greater use of EFTPOS and a lower cost for the payment system as a whole. This may be true but is irrelevant in deciding the merits of the Application. The Application does not cover credit cards and, in any event, changes in the regulation of credit cards are already in the process of being implemented.

The *Joint Study* presented no empirical evidence to support its prognosis of the pricing adjustments that would occur in response to the mandatory abolition of EFTPOS interchange. Taken overall we consider that most of these pricing adjustments are very unlikely to occur in practice. Some are contradicted by the rest of the analysis in the *Joint Study*.

If the *Joint Study* is correct about the lack of pricing pressure in EFTPOS issuing and acquiring, then the most likely outcome is that issuers will not pass the windfall gain from the abolition of interchange fees onto their cardholders. This means that cardholders will be worse-off to the extent that they have to pay more to merchants to exercise the EFTPOS option when making a purchase. In our view this is highly likely. In this event there would be a loss of public benefit associated with the pricing adjustments to cardholders.

On the other hand EFTPOS acquirers will certainly seek to recover their revenue shortfall through higher merchant charges, which will in turn be passed on to their customers. That said, it is not clear that the merchants in question would want to confine their increase in prices to those customers who were cardholders. It is equally unclear whether such merchants would be able to be so selective even if they wanted to do so.

The pricing of goods and services is not a costless activity — the more complex the pricing, the greater the costs for both merchant and consumer. The imposition of a surcharge for the use of a debit card (as a consequence of a zero interchange fee) could be expected to complicate the bookkeeping for a merchant. Moreover the size of any surcharge (around 20 cents a transaction on average) means that surcharging is unlikely to be worth the additional cost for many merchants.

Given the dominance of debit cardholding among the customers of most merchants, it is highly likely that most merchants would opt for adjusting all prices and would not discriminate between those who use EFTPOS and those who do not. This means that the abolition of interchange fees on EFTPOS would lead to the imposition of additional costs on non-EFTPOS users as well.

The net change for consumers will be a loss of net consumer benefit and for the issuing banks and financial institutions, a windfall gain.

The Application makes much of the fact that the credit card reforms will encourage the use of EFTPOS. This may well be true but misses the key point. The credit card reforms are in the process of being implemented so that they are a given. Any benefits that accrue to EFTPOS users from the

credit card reforms will be generated regardless of what decisions are made on the Application. The key question is whether the proposals in the Application will produce a net public benefit in their own right, not whether they will do so in combination with the credit card changes.

4.3.2 Loss of network benefits

The imposition of a zero interchange fee would reduce the ability of the operators of the EFTPOS network to maximise the value of the network for all network users. A zero interchange fee would only maximise the value of the network for all its users where the costs and competitive pressure in issuing and acquiring were identical.

The results of the *Joint Study* make clear that neither condition is fulfilled in EFTPOS. Even the Application implicitly admits that this is correct by proposing an arrangement to allow the reintroduction of interchange fees at some time in the future. Both confirm that the imposition of a zero interchange fee can be expected to result in the loss of the net pubic benefit associated with the EFTPOS network.

Economics of networks

Payment instruments generally require two sorts of networks for successful operation.

- The first is the network of *contractual* obligations that bind the various parties to the transaction in question. The consumer and the merchant each have a contractual relationship with their respective bank and the two banks have an agreement with each other. The merchant and the consumer are linked by their agreement to exchange the good or service in question.
- The second is the *physical* network used to process the payment messages between the four parties to the transaction in question.

Networks may be thought of as links connecting nodes. In the EFTPOS network, merchants and cardholders form the nodes of the *contractual* network with the links being the clearing and settlement arrangements between their respective financial institutions. The *physical* network in EFTPOS payments has the merchants' terminals and their financial institutions' mainframe computers as the nodes with the electronic switches and data lines as the links between them.

The cost of installing and operating each is likely to be quite different to the other. For example, the physical EFTPOS network involves a relatively high level of fixed investment in terminals, communications and information technology and a relatively low level of costs that vary with the level of output. Moreover a significant part of these costs are common to other payment instruments, such as credit cards and transactions accounts.

As the *Joint Study* has noted there is a lively debate about the economic characteristics of networks. Some economic commentators have concluded that the unique features of networks may have significant implications for competition and efficient pricing of network services (see for example Economides 1996 and McAndrews 1997).

A critical economic relationship in a network is the complementarity between its components. The more links and nodes a network has, the more valuable it is to any network user or network operator. A telephone system with only one subscriber is of little benefit to anyone — there would be no one to call and no one to charge for its costs. Complementarity is a critical relationship in both the physical and contractual networks that make up a payments system.

Network complementarity means that the more who use a network, the greater the potential benefit to a new user. While the network is not congested, network users will prefer a larger to a smaller network.

These demand-side benefits have important consequences for the development and operation of all networks:

- Compatibility of network components may be necessary to realise the potential network benefits.
- Industry standards may be required to achieve compatibility of network components.
- An installed base of network facilities can give the network owner an advantage in establishing the industry standard.
- Once it is large enough, the terms of access to the network can affect the extent of competition in downstream markets.

Much of the debate about these network benefits has focused on whether they are likely to be reflected in the prices charged to network users. Some contend that network benefits are externalities and cannot be reflected in user charges.

ACIL Tasman agrees with the RBA and Professor Katz that network effects are not externalities but are simply the pecuniary consequences of shifts in demand. These shifts are capable of being 'internalised' by the network operators. They are part and parcel of the dynamics of properly functioning markets and certainly do not call for external intervention.

Liebowitz and Margolis have developed a very persuasive analysis of network externalities (Liebowitz and Margolis 1994). Their analysis applies to both physical and contractual networks and relates network benefits to the *number* of interconnections, rather than to the *nature* of connections themselves.

Even if network effects were externalities, this does not mean that the network operators are incapable of taking them into account in their decisions about the size of the network. If network users value more

users or connections, network operators will be prepared to invest in network expansion and users will be prepared to pay for it. For instance, mobile telephone operators, such as Telstra, Optus and Vodaphone, routinely subsidise the purchase of handsets to encourage users to connect to their proprietary networks.[6]

The only potential impediment to the interconnection of networks and the connection of new users are the transaction costs involved. These costs include the costs involved in harmonising incompatible network technologies. Such costs represent real constraints and they cannot be ignored if intervention is to enhance economic efficiency.

Electronic payment networks

In the case of the card payment networks, the network effects are potentially powerful but the network operators seem to well appreciate the benefits of open payment systems.

