

## **PETER MAIR: SUBMISSION TO UK PAYMENTS SYSTEMS REGULATOR**

### **RESPONSE TO CALL FOR INPUTS**

A formal inquiry into Australia's financial system is presently underway – fsi.gov.au: a range of submissions deal with payments system policy issues and mine does so almost exclusively. Ideally, those advising the Australian panel will have an opportunity to discuss UK developments directly with you.

I briefly recast three familiar themes in a way that fits into the '27 questions' format.

#### **-- destructive tax-free bartering of 'free deposits' for 'free services'**

My interest in relevant issues in the UK started in the 1960s – in particular a mid-sixties report of a 'Monopolies Commission' and, later, a similar report of a 'Competition Policy Commission'. What stayed with me was a keen appreciation of a so-called 'endowment' effect identified by those initial inquiries – the 'endowment' of an almost overwhelming competitive advantage to the 'clearers' arising in the non-payment of interest on transaction account deposits with banks. More recently an undercurrent of this 'endowment' coloured the Cruickshank criticism of the BOE implicitly indulging the 'big banks' in return for 'cooperation'.

Whatever, the endowment is rarely mentioned these days – save possibly for the central banks in Finland and Norway who made much of it before their payment policy role was subordinated into centralised European policy agencies. The published work of both these central banks in the mid-1990s remains a useful conceptual framework.

Whatever, again, in most countries the 'endowment effect' remains very relevant to the typical dominance of a few retail banks and the typical absence of any credible new entrants.

As you may read in my various submissions, it is about time the 'endowment' was moderated – possibly by ensuring bank customers are 'deemed' to have received a market-rate of taxable interest-income paid on the daily deposit balances in transaction accounts on which no material interest is now paid. Not to correct this anomaly legitimises a destructive form of tax-avoiding barter where bank customers get 'free services' for 'free deposits' – but bank conglomerates holding an entrenched advantage are also able to use the endowment to 'compete' in other markets.

I would be pleased to see the UK pick up this 'endowment' ball and take it away so the playing field for competitive retail banking is more level.

In the meantime there is no force more destructive of competition in retail banking.

#### **-- ad-valorem transaction fees: the credit card racket**

A few moments of insightful reflection will reveal, to most minds, that the essential nature of the global credit card schemes is a racket. An illusion of 'free credit' for 55 days is parlayed into an arrangement where the card users believe the transactions are 'free' as is the 'credit' taken before paying the account in full by the due date -- using funds already on deposit in a transaction account on which no interest is paid.

Card users have no incentive to save merchants from paying excessive ‘scheme’ fees’ and ‘interchange fees’ levied as a % of purchase values.

The credit card is, frankly, now a redundant product being misused to exploit both card users and merchants negotiating with what many regard as, de facto, an international cartel. There is no good reason why a user-pays line of credit could not be added to a debit card account.

Looking forward, the credit card product is now playing an embryonic, loss-leader role in developing ‘tap-and-go’ payments arrangements conducive to the displacement of cash – a latter day Mondex if you like.

I suggest two policy initiatives – first, the proscription of all ‘ad valorem’ transaction fees, especially those known as merchant-service and interchange fees and, second, the deeming, as taxable income in the hands of card users, of any ‘free credit’ taken all calculated at the interest rate applied to credit rolled over. Alone or together, those steps would stop the rot.

It is disappointing that the EU has gone down a track of allowing ad-valorem fees of 20/30 basis-points for debit card and credit card transactions – but, hopefully, that is a short-term compromise.

#### **-- no need for large denomination currency notes**

In Australia a combination of means-tested entitlements to age pensions and the usual hiding of cash sales income has resulted in a grossly-inflated and hoarded currency note issue from a Reserve Bank ‘dependent’ on the seigniorage from the note issue to fund its operations and capital base.

[This ‘seigniorage’ is, of course, the counterpart of the abovementioned ‘endowment’ commercial banks enjoy from similarly issuing deposit liabilities on which no interest is paid.]

The situation in Australia has degenerated into a farce where the central bank is, effectively, issuing zero-coupon bearer bonds on demand – disguised as banknotes – that are hoarded for the purpose of facilitating assaults on the public purse of its owner, the government. The associated ‘losses’ from the public purse do, of course, greatly exceed the ‘profit’ on the note issue flowing to the central bank.

This nonsense aside, there is another line of attack based on the sense of withdrawing large denomination currency notes to foster the development of EFT payment systems and otherwise facilitate the management of tax-evasion associated with cash dealing and hoarding.

The policy issues about currency notes now coming into sharp relief may not be easily dealt with – including in Australia – but it is surely about time they were given some exposure so the community is on notice of an emerging case for reform.