, 2010 at 08:46 AM

DCW, I fear that Eric is becoming the Burton Natarus of columnists.

Posted by: DaveB | Tuesday, March 02, 2010 at 08:54 AM

Hey, DCW, you didn't practice at KMC, did you?

Posted by: MCN | Tuesday, March 02, 2010 at 08:56 AM

This Shapiro is a hysteric. He should go after the regressive sales tax. As applied to gasoline, it is especially onerous, because as a percentage, it increases as the cost of gas increases. Go

after tobacco and liquor tax (which just rose mightily for no good reason other than the state could do it). Maybe the poor don't have to smoke, but they do so in the largest numbers.

And as someone else pointed out, the use of cash is not "free." Not 2 percent--especially in very small businesses, but not insignificant. (When the CTA handled cash, it was quite significant.)

I think the crusaders have to pick their argument. If you say it is the merchants being harmed because they are paying the fee, you can't also say the public is being gouged because you are in effect saying the merchants did not raise the price over what the cash price would be and is eating the 2 percent. If you are saying the public is paying the fee, then you are saying the merchant has priced in the fee and is really just the collector, as with sales tax. I side more with the second line, which makes it more of a type of a hidden tax. Still, I just can't get so worked up. For one thing, my credit cards are a huge convenience. At least I am getting a service of some kind, which is more than I can say about all the ridiculous taxes on my phone bill, on most of the money that goes to Cook County, and my endlessly rising property taxes.

Posted by: quotidian | Tuesday, March 02, 2010 at 08:58 AM

Life is not and never will be fair. The last thing we need is government with its highly paid employees getting involved in this.

Posted by: Edinelgin | Tuesday, March 02, 2010 at 09:01 AM

Quotidian, FYI, the cost of handling cash and checks is about 0.50%.

Posted by: MCN | Tuesday, March 02, 2010 at 09:05 AM

Well good luck trying to reverse this trend now.....Generation P (P for plastic) is conditioned to whip it out for even the smallest purchase (remember that commercial a few months back where the cafeteria was a well oiled machine serving consumption monkeys, right up to the point where someone decides to pay cash, and then the whole system comes crashing to a halt?). Challenge them on it, and they will either say "I pay it off at the end of the month, so no worries" or the dreaded "I get miles", completely missing the point.

Posted by: Stosh | Tuesday, March 02, 2010 at 09:08 AM

Seems to me that credit card fees are no different than any other cost of doing business that retailers face. The most salient point in this whole article is the comment that retailers are free to offer cash discounts. The fact that next to none do shows that retailers value the convenience of not having to deal with cash.

Posted by: Paul | Tuesday, March 02, 2010 at 09:15 AM

As I've said before, general purpose credit cards drive incremental sales and relieve retailers of the burden of issuing credit themselves.

I would suggest that it would be more important to focus on why there is a tendency for prices to be higher in low income areas than they are in other areas.

Posted by: MCN | Tuesday, March 02, 2010 at 09:19 AM

there's no actual reporting in this column. the purchase at the start of the article is theoretical and the quotes are pulled from god knows where. this weak effort shows that even zorn is bored with his work. abolish all columnists. make them all report from the street again.

ZORN REPLY -- There's plenty of reporting in this column. I interviewed Shapiro and Trish Wexler, which you can tell because they're quoted, and several other people whose quotes I didn't have room for but who sent me materials that I read. Link to the webliography at the end of the piece to see all the materials that I read (and that you can read, too!) on the subject.

Posted by: Off with their heads | Tuesday, March 02, 2010 at 09:32 AM

MCN--about poor neighborhoods, I assume you are generally talking about food and staples. Isn't it mostly a function of size? In a small market anywhere, the owner has to pay close to what would be retail in a large store because of the way distribution works now. In Oak Park, a popular small but full-service market just closed. The main reason was that his supplier of non-meat items went out of business. He told me that it would cost him a fortune to sign up with another supplier/distributor and the deal would not be as good. I doubt WalMart has appreciably higher prices in its poor-neighborhood location (although of course the unions are trying to make sure there are no WalMarts in poor neighborhoods).

Posted by: quotidian | Tuesday, March 02, 2010 at 09:42 AM

So people pay \$230 a household more per year because of swipe fees?

I wonder how many of these "poor" households also have cable TV at home. Should the rich pay for that too?

Feed the hungry and clothe the naked.

Not "subsidize the credit card-less".

Try not destroying your credit rating, so you can get a credit card or bank account.

ZORN REPLY -- Umm....no. The \$230 estimate is excessive swipe fees. No one is talking about subsidizing the credit card less, which makes me doubt that you even read this column before sharing your opinions with us. The subsidy referred to is the subsidy that poor people who pay with cash provide those of us with "rewards" cards.

Posted by: brad | Tuesday, March 02, 2010 at 09:52 AM

What business does the government have telling banks or credit card companies how much they can charge retailers? By sticking their nose into healthcare pricing, the government will almost certainly cause top doctors to ration their services to cash paying customers. Similar unintended consequences will probably happen if the government gets involved in this non-issue.