The EFTPOS network is a good illustration of the fact that the network benefits of open payment systems are well appreciated. The proprietary segments of the network are now fully compatible with each other. The Australian Payments Clearing Association (APCA) has put in place comprehensive interconnection standards for the proprietary segments. A payment card issued by any financial institutions in Australia can now be used to pay for goods and services, and to obtain cash, from any EFTPOS merchant.[7]

Originally each EFTPOS operator installed its own proprietary network. The successful interconnection of these proprietary networks evolved through a series of bilateral connections between individual proprietary networks contingent upon the payment of interchange fees on the transactions that were passed between them. This implies that bilateral interconnection and setting of interchange fees was in the interests of the operators of each of the proprietary networks.

As compatibility and ubiquity have effectively been achieved within the EFTPOS network, the only remaining issue is whether there is a need to retain interchange fees to ensure that the potential network benefits of the EFTPOS system continue to be fully captured.

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6 McAndrews has pointed to a more compelling example in the evolution of the railways in the US (McAndrews 1997). In their early years, the US railways only provided a local service and a multiplicity of gauges emerged. As industrialisation proceeded the higher cost of shipping across different gauges became more apparent. By the 1880s the lines that did not use what had become standard gauge, voluntarily changed to that standard. The Australian experience of persistent multiple gauges reflects the fact that the railways in Australia were in public ownership, compared to the private ownership that was the norm in the US

7 Charge cards, such as American Express and Diners Club, can also be used to pay for goods and services and to obtain cash through their proprietary electronic networks.

The *Joint Study* found that the economic necessity to redistribute costs between EFTPOS issuers and acquirers had passed because the EFTPOS network had reached maturity and the network effects had ceased — on this argument, new cardholders or new merchants would be of little benefit to the existing cardholders and merchants who already participate in the network.[8]

Zero interchange not supported by economic research

This conclusion is not supported by the work of the bulk of the economic researchers in the field of card payment systems (see Small and Wright 2000; Rochet and Tirole 2000 and 2001; Gans and King 2002; Chang, Evans and Schmalensee 2002; and Schmalensee 2002).

As summarised by Richard Schmalensee, one of the leading economic researchers in this field, the main economic role of the interchange fee:

> '...is not to exploit the system's market power; it is to shift costs between issuers and acquirers and thus to shift charges between merchants and consumers to enhance the value of the payment system as a whole to its owners.' (Schmalensee 2001)

The direction and extent of the interchange fee that maximises the overall value of the EFTPOS network will depend upon a number of factors. They include the following:

- the differences in costs between EFTPOS issuers and acquirers;
- the differences in the sensitivity of demand by cardholders and by merchants for EFTPOS services; and
- the relative strength of competition between EFTPOS issuing and acquiring.

This body of work shows that an interchange fee set at zero would only generate a net public benefit if there were symmetrical conditions in issuing and acquiring. This is highly unlikely. Indeed the evidence in the *Joint Study* suggests that this requirement is not met in the EFTPOS network in Australia. For example it found that both costs and competition differ between issuing and acquiring in debit cards.

The conclusion that interchange fees were no longer required was not even supported by the RBA's own economic expert on card networks. Professor Katz concluded that:

> '...consumer expectations *can* be an important driver of the market outcome....card networks *can* share a self-fulfilling expectations property with other networks...Once a network has become established, the

8 This assertion of a general relationship between network effects and network maturity was subsequently reasserted by the RBA in the context of its proposed credit card reforms (RBA 2001).

> expectations process *may* get past the chicken-and-egg problem. The network's viability *may* then be less sensitive to small changes in the size of the network and the network *may* need to do less to promote membership.' (Katz 2001) [emphasis added]

Professor Katz has simply acknowledged that the diagnosis in the *Joint Study may* be correct but has *not* been prepared to say it is *definitely* so.

In any proposal to mandate a zero interchange fee for EFTPOS, the onus of proof has to be on the proponents to demonstrate with a high degree of confidence that network effects no longer require those fees for their realisation. On the present evidence the risk of regulatory error must be significant. In the words of the RBA's own economic expert in this matter:

> 'It must be emphasised that while efficiency problems provide opportunities for government intervention in the economy, they do not require it. That the market-generated allocation of resources in the economy is imperfect does not mean that the government can do better...governments like people make mistakes.' (Katz 1998)

Implications of zero interchange

On this basis, mandating a zero interchange fee in the EFTPOS network would be likely to result in a loss of some of the network benefits to cardholders and merchants on the network. Indeed any move to impose a particular level of interchange fee on the network operators, either by a regulatory agency or by a collective decision of the industry, would be likely to yield a similar result.

The major risk to the network benefits associated with EFTPOS from mandating a zero interchange fee is not in the loss of merchants from the network — as the Joint Study and the Application seem to believe — although that risk is real enough for some merchants. The most significant risk is likely to be that merchants on the network will:

- reduce the extent they are prepared to provide 'cash outs' to their customers; and/or
- decline to accept EFTPOS for the lower margin transactions.

Any combination of these outcomes would reduce the attractiveness of EFTPOPS to debit cardholders and, if they came to pass, would result in a further loss of revenue to the network operators.

To the extent that issuers and acquirers respond to such a development with another round of fee increases to their cardholders and acquirers, as would be expected, the net value of the network to network users would be further reduced, with additional loss of public benefit.

4.3.3 Increased transactions costs

The Application proposes that the ACCC allow the reintroduction of interchange fees, at some time in the future, on the basis that they set multilaterally. Any centralisation of the decisions on interchange fee levels could increase the transactions costs involved with in the interchange arrangements.

Despite this possibility the *Joint Study* ignored the issue of transaction costs in its analysis of the public benefits of mandating the abolition of EFTPOS interchange fees. This represents a significant oversight.

For its part the Application asserts that multilateral setting of interchange fees for the EFTPOS network would be easier than the present bilateral arrangements. However, the Application does not present any empirical or theoretical evidence to support the assertions.

Nature of transaction costs

Transaction costs are simply the 'cost of using the price mechanism' (Coase 1988). They may be thought of as the 'frictions' within an economic system that prevent it operating as postulated by the highly abstracted model of perfect competition. Although this seems to be a simple and straightforward insight at first glance, its significance to economic analysis has been hailed as revolutionary by a leading economic commentator (Cheung 1983).

Transaction costs are a reflection of ignorance. For example to transact an economic exchange, the prospective parties to it must first:

> '...find each other, they have to communicate and to exchange information...goods must be described, inspected, weighed and measured. Contracts are drawn up, lawyers may be consulted, title is transferred and records have to be kept. In some cases, compliance needs to be enforced through legal action and breach of contract may lead to litigation.' (Niehans 1987)

The use of an appropriate payment instrument is one part of this transactional calculus. Some of the direct costs of using a payment instrument are obvious: they include the cost of 'purchasing', storing and exchanging the instrument in question.

