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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS, FINANCE AND
PUBLIC ADMINISTRATION

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ports 2005**

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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

Thursday, 15 June 2006

Members: Mr Baird (*Chair*), Dr Emerson (*Deputy Chair*), Mr Ciobo, Mr Fitzgibbon, Ms Grierson, Mr Keenan, Mr McArthur, Mr Secker, Mr Somlyay and Mr Tanner

Members in attendance: Mr Baird, Mr Ciobo, Dr Emerson, Mr Keenan, Mr McArthur, Mr Secker and Mr Somlyay

Terms of reference for the inquiry:

To inquire into and report on:

The 2005 annual reports of the Reserve Bank of Australia and the Payments System Board

WITNESSES

DIMASI, Mr Joe, Acting Chief Executive Officer, Australian Competition and Consumer Commission..... 1

GREGSON, Mr Scott, General Manager, Adjudication Branch, Australian Competition and Consumer Commission..... 1

GRIMWADE, Mr Tim, General Manager, Mergers and Asset Sales, Australian Competition and Consumer Commission..... 1

NORTON, Ms Jaime, Acting Director, Adjudication Branch, Australian Competition and Consumer Commission..... 1

Committee met at 9.46 am**DIMASI, Mr Joe, Acting Chief Executive Officer, Australian Competition and Consumer Commission****GREGSON, Mr Scott, General Manager, Adjudication Branch, Australian Competition and Consumer Commission****GRIMWADE, Mr Tim, General Manager, Mergers and Asset Sales, Australian Competition and Consumer Commission****NORTON, Ms Jaime, Acting Director, Adjudication Branch, Australian Competition and Consumer Commission**

CHAIR (Mr Baird)—Welcome. Although the committee does not require you to give evidence under oath, I am sure you are all aware that these proceedings have the same status as proceedings of the parliament. Would you like to make a brief opening statement?

Mr Dimasi—Yes, I will start with a brief opening statement which hopefully will help clarify the role of the ACCC in relation to the payments system. As the committee is no doubt aware, the ACCC is responsible for ensuring compliance with the fair trading and competition provisions of the Trade Practices Act. In relation to the payments system and, more generally, financial services, the ACCC is responsible for considering allegations of anticompetitive conduct to the extent that such conduct may raise concerns under the provisions of the act. Following payments system reforms which were implemented by the Reserve Bank, and the designation of those services by the Reserve Bank, the arrangements behind the interchange regime in relation to both credit and debit card systems fall outside the scope of the competitive provisions of the TPA and, accordingly, fall outside the scope of our enforcement and compliance activities.

CHAIR—That is the technical answer, is it?

Mr Dimasi—Yes, that is the technical answer. Issues of misleading and deceptive conduct in financial services, which are normally dealt with under part V of the Trade Practices Act in relation to financial services, rest with the Australian Securities and Investments Commission. That is the technical answer on part V, as well. The ACCC has been involved in a number of activities in relation to payments systems in the past, and I will briefly mention those. There was enforcement activity—and that goes back to 1997, when the ACCC, following a complaint, commenced investigations into participants in the credit card system and allegations that the interchange fees agreed between the participating banks constituted price agreements, which are prohibited under the act. Being unable to resolve the issue, in 2000 the ACCC commenced proceedings against the National Australia Bank.

At the same time, the ACCC conducted a joint study with the Reserve Bank on debit and credit card schemes in Australia. The study concluded that the interchange fees did not reflect the respective costs associated with the credit and debit payment systems. This resulted in providing some inefficient pricing signals to consumers. As the committee is aware, following the joint study in April 2001 the Reserve Bank designated the credit card payment system and

ultimately set standards for the calculation of interchange fees and the introduction of an access regime. The ACCC discontinued its proceedings against the National Australia Bank in light of the bank's regulatory reform proposals.

The third item was the EFTPOS authorisation. In 2003, under the authorisation process in the act, the ACCC was asked to consider a proposal by the banks to reform the EFTPOS interchange fees. Essentially, that was an agreement between banks to reduce interchange fees to zero. Authorisation was required as agreement between competing banks would have raised concerns under the act. After initial concerns over the access issues to the system, the ACCC granted authorisation to the arrangements, believing that they would correct some of those inefficient pricing signals that I mentioned earlier. The matter was reviewed by the Competition Tribunal, which disagreed with the ACCC decision. The tribunal was not convinced that a collective agreement to reduce interchange fees was the answer. The tribunal also believed that further work was required to better facilitate access to the system.

As I am sure the committee is aware, the Reserve Bank has since designated the EFTPOS system as well and has proposed interchange fee methodology and access arrangements. I guess it is fair to say that, while the ACCC has had an interest and continues to be an interested party in relation to payment systems, our role in recent years is now quite limited. We would be happy to answer any questions.

CHAIR—Thank you very much. We appreciate you coming today. We have been through this exercise a couple of times. We had the first session behind closed doors. In some ways we thought that was a mistake because there was some criticism in the media after it when we made some questions to the Governor of the Reserve Bank without having the understanding of the day's hearing.

Now we have had an open session. I suppose that, having been through this recent hearing, the view of the committee is generally the same. We understand the reasons that have been made. There were a number of recommendations that it should have been handled by you guys all of the time as it was really about competition. But the concern of the committee was that, in the changes that were made regarding designation and the regulation of interchange fees, it disadvantaged the four-party system and advantaged the three-party system, or the cards, so that they now are untrammelled in terms of their ability to compete in the marketplace, whereas the others have restrictions.