Posted by: Paul | Tuesday, March 02, 2010 at 10:03 AM

MCN, you stated that the cost of handling cash is about 0.50%. But I would bet that in higher crime areas, and there is often a correlation between low income and higher crime, the cost is increased due to the higher security costs.

Posted by: Wayne | Tuesday, March 02, 2010 at 10:04 AM

Q-man, you're right, size is an issue because larger retailers are more reluctant to do business in poor areas due to crime (especially shoplifting), smaller average purchasers, and the cost of credit. In turn, smaller businesses are even more subject to robberies and don't get size discounts from their suppliers, so their prices are higher.

Wayne, I should have said that the 0.50% cost of cash was what we calculated when I was working for a very large retailer that had an extremely efficient cash management system. It's undoubtedly higher for a small business.

Posted by: MCN | Tuesday, March 02, 2010 at 10:20 AM

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Correct me if I'm wrong but this is why I "swipe" with debit. If you use bank debit the retailer doesn't get hit with the credit card fee (what I was told by a retailer, I've been asked to specifically use debit and have since).

I don't agree with this pure profit based on a percentage. I understand credit card agencies have overhead, but why not charge a flat rate for every purchase, 2 cents per charge rather than 2%. Why should a credit card profit more off one charge as opposed to another, \$30 vs \$300 is still the same amount of work for them yet they make significantly more off the latter.

Not to mention the fiasco over credit card companies making such a profit of the Haiti earthquake, pure profit off devastation and charity. Haven't touched by Citibank card for 8 months now. If I can't buy it in cash, I can't buy it. I use my debit for all online transactions, it's protected under the same identity fraud laws as a credit card.

Posted by: Anonymous | Tuesday, March 02, 2010 at 10:28 AM

Anon, you make a good point about percentage. There should at least be a set of ranges, or the fee going down as the amount goes up. This reminds me of the problem faced by gas retailers. Everybody loves to hate them when prices go up, but their margins are extremely thin, especially with upward price pressure. When prices really went up, they felt it more, because for each gallon they sold on a credit card, they had to pay more to the credit processors, since the fee is on the sale total, not the number of gallons. They couldn't necessarily

raise their prices because in times of high prices consumers are hypervigilant and will flee you for a couple of cents. (In the same vein, this is why I think the sales tax on gas should be per gallon, as the federal excise tax is.)

Posted by: quotidian | Tuesday, March 02, 2010 at 10:37 AM

Worry not, Zorn, most of these people are using WIC cards to buy soda and Doritos, and all the diapers are paid for by the person in line behind the with the credit card.

Posted by: APorte | Tuesday, March 02, 2010 at 10:38 AM

I am amazed at the silliness of Robert Shapiro. If the government imposes swipe fees and other regulatory burdens on the credit card companies, to whom do you think such fees and costs will be passed? You got it - the consumer.

Also, quotidian and DCW have it exactly right. If you want to be a class warrior, start complaining about the regressive taxes on alcohol, gas, cigarettes, utilities, etc. Then move on to trade barriers, tariffs, and duties, all of which are imposed in the name of "fair trade" but are anti-consumer and ultimately regressive.

If businesses want a better deal with the credit card companies then let them negotiate for one. If some businesses are too small to negotiate effectively let them come up with cash discounts or other creative solutions as a work around.

Posted by: Greg J. | Tuesday, March 02, 2010 at 10:46 AM

A couple things not mentioned by your column:

Consumers are protected by the credit card companies in case of problems. Of course, we need to educate people (especially in low income neighborhoods) to use this feature.

Responsible consumers can also use the credit card info to help keep track of expenses, and where their money goes.

How much is saved by businesses in using credit card when robberies happen? Robbers take the cash in the register. But income from credit cards is safe.

Another question not asked -- how cheap is it nowadays for credit card companies to run their service? It's like phone long distance -- it might have been expensive in the past, but new technology, such as the internet, makes long distance as cheap as a local call. Isn't it the same with credit card machines?

Posted by: JP Paulus | Tuesday, March 02, 2010 at 10:50 AM

Anon, you may pay for everything in cash now, but would you pay cash for a refrigerator, laundry machine, Brooks Brothers suits, computer or TV?

One thing I'm unclear about and I think is yet undiscussed is this: Of the interchange fee (i.e. the "swipe fee", a term I've never heard used in the business), what percentage goes to Visa/Mastercard and what percentage to the issuer?

They are not the same thing.

Posted by: MCN | Tuesday, March 02, 2010 at 10:53 AM

"Correct me if I'm wrong but this is why I "swipe" with debit. If you use bank debit the retailer doesn't get hit with the credit card fee (what I was told by a retailer, I've been asked to specifically use debit and have since)."

But many banks will charge you a fee, usually a dollar, when you use debit. Rewards are only earned by using credit. That's pretty much the reason many will use credit instead.

And I agree with Mike, the focus should be on the poor not having access to better food at cheaper prices, offered by the big box grocery stores. I understand why the bigger stores won't locate in these areas, there is very little profit gained from people with fixed incomes. But it's really not fair, I know Mary Schmich has spoken about this, often.