In the case of EFTPOS the more obvious costs include the fees that issuers charge their cardholders as well as the merchant fees levied by acquirers. That said, there are other less obvious costs that the various parties incur to use EFTPOS. These include the time and effort in reconciling EFTPOS transaction statements, the inconvenience in time and effort were the debit card to be lost or stolen and the possible loss of funds in that event.

Advantages of current bilateral arrangements

The most important feature of the current practice of voluntarily negotiated access and interchange fees in the EFTPOS network is that it leaves the determination of interchange fees and access conditions to those who are in the best position to identify and to minimise the transaction costs that are associated with EFTPOS. Acquirers and issuers have both the information and the incentive to do so for their merchants and cardholders respectively.

These incentives include the incentives to deal with the ignorance that naturally surrounds such questions and answers. As a consequence the decisions taken will be most likely to maximise the private benefits that they receive as a result of their decisions.

Subject to the market in which EFTPOS services are provided being sufficiently contestable, over the longer run the threat of competition will ensure that these decisions will also tend to maximise the benefits to the community as a whole. In other words, voluntary action to deal with the transaction costs associated with EFTPOS will maximise both the net private benefits as well as the net public benefits from interchange.

The more the answers to these questions are mandated collectively, either by the regulators or by the industry itself, the less likely the answers chosen will be in the best interest of the community as a whole.

This is because of the fundamental limits to knowledge in the economy and the society at large.[9] In the first place ignorance and uncertainty are both significant and pervasive. Much knowledge is informal and dispersed. All knowledge is costly to collect, formalise and disseminate. Because of this consumers and producers have to economise on their investment of time and effort in obtaining the knowledge that they expect to need to make consumption and production decisions.

Disadvantages of proposed multilateral arrangements

The more centralised the decision-making becomes, the less information that can be brought to bear on the issues that have to be decided. Much of the relevant information is informal and is not centrally available to the top management of the banks in question but is only known to those who deal with particular participants or groups of participants lower down in the EFTPOS network.

Equally the issuers and the acquirers have stronger incentives to ensure that their EFTPOS operations will yield the highest return to their shareholders. The only way for them to succeed in this is to be able to

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9 The dichotomy between the neoclassical textbook world of perfect competition and the real world of significant and pervasive ignorance, uncertainty and transactions costs is well articulated in Sowell (1996). The original insight is attributable to Hayek (1937 and 1945) for which he was awarded the Nobel Prize in Economics in 1974.

satisfy their customers with a service, which they value more than they are charged for it.

In contrast to issuers and acquirers, the RBA and ACCC do not have access to the same information and therefore could not, take those considerations into account to anything like the same degree. Moreover their economic livelihood does not depend upon them doing so successfully and it would probably be unacceptable from the probity perspective if they were.

4.3.4 Risks to investment in EFTPOS network

The abolition of interchange fee means that acquirers will lose the revenue that has traditionally underpinned their investment in their proprietary EFTPOS facilities. To the extent that the acquirers are constrained in replacing that revenue stream, either by competition or by increased transactions costs, future investment in the EFTPOS system is likely to suffer.

Evolution of investment in EFTPOS

EFTPOS is the newest payment instrument and was introduced only relatively recently — at the beginning of the 1990s. It took some years for EFTPOS to establish itself on a broad basis with cardholders and merchants. Even after quite strong growth in recent years, EFTPOS is still used less than either cheques or credit cards, in terms of its share of the total number of non-cash transactions, although its per capita usage continues to increase.

When the banks set out to introduce EFTPOS into Australia, they faced a need to commit a substantial investment over an extended period before they could expect to see a return. The banks would have to set up an extensive network of EFTPOS terminals with their associated IT and communications infrastructure just to attract a single customer. Even then there was no certainty that the network would attract the numbers of cardholders and merchants they would require for long-term viability and to do so sufficiently quickly.

The risks of that investment were clearly much greater than those associated with cheques, which were then the dominant non-cash payment instrument. Cheques were well entrenched among consumers and the economics of cheques were better understood by the financial institutions that offered them.

Despite the fact that EFTPOS is well-established, there is a need for ongoing investment in the EFTPOS network simply to maintain EFTPOS as a secure and effective payment instrument. Indeed APCA has recently announced a major industry project to upgrade the security levels in all EFTPOS and ATM terminals (APCA 2002).

Impact of zero interchange

As pointed out earlier, the *Joint Study* significantly underestimated the costs of issuing and acquiring in debit cards, particularly the capital costs which are a significant part of the cost of the EFTPOS network. A key element of the cost of capital for a prospective investor in the EFTPOS network ifs the risk premium that is necessary to support an economically efficient level of investment.

As a consequence the abolition of interchange fees will mean that EFTPOS acquirers will have to recover a larger amount of revenue than has been estimated by the *Joint Study*, if continuing investment in the EFTPOS system is to remain attractive to them.

The *Joint Study* has assumed that acquirers will easily be able to make good the revenue losses in question by increasing their merchant charges. However, it has presented no evidence to show that any increase in the charges to merchants would not be at the expense of participation by some merchants in the EFTPOS network.

To the extent that participating merchants recovered some of the increased charges from their customers who do not use EFTPOS, they would be likely to experience an overall loss of sales volume. The loss of sales would, in turn, reduce the overall profitability of their business. .

All this implies that mandatory abolition of interchange fees would be likely to have an adverse effect on merchant participation in the EFTPOS network and on the profitability of participating merchants. In turn this would have a negative impact on the attractiveness of innovation and investment in the EFTPOS network.

This negative impact is likely to be particularly pronounced in the case of those network operators that are not also involved in debit card issuing. They will miss out on the benefit of the offsetting savings that flow to the issuing businesses.

While most banks will have a significant offset to their acquiring revenue loss because they are also involved in issuing, the same is not true for all network operators. Those operators that are acquirers only will be particularly disadvantaged by the proposed changes and will be discouraged from further investment and innovation in the EFTPOS network. This is likely to represent a significant loss of dynamic competition in the network.

4.3.5 Risks to emerging payment instruments

Acceptance of the proposals in the Application is likely to increase the perception of sovereign risk of investment in new payment networks in Australia. This perception would be reinforced by the fact that the evidence of 'market failure' presented to date has been weak and neither

the *Joint Study* nor the Application have made any serious attempt to assesses the significance of the risk of 'regulatory failure'.