There was a statement made by the Governor of the Reserve Bank at the public hearing on 15 May that interchange fees are not subject to competition. We are interested in your assessment of this comment. If you stand back from it, you could say that the comment you could make is: 'Why aren't we like the US, which just leaves it to the marketplace and people can sort it out? If they find that the card costs are excessive, they can move to other cards. If you have enough players, the competition will drive down costs.' What are your views on that?

Mr Grimwade—I think you are going back prior to designation. But I think the real answer to that question is that, given that the participants in the system were both acquirers and issuers, there was no real incentive to compete on interchange fees. In addition to that, there was a real lack of transparency in how those fees were set. Indeed, there was no real methodology ever disclosed to us initially as to how those fees were set, nor were any reviews conducted in relation

to the setting of the fees. So it was pretty clear to us that, at the very beginning when we started working with the Reserve Bank on the joint study, there were some real problems—real competition and efficiency issues—arising from the interchange fee system.

CHAIR—So you think the main advantage is transparency?

Mr Grimwade—I would go beyond that. A critical concern for the commission from the outset was the access issues—the fact that there were real restrictions in terms of the participants in card issuing and acquiring. In addition to the issues of interchange fees and access, there were the restrictions on no surcharging as well. That was also canvassed in the joint study. Those are the three broad issues that we looked at.

CHAIR—In terms of the no surcharge rule, accepting all cards and the other changes that were made, do you think that would have been enough?

Mr Grimwade—I know that the Reserve Bank did consider this and decided that it was not. We would, I think, agree that that would not have been sufficient because, as I mentioned at the outset, it would not have resolved the transparency issue. Indeed, what has transpired is a reform that is much more transparent and public in terms of the setting of interchange fees. At the time this all commenced there was a real lack of understanding, even by the participants in the process, as to how interchange fees were set and how that methodology was arrived at in terms of devising the interchange fee.

CHAIR—Doesn't it concern you, when a change made by a regulatory authority then provides a substantial market boost to other players in the field—such as Diners and Amex—and that this is meant to be to the benefit of consumers? There is \$500 million that is going nebulously into the storeholders' pockets or to the consumers, but we cannot actually find evidence of that occurring. Yet the average cardholder is faced with increased prices of cards and reduced benefits. If they are not with American Express or Diners they have seen a reduction in the benefits from the card and quite a significant increase in the card fee. So from the consumers' viewpoint are they better off?

Mr Grimwade—I think there are two questions you are asking. The first is a comparison between the three- and the four-party schemes. In relation to the advantages or disadvantages—I mentioned there were three issues before—the interchange fee and the access issues do not really arise in relation to the three-party schemes as they do in the four-party schemes. The real issue that arose, as I understand it, in relation to the three-party schemes was the restriction on surcharging. I believe that the RBA reached an agreement with Amex and Diners for them to voluntarily pursue the same course of action that they had required of Visa and Mastercard.

CHAIR—Is this a case of regulatory authorities sticking together in terms of your supporting of the RBA approach?

Mr Grimwade—The fact is that from the very beginning we have been quite supportive. We together authored the joint study and we both have an interest in enhancing the competitiveness and efficiency of payment systems. So, yes, we do have a joint interest in seeing that—

CHAIR—We basically have had no new entrants, have we? If it is going to be a more competitive environment, why haven't we seen more players come into it?

Mr Grimwade—I have not reviewed the outcome of the reforms in both EFTPOS and credit cards, but I understood that there was more competition, particularly in card issuing and on that side of things. In terms of reforms on—

CHAIR—I think we have only found one new card.

Mr Grimwade—I believe reforms in terms of access on the EFTPOS side are fairly recent. I am not sure how recently the access reforms have been implemented, but I imagine there is probably a bit of time before you will see the outcome of those.

Mr Dimasi—I suppose the alternative might have been to think what could have been achieved through the Trade Practices Act. If the service had not been designated by the Reserve Bank and it would have been left to the provisions of the Trade Practices Act, the act can deal with issues of anticompetitive behaviour, but that does not guarantee that you will get necessarily additional entry or, if you like, efficient or optimal charging for cards either.

CHAIR—Could you have done something on the no surcharge and accepting all cards in terms of trade practices, or would that have to be designated to do that?

Mr Dimasi—The Trade Practices Act will not necessarily deal with the level of any charge—whether it is a surcharge or a charge for the cards, it need not be in breach of the Trade Practices Act. The breach may arise if there is some collusive arrangement or some agreement or understanding. I guess what we are saying is that by working jointly with the Reserve Bank you may end up with getting a better outcome than you could have with the alternative. We are not trying to wash our hands of the issue; that is just simply the facts of the way things stand.

CHAIR—I understand.

Mr Grimwade—I have another point to make in relation to the entry issue. It is not just entry that you look at: it is the ability for potential entrants to impact upon the effectiveness of competition. So the threat of entry is just as important as entry.

Dr EMERSON—We understand the concept of contestability. The interest of an organisation such as the ACCC is aroused when there is evidence of anticompetitive behaviour. What characteristics, going back to first principles of this market, make it in your view a market that is characterised by anticompetitive behaviour?