Posted by: Wendy C | Tuesday, March 02, 2010 at 10:58 AM

I don't know about where you are, but there are some stores here that add a surcharge if you use plastic. To be fair, it is clearly stated on big signs by the register.

Posted by: BAW | Tuesday, March 02, 2010 at 10:58 AM

The overarching problem here is that a government technocrat thinks he is smarter than the sum wisdom across the myriad of individual economic decisions made by millions of free producers and consumers pursuing their interests, that he somehow can account better for all the costs and all the benefits, all the aspects of each economic transaction, all the ramifications today and in the future and impose a "solution" that will be better for everyone. The hubris implicit in that is monumental.

Even scarier is how many people -- I am afraid, the majority -- buy into this technocratic view of the economy. This view is exactly the same one, albeit in the U.S. still fortunately practiced on a smaller scale (and at times, via oxymoronic government imposed "free market" "solutions"), which was behind Soviet 5-year economic plans. We know how well that worked out, but alas, so few learned the economically distractive nature of technocratic "management" of the economy in principle.

This is scary, but paradoxically understandable in light of basic limitations of the human mind. We have no innate instincts that allow us to sense how a free market economy works, because it wasn't present when the evolution shaped our brain, but we do have instinctive sense for how an economy managed by a small group of people would operate, because that was the proto-human environment.

We don't have instincts for the laws of physics either, even Newtonian ones let alone Relativity and Quantum Mechanics, but manage to learn that obeying scientifically discovered laws of Nature is much more beneficial to us than following our intuitive physics. It would be wonderful if an educational program could be devised to help people to really internalize economic laws to a point to have the confidence that they do work despite often being counter or non-intuitive.

Posted by: Boris Gendelev | Tuesday, March 02, 2010 at 10:58 AM

doesn't obama also discriminate against the poor. I didn't see many middle class people or lower at any of his elitist parties. I guess they were being penalized for not having enough money.

Buy in bulk you get lower prices. The more business you do

the better deal you can cut with any business. The more money you have the better treatment you get. This is the real world.

The bigger question is: shouldn't the poor be making purchases at discount stores, not overpriced gas station prices?

Posted by: moreofthesame | Tuesday, March 02, 2010 at 11:09 AM

I wouldn't want to suggest that the poor folks don't regularly get the short end of the stick, but I think it's misleading to characterize this just as cash vs credit. Cash isn't free either, either for merchants or customers.

Charge slips don't adhere to sticky fingers at the till, don't require secure trips to the bank for deposits, etc. You don't much see merchants displaying bounced checks by the counter any more -- that's a risk and a cost they are avoiding by encouraging the use of credit cards.

Of course nonaffluent consumers get hit in multiple ways, as always. Not only do they share in the credit card levy, but ATM fees, check cashing fees, and/or bank account charges generally make cash an even more expensive alternative than paying with plastic.

Posted by: Rick Weiland | Tuesday, March 02, 2010 at 11:11 AM

Boris, you sound as if you've spent a lot of time reading Ludwig von Mises and Reisman's "Capitalism".

Posted by: MCN | Tuesday, March 02, 2010 at 11:14 AM

As usual, Zorn misses a salient point. Swipe fees are not "pure profit" to the card issuing institution. Rather, those fees specifically subsidize payouts to merchants, who unintentionally accepted stolen or fraudulent cards. If you as a card holder enjoy fraud protection, then who do you think pays the piper on illegal charges? And what economic class of folks are most likely to engage in common credit card fraud and identity theft?

Posted by: Peter B Pabst | Tuesday, March 02, 2010 at 11:33 AM

Processing/handling cash and checks is more expensive for the store than debit or credit card. I see no mention of that!

Posted by: charlotte | Tuesday, March 02, 2010 at 12:16 PM

Charlotte, no it is not. See above comments.

Posted by: MCN | Tuesday, March 02, 2010 at 12:30 PM

Eric Zorn wrote: "That person may not have that choice because he or she is among the roughly half of low-income Americans who can't pay with credit or debit cards."

What's to prevent these people from opening a free checking account that includes a no-fee debit card? I see numerous ads for such accounts. I could be wrong, but I don't think you need a credit history to open such an account, so they're available to pretty much everyone.

Posted by: RDG | Tuesday, March 02, 2010 at 12:30 PM

I agree with Boris. I trust the "sum wisdom" of millions of consumers/businesses over the decisions of some bureaucrat, and I'm tired of having so-called sin taxes subverted by government do-gooders.

When the govt limits credit card swipe fees, late fees and interest rates, who ultimately pays? The responsible credit card user.

Posted by: Brian | Tuesday, March 02, 2010 at 12:38 PM

Gas stations do offer discounts for cash.

Also, one reason more stores do not open in low-income areas is due to the high crime rate..and not just from the customer but from the employees!

We need to start at the ground level to fix this problem, which in majority of cases is self-inflicted by the poor. Maybe high schoolers should be told the consequences for bad behavior: not paying bills = poor credit = no cards! However since credit card companies market even to jobless college students (infamous for running up bills they can't pay), maybe we should question the credit card co's tactics?