Any increase in the risk premium associated with payments networks would, of course, have a negative impact on investment in the payments systems as a whole. This would, in turn, mean a loss of net public benefit over the longer term.

Scope for new payment instruments

Advances in information technology and telecommunications are opening up possibilities for lower cost means of making retail payments and providing new financial services.

There is considerable potential for stored-value cards (SVC) to replace notes and coin, especially for low value purchases. The most sophisticated SVCs contain a computer chip to hold and process the data required for financial transactions, as well as for non-financial applications (for example access to buildings or storage of medical records).

Regional pilot tests of general-purpose stored-value cards based on 'smart card' technologies have been implemented in all of the countries in the Group of Ten, as well as Australia. Nation-wide implementation is under way in a few of these countries (Group of Ten 1997).

Realising the potential

None of these prospective or recently initiated retail payment innovations are assured of commercial success in the Australian marketplace. If they are to succeed they will require significant capital investment and will entail a high degree of risk.

A critical determinant of any successful entry by a new payment instrument will be the nature and the extent of the regulatory regime that the investors will confront. This will also influence the attractiveness of the EFTPOS system for future major investments to upgrade its technical efficiency or its functionality. As we indicated earlier, this may be a real issue for the EFTPOS network in the foreseeable future.

In all cases the network effects associated with any new payment instrument are likely to be a significant. For example, any new payment instrument is likely to build upon the communications and computer processing infrastructure that supports the existing payment networks, as far as practicable.

Any new payment network is most likely to be an 'open' network with different operators acting as acquirers and issuers. In such a case, the network operators will need to avail themselves of a mechanism to redistribute the network benefits among themselves. Only in this way will the network operators maximise the incentives of both acquirers and

issuers to maximise the value of the new network to themselves, and thereby to its ultimate end-users.

This mechanism is provided by the interchange fee. However, to be most effective the network operators need to be able to set the fee at whatever level they believe will maximise the value of the network. Any constraint upon their freedom of action will diminish the attractiveness of the prospective investment in the new network and will discourage the emergence of new payment instruments.

The mandatory introduction of zero interchange in the EFTPOS network is likely to increase the perception of the sovereign risk on investment in all payment networks in Australia. This perception would be reinforced were the ACCC to accept that, in future the reintroduction of any interchange fee in the EFTPOS network would be set on a multilateral basis

Both of these reforms would act to constrain the ease with which a prospective investor to recover the costs of its investment. If the Application is accepted, a zero interchange fee would have been introduced in the EFTPOS network

- on the basis of weak evidence of a 'market failure' in the setting of interchange fees;
- in the face of a significant risk of 'regulatory failure' associated with mandating of a zero interchange fee level; and
- in the knowledge that any possibility of unwinding of a poor decision would require a consensus among the Applicants as to the level of any reimposed fee.

4.3.6 Market power in payments & within EFTPOS

The *Joint Study* has concluded that mandating a zero interchange fee in the EFTPOS network would effectively and efficiently address the issues of market power in the network. This is presented as a public benefit from such a change.

Although the *Joint Study* did not undertake a formal analysis of the market in which EFTPOS services are provided, the Joint Study clearly implies an overly narrow definition of this market. Both facets represent significant shortcomings of its analysis.

In our view the *Joint Study's* diagnosis of the extent of market power in the EFTPOS network and its prognosis of the ability of a zero interchange fee to neutralise market power are both seriously flawed. In other words mandating a zero interchange fee will not yield a net public benefit in terms of either increased competition or reduced market power in the market in which EFTPOS services are provided.

Competition within the EFTPOS network is determined by the ease of access to the network and the willingness of new players to enter the market.

The proposal for a zero interchange fee does not address the barriers to entry into the EFTPOS network. Moreover it does not encourage new acquirers to enter the market. If new acquirers are not able to be drawn to the marketplace, then there can be no greater competition in the market than exists today and hence no greater pressure on pricing for merchant services to offset the anticipated fee increases. The market power of the incumbents will therefore not be affected.

The RBA has announced significant reforms of the credit card system with new regulations aimed at removing barriers to entry to the credit card system to allow increased competition and greater transparency. For new EFTPOS acquirers to be encouraged to enter the Australian market, the ability to acquire in both debit and credit cards will be necessary for the new entrants to compete effectively with the existing acquirers in the market.

Market in which EFTPOS operates

Since 1980, ATM and EFTPOS transactions have grown from 1 per cent to 30 per cent of all non-cash transactions — see Table 1. In contrast the proportion of transactions that use cheques has more than halved. Although some of the cheque's loss of market share is due to the parallel growth in direct entry and credit card transactions, these account for no more than one-third of the change.

As we saw previously, since the mid-1990s the ratio of the value of cash and coin on issue to nominal GDP has declined sharply. This decline has coincided with a quadrupling in EFTPOS terminals and a doubling in EFTPOS transactions (Australian Payments Systems Council 1997). These changes reflect the vastly greater accessibility and acceptance of EFTPOS.

EFTPOS transactions have substituted for both cash and cheques. The implication is clear — all payment instruments can be substituted for each other to a significant degree.

Nevertheless, even weak substitutes may be enough to make a market workably competitive (PC 2002a). Even if they were weak substitutes for card payments, the dominance of cash and cheques in retail payments in Australia means that they should be able to exert significant competitive discipline on the card payment networks. For this reason the extent of competition within those networks is of less concern.

In the US the courts have reached a similar conclusion about the market in which EFTPOS operates. In deciding anti-trust cases in financial services, US courts have defined this market very broadly. The *Nabanco*

case on credit card interchange was a watershed in this regard. In that case, a US District Court summarised its position in the following way:

> 'This market [for retail payment services] includes VISA, MasterCard, T&E [travel and entertainment] cards, merchants' proprietary cards, merchants' open book credit, cash, travellers' cheques, ATM cards, personal checks and check guarantee cards.' (quoted in Balto 1995).

In doing so the District Court acknowledged that none of these instruments was a perfect substitute for any of the others. It relied on an examination of the cross-elasticities of supply and demand to determine the extent of substitution (Balto 1995).[10]

As all of these payment instruments are available in Australia, we conclude that competition in the market in which EFTPOS is provided is relatively strong. Indeed the main competition to debit cards is not credit cards, as suggested by the *Joint Study,* but cheques and cash. Between them cheques and cash are used in many more transactions than are credit cards. Indeed over the past decade both debit and credit cards have gained substantial market share at the expense of both cash and cheques.