Mr Dimasi—I might try that one first, and my colleagues can join in. It is not a question of the characteristics of the market. There could be any number of markets where you might consider there is not adequate competition, and that need not necessarily lead to a potential breach of the act. It is behaviour that could arouse the interest of the ACCC. For example, there are a number of provisions in the act, and the example here was whether the sorts of fees were put together under some arrangement, agreement or understanding that was in breach of the act. The characteristics of the market might then have a role when you have a look at the issues, but it is the behaviour itself rather than the characteristics.

Dr EMERSON—But you are not going to get, for example, anticompetitive behaviour in the restaurant market because there are so many entries—barriers to entry are very low and it is highly contestable. You are not going to get all the restaurants in Sydney, Melbourne or the Gold Coast colluding to set prices. We know that, and I do not think you would have too many sleepless nights worrying about the restaurant industry colluding because it is such a market with low barriers to entry—it just would not be feasible to engage in anticompetitive behaviour. Another way of casting my question is: what characteristics of this market would make anticompetitive behaviour feasible?

Mr Dimasi—There are a number of provisions that are per se offences under the act, so I would not want your comments to be misunderstood with an idea that there is carte blanche for anybody, whether in the restaurant industry or anywhere else, to undertake behaviour that could be in breach of the act. First of all, I want to be clear that it could be any sector where these are these sorts of issues.

Dr EMERSON—I understand that, but in terms of arousing your interest, I do not think you would have a restaurant section of the ACCC which regularly monitors pricing behaviour.

Mr Dimasi—No, we do not, but monitoring pricing behaviour is a separate activity to enforcing the provisions under part IV of the act. I think where your point is leading, if I may say so, is that in undertaking our enforcement activity some areas are likely to be of greater priority than others because of their potential impact on consumers and the economy. So clearly we would have priorities where we could see that there is greater consumer detriment occurring, so I would not necessarily disagree with that point.

I guess the potential for collusive behaviour or breaches of the act is greater where you have a smaller number of players or a potential for less competition, so these are obviously all things that we would consider and take into account. But, at the end of the day, in enforcing the act we respond to information and evidence that there is a potential breach; that is how we deal with it. We do not go and try to, if you like, deal with an industry because we do not particularly like its structure or we think there should be some other structure. That is not the sort of role that the act gives us.

Dr EMERSON—How could this industry get away with anticompetitive behaviour? What features would allow it to? Is it a lack of contestability? When you talk about a small number of players, a small number of players are in the airline industry in Australia, but entry is not that hard because people can lease planes. So if a domestic airline said, ‘We have got this all sewn up, there is only one or two players,’ and jacked up its prices, then you are going to get a Compass or someone like that come in, lease some planes and cut it down. So it is not just the number of players, as we know from economic theory, that determines the competitiveness or otherwise of a market but other characteristics such as contestability.

Mr Gregson—Barriers to entry, for example.

Dr EMERSON—I am just trying to get back to first principles as to why the ACCC—or in lieu of the ACCC, the Reserve Bank—says, ‘We are interested in this market because,’ and what is the ‘because’?

Mr Gregson—The joint study that the ACCC engaged in with the Reserve Bank in 2000 identified sticky prices in relation to interchange fees. It reflected that those prices had not changed in response to costs, so that is obviously a signal that there are some issues to be looked at there. It is also fair to say that in that joint study a number of the features of the market were taken into account, including barriers to entry, but importantly the transparency issue—that is, that consumers are one step removed from those transactions—and I think that was an important feature when both the ACCC and the Reserve Bank identified those initial concerns in 2000.

Dr EMERSON—I still have to say there is lack of transparency. Let us take the situation of a furniture shop. It could be quite a competitive market and if one furniture store increases its prices, another furniture store says, ‘You beauty, I have got the market share,’ but the ACCC would not be interested in how a furniture store in Logan City sets its prices. It would not be a transparent process. The store does not say to consumers, ‘Come in and we will show you what our fixed costs are, what our current costs are, what our margin is,’ or anything like that. People just go in and say, ‘That sofa looks okay to me, I will hit the phones, or the internet, or walk and see if I can get a better price,’ so there is no transparency in that either. But that does not excite the interest of the ACCC, nor should it, so I am not sure that lack of transparency on its own is a valid criterion.

Mr Dimasi—I guess there is an implication in your question that in an industry or a market where there is not, if you like, strong competition and where as a result prices might be above what might be described as an efficient level, that that would necessarily lead to the ACCC being able to undertake a function. I should be clear that that is not necessarily the case. The ACCC’s role is to administer parts 4 and 5 of the act. We also have other regulatory functions in particular sectors. For example, there are a number of sectors—whether telecommunications or energy or other sectors—where some of the characteristics you are alluding to are involved where there are specific—

Dr EMERSON—We know that with the fixed line network, for example. It does have characteristics of a monopoly.

Mr Dimasi—Yes, that is right.

Dr EMERSON—So you are going to be immediately interested.

Mr Dimasi—But there are, if you like, specific provisions or we have specific powers to deal with those sectors under either part IIIA of the act or part XIC of the act, which deals with telecommunications issues. We do not necessarily have those powers and functions across the economy as a whole. For example, there might be concerns in particular sectors. It does not necessarily mean that we have any concerns other than under the part IV or part V provisions, where there might be collusive behaviour or some other conduct that could be in breach. The mere fact that people undertake monopoly pricing or pricing that might be considered to be efficient or socially optimal in and of itself need not be a breach of the act. We may not be able to do anything about it. Whilst I take your point, it does not mean that there is a general provision in the act for us to pursue pricing where we may not consider that pricing to be optimal.