Posted by: Barbara | Tuesday, March 02, 2010 at 12:51 PM

Good Morning Eric:

Thank you so much for your commentary on "Swipe Fees." Too few consumers realize that merchants pay these fees. We have a small retail business in the family and the fees add up to thousands per year! I have been active in corresponding with Senator Durbin to encourage Congress to enact protection for the merchants along with the consumer but to little avail as you pointed out. Your commentary only scratched the surface regarding the charge card policies toward merchants. It's not uncommon for them to levy additional "fees" with along pages upon pages of "explanations" for the fees that lull the merchants into a stupor! Also, they are extremely callous when approving questionable (possibly fraudulent) charges because they know that they can pass any and all losses on to the merchant without any recourse from the merchant. Last year we processed some overseas sales with absolutely total approval from all entities (Visa, Fifth Third Bank, the various fraud departments etc.) and when the sales proved to be fraudulent, they took the money back and denied that they had ever approved the sales! That cost the business in excess of \$10,000. All this escalates the costs to the consumers. Keep up the good reporting and thanks again for today's commentary!

Posted by: KT | Tuesday, March 02, 2010 at 12:59 PM

I would like to see the cost of Credit Cards Vs. Debit Cards or CC's that directly withdraw from a checking acct. I tend to just use my CC and pay it off monthly no worries, but I would be willing to consider switching to one of the later two ... Look at Woodmans, they don't accept Credit Cards and seem to be doing alright.

Posted by: Kay | Tuesday, March 02, 2010 at 01:09 PM

With respect, KT, as was already pointed out, you would very likely have much less business to begin with if there were no credit cards. Credit card processors are also businesses, business that like all business had to start small. They became big because their customers saw the value they created. Businesses that like your business have real people who invested (and put at risk) their labor and resources into them. If you are one of the investors, you have a say, a vote proportional to your investment, in how the company operates. If you are not, but you are a customer, you have no legal vote, but you have, individually or collectively via an association of customers, have influence on your vendor, such as a credit card processor. But what you are seeking is a government force to make your vendor, who benefits you by providing the service – else why would you buy it, lower prices. That would be like me walking into your store, deciding that I can't afford something I want or would simply rather pay less, so I can have more money left for something else, and calling my Senator to demand a law to force you to lower prices. How would you feel about that?

Posted by: Boris Gendelev | Tuesday, March 02, 2010 at 01:33 PM

@MCN. E "Boris, you sound as if you've spent a lot of time reading Ludwig von Mises and Reisman's "Capitalism".

Mises's "Human Action", Hayak's "The Road to Serfdom", ages ago, but it stuck. The "Austrian School" had a remarkable insight, an inspiration to look at the world not in the fixed "zero sum game" moment, as statist economists (including Keynes) do, or in the imaginary stable equilibrium of the long run, as classical economists do – both of which are much easier for the mind to wrap around, but at the true dynamic world of constant change. The economic and political theory they developed is amazingly consistent not only with history, but with emerging scientific knowledge of human psychology and cooperative behavior.

Posted by: Boris Gendelev | Tuesday, March 02, 2010 at 02:00 PM

Boris, I've got both of them on my shelf. No surprises there.

Posted by: MCN | Tuesday, March 02, 2010 at 02:10 PM

Eric,

Super Duper Article. Big corporations = Bad. Hey I'm surprised by this theme. Just kidding. How much do you think 'poor' families could avoid in fees if they avoided the 'Poor' taxes i have listed below? Think its more than \$260?

Here are a list of other 'Poor' Taxes:

The Lottery

Cigarettes

Alcohol

Multiple kids by multiple partners

Dropping out of school

Drug Abuse

I know there are more but I thought i would point out the less controversial ones. Too bad there is only one person to blame for these taxes. Sorry Eric sometimes people have to take responsibility for themselves.

Posted by: Iowa Conservative | Tuesday, March 02, 2010 at 06:54 PM

Eric, please research what happened in Australia after they regulated swipe fees. Alas, prices never were reduced and the merchants just kept the profit differential. Thus there was no benefit to consumers whatsoever. Also, card members were harmed more when the credit card companies had to make up that lost revenue other ways, with fees and decreased rewards, to remain profitable. Not a good solution.

Also, see this SNL skit... <http://consumerist.com/2007/04/snl-skit-dont-buy-stuff-you-cant-afford.html>

ZORN REPLY -- There is ammo for both sides of this debate in the Australia experience, and if you poke around the in the webliography linked at the bottom of the column you'll see how it's spun.

My view is that these fees should be transparent, negotiable and subject to free market pressures, not govt. regulations. That is, merchants should be allowed to put surcharges on credit card purchases if they wish (not just cash discounts, which are trickier) and the amounts of these fees should be prominently posted at businesses. Stores should be allowed to charge more for "rewards" cards if they wish. Perhaps many wouldn't, but right now the card companies seem to operate more like a cartel than competing businesses.