This means that debit and credit cards each substitute for cash and cheques in rather different types of transactions — debit cards for the lower value transactions and credit cards for the higher valued ones. In other words cheques and cash are a closer substitute for debit cards than credit cards are for most transactions in which debit cards are currently used.

Contestability in the payment system

The *Joint Study* concluded that competition within the EFTPOS network was such that there was little or no pricing discipline on issuers or acquirers. If so this suggests either the presence of natural monopoly in the EFTPOS network and/or barriers to entry in and within the payments system..

We examine each of these possibilities in turn.

Is EFTPOS a natural monopoly?

A natural monopoly is where one producer can produce all the output that is demanded at lowest cost. Such technologies are characterised by economies of scale or scope due to the dominance of fixed costs, particularly sunk costs. Fixed and sunk costs are significant in retail payment services such as EFTPOS.

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10 It is notable that the *Joint Study* did not even review the empirical literature on substitution between payment instruments let alone attempt to undertake such an analysis.

There are several reasons why the EFTPOS network could not be said to qualify as a natural monopoly.

- It is not clear that one operator could run the EFTPOS network at lowest cost. If this were true, competition between the proprietary networks should have reduced their numbers. Since the launch of EFTPOS there has been no reduction in the number of operators. On the contrary the number has since increased — including the entry of merchant principals to undertake part of the acquiring function.
- Cash, cheques, EFTPOS, credit cards and charge cards all compete against each other for low value retail payments, at least to a significant degree. EFTPOS does not have a credible monopoly over any group of transactions.
- The Explanatory Memorandum that accompanied the *Payments System Regulation Act* made it clear that the Commonwealth Government considered that a natural monopoly had not emerged in any part of the payments system at that stage. (Commonwealth Parliament 1998).
- EFTPOS is under competitive threat from the emergence of new consumer payment instruments. Although views differ as to how imminent this threat is in fact, the uncertainty is unlikely to encourage network operators to charge aggressively for network access — this would be likely to improve the business case for investments in new payment instruments.

Barriers to entry & exit in the payments system

To operate efficiently the market for payment services requires that the financial intermediaries that provide those services are able to settle any outstanding financial obligations with each other, once they have exchanged their various payment instructions. A central bank deposit is generally regarded as the only financial asset that is free of the risk of default and therefore suitable for settling outstanding payment obligations.

In Australia this role is performed by Exchange Settlement Account (ESA) balances maintained at the RBA. The establishment of these accounts by the RBA has provided a degree of reassurance to those financial institutions fortunate enough to have access to them.

At the time of the Wallis inquiry, access to ESAs was restricted to the banks and the two Special Service Providers that provide settlement services for building societies and credit unions respectively[11]. Entry to all three of these groups of financial institutions was also tightly regulated — in the case of banks by the Commonwealth and credit unions and building societies by the States. All deposit-taking institutions were

11 The Australian Association of Permanent Building Societies Ltd and Credit Union Services Corporation Ltd respectively

licensed and are subject to prudential restrictions on their ownership and corporate structures. Only banks could issue cheques in their own right. These regulatory restrictions had the effect of limiting entry into the market for payments services.

In the wake of the Wallis Report the Commonwealth Government has created a single licensing and regulatory regime for all deposit-taking institutions under the auspices of the Australian Prudential Regulation Authority (APRA). In the process the Government has moved to make the regulatory regime less restrictive to entry, consistent with the need to maintain systemic stability and depositor protection. These regulatory changes aim to:

- allow deposit-taking institutions to issue cheques in their own name;
- allow institutions other than deposit-taking to have ESAs; and
- allow non-deposit-taking institutions to settle retail and wholesale electronic payments.

One consequence of these regulatory changes has been to reduce substantially the barriers to entry to payments services, and thereby promote greater competition in their provision.

Barriers to entry remain and will, to some extent, allow deposit-taking institutions to exercise a degree of market power. That market power will be able to be exercised across the range of services where the remaining entry barriers are effective.

The remaining market power will exist whatever is done to interchange fees in either credit or debit cards. Those institutions that hold this market power will be able to exercise it wherever their commercial freedom is unconstrained.

The cost of this market power in reduced output should have been fully taken into account when the Government decided upon the level of prudential regulation that was necessary for the stability of the payments system. In other words the economic cost of market power should be offset by the economic benefits of greater stability in the financial system as a whole.

Barriers to entry & exit in the EFTPOS network

Under the current arrangements for a prospective acquirer to interconnect to other proprietary EFTPOS networks, the new entrant would have to:

- enter into a bilateral interchange agreement with each issuer in the network, or enter into an arrangement with a 'gateway' acquirer that has bilateral interchange agreements with issuers in the network;
- be able to settle its clearing obligations with each issuer, namely by drawing on its own ESA or that of another institution's ESA

In relation to the second point, the RBA's policy has been enunciated in the following terms:

> 'Any provider of third party (customer) payment services that has the need to settle clearing obligations with other providers of such services and the liquidity to meet these obligations may apply for an ESA.' (PSB 1999).

On this basis, the key access issue is therefore the ability for new entrants to enter into bilateral interchange agreements with all issuers in the network.

Similarly for a prospective issuer to participate in the EFTPOS network as an issuer, the organisation must:

- be an approved deposit-taking institution (ADI) and maintain customers' deposit accounts, or deposit-like sources of value, which the customers can draw upon in EFTPOS transactions;
- enter into bilateral interchange agreements with each acquirer in the EFTPOS network, or enter into an arrangement with a 'gateway' issuer that has bilateral interchange agreements with the acquirers in the network
- have a means of settling EFTPOS clearing obligations with each relevant acquirer, either by way of its own ESA or access (under a commercial arrangement) to another institution's ESA.

The key access issue for issuers is therefore similar to that of acquirers. Direct access is linked to the successful negotiation and implementation of an interchange arrangement with existing issuers and acquirers. The EIWG discussion paper suggests that mandating a zero interchange fee is likely to reduce some of the barriers to entry to the EFTPOS network that exist today.

Clearly a key element in the successful negotiation of an interchange agreement requires that the parties agree on price. There are, however, a number of other significant hurdles that must be overcome before a new entrant can gain access to the EFTPOS network. Other important issues that require agreement between existing and potential participants in the EFTPOS network include::

- The detailed specification, design and development, testing and certification of the technical interfaces between the parties' infrastructure.
- The timely commitment of financial and other resources to the construction of the interfaces.
- Satisfactory commercial arrangements that provide existing interchange participants with an incentive to enter into agreements with new network entrants. Otherwise, new entrants must use a gateway to gain access through existing bilateral links established by

the gateway provider. As this access route involves additional costs, a lack of commercial incentive to encourage existing participants to enter into new agreements represents a substantial obstacle to the EFTPOS network..