Dr EMERSON—I will check with my colleagues, but when we were in Sydney there was a document from overseas that described interchange fees as illegal payments. It was very strong language.

Mr CIOBO—It was testimony.

Dr EMERSON—Yes. It was very strong wording. Do you share that view?

Mr Grimwade—It should be recognised that the commission did find that there was a potential breach of the act back in 2000 in the setting of interchange fees. This was prior to the designated—

Mr CIOBO—Because of the collusion, do you mean?

Mr Dimasi—The way the fees were set was the issue.

Mr Grimwade—There was a multilateral agreement between banks whereby they would set an interchange fee which had the effect or likely effect of controlling or maintaining the merchant service fee levels.

Mr SECKER—But didn't you withdraw that?

Mr Grimwade—We did, but only after designation by the Reserve Bank, which indicated to us that a satisfactory reform to the process would be adopted. It should be mentioned that, in March 2000, when we advised the banks that we considered that they were in breach of the act, we also identified that we did not have necessarily a problem with the interchange fee system as such and that there were potential public benefits that could result from a proper system being devised. We encouraged the banks to approach us for authorisation of an interchange fee system. In fact, we spent a year considering reviews conducted by the banks. Ultimately, in March 2001, it was the commission's view that effective and timely reform of the interchange fee system was not occurring. We therefore recommended that the Reserve Bank actually designate and use its powers to reform the system. Indeed, it did designate. Following that, we discontinued proceedings against the banks.

Dr EMERSON—Does that referral, if you like, or designation by the Reserve Bank constitute an admission by the ACCC that, although it believed that these practices were in breach of the Trade Practices Act, you could not enforce them?

Mr Dimasi—No, I do not think it necessarily means that. I think what it means is that, prior to designation, if there were a potential breach—a collusive arrangement, for example—then, subject to the evidence and being able to pursue it through the courts, there was no reason why we need not be able to enforce the provisions as we enforce them elsewhere. But, as Mr Grimwade said, there were a number of other issues in terms of getting more efficient outcomes out of the reforms. The designation process of the Reserve Bank is a more direct and potentially more effective way of achieving those goals.

Dr EMERSON—And cheaper.

Mr Dimasi—It may be that as well. But, in pursuing an action under part IV, for example, we could take an action to the courts or we could establish that there had been a breach, consequences would follow and you would get that conduct stopped. It does not mean that you would get the efficient pricing that a regulatory scheme might be able to achieve. So it is the sort of circumstance where the regulated outcome might achieve a more effective result.

Dr EMERSON—My final question relates to the accept all cards rule. Why wouldn't it be, in your view, reasonable for a card issuer to say to a potential customer, 'Here is the deal: you take my credit card and my debit card or you take neither.' To me, that does not sound like anti-competitive behaviour. I can simplify or illustrate this matter by reference to motor cars. Someone is selling a car to you and you say: 'I like the car, but it has Pirelli tires and I like Michelin tires. You keep the Pirelli tires, I will go and buy four or five Michelin tires and you can charge me the cost of the car minus the cost of the Pirelli tires.' The car supplier says: 'No, I'm not going to do that. We have an accept all components rule in the automotive industry. This is the vehicle and you buy it or you do not buy it.' That does not constitute anti-competitive behaviour on the part of the car supplier. Why would requiring customers to accept both credit and debit cards constitute anti-competitive behaviour in your view—or would it? That might be a better way of asking that question.

Mr Grimwade—I think this is a relatively recent issue for the Reserve Bank, but my understanding is that this issue relates to the Visa credit card and Visa debit card. The Visa debit card looks like a debit card but acts like a credit card in terms of the incentives and the way that interchange fees are structured. My understanding is that the Reserve Bank had an issue in terms of the incentives and the efficiency of interchange fees in relation to that particular bundling issue—the Visa credit card and Visa debit card.

Dr EMERSON—That does not help me much. I do not expect you to help me much because it is not your area. But it does not really enlighten me on it.

Mr Gregson—Just more generally, in relation to bundling issues, there are a number of features you would look at primarily, such as the leveraging power off one of the primary products. I cannot help you in the sense of looking at these specific accept all cards rules, but there are a number of features when you look at bundling.

Dr EMERSON—It is like Microsoft in the United States, where they bundle.

CHAIR—Visa would have a lot of market leverage. It is the major card in the market.

Mr Gregson—In your car example, it might be that there is low leveraging off the primary product. But in a different industry you would find very different leveraging strengths. They are the types of things we would look at.

CHAIR—That is actually quite a good point.

Mr CIOBO—Can I take it back one step. Can I ask what the ACCC defines as the market? Is it the payment system? Is it cash versus credit versus EFTPOS? Is it just credit cards? What is the market from the ACCC's point of view?

Mr Grimwade—You would only define a market if you were actually investigating and making a decision in relation to anti-competitive conduct within that market.

Mr CIOBO—You obviously did that.

Mr Grimwade—Going back to 2000, as to what the market was that we defined in instituting proceedings, I cannot remember. But I imagine it was in relation to credit cards.

Mr CIOBO—But aren't credit cards part of a broader payment system? When a consumer goes to pay for something, they can choose between EFTPOS, debit cards, credit cards and cash. Why are credit cards not a submarket? Why are they a separate market to the payments system generally?

Mr Grimwade—There are certain principles in trying to identify the relevant market definition to assess anti-competitive conduct.