Posted by: Northerner | Tuesday, March 02, 2010 at 07:42 PM

One thing that often pops up in these sorts of discussions implicitly or explicitly is the idea of "fair" or "reasonable" profit. People are ok with someone making a profit (well, most Americans seem to be, thankfully), but it not too big a percentage. Usually they are talking about profit margins. What is missed is that

1. Margins are not the right measure of how well a business is doing profitability-wise. The rate of return investment is. If you invested a million into a business to set up production and then manage to sell 100 units of your output at \$100 with a huge \$90 operating margin, you are not doing well. A profitable business has to have net present value – a time-discounted value of its net cash flows - larger than it's investment.

2. How much larger that has to be to make investors interested in risking their money depends on perceived risk. So even if we switched the target of complaints about "fairness" from margins to return on investment, there in principle can't even be any fairness in the complaint without consideration of risk.

Purely theoretically, in the long run all industries tend toward the same "risk adjusted" return on investment. But there is no knowledge and method available for a technocrat to determine what a "fair" rate of return ought to be. For at least two reasons:

1. There is no way for a technocrat to assess all the risks. They are implicit in investment decisions, but there is no formula for formulaically quantifying all the risks, or even most of the biggest risks, by definition, because the main risk is unpredictability of the future.

2. Nothing is really ever getting to equilibrium. Equilibrium is stagnation. The ultimate equilibrium is a flat line. In the healthy economic world, industries die and new ones are born. Companies go out of business and new ones emerge. Naturally the ones that are going under and not producing sufficient return on investment, while the ones that are flourishing and growing are, making the capital flow there for as long as returns are high. Because of the law of diminishing returns and because of randomness, nothing lasts forever. What was a "fair" return, for whom and when?

Yet, the human mind, the subconscious, where most of the "thinking" actually takes place, is fundamentally technocratic, instinctively much more at home with centralized controls than with seemingly chaotic free market economies. (This is paralleled in the ease with which people hold a belief in God and his powers to create all we see around us vs. the difficulty of grasping the unplanned and unsupervised evolution through natural selection.) This country, unlike any country before it, was born out of an idea, rooted in patterns the Founding Fathers and the philosophers that inspired them recognized in the historical human experience – the best ideas of social and behavioral science available then, of how to best organize the governing of relationships among people to maximize their happiness. It produced previously unimaginable standard of living. But instinctive human worldview has always been and will remain at odds with the ideas behind the American Revolution, just as there are and will remain at odds with the scientific view of nature, always unwittingly, with the best intentions trying to undermine the very foundation of prosperity.

Posted by: Boris Gendelev | Tuesday, March 02, 2010 at 09:21 PM

Eric, you make good points, and I'd just ask you to distinguish between the card issuers (e.g. Citi, Chase) and Visa/MasterCard. I think it's Visa/MC that sets the contract and interchange terms, not the issuers.

Visa/MC recently had to pay out very big money to the issuers for price-setting or something like that.

Posted by: MCN | Wednesday, March 03, 2010 at 09:09 AM

Given the level of regulation of the credit industry, which typically has a protectionist side-effect, cartel-like behavior wouldn't be surprising at all. But a "free market" mandate is an oxymoron. Better reduce the regulation that is putting up barriers to competition.

This is not to say that cartel-like behavior cannot arise in a truly free market. Without delving into whether such behavior is sustainable in the face of competition, I'd like for the proponents of trust busting to do a thought experiment. Imagine that you started a company and for simplicity of this exposition, you are the only one who ever invested (put at risk, with a possibility of zero payoff) labor and resources into it. Your product became a great success, to a point where people don't even remember life without it, such is the tremendous value you created for millions of your customers. For whatever reasons, you decide to attach certain strings to the sale of your product. The reasons may vary, from you thinking that's how you can make more money in the short term and retire while you are still in good health, to not wanting your product to be misused in some way. The point is, they are your reasons. What would be the principles and the logic that should allow someone else to use force to prevent you from doing that? In answering this, stay in the investor/owner shoes.

Posted by: Boris Gendelev | Wednesday, March 03, 2010 at 12:23 PM

The use of a credit card is a convenience. Rather than offer a cash discount, there should be a fee to use the card. Otherwise, it \*is\* deceptive.

I have no problem paying a fee for using a credit card. I have a problem with paying that same fee when I purchase with cash because the fee is build into the price (on account of the law not allowing a fee for using a card). Convenience has value or else we wouldn't use it.

Posted by: Scott Hedrick | Wednesday, March 03, 2010 at 10:22 PM

@Scott Hedrick,

With respect, merchants pass all kinds of "deceptive" (your word not mine) fees into the price of goods. These fees include not only credit card fees but taxes (particularly excise taxes), regulatory costs, tariffs etc., which cause certain consumers to effectively subsidize other consumers. If you are really offended that credit card companies are causing merchants to raise the prices of goods for cash customers, you should be equally offended by the built-in costs associated with these other items. The fact of the matter is that prices are exceedingly complex and merchants generally are free to charge what they want. You are under no obligation to purchase any items from any business that has a pricing structure with which you disagree. Vote with your wallet.

Posted by: Greg J. | Thursday, March 04, 2010 at 10:42 AM

---There is also a cost to maintaining and communicating a complex pricing structure.

ZORN REPLY -- NOT really. Not if you could have a 2% "convenience" surcharge on credit car purchahses,, 2.5% on "rewards cards" purchases. No tougher to add on than sales taxes.