The fact remains that market power will continue to exist whatever is done to interchange fees in either credit or debit cards. Those institutions that hold this market power will be able to exercise it wherever their commercial freedom is unconstrained. If a constraint is placed on one avenue of commercial freedom, such as the setting of interchange fees, the institutions in question will still be able to exercise it in any area of their business where they remain unconstrained. In that event there will be no obvious public benefit, other things being equal, from merely changing where the market power may be exercised.

In reforming the credit card market the RBA announced a package of reforms for credit cards, not just to interchange fees. These included changes to address issues of access and the level of competition in credit card markets. Consistent with this approach, changes to the access arrangements for the EFTPOS network need to be considered as part of any changes to interchange fees.

Attachment – Critique of Application

Introduction

The Applicant issuers and acquirers propose that:

- they enter into a contract to set a zero interchange fee on all EFTPOS transactions between themselves;
- they review the fee level after three years, or earlier if circumstances were to change significantly in the meantime; and
- each applicant uses its reasonable endeavours to renegotiate bilaterally a zero interchange fee with those issuers and acquirers that are not parties to the multilateral agreement.

As the proposal may breach Part IV of the *Trade Practices Act*, the Applicants have applied to the ACCC for it to authorise the proposal under section 88(1) of the Act.

Sub-section 90(6) of the Act provides that the ACCC shall not grant an authorisation unless it is satisfied that the proposal would result in or would be likely to result in a benefit to the public, and that public benefit would outweigh any anti-competitive detriment that is likely to result from the proposal.

The Application draws upon the results of the *Joint Study* published by the RBA and the ACCC in 2000. In doing so, however, it shows a more sophisticated understanding of the economics of networks and payment systems as well as of the role of interchange fees in EFTPOS networks.

The Application does not, however, establish that the proposed changes to the setting of EFTPOS interchange fees are likely to generate a net public benefit as required by the Act. In our view the changes are more likely to result in a net economic loss to the community as a whole.

Our reasons for reaching these conclusions are as follows:

- The Application has not explicitly defined the market in which EFTPOS services are provided to cardholders and to merchants. Without doing so it is not possible to establish the extent of the net public benefit, if any, from the proposed changes.
- The Application does not give adequate recognition to the network benefits that the EFTPOS network is generating at the present time. The Application seems to think that these benefits are confined to the past and the future.
- The Application assumes that the savings to issuers from the abolition of interchange fees will be passed onto their cardholders in lower debit card fees or enhanced debit card services. Neither

outcome is likely while the domestic banking industry is trying to increase the return on its investment in retail transactional banking services.

- The Application largely ignores the implications for retail pricing from the increased merchant fees that will be generated by the abolition of interchange fees. The fact that the impact on retail prices is relatively small does not mean that consumers will not respond to the changes, contrary to the assumption in the Application.
- The Application discounts the adverse implications of abolishing interchange fees for innovation and investment in the EFTPOS network. This is despite the Application's acknowledgement that the interchange fee is the obvious way of encouraging the ongoing investment and innovation that will maximise the net public benefit from the EFTPOS network.
- Similarly the Application does not address, let alone recognise, the adverse implications of abolishing interchange fees for innovation and investment in new payment instruments to compete with EFTPOS.
- The Application does not analyse the issue of transaction costs when it proposes to replace the current system of bilateral setting of interchange fees by issuers, acquirers and merchant principals. Accordingly it cannot demonstrate that a move to the multilateral setting of interchange fees would generate a net public benefit.
- Finally the Application does not recognise the need to address the issue of access to the EFTPOS network in parallel with setting the interchange fee for the network. Instead it has argued that the access issue is beyond the scope of the Application and should be left to the Australian Payments Clearing Association

Each of the above reasons is elaborated in turn below.

Application does not define a market for EFTPOS

Any attempt to assess whether the Application meets the requirements of section 88(1) must begin by defining the market in which EFTPOS services are provided. Only then can the public benefit and competitive implications of the Application be established.

Defining the market is the first step in the well-established economic methodology for assessing potentially anti-competitive arrangements or behaviour. For example it is standard practice for the ACCC when administering Part IV of the Act. Despite this well-established practice, the Application has not explicitly addressed the question of market definition.

The Application clearly accepts that credit cards are substitutes for debit cards. However it only implies that that there are other substitutes for debit cards when it states that its proposed changes will:

> '...make EFTPOS more attractive to cardholders (*particularly* relative to credit cards).' [Emphasis added][12]

The Application goes on to observe that the concurrent reforms to the credit card system will assist in this regard. [13]

The highlighted reference quoted above implies (correctly) that there are other payment instruments that compete with debit cards. In the influential *Nabanco* case, the US courts concluded that *all* other retail payment instruments competed with debit cards, including charge cards, cheques and cash.[14]

The failure of the Application to address explicitly the details of the other payment instruments that compete with debit cards means that the discussion in the Application is solely concerned with the competition between debit cards and credit cards. In particular the Application neglects the scope for cash and cheques to substitute for debit cards.

By doing so the Application has effectively compounded the mistake of the *Joint Study* in defining far too narrowly the market in which debit and credit cards operate.

As we pointed out in the main report, debit card transactions (via EFTPOS and ATMs) have grown strongly since 1980. Their growth has been such that debit cards' share of the total volume of non-cash payments increased many times over during the period to 1995. More significantly, this growth was at the expense of the share of the volume of non-cash transactions by cheque.

From 1980 to 1995, credit cards also increased their share of non-cash transaction but nothing like as rapidly as debit cards did. It has only been since 1995 that credit cards have increased their share of non-cash transactions more rapidly than debit cards.

Nevertheless the most important point to note is that both debit and credit cards have continued to gain market share from cheques since 1995. Cash has most probably experienced a similar fate. Since the early 1990s the ratio of the value of notes on issue to GDP has decreased (Australian Payments System Council 1997). This suggests that the transactions

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12 ANZ et al 2003, p.12.

13 ANZ et al 2003, p.12.

14 National Bankcard Corp. v. Visa USA Inc., 596 F. Supp. 1231(SD Fla 1984), *aff'd.* 779 F. 2nd 592 (11th Cir. 1986, *cert. denied*, 479 US 923 (1986).

demand for cash has decreased to the point where the share of cash transactions as a share of all transactions in economy has declined.