Mr CIOBO—But isn't this the starting point, though? If you do not define a market, how do you even determine the level of competitive tempo?

Mr Grimwade—It is. But it is just a tool. It depends on the transaction. Defining the market is purposive to what you are trying to achieve.

Mr CIOBO—Sure. But you have made comments this morning about it being a less efficient payment system. You have made comments about the level or lack of competitive tempo in the market. With respect to credit cards, how can you make those comments if you do not even define what the market is?

Mr Grimwade—For a start, when we looked, for instance, at EFTPOS, we looked at an authorisation application. You look at net public benefit. There is no need to actually define a market in terms of making a public benefit/public detriment analysis.

Mr CIOBO—But with respect to credit cards, though, I want to know what the market is.

Mr Grimwade—I cannot recall exactly what our statement of claim said in relation to the market.

Mr CIOBO—So how can you say it is inefficient?

Mr Dimasi—No, that is what we said back then in our joint study.

Mr CIOBO—Did you define the market back then?

Mr Dimasi—No doubt we did, but we might have to refer you to the joint study though.

Mr CIOBO—Can I put to you that it would seem logical to me, on a first principles basis, to say that the market is the various types of payment methods available—cash, credit card, EFTPOS, debit card.

Mr Grimwade—We would use the principle of what is closely substitutable with credit cards and then you would look at the boundaries of substitutability. Are debit cards closely substitutable for the purpose of analysing a particular transaction—

Mr CIOBO—Paying for a good or a service.

Mr Grimwade—Cheques, cash and so forth.

Mr CIOBO—To me that seems a fairly reasonable proposition to make.

Mr Grimwade—I cannot comment on that, because there is no particular transaction we are looking at at the moment that requires us to—

Mr CIOBO—If I go and buy a loaf of bread, I can choose to pay by credit card, cash or debit card—they are all fairly substitutable. Is it a fairly reasonable proposition to say that that therefore would be the market—

Mr Dimasi—At first glance it might, but—

Mr CIOBO—At first glance? That is all—

Mr Dimasi—Let us be clear. In defining a market, as Mr Grimwade has said, we look at specific transactions because we do need to look at the degree of substitutability. This is a well-established and well-understood area of work for the ACCC and the theory behind it.

Mr CIOBO—That is why I am amazed why you cannot recall what the market was.

Mr Dimasi—It was 2000, I think, when the study was done, so it does go back a little way.

Mr CIOBO—There is a whole range of comments you have made that I am interested in, but you say that interchange fees do not reflect costs, that it is sticky pricing, prices have not changed with respect to costs—

Mr Dimasi—Sorry, we said that they were some of the things that the joint study found back in 2000.

Mr CIOBO—My question then is: when you look at, for example, efficiency, do you believe that credit cards are a more efficient payment method than cash?

Mr Dimasi—We do not have a view on that.

Mr CIOBO—If they are substitutable items, if I go to buy a loaf of bread and I can pay cash or credit card, and you are talking about ‘efficient’ being concerned with efficiency of payment method—

Mr Dimasi—No, our concern is about efficient pricing—consumers can make their own choice about whether they want debit cards or credit cards or whether they want to pay cash or

cheques. Our notion of efficiency is, if you like, economic efficiency, which does not distort consumer choice and so consumers are able to make their own choices.

Mr CIOBO—But you want to see prices reflecting those efficiencies, don't you?

Mr Dimasi—Again, our concern is in administering the act. One of the outcomes of the joint study was to indicate that it thought some of the pricing was inefficient, and we simply made that point. In terms of administering the act, the question of efficiency is something that comes up, but our general principle is that we have to administer the act and apply the principles that are in the legislation.

Mr CIOBO—Let me take it from my perspective and what I think the committee is grappling with. You said you recommended designation to the RBA; the RBA has taken that decision. From a committee perspective, we concern ourselves with whether or not that decision was the right decision, given that it has resulted in a market distortion. In addition, why could it not have been the case that the ACCC could have achieved similar outcomes through the application of the Trade Practices Act? What we need to be concerned with is that we have had a regulatory intervention which results in a market distortion: the basis for that intervention is effectively on two limbs. The first limb is that it is an inefficient system and interchange fees do not reflect the cost base. The second is that, apparently, according to the RBA testimony, normal competitive pressures do not apply in that marketplace with respect to interchange fees. I struggle especially with the second one. My concern is that if I, as Joe Public, go to buy a loaf of bread I can pay by cash or by credit card. Cash is clearly a less efficient system than using a credit card, and yet for some reason neither the ACCC or the RBA concern themselves with that. In fact, if I go to a retailer I can get a discount for paying by cash and a surcharge for paying by credit card, even though the credit card is a more efficient system than the cash system, and yet there is no comment about that. When there has been a regulatory intervention by a regulator that results in a market distortion, I find the rationale for that very weak and I am not hearing anything from you to justify the intervention.

Mr Grimwade—I will make two comments. Firstly, I do not think it is an appropriate comparison to compare the substitutability of the different payment methods for the purchase of a particular retail product when what we were looking at at the time was the competition between the banks in issuing and acquiring credit cards for which an interchange fee was set. There was quite a different arrangement in different interchange fee systems for debit cards, which were bilateral ATMs. The conduct that we were looking at back in 1997 up to 2000 related to arrangements between banks for credit cards. In terms of taking a purposive approach to market definition, you are looking at that market which really only involved credit cards. It was quite a different system for debit cards. Having said that, you asked what could the ACCC have achieved, why it did not take this matter on and why it did make the recommendation. With regard to what the ACCC could have done, we had an arrangement between the banks and reviews put forward by the banks to us. The next step for them would be for the banks to propose a solution to us under the authorisation process. We are not the author of the reform process. In fact, the authors of the reform process are the ones who probably have the most to gain by it not being achieved. At the same time, we noted that we were not getting any resolution or any decent proposal from the banks at the time. We had many discussions over that year with the banks to try to reform interchange fees and really extricate a reasonable proposal that we thought could be in the net public benefit.