I would think the free marketer in you would lunge at the idea of merchants getting that option. Don't know how many would take it, but let the market decide

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 11:24 AM

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But don't you think the market has decided :-)? Unless you believe that the protectionism that resulted from regulation indeed caused the pricing behavior to be distorted. Which is, as I mentioned before, very possible. But then, let's remove regulation and make it a free market. The idea that you can create a free market through specific regulation, by mandates – which is very different from creating an environment of confidence that contracts will be enforced and fraud will be punished, seems oxymoronic at face value.

You can't say that there is no cost to maintaining a price structure that includes conditional surcharges. Start with the fact that the software running checkouts has to be programmed and maintained to do that – an upfront cost that has to be amortized and some on-going cost. The checkout time can be affected as well. If it is high volume retail, extra seconds spent to check people out also add up to lower sales. There will have to be displays telling customers that there is a surcharge relative to the sticker price they see. There will be customers who will

not get the message and will be upset at checkout. Some will not buy because of the surcharges.

ZORN REPLY -- I can't believe I'm lecturing YOU on free markets, Boris. But sure, maybe all these hassles are there and maybe customers don't want that. Maybe it will cost lots to reprogram the computers at checkout (I never hear anyone talk about this when sales tax rates are increased....my guess is its trivially easy to tell your computers to add a surcharge).

Rules blocking merchants from tacking on surcharges are anti-competitive, and if not allowing credit card companies to force this on merchants is "excessive regulation," well, I can't help you. Not all regulation is bad, I hope we can agree on that.

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 12:17 PM

I think before we agree or disagree on that topic we would have to make sure we mean exactly the same thing by "regulation" in general. That may end up being a big discussion in its own right. But we can talk more easily about specific regulation such as limits on how much credit card issuers can charge in interest or change the rates. That's definitely not a good thing. It's just price controls in a different dressing, with the concomitant outcome of price controls – reduced availability of the product and reduced opportunities for competition (now there is less room for someone who can be more efficient to come in and undermine the price, or someone who dreams up an innovative bundled service that comes with a higher price).

You are talking as if credit card issuers and processors are somehow extra-market agents imposing rules on the free market. But they are very much part of the market. The merchants are free to use or refuse to use their services. They are even free to act collectively through associations.

I already posed this question earlier, so for a more detailed scenario please see my earlier post; to restate briefly: imagine you went into business and created a product or service people are interested in buying; you are certainly free to decide how much of it you want to sell – it's your product, your investment, don't you think, including not to sell any at all; what are the principles that would allow someone else to use government force to make you not free to decide under what conditions you want people to have your product or service?

ZORN REPLY -- This all might work fine were it not for the cartel quality of the credit card companies. You don't see collusions where I see them -- this takes us back to my post long ago about how suspicious I find it that cell phone companies ALL charge exorbitant rates for text messages that are essentially cost free. You don't find it strange that no company has broken ranks to offer free texting, I do. Just as I find it strange that ALL the credit card companies would magically agree not to allow merchants to impose surcharges and to put other anti-competitive conditions on the way they let customers use the cards. They know it would be business death for a merchant like, say, Walgreen or Target, to say we'll only take Visa, not MasterCard. The evidence of genuine competition isn't there. You whistle in the dark.

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 01:11 PM

P.S.

Eric, from the preponderance on your posts on economic topics like this one, I gather that you think the classical economics theoretical "perfect competition" is a social ideal and government regulation should be used to move imperfect markets towards that ideal.

I can easily see how such an ideal and the desire to use technocratic management has a physiological attraction, resonates with our technocratic instincts. But I think this is where our innate instincts fail us once again.

This ideal is at best a methodological ideal – sort of like the "infinity" in mathematics - in a particular school of economics, the school that analyzes the world by focusing on long runs and equilibriums. See my earlier post (maybe it was in the prior thread on the same topic) on what I see as the limitations of that perspective. In brief, the essence of life and economy is not in the equilibrium, but in the constant movement towards equilibriums that themselves are constantly moving, and that no one actually has any way to measure.

"Perfect information" is another methodological simplifying construction behind "perfect competition" that like "equilibrium" does not and in principle cannot describe reality. Information cannot be "perfect" for a number of reasons, including the fact that it itself is a product with a cost. Classical economists treat such costs as a nuisance, to be assumed away, but in the real world they are often drivers of human activity. The Internet is an obvious example, but hardly the only one.

I think part of the confusion is that in a technical methodology "ideal" means something rather different from "a desirable social goal". The same with "perfect" in "perfect competition". Just as in "perfect storm", it doesn't have the connotation of "desirable".

And since you are bringing back the cell phone message rate debate, which was mostly about margins, see my recent post regarding the uselessness of looking at margins as a measure of profitability and the large topic of "fair profits".

I don't think it is fair for you to accuse me of whistling in the dark, when I very clearly said several times that the credit card industry very likely has cartel-like attributes that have extra-market, more specifically regulation (which leads to de facto protection), origins.

But I also don't think you are right in assessing the strength of this government protected cartel. Walmart or Walgreens or Target not accepting a credit card brand might be the death of that brand, not Walmart. Or rather, significant damage to both.

