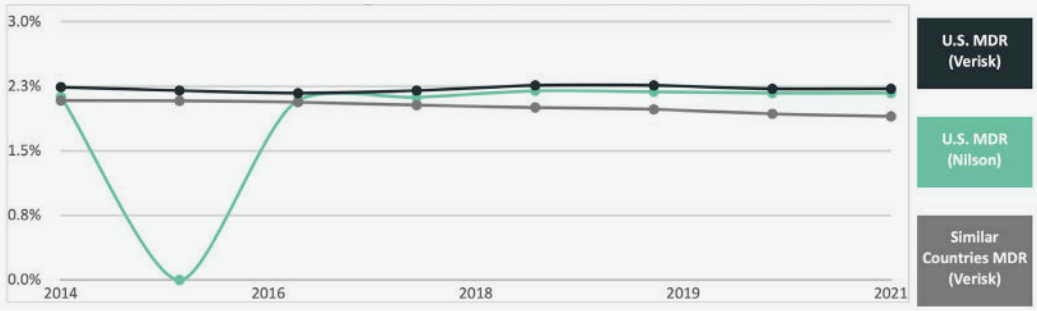
THE TRUTH ABOUT INTERNATIONAL INTERCHANGE

Retail interest groups frequently make misleading claims about how the U.S. credit card market compares with international markets, focusing solely on different interchange rates among countries, which are meaningless in isolation from crucial distinctions such as the value of credit cards and other market characteristics.

U.S. Interchange Is Not an Outlier Among Similar Economies

Merchants pay a price (called the merchant discount rate, or MDR, which includes interchange) to accept credit cards at their stores or online. The U.S. and Japan—the largest and third-largest economies in the world—have essentially the same interchange rates, trading places by a few basis points depending on the year. The U.S. and Japan have the most highly developed consumer credit markets in the world, and this is reflected in the value created for their consumers and merchants by their respective electronic payments systems.

Merchant Discount Rates



Source: The Nilson Report, Verisk Financial

There are six global electronic consumer payments networks: four American, one Japanese, and one Chinese. The American payments networks are vital to the projection of U.S. economic power around the world. These networks have added tremendous value for U.S. consumers and merchants, yet merchant lobbyists want to regulate them into valueless, lowest common denominator systems that in the short term would appear cheaper for them without regard to the consumer.

The MDR in the United States was 2.17% in 2021, only slightly above the 1.96% seen in countries without artificially imposed controls. China, the world's second largest economy, has a lower average MDR, but China also has a vastly different economy, credit market, and political system. There, consumer lending often occurs through a combination of unregulated microlenders and heavily regulated electronic payments. Comparing the U.S. credit card market to China's market is misguided at best, and the U.S. has made a choice as a nation not to emulate what is essentially a command economy.

Interchange rates are also artificially low in the EU due to regulation. There were two rounds of interchange regulation in the EU (which has no global payments systems), and both coincided with aborted plans to establish their own European electronic payments network. The first attempt was undertaken by European banks. After spending about $50 million, they realized that establishing a competitive global network was extremely expensive. The second, more recent attempt would have required EU funding.

In each case, the decision was made to regulate interchange, which hobbled American competitors. Moreover, the payment card market in Europe is predominantly debit, and their consumer credit market is much different than in the U.S., frequently taking the form of "deferred debit" as opposed to revolving credit. Credit cards in the EU have lower market penetration, lower credit limits and fewer

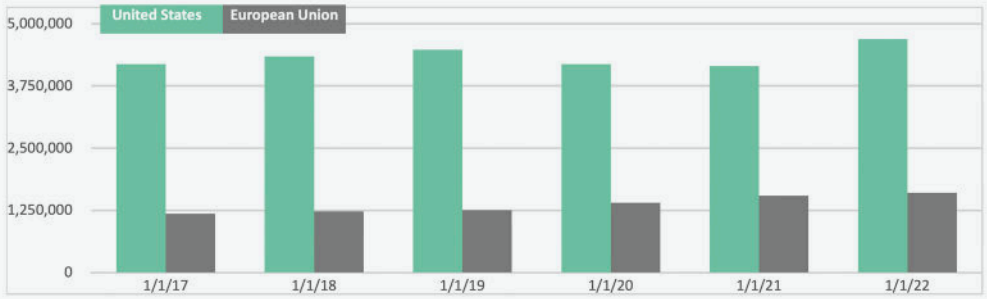
features than U.S. cards. In the U.S., by contrast, market prices and lower regulation have led to a dynamic two-sided credit card market with immense value for consumers.

Regulating Interchange Has Consequences

When market observers or regulators focus solely on the prices merchants pay, they overlook other parts of the market, including the value credit cards provide to merchants, along with the price and value of credit cards to cardholders. As noted above, credit card interchange rates are significantly lower in the European Union than the United States. However, this comes at a cost of reduced innovation, security, and rewards in the electronic payments industry, which are the very qualities that make credit cards so popular among U.S. consumers.

Global Card Volume

Total number of financial cards in the United States versus European Union



Source: Euromonitor

It is not surprising that there are consequences to artificially capping one price in the credit card market. The credit card market is two-sided, with both merchants and consumers receiving a product or service from card issuers: merchants can accept credit cards, and consumers can use them. Both sides of the market benefit from this arrangement: merchants benefit from prompt transactions, fraud protection, increased spending, and the ability to operate online. Consumers receive a revolving line of credit, the convenience of fast in-person transactions, the ability to purchase goods online, and rewards. Both sides of the market also pay a price; merchants pay the merchant discount (including interchange fees), and consumers pay interest, annual fees, and other fees.

The Two-Sided Credit Card Market

Merchant		Cardholder	
Price of Credit Cards	**Value of Credit Cards**	**Price of Credit Cards**	**Value of Credit Cards**
• Merchant discount (including interchange fees)	• Prompt transactions • Fraud protection • Increased spend • New retail channels (e-commerce)	• Interest • Annual fees • Other fees	• Revolving line of credit • Convenience • Online shopping • Rewards

The current system in the U.S. works for everyone, and adjusting prices—on either the cardholder or merchant side—leads to consequences for the rest of the market. If the merchants' price were reduced, then either the value of the product would decrease, or the prices cardholders pay would rise. In fact, these market effects have been proven through U.S. debit market regulation. When Congress capped debit interchange, the value of debit cards decreased for consumers, and prices rose. Debit card rewards disappeared almost entirely, and consumers faced higher fees for checking accounts and other debit products—a natural consequence of regulating one side of the two-sided market.