Mr CIOBO—So we have used a sledgehammer to crack a walnut.

Mr Grimwade—No, not at all because, in essence, the authorisation process gives us no power to try to optimise the public benefit. It is a net public benefit test. In addition, the banks were not really coming to the party at the time with any reasonable proposal, and it had been a year since we had advised them that we thought that it was in breach of the act and that there was a reform needed. A reform was capable of being achieved, but we were not in a position to effectuate that reform, hence the recommendation that the RBA implement the reforms that parliament had given them.

CHAIR—But yet nothing has been done on the fact that we have the surcharging which is going on by airlines. Booking over the internet, you have to use your credit card and they automatically pass on the surcharge, no questions asked. There has been no questioning by you as to whether that is appropriate or not. It is a very efficient system for them and results in lower costs, yet the consumer is paying more.

Mr Gregson—The finding in the joint study was that the costs of the credit card system were always there. They were hidden within interchange fees and arrangements between banks. The whole idea behind the reforms to interchange and then the no surcharge was to ensure that there was transparency in where those costs were applied. That will ultimately lead to benefits.

CHAIR—The most popular card is the Qantas Visa card. That is the one most used. If you cannot use cash or cheques when you go and book online and you can only pay by credit card, they are the beneficiaries twice in the process. It is more efficient for them. They are trying to get people onto the net to make their bookings for a number of reasons, yet you guys leave that aside.

Mr Dimasi—What section of the act do you think it breaches, Chair?

CHAIR—You interfered in this market, or took action and inflicted it on the Reserve Bank.

Mr Dimasi—To be fair, I think I made it clear that we interfered in this market because we believed there was a potential breach of the act by a potentially collusive arrangement in the way those fees were set.

Mr CIOBO—So why not action it?

Mr Dimasi—We did.

Mr CIOBO—So why recommend designation? Why not carry through with the action?

Mr Dimasi—As I think Mr Grimwade was pointing out, action under part IV is able to deal with the issue of the collusiveness of the arrangement not with the fee. It does not mean that having a fee is in any way illegal. It was just the collusive arrangement. The concern of the joint study was with the efficiency of the outcome.

Mr CIOBO—Focusing in on that issue of efficiency, we do not seem to be concerned in any way with anything else being efficient. How will we focus in on credit cards being efficient? It does not make sense to me.

Mr SECKER—That is not their job.

Mr CIOBO—It is their job. Why is there this focus on credit cards?

Mr Dimasi—We do not have a focus on credit cards. We are not involved in credit cards. I think I made that clear at the start. We will become involved if there is a potential breach. They are protected by the designation system.

Mr CIOBO—Mastercard and Visa invest millions of dollars into their payment system and then, because of a regulatory decision, the goalpost is shifted and their competitors have benefited in terms of Amex and Diners and we just say, ‘Sorry about that.’

Mr Dimasi—That is something that you would have to take up with the regulator.

Mr CIOBO—But you recommended designation yourself. I am asking you: why?

Mr Dimasi—We recommended designation as a result of the joint study—

Mr CIOBO—You cannot have it both ways. You cannot say, ‘Take it up with them’ and then say you were part of the joint study and you agreed, you will lock yourself in.

Mr Grimwade—The important point to make is that a four-party system, an interchange fee system, gave rise back in 2000 to a collusive arrangement because there were interchange fees being paid between issuers and acquirers. With a three-party system with Amex just sitting there, there are no interchange fees, there is no collusive arrangement, because it is Amex. There is no breach of the act. To the extent that we could, we tried to address what was an anti-competitive problem over which we had responsibility which was under section 45A at the time and that is why we instituted proceedings. There was no potential for us to take any action against Amex, because there was no possibility of there being a breach of 45A. There was no agreement between competitors. It was just a three-party system.

Dr EMERSON—Was there collusive behaviour? Apart from price stickiness, that cannot of itself constitute evidence of collusive behaviour.

Mr Grimwade—As I mentioned before the ground for taking action as I recall was under 45A of the Trade Practices Act which is a per se provision where there is no requirement for the commission to approve a substantial lessening of competition. It is automatically an anti-competitive arrangement. Essentially, as I recall, the argument was that the interchange fees between issuers and acquirers, the banks, had the effect or likely effect of controlling or maintaining the merchant’s service fee level and that was the basic ground for ability to take action in the NAB case.

Mr CIOBO—You made comments that interchange fees did not reflect the cost base. Can I ask what it was that you incorporated into the cost base? Have you got a cost base composition?

Mr Grimwade—That was actually a finding of the joint study. We were not privy to any of the confidential financial information that was provided by the banks to the Reserve Bank because we had at the time a separate court proceeding against NAB, so none of that information was available to us.

Mr CIOBO—So that was the RBA's finding that it did not reflect the cost base?

Mr Grimwade—That is right. It had the financial details to come up with the figures.