Nor do I think that "not breaking ranks" as such is an indication of a cartel. There are things that work well enough for an overwhelming majority and do not present an entrepreneurial opportunity for a long time. Just about all window-makers make them out of glass. Does it mean they are colluding to deny us better materials?

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 02:53 PM

So, to be really fair, there should be 4 prices for everything, since every form of payment has different costs:

Cash price  
Debit card price  
Credit card price  
Check price

That would make shopping so much more efficient, and I'm sure retailers would love listing 4 prices for everything on their shelves.

Posted by: Barry Aldridge | Thursday, March 04, 2010 at 06:00 PM

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Actually, more than that, since different credit brands have different % processing fees.

ZORN REPLY -- How hard would it be to post signs at the door and register.

XX cards -- 2% surcharge at the register

FF cards -- 2.5% ....

CC cards -- 1.5%..

pretty darn easy. And so why not?

ZORN REPLY -- They're forbidden to levy surcharges for use of credit, that's why not.

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 06:15 PM

No one said it would necessarily be very hard, I only said it had some cost to implement as well as in lost customer satisfaction and sales, a cost that neither you nor I, nor any technocrat could even dream to estimate reliably. And I also effectively said that in a heavily regulated credit card industry, it is impossible to say whether and to what degree something is the result

of normal market functioning or a side effect of the regulations that as a known side effect limit competition. Regulation to "correct" bad effects of the original regulation is usually not a terrific idea either. Get rid of the original regulations, particularly of the price controls.

Eric, you didn't reply to my guess as to where you are getting your idea of what a free market is. That you are equating it with a notion of "perfect competition", a notion is a tool of a particular economic analysis methodology, moreover, of methodology unrelated to any reality because it omits essentials, such as information and constant change. In the real world, where at the root of the economy is human nature, not disembodied equations whose existence stems from the ability to solve them, and not from their fidelity to reality, the notion of a market place where all the buyers and sellers and their products are undifferentiated and the only competition is price competition is ridiculous at face value.

When you, Eric, negotiate your contract with the Tribune, do you go in and present yourself as a columnist same as any other columnist and sell your services based on price or do you emphasize what makes you different, why you would add more value than the alternatives? And regardless of whether you do it or not, do you think it should be illegal for you to restrict competition by asking that your contract includes guarantees of how many of your columns will be published, their placement and size? And as your fame and readership grows, should it be illegal for you to use that as a negotiating leverage to create conditions more conducive to perpetuating and increasing that fame and readership?

Posted by: Boris Gendelev | Thursday, March 04, 2010 at 10:55 PM

ZORN REPLY -- How hard would it be to post signs at the door and register.

XX cards -- 2% surcharge at the register

FF cards -- 2.5% ....

CC cards -- 1.5%..

GREG J REPLY -- It's not hard but let's not legislate that when there is an easier, obvious workaround.

Instead of setting surcharges for credit cards, which is in violation of current agreements, have businesses set discounts for other types of payments. The math works the same way and I don't believe (but someone please correct me if I'm wrong) that it violates the common agreements.

What we don't need is government essentially renegotiating credit card agreements on behalf of businesses. Again, we have too much corporate welfare already. Let the businesses who choose innovative price structures benefit by attracting customers who care about this issue.

I respect small business owners like KT, who posted above, but I don't feel sorry for them when it comes to this issue unless they are really trying to figure out a solution and running up against regulatory or cartel-induced barriers. I know this sounds harsh, and I mean this respectfully, but you need to show some leadership instead of running to Dick Durbin every time you have a problem with a service provider. This idea that government should be on the side of certain businesses rather than act as a neutral enforcer of the rules is the type of mentality that makes our economy less competitive and imposes real costs on everyone. Ok, I'll step off of my soapbox now.

ZORN REPLY -- You mean, say, Charge \$2.00 for an item, assuming it will be paid for by the most expensive card, give a one cent discount at the register for a plain card, two cent for a debit card, a nickel for cash, or whatever? Could work, I suppose, but any store that would do that would have to, per the rules, advertise prominently its higher price, so that would put it at a competitive disadvantage with the store that didn't offer cash discounts. What strikes me as fair is demanding that merchants be given maximum latitude in how they accept cards and price goods and post signs. Let the market sort it out instead of self-perpetuating rules by the credit card companies.

Posted by: Greg J. | Friday, March 05, 2010 at 09:44 AM

Eric, is that much different from a store that, if allowed by credit card companies, charges a surcharge to credit card users vs. a store that chose not to have such surcharges?

And again, you are acting as if "self-perpetuating rules by the credit card companies" didn't happen in a voluntary manner between free participants in the market place. And if they were not free due to government price controls, then advocate removal of the controls!

Answer my questions above where tried to make you think about how you yourself, as a seller of certain labor to your employer, would act in a market place.

It is normal for free people in a free market place to try to create as much of a monopoly – differentiation from others - on whatever one sells in the market place, be that labor, product or service, for as long as possible. To be competitive is to be trying to leave competition behind. The drive to avoid bloody waters of price competition, to be the first, to have something exclusive, is in fact behind risk taking, innovation, and investment in knowledge, skills and capital, all prerequisites of economic progress and prosperity.