As we pointed out in the main body of this report, the failure to define the market in which EFTPOS services are provided is a serious flaw.

When analysing parallel reforms to debit and credit cards, the overriding consideration is the impact that the changes proposed would have on the payments system as a whole. The impacts on the relative usage of debit and credit cards are secondary considerations.

To the extent that the parallel reforms in both card networks — currently being pursued in part by this Application — were to encourage greater use of cheques, the reforms would decrease the overall efficiency of the payments system. This is based on the RBA conclusion that cheques are the most costly non-cash payment instrument.

Application ignores the existing benefits from EFTPOS

In contrast to the *Joint Study,* the Application demonstrates a greater awareness of the economic benefits of the EFTPOS network and the role of interchange fees in redistributing them among network participants.

The Application correctly states that it is not possible to specify the economically efficient level of interchange pricing for the EFTPOS network in terms of marginal costs as the *Joint Study* has done. Rather it points out that efficient pricing on the two sides of the network — cardholders and merchants — has to be determined simultaneously so as to maximise the net benefits of the network to cardholders and merchants. In doing so the Application concludes that accurate cost information is not enough but one would also need information on demand elasticities.[15]

Having done so, however, the Application goes on to ignore the implications of these conclusions. Once an EFTPOS network includes large numbers of merchants and cardholders, the Submission asserts that the network benefits from adding additional participants are relatively small.[16] In such a mature network, the Application concludes that;

> '...the role of interchange fees *may* be minimal until some disruptive occurrence, such as the development of a new product such as a smart card.'[17] [emphasis added]

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15 ANZ et al 2003, p. 13.

16 ANZ et al, 2003, p. 15.

17 ANZ et al, 2003, p. 15

In reaching this conclusion the Application — like the Joint Study before it — did not even look at the demand elasticities for cardholders and merchants or try to estimate the benefits simultaneously derived by the two groups from the EFTPOS network.

One can only assume that the Application is relying on the conclusion of the *Joint Study* that the network benefits of mature networks are largely, if not completely, exhausted. However the *Joint Study* did not offer any empirical evidence in support of this proposition in the EFTPOS network.

The Application seems to ignore its own conclusion that the entry of a new instrument entering the payments system would require the reintroduction of an interchange fee for EFTPOS so as to optimise the development and operation of the network.

The logic of this argument in the Application is not limited to the period *after* a new instrument enters the payment system. The mere threat of entry is likely to be enough to require the costs of the EFTPOS network to be redistributed among the network principals so as to forestall the introduction of the new payment instrument — and the possible consequential loss of market share by the EFTPOS network — for as long as possible.

Application assumes issuer savings passed onto cardholders

The *Joint Study* was concerned at the extent of competition in debit card issuing services. In contrast, the Application thought that issuing was sufficiently competitive to ensure that any cost savings to issuers from the abolition of EFTPOS interchange fees would be passed onto their debit cardholders in the form of lower cardholder fees and/or enhanced cardholder services.

For this to happen, the Australian issuers would have to be earning normal or above normal rates of return on their investment in debit card services. If the rates of return in debit card services were below normal levels, the financial institutions in question would be more likely to seek to retain any cost savings from interchange abolition as enhanced profitability.

In that event, only the threat of new entrants into debit card issuing would be likely to put any pressure on the existing issuers to pass on these cost savings to their cardholders. As debit card issuing is intimately tied up with the provision of transactional banking services, the extent of this threat depends on the likelihood of new entrants into domestic retail banking. Given sub-normal rates of return were being earned in domestic transactional banking, entry into the domestic market would not be likely to be very attractive to any prospective entrants.

There is some indirect evidence that sub-normal rates of return are being earned in retail transactional banking in recent years, notwithstanding the overall levels of profitability being earned by Australian banks. In part this is due to the structural shift in bank revenues — from interest rate margins to fees — that is evident as the domestic banking industry adjusts to financial deregulation and innovations in securitisation and financial intermediation.

In the first place there is no sign of significant entry activity by new players in the Australian banking market in recent years.

In the second place, during this period most of the major Australian banks have made many attempts to increase and/or restructure the fees they charge for their transactional banking services. Although some of these changes have ended up being withdrawn in the face of adverse political and consumer reactions, the pressures on the banks to increase their fee income has persisted.

Application ignores impact of acquirer costs on retail consumers

The Application concludes that the loss of revenue to acquirers from the abolition of EFTPOS interchange fees will need to be made good. Only in this way can acquirers recover all the costs that they currently incur in developing and operating their EFTPOS systems.

To do so the Application considers that acquirers are most likely to raise their fees to their merchants and, in turn, these merchants, are likely to raise their prices across the board. The Application concludes that the extent of the increase in retail prices will be insignificant and, accordingly, consumers will not notice them.[18] On this basis the Application assumes that the benefits to cardholders — in the lower fees charged by their issuers — will mean that, overall, there will be a net increase in the use of EFTPOS.

The key issue is not whether the *absolute* increase in retail prices will be big or small but the *relative* sensitivity of consumers to a given increase in those prices.

At any one time, there are many pressures on retail prices. Were issuers to increase their merchant fees by the amount assumed in the Application, they would generate only one source of the adjustment pressure on retail prices. The net impact of all these pressures in the period in question would not necessarily be insignificant in the eyes of consumers and they would be expected to alter their behaviour in response. It would not be reasonable to assume that some components of the overall cost adjustment contributed to the increase in retail prices but some did not.

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18 ANZ et al. 2003, p. 16.

Moreover, if the Application is correct, then Australian retailers would be able to increase their prices in advance of the abolition of interchange fees and increase their profitability by the equivalent of around $100 million a year— all because their customers would not notice the change. Indeed, logically they should be able to regularly put up their prices by individually insignificant amounts on a regular basis.

In an industry as competitive as retailing with profit margins as slim as they are, such a 'free lunch' seems highly unlikely.

Application understates impacts on EFTPOS network

The Application accepts that interchange fees have encouraged acquirers and merchant principals to invest in EFTPOS facilities for the retail sector.[19]

For this reason the proposed abolition of EFTPOS interchange fees will mean a loss of revenue for debit card acquirers and merchant principals in the absence of any corrective action that might be taken by them. For its part, the Application assumes that both acquirers and merchant principals will be able to make good this revenue loss. This is necessary to ensure that investment and innovation in the EFTPOS network would not be put at risk.

This not only relates to the investment to enhance and extend the EFTPOS network but also that investment which is required simply to maintain its effectiveness and the quality of its service levels. As any payments network requires regular replacement of ageing and outdated equipment and facilities, this requirement would be expected to be an ongoing one.