Mr CIOBO—I take it the same applied with respect to sticky prices. I assume that the cost base has declined but interchange fees stayed up.

Mr Grimwade—The point about sticky pricing is that there had been no change to the interchange fee, as I recall, for years and years.

Mr CIOBO—Despite the declining cost base.

Mr Grimwade—Despite any changes in any circumstances, there was this one fee.

Mr CIOBO—How do we know that the cost base was not increasing?

Dr EMERSON—They might have been incredibly competitive and said, 'We'd love to increase the interchange fee but we can't.'

Mr Gregson—The stickiness of prices upwards or downwards still is reflective that competition signals are not being passed through.

Mr CIOBO—So even though you can have an increase in cost base, if the interchange fee stayed the same despite an increase in cost base you would still be concerned about that?

Mr Dimasi—We would not be concerned. This was a finding of the cost study. I would stress that under the act we are not necessarily concerned if prices are inefficient. That is not the role the act gives us.

Dr EMERSON—But the proposition that stickiness in prices upwards or downwards is evidence of anticompetitive behaviour—

Mr Dimasi—No, we would not suggest that.

Mr CIOBO—That was what we were just told.

Mr Gregson—We would not suggest that.

Mr CIOBO—That is exactly what you just said.

Mr Dimasi—Without putting words in Mr Gregson's mouth—

Dr EMERSON—No, we heard words coming our way. We just repeated them.

Mr Dimasi—I think the point he made—

Dr EMERSON—Is this being recorded in *Hansard*? We will have to have a look.

Mr Dimasi—I think the point that was being made was that there was not a change in price regardless of what was happening to the cost base.

Dr EMERSON—My argument is that in a competitive market costs might be going up and if the price does not go up that is not evidence of a lack of competition, it is actually very strong evidence of the operation of competition where margins or profitability are going down as a result of the forces of competition. It was be terrifying if the ACCC had the view that the failure of prices to rise in line with costs constituted anticompetitive behaviour.

Mr Dimasi—We do not have that view.

Mr CIOBO—I will repeat my question then. Do you know whether the cost base is increasing, decreasing or staying the same?

Mr Dimasi—We do not know. We are talking about the joint study that occurred in 2000. In terms of what we know, we have not been involved in this for a number of years, so I just want to reiterate that.

Mr CIOBO—You recommended designation. That is what you said.

Mr Dimasi—Correct.

Mr CIOBO—We have established a very big precedent here, where we have had a regulatory intervention which has resulted in a market distortion. It is a very big issue, as far as I am concerned. I think we rightly can question regulators as to the rationale for their decision. You recommended designation. You say it was not because of concerns about the cost base. You say it was not because of your considerations of efficiency. So it seems to me that the only platform you have advanced to this committee recommending designation was because there was evidence of collusion or possible collusion.

Mr Grimwade—No.

Mr CIOBO—So what were the other reasons for recommending designation?

Mr Grimwade—At the risk of repeating myself, the reason we recommended designation is that we considered that we were not able to achieve reform of the system in a timely and effective manner, despite a year of trying to encourage reform through the authorisation—

Mr CIOBO—Okay; why was reform needed?

Mr Grimwade—Reform was needed for two reasons. One was that we had identified that there was a breach of the act—

Mr CIOBO—In terms of collusion?

Mr Grimwade—In terms of collusion. But, secondly, the joint study had found that applying an objective, cost based methodology to interchange fees for credit cards and others would give rise to much lower interchange fees. There was a lack of transparency in how they were set, and the view was that there was a real need for some fundamental reform in how interchange fees were set.

Mr CIOBO—But you do not know what the cost base is? You relied on the RBA?

Mr Grimwade—That is right, at the joint study.

Mr CIOBO—That is what I am trying to ascertain. So those two bases, the first being recommendations that the RBA gave you or findings that the RBA made, coupled with your concerns over collusion, were the reasons you recommended designation.

Mr Gregson—The joint study sets out what the commission's and the Reserve Bank's findings were, based on the information that was available either to both of us or to the Reserve Bank with respect to costs. It sets out in detail some of the tests that were applied to whether these interchange fees were efficient or not. In fact it applied two simple tests and found that it failed on both fronts. That is set out in an 80-page document. We are certainly not shying away from that.

Dr EMERSON—I can understand absolutely collusive behaviour as a criterion, but I struggle with cost based pricing. Does that mean that in all markets businesses are allowed only to charge a price equal to the cost of production plus some normal level of profit?

Mr Grimwade—That is not what we are saying; we were saying that in the joint study there was absolutely no apparent methodology for calculating the interchange fee with which we had identified a problem. The joint study explored what a more effective interchange fee system would look like if you applied various methods including the cost base methodologies.

Dr EMERSON—You would not fail the test of being a cost base price because if you did that then you would be wandering around the entire Australian economy whenever a business came up with a new idea and appropriated the rents associated with it.

Mr Dimasi—I think I made it clear that that is not what we do.

CHAIR—It is also related to market power, is it?

Mr Dimasi—Correct.

Mr Gregson—And some other specific features in the market—the joint study referred to the transparency issue—and I think you only picked up on a part of the comment. The other one is that consumers are one step removed from these transactions. That was a fundamental premise.

Dr EMERSON—Therefore I cannot apply competitive practice.

Mr Dimasi—So with your example about the furniture store, consumers are perfectly able to go along and find out which is the most affordable, competitive price, and market signals are sent. The fact that consumers are one step removed from interchange fees was fundamental to the joint study in terms of saying why this is a market that needs to be looked at.