Posted by: Boris Gendelev | Friday, March 05, 2010 at 11:07 AM

ZORN REPLY -- You mean, say, Charge \$2.00 for an item, assuming it will be paid for by the most expensive card, give a one cent discount at the register for a plain card, two cent for a debit card, a nickel for cash, or whatever? Could work, I suppose, but any store that would do that would have to, per the rules, advertise prominently its higher price, so that would put it at a competitive disadvantage with the store that didn't offer cash discounts. What strikes me as fair is demanding that merchants be given maximum latitude in how they accept cards and price goods and post signs. Let the market sort it out instead of self-perpetuating rules by the credit card companies.

GREG J REPLY -- That is exactly what I'm suggesting. I agree that the store would have to prominently advertise its highest price but I'm not so sure that it puts the store at a competitive disadvantage. For starters, aren't we assuming that the credit card fee is already factored in to the price of a given item? Therefore, if Store A and Store B currently charge the same price for the same item, Store A isn't at a competitive disadvantage for offering a cash discount because it theoretically recoups the discount from not having to pay the transaction fee. It's actually put at an advantage, especially when word spreads about its policy.

That said, I think your idea is reasonable but I wouldn't implement it (at least right away). My problem with it is twofold. First, our economy works best when the government isn't constantly bailing businesses out of bad deals that they make voluntarily. That goes to the corporate welfare point that I made earlier but it also relates to respecting private contracts. Consenting adults should have to live with the consequences of their bargains.

Second, I think the credit card companies deserve to profit handsomely from their services. This is similar to the argument that I made when California was going to make it illegal for banks to charge certain ATM fees. We can walk up to a machine on a wall, insert a card, and money comes out. That's pretty cool and convenient, and I don't mind someone profiting from that. Similarly, we can walk into a bar, put down a piece of plastic, have the time of our lives, and feel horrible the next day and even worse when we look at our on-line statement. That's pretty cool too and I want to thank the credit card companies for giving me many such experiences.

However, to your point, if credit card companies are engaging in anti-competitive behavior, then by all means the government should step in. Any so-called conservative who doesn't believe in antitrust law or allowing the government the role of establishing and enforcing the rules of the game needs to put down the tea and pick up a Bork or Friedman book. Of course those powers should be exercised very carefully (and often they aren't) but there are situations where it's necessary. When it comes to credit card fees, I'm not sure we're there yet. I'm not sure if businesses have tried hard enough to work with credit card companies or come up with innovative price structures. It seems to me they would rather have the government sort it out for them. If I'm wrong about that, or if they eventually try and fail, then let's go with your idea.

Sorry if that was long-winded but it's complicated as you know.

Posted by: Greg J. | Friday, March 05, 2010 at 12:43 PM

Greg, here is Milton Friedman anti-trust, from [http://www.cato.org/pubs/policy\\_report/v21n2/friedman.html](http://www.cato.org/pubs/policy_report/v21n2/friedman.html):

"... as I watched what actually happened, I saw that, instead of promoting competition, antitrust laws tended to do exactly the opposite, because they tended, like so many government activities, to be taken over by the people they were supposed to regulate and control. And so over time I have gradually come to the conclusion that antitrust laws do far more harm than good and that we would be better off if we didn't have them at all, if we could get rid of them."

Also, in the first paragraph, Friedman writes about corporate welfare: "I can't blame a businessman who goes to Washington and tries to get special privileges for his company. He has been hired by the stockholders to make as much money for them as he can within the rules of the game. ... Blame the rest of us for being so foolish as to let him get away with it."

In this article he is not making the explicit connection, but I think it is obvious: the origins of anti-trust that was deemed, even by younger Friedman as a worthy cause, are in the corporate welfare. The persistent railroad trusts were creatures of government's special privileges and protections. But even when regulations are not specifically intended to be protectionist, such as price controls, they de facto are, as I talked about earlier. Rather than fighting bad policy effects with more bad policies – bad because they disregard fundamental human nature, it is much more preferable to eliminate the policies that promote non-free-market behavior, policies that effectively give businesses the ability to wield some of the government power.

Posted by: Boris Gendelev | Friday, March 05, 2010 at 02:59 PM  
@Boris,

In my comment above, I was thinking of Bork's position on antitrust (if you haven't read his "A Time to Speak," I highly recommend it) and Friedman's thoughts about the government protection of property rights, contracts, etc. I didn't realize that Friedman was a proponent of getting rid of antitrust law entirely. I take his point that antitrust laws have done more harm than good; however, I'm not sure I agree that they should be abolished outright. I suspect that both of you were/are more libertarian than I am but, as you may suspect from my other comments, I have very few disagreements with libertarians. Your last paragraph makes a very compelling argument in favor of your position. Thanks for posting - as always you gave me some things to think about.

Posted by: Greg J. | Friday, March 05, 2010 at 03:27 PM  
So many good books, so little time :-).

Posted by: Boris Gendelev | Friday, March 05, 2010 at 03:35 PM

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