Editor’s Introduction

This Review contains the proceedings of a symposium on antitrust issues in the operation of payment system networks, sponsored by the Federal Reserve Bank of St. Louis in March 1995. This article introduces the topic and provides an overview of the articles in this issue.

Antitrust enforcement in the banking industry, which dates from the early 1960s, has focused primarily on banking consolidation, not on the operation of payment systems. For several decades preceding the 1960s, the overriding objective of federal banking regulation had been the safety and soundness of banks. Restrictions on banking competition were part of a policy to limit the chances of bank failure. Federal legislation and rulings of the U.S. Supreme Court in the early 1960s, however, changed this policy by making the banking industry subject to the antitrust laws.

The new legislation and court rulings sparked research on the effects of consolidation on competition among banks. Research on the determinants of banking competition has focused primarily on the concentration of deposits or assets among banks with offices in local markets. In this framework, researchers assume that all banks in a market compete with each other for consumers, who are limited to services from banks in their market. Banks in markets with higher concentration are assumed to compete less aggressively for local customers.

This framework is not adequate for dealing with some issues concerning banking competition. An efficient payment system requires that banks cooperate to process the payment orders of their depositors. The challenge of applying the principles of antitrust to the payments activities of banks involves permitting enough cooperation among banks to facilitate an efficient payment system, while preserving incentives for competitive behavior.

The development of clearinghouses in the United States illustrates how banks can improve the efficiency of the payment system through cooperation. Myers (1931, pp. 94–97) describes the problems that banks in New York City had in operating the payment system prior to the formation of the clearinghouse in that city in 1853. To settle for banknotes and checks drawn on other banks, each bank would send messengers with banknotes or checks to other banks to receive gold coin in exchange. Banks had to hold large inventories of gold to meet these demands and had to face the risks inherent in having their couriers moving about the city with large amounts of gold. Bankers learned that they could settle their accounts more efficiently by exchanging bank notes and checks at a local clearinghouse, which also would hold the gold inventories of the clearinghouse members. Settlement among banks in the clearinghouse involved the movement of gold within the vaults of the clearinghouse. In addition, banks coordinated their activities through clearinghouses when facing widespread runs by depositors.

The cooperation of banks through clearinghouses also became a means to limit competition. Clearinghouses attempted to coordinate restrictions on the interest rates that banks paid on deposits. At times, clearinghouses expelled member institutions that were considered to be competing for deposits or loans too aggressively or unfairly.

Banks must cooperate to achieve efficiencies for themselves and their customers in operating networks of automated teller machines (ATMs). The first two articles in this issue examine the history of antitrust policy on mergers of ATM networks from

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3. For a survey of these studies, see Gilbert (1984).
the perspective of antitrust lawyers:
Donald I. Baker, "Shared ATM Networks — The Antitrust Dimension" and David A.
Balto, "Payment Systems and Antitrust: Can the Opportunities for Network
Competition be Recognized?" Baker and Balto note that a series of ATM network
mergers have resulted in virtual monopolies of ATM systems within large regions of
the country. They interpret the actions of the antitrust authorities (including the
Federal Reserve in its role of approving acquisitions by bank holding companies)
as reflecting the view that regional ATM networks have characteristics of natural
monopolies. Baker and Balto challenge the view that regional ATM networks are nat-
ural monopolies and argue for the benefits of preserving network competition. They
cite cases of vigorous competition between ATM networks that ceased when networks
merged. Baker ends his article with a warning that the policy of permitting the
formation of ATM network monopolies over large regions will require involve-
ment of government agents (including the Federal Reserve). Because banks can
argue that participation in regional monopoly networks has become essential for
remaining viable, the government will have to participate in settling disputes
over the terms on which banks may join the networks.

The third article focuses on the privilege of payment systems to restrict their
membership: Dennis W. Carlton and Alan S. Frankel, "Antitrust and Payment
Technologies." Their article focuses largely on a court case involving Visa and
Discover Card. Visa denied an application for membership by a depository institution
owned by Discover Card, and Discover Card sued Visa. Their analysis of this case
includes evidence that the entry of aggressive competitors into the Visa credit card
network made the credit card industry more competitive.

One of the discussants, James J.
McAndrews, examines the arguments of Carlton and Frankel concerning two
aspects of the market for credit cards: interchange fees and duality. Interchange
fees involve the payments from banks that issued cards to the banks that received the
deposits of the merchants that accepted the credit cards as means of payments.
The issuing banks pay a fraction of the amounts purchased with the cards to the
acquiring banks. The fraction of the purchase price withheld by the issuing bank
called the interchange fee. Carlton and Frankel examine the potential for mem-
ers of credit card systems to extract monopoly profits from merchants through
interchange fees. McAndrews challenges the argument that the existence of
interchange fees necessarily reflects anti-
competitive practices by members of a payment system.

Duality involves the freedom of banks to offer their customers access to more
than one competing payment system. In
the past Visa and MasterCard restricted
duality. A bank that joined one card
system was not permitted to join the other. The credit card systems removed this re-
striction and permitted duality in response to a legal challenge. Some antitrust ana-
lysts, including Baker and Balto, argue that
duality reduces the degree of competition
among payment systems. McAndrews
argues that a policy of restricting duality
may be ineffective as a means of promoting
competition among credit card networks.
To increase its market share, a network
would have to induce banks to switch all
of their credit card business from other
networks, possibly disrupting relations
with its merchant customers and card
holders. The costs to banks of switching
networks may be too high for effective
competition among networks, operating
under restrictions on duality.

Nicholas Economides, a second dis-
cussant, examines the competitive implications of payment system networks from
the perspective of his research on other industries characterized as networks,
such as the telephone industry. He sug-
gests a solution to the natural monopoly
issue that is being implemented in other
network industries: connectivity. To
illustrate, long-distance companies are
authorized to route their customers' calls
over lines owned by other telephone companies, including their competitors. The equivalent arrangement in the operation of ATM and point-of-sale (POS) systems would be a network with no ATM or POS terminals in a given market area offering its payment services through the terminals of the existing regional monopoly network. This would be a new approach to dealing with the natural monopoly issue in the operation of payment systems.

The articles and discussant comments in this issue of the Review deal primarily with two components of the payment system—ATM networks and credit card systems. The articles and comments indicate that issues concerning competition among payments networks are far from settled. These issues are relevant for other components of the payment system, since all components of the payment system function as networks. In addition, development of new payment instruments, such as stored value cards, will have implications for the competitive pricing of payment services. These developments will create new challenges for research.

—R. Alton Gilbert

REFERENCES