Mr Grimwade—Let us not ignore the point that was made before about the lack of contestability in the market. That was also a finding in the joint study.

Mr CIOBO—That there was a lack.

Mr Grimwade—Yes, that is right.

CHAIR—There is also a lack if you have only got one new entrant, but we take your point that they have got the ability to enter if they want to.

Mr CIOBO—We have lowered, presumably, revenue in the system because we have had a significant decrease in the interchange fee. Presumably, there has also been a decrease in profitability. Is there likely to be more or less contestability and profitable industry?

Mr Grimwade—In which?

Mr CIOBO—Credit cards.

Mr Grimwade—Between the banks?

Mr CIOBO—Between banks.

Dr EMERSON—I think his point is: it is not very likely to be new entrants into an industry which had a particular level of profitability and now have a lower level of profitability.

Mr Dimasi—To answer the general proposition, you would reduce the incentive for new entrants to the extent that profitability is lower. It does not mean it does not exist, especially if profitability is high relative to other options.

CHAIR—Then you also have the substitution, so you have ANZ Bank who is issuing the Visa and it moves into the arrangement with Diners. The Qantas Visa card now takes in American Express, so you have the substitution, which continues the distortion of the market. What about the comment that in the UK it is not the Bank of England that controls it; I think it is the Office of Fair Trading, which is probably your equivalent.

Mr Dimasi—Our equivalent; that is correct.

CHAIR—What has the experience been there?

Mr Grimwade—I do not know.

Mr CIOBO—Do you think it would be better for the ACCC to regulate in this area? I am still interested as to why.

Mr Dimasi—Again, it is a question of being careful about what you mean. If, by regulation, you mean applying the Trade Practices Act, we apply the Trade Practices Act across the economy, including this area, subject to the designation of the services which provides the exemption. If you are asking whether it should regulate, as we regulate in some other sectors where the government through legislation asks us to regulate, for example, in either price monitoring—part XIC delivers telecommunications—that is an issue for policy makers but it involves additional tools to deal with a particular problem that arises. We do not see there is any need for us to do that in this sector. The Reserve Bank has got the powers to deal with it, but that is a question for policy makers, not for us.

Dr EMERSON—I have one further question. The savings, if you like, associated with the Reserve Bank's interventions seem to be estimated around \$580 million. In Sydney there was a two-day debate about whether these savings would have been passed onto consumers. I know you will not have done any studies on this but with your experience of the retail market in Australia, would you expect that \$580 million will have been passed on wholly to consumers, in part to consumers or not at all?

Mr Dimasi—Because we have not looked at this particular sector—

Dr EMERSON—I am talking about the retail market generally.

Mr Dimasi—More generally, obviously it depends on the level of competition—the higher the level of competition the greater the prospect that a fair proportion of savings are passed on to consumers. That is the normal operation one would expect in a competitive market. So you would expect that if there were competition here a substantial proportion of those savings would be passed on.

Dr EMERSON—I fully understand that, but, in your work in general at the ACCC, would you regard the Australian retailing industry as more or less competitive? That helps us resolve this issue where I think the Australian Bankers Association said none of it—not a cent—would be passed on to consumers and obviously people with the opposite interest would say, 'Oh, all of it, every cent was passed on to consumers,' and we are sitting here receiving this evidence which I think was—

Mr SOMLYAY—That the ACA didn't care.

Dr EMERSON—That is right. So I guess it is a question about your experience of the competitiveness of the Australian retailing sector.

Mr Dimasi—The answer I would give is that there are a number of markets across the retail sector characterised by degrees of competition. Whilst I could not give you a definitive answer about the level of competition in each of those markets without looking at them, whenever we have had an opportunity to look at them we have seen different degrees of competition. Clearly there is competition across those various markets, so to suggest there is no competition would not be a proposition that we would think was right. The question of how much competition

depends on each specific market and we would have to look at them to give a more specific answer.

CHAIR—There are 20 million Australians and there is \$500 million—that is about \$25 bucks a year—50c a week—and if you compare that with the increase in credit card fees you have to debate whether the consumer is better off in that move. We notice that the Reserve Bank is going to make a review of the system in 2007, including examination of the interchange fees, the credit card system, the debit card schemes and BPay. Do you think it is still appropriate that it should carry that out and not you?

Mr Dimasi—We don't have a view on that.

CHAIR—Okay.

Mr CIOBO—Do you have a view on the level the interchange fee should be?

Mr Dimasi—We don't.

Mr CIOBO—Did I hear one of you mention that there is some public benefit that flows from the interchange fee?

Mr Grimwade—From the interchange fee system.

Mr CIOBO—From the interchange fee there is a public benefit that flows?

Mr Grimwade—From the interchange fee system.

Dr EMERSON—So zero would not, therefore, be the optimal level?

Mr Grimwade—In relation to debit cards, there was an agreement put to us by the banks for authorisation—this is prior to designation. They considered that there was a public benefit in setting interchange fees to zero. We ultimately authorised that and found that there was a net public benefit in relation to debit cards having the interchange fee at zero.

Mr Dimasi—That was overturned by the tribunal.

Mr Grimwade—Subsequent to the tribunal's decision the RBA designated it.

CHAIR—Thank you for your attendance here today. It has been a very interesting session. Because we have been across this issue quite a bit before obviously we have had lots of questions to ask.

Committee adjourned at 10.49 am