



## **Hidden Credit Card Fees Penalize Hard Working Consumers and Small Businesses**

*Consumers and small businesses find themselves burdened by growing charges collected by banks and credit card companies. One of the largest of these fees are hidden “interchange” or “swipe” fees that are charged to merchants who accept credit cards for payment. These charges are quite varied and complex but, more importantly, they absorb an increasing share of consumers’ expenditures. They are burdensome enough in normal times, but as they grow rapidly they are coming to be serious drag on consumer budgets and on the health of many small businesses. The burden is especially heavy during the coming holidays when many families are financially stressed and looking to economize on gift giving and other holiday spending. This ConsumerGram explores these charges and some consumer implications.*

This has not been a good year for households and consumers. Signs of distress are everywhere in the economic data; experts differ on the pace and shape of recovery; governments at all levels are struggling with remedial ideas; and there is widespread concern that the unemployment rate will continue to increase. All that said, the human drama is not in the statistics, but reflected in the anxieties and efforts of families to adapt.

As the year-end holidays approach most families are, or soon will be, thinking about how to modify traditional spending plans to reflect changes in real income and their prospects. According to the Gallup Poll, the average family is projected to spend about \$740 during the coming holiday season – down from \$801 in 2008. Of course many families will spend less than the average and the marginal impact of the recession and rising unemployment is greater on those lower income families. Thus, any unnecessary charges on Christmas sales will be especially burdensome.

Whatever the level of consumer spending might be this holiday season, the reduction will reflect both economic malaise and uncertainty about the future. Most importantly, it will reflect the efforts of consumers to economize by buying fewer and lower priced items.

### *Credit Card Fees Are Growing Drains on Consumers’ Dollars*

More than two-thirds of American consumers use plastic payment technology – credit or debit cards. Convenient, to be sure, but costly -- increasingly so -- and especially burdensome in the midst

of current economic distress. Households credit card debt hovered around one trillion (that is one thousand billion) dollars at year end 2008. Total fees for card related services amounted to more than \$67 billion in 2008.

Markets for credit cards are “multi-sided” and very complex. They involve not only consumers and the card companies and merchants who accept them, but also banks that underwrite consumer debt and provide payment clearing services. The credit card system offers participants a variety of benefits, but also gives rise to a baffling array of charges and fees. Some are associated with penalties (late payment or other violations of cardholder agreements); others with cash advances or annual subscription fees; and still others related to so-called enhancement income which is a form of risk offset or compensation.

Most importantly, almost \$40 billion or 57% of the total credit card fee income for banks (\$67.6 B in 2008) is attributable to so-called interchange fees. These interchange fees, also known as *swipe fees* are rapidly growing and the source of growing controversy. This interchange fee income, \$67.6 B for banks, is roughly two-thirds of bank income derived from interest payments on credit cards, which was \$101.4 B in 2008.<sup>1</sup>

When a consumer makes a purchase from a retailer using a credit card, the payment is processed through the retailer's bank and the bank that issued the credit card. The issuing bank charges the retailer's bank an interchange fee to process the transaction. These interchange fees are passed on to the retailer and ultimately every consumer, including those who pay with cash or check. Interchange fees are set in undisclosed ways by the card companies (Visa, MasterCard, et al) and the banks that issue the cards.

These and related charges and services are beyond the ability of consumers to control. They are hidden from view and unavoidable to the most conscientious of penny pinchers. While consumers are cutting back on spending, they pay a hidden tax (an interchange fee) on credit card purchases. For example, for every \$100 charged by consumers, retailers receive approximately \$97.50.

Interchange fees were around \$337 per household in 2008 and are likely higher this year. This amounts to more than 45% of the amount consumers plan to spend this holiday season. Put differently, if consumers and households were freed of interchange fees and elected to set them aside,

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<sup>1</sup> See [www.rkhammer.com](http://www.rkhammer.com).

they would be able to spend over \$1,000.00 this holiday season – that is the \$740 they planned to spend plus \$337 in saved interchange fees.

### Gifts Not Given Because of Bank Interchange Fees



To be fair and accurate not all of the interchange fees could be saved by banks and reflected in lower consumer charges. However, most could. According to the Food Marketing Institute (a nonprofit research and public affairs group):

“Interchange fees far exceed actual transactions costs. In fact, a small portion of the Interchange fee covers the transaction processing cost...” Thus, “13 percent...covers processing costs, while 44 percent pays for rewards programs; the balance covers marketing, advertising, network servicing, and profits.”

It is notable that the main beneficiaries of the rewards programs to which much of the proceeds of the interchange fees are funneled are wealthier card users with higher annual credit card expenditures. Interchange service fees constitute a very high margin business for banks inasmuch as it appears that up to one-third of the interchange fees accrue as bank profit.<sup>2</sup>

<sup>2</sup> “Hidden Credit Card Fees: Interchange Fees Cost Consumers Billions Each Year,” FMI, available online at [http://www.fmi.org/media/bg/Interchange\\_Fee\\_Backgrounder.pdf](http://www.fmi.org/media/bg/Interchange_Fee_Backgrounder.pdf).

## *The Facts about Hidden Credit Card Fees*

There are several aspects of interchange fees, aside from their size and unclear value to consumers that should motivate greater attention to them and to their possible reform. These include:

- Americans pay the highest interchange fees of all industrial nations.
- Convenience stores and gasoline retailers annually pay credit card companies more than twice as much as they earn in profit. Many of these are family businesses and the cost converts directly to a burden on them as consumers. The burden has worsened in the past four years. Convenience stores – a popular retail outlet for working class and lower income families – saw their interchange fees triple from 2004-2008.
- The average convenience store has paid in recent years interchange fees in amounts roughly equivalent to its pretax income, while the share of a grocery customer’s dollar going to card companies and banks is almost double what goes to the grocer’s bottom line. (Federal Reserve Bank of Minneapolis Study at p. 4)<sup>3</sup>
- Poor households are hard hit by these fees and those who pay by cash pay higher prices to reflect “swipe” fees incurred by higher income card holders who reap rewards (travel, merchandise, rebates, etc.) from their card use. (FMI)
- The interchange fee on purchase of some items exceeds the retailer margin, thereby forcing them to sell those items at a loss. High turnover, perishable items are particularly vulnerable.
- Interchange fees paid by some small businesses often exceed their expenditures on health care insurance.

## *Conclusion*

There are other contexts in which to place these fees that give rise to concerns about their overall size, their incidence and implications for good economic policy. The foregoing are illustrative. We have not explored and evaluated the policy alternatives. But, we agree with the conclusion of a (just released) GAO study of these fees: “Rising interchange fees have increased costs for merchants, but options for reducing fees pose challenges.” For the GAO report and its discussion of public policy options to reduce fees, see <http://www.gao.gov/new.items/d1045.pdf>.

### ***About The American Consumer Institute Center for Citizen Research***

The American Consumer Institute Center for Citizen Research is a 501(c)(3) nonprofit educational and research institute. For more information about The American Consumer Institute, please visit us at [www.theamericanconsumer.org](http://www.theamericanconsumer.org).

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<sup>3</sup> [http://www.minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=3235](http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3235).