In the case of the EFTPOS acquirers, the most likely source of additional revenue would be for them to increase their merchant fees — which, in turn, would be likely to generate an increase in retail prices by the merchants in question. For the merchant principals the revenue loss would be most likely to be made up by the merchant principals directly increasing their retail prices.

The Application implicitly assumes that each of these revenue losses could be made good without the corrective action imposing any additional costs on either the acquirers or the merchant principals in question.

Such a fortuitous outcome is not likely. All pricing adjustments involve information and search costs to work out the approach that will minimise the loss of business volume that would normally be generated by a price increase. Any loss of business volume immediately raises the possibility of the replacement revenue source being unable to make good the full

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19 ANZ et al. 2003, p. 17.

revenue loss. Any reduction in the rate of return on existing EFTPOS investment would act as a disincentive to further investment in the network.

Discontinuing the use of the interchange fee would merely substitute a relatively well–understood approach to pricing in the EFTPOS network for a less understood one.

The Application acknowledges the very real risk to investment in the EFTPOS network. Accordingly it has proposed that a number of safeguards be built into the proposed arrangements to avert such adverse consequences. These include:

- monitoring the proposed arrangements to determine whether they are causing such problems in the EFTPOS network;
- a review of the proposed arrangements after three years; and
- an earlier review if there is a material change in the circumstances of the EFTPOS network.[20]

The problem with this approach is that there is no certainty that such a review would lead to the reintroduction of EFTPOS interchange. If it did, for the reintroduced fees to be set at a level that would maintain the future investment that was required to maximise the value of the EFTPOS network to cardholders and merchants. In both cases, the agreement of the ACCC would be required. There is no certainty that the ACCC would be able to determine which outcomes that would be the most socially beneficial due to the uncertainties surrounding the relevant data and its analysis.

Application does not recognise impact on payment system

Although the EFTPOS network is only one part of the payments system, and all the retail payment instruments compete with each other, the Application does not consider the impact that its proposals might have on innovation and investment in the rest of the payments system, particularly the introduction of new payment instruments.

In the case of new payment instruments, the network benefits are likely to be significant and those investing in them will need to redistribute those benefits among themselves to ensure balanced incentives to participate in the network. This mechanism is provided by the interchange fee.

To be most effective the putative network operators need to be able to set the fee at whatever level they believe will maximise the value of the network. Any constraint upon their freedom to do so will diminish the attractiveness of the prospective investment.

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20 ANZ et al 2003, pp. 17-18.

The mandatory introduction of zero interchange in the EFTPOS network is likely to increase the perception of sovereign risk of investment in all payment networks in Australia. This perception would be greatly reinforced by the knowledge that the proposed co-regulatory regime for the EFTPOS network was introduced on the basis of weak evidence of 'market failure' or in the face of a significant risk of 'regulatory failure'.

Application largely ignores transaction costs

The Application proposes that hereafter EFTPOS interchange fees be set on a multilateral basis. This is in contrast to the existing approach whereby interchange fees and access conditions are set on the basis of bilateral negotiation.

The Application concludes that one of the problems with the bilateral basis is that it promotes inertia in fee-setting.[21] This is due to the difficulty of co-ordinating system-wide initiatives, which require all network principals to co-ordinate their fee adjustments, on a bilateral basis.

Interestingly enough the bilateral approach to co-ordination does not seem to have inhibited:

- the successful introduction of EFTPOS;
- the integration of a series of proprietary EFTPOS systems to form interconnected EFTPOS networks;
- the emergence of a national network with all issuers and acquirers connected to it; or
- the entry of a merchant principal — Coles Myer — into the EFTPOS network to take over certain acquiring functions.

Other types of networks have had a similar experience with bilateral co-ordination. As pointed out in the main report, the US railways bilaterally negotiated the conversion of the various railway gauges in the US to standard gauge during the 1880s (McAndrews 1997).

The important point to make is that there is no inherent advantage to either a bilateral or multilateral approach to such network co-ordination issues as access conditions and fees. The key to making the selection that will generate the greatest public benefit is to choose that approach which is expected to minimise the transaction costs that are involved.

As outlined earlier, transaction costs are the cost of using the price mechanism and consist of the costs of negotiating, monitoring and enforcing an agreement between the parties to an economic exchange. There are transaction costs involved in both a bilateral and a multilateral approach to negotiating, monitoring and enforcing such an agreement.

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21 ANZ et al. 2003, p. 22.

These costs will depend on the circumstances of each case of network co-ordination.

In undertaking its analysis the Application does not consider the issue of transactions cost let alone canvass the empirical circumstances of the EFTPOS case. Nevertheless, it feels able to presume that co-ordinating all the participants in a network at the one time is easier and therefore less costly than doing so two at a time.

The real test of whether transaction costs would be increased or decreased by a move towards multilateral interchange fee setting would be to leave the choice to the network participants. They have the incentive to minimise the transaction costs involved in fee setting and are in the best position in terms of information to make the choice. However, the choice has to be a genuinely voluntary one.

In this regard it is notable that the Application has only come forward after the publication of the Joint Study and after considerable pressure was placed on the applicants — and others — to address the problems that were perceived by the *Joint Study* in the bilateral setting of EFTPOS interchange fees. The most likely response to these pressures was for the Applicants to propose the multilateral setting of the interchange fee, as they have done. This does not constitute a truly voluntary choice between the two competing approaches.

Application does not address access simultaneously

The Application concludes that reforms to improve access to the EFTPOS network are beyond the scope of its proposals. It considers that any move to address the access issues on a multilateral basis would represent a quantum change in the existing arrangements and could not be negotiated by the network participants in the time frame set for the credit card reforms. Accordingly the Applicants propose that the access issue be left to the Australian Payments Clearing Association to resolve.[22]

The price of access to any network is intimately tied up with the other terms of access. Logically one cannot be sensibly separated from the other without the risk of increasing the overall transaction costs associated with the arrangements.

For this reason it is not sensible to separate them. This is the approach of the existing bilateral arrangements for the interconnection of two parties' EFTPOS systems. These bilateral arrangements cover both the interchange fee to be paid between the parties as well as the other terms on which each obtains access to the other party's proprietary EFTPOS system.

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22 ANX et al. 2003, p. 19.

The notion that access reform could not be negotiated multilaterally within the time horizon of the credit card reforms simply confirms that the Application would be expected to increase the overall transaction costs of the proposed arrangements and that the existing bilateral approach to determining these issues is likely to involve lower transaction costs overall.

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YES / NO

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