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Abstract
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Public Good or Monopoly?

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Assistant Professor of Economics

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The American Express Case:  
Public Good or Monopoly?

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The Issue

On February 20, 1974 a civil complaint for declarative and injunctive relief was filed by Consumers Union and one Linda Blitz against the American Express Company and the U.S. Shoe Retail Corporation under section 1 of the Sherman Act.\(^1\) American Express and U.S. Shoe Retail were charged with being in restraint of trade. Specifically the companies were charged with being parties to a "restrictive contract", which "eliminates price competition in the sale of goods and services to cash customers and credit card customers...", and with imposing a tie in sale. Both activities are viewed in the law as being in restraint of trade. The provision of the contract to which objection was made read as follows:

You [the seller] agree that the prices (including any service or other charges) charged to our Cardmembers including advertised sales will not be greater than those charged to other customers.

In effect this provision forbade the granting of discounts to those customers offering to pay in cash. Retailers accepting the American Express Card as means of payment generally pay a percentage of the sales price ranging from 4 1/2% to 6% of the sale price.\(^2\)

Consumers Union apparently believes that prices posted by retailers who accept credit cards as a means of payment are higher than would

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\(^1\) All references to the content of the suit are to the complaint as filed in the U.S. District Court for the District of Columbia (plus appended Retail Store Agreement), and as supplied by Mr. Paul Gewirtz, attorney for the plaintiffs. The cooperation of Mr. Gewirtz and the Center for Law and Social Policy in supplying requested information is hereby gratefully acknowledged.

\(^2\) There is an additional charge of $25 "endorsement fee" per year for establishments generating less than $1000 in American Express credit card sales, the significance of which will be examined below.
otherwise be the case. Consumers Union\(^3\) wants retailers to be permitted to reduce the prices paid by consumers not using credit cards (specifically, the American Express card in the case under review). Presumably, Consumers Union believes that, given the opportunity, many retailers would in fact so reduce their prices to cash-paying customers because of competitive pressures.\(^4\)

The suit against American Express was intended to set a precedent, and, eventually to lead to lower prices at the retail level to cash-paying customers. In fact, the American Express Company has agreed, in an out-of-court settlement, to permit retail stores that accept its credit card to grant discounts to customers who pay cash, and so to inform all retail establishments accepting the American Express card.\(^5\) Agreements with other credit card companies have followed upon the American Express settlement. One could reasonably infer, then, that the settlement between Consumers Union and American Express has served as a precedent. The suit, previously pending against American Express, has

\(^3\) As a fine legal point, one should refer to "the plaintiffs", but in this paper "Consumers Union" will be used at times when the former is what is meant.

\(^4\) A lawyer for Consumers Union argued this very point. Cf. The Wall Street Journal, XC (April 18, 1974).

It should perhaps be noted here that the Consumers Union is a non-profit organization that articulates what it believes to be the interests of the consumer. Among other things, the organization publishes a magazine (Consumers Union Reports), in which results of product testing of interest to consumers are presented.

That prices to cash paying customers are alleged to be higher than they would be, in the absence of the aforementioned contractual agreement between American Express and its retailers, can be seen from the following allegation contained in the original suit: "Plaintiffs Blitz and Consumers Union and its members have suffered and will continue to suffer irreparable injury from the practices described in...this Complaint".

\(^5\) Cf. the article cited in footnote 4, above.
been withdrawn by the plaintiffs as part of the settlement.

The out-of-court settlement should be of interest to the economist both as theorist and as policy adviser. Important theoretical issues are raised by this case. These issues include the applicability of the monopoly model to cases of less than perfect information; and the ability of the market to supply public goods profitably. Further, the suit against American Express has already served as a precedent in other cases, and may continue to serve as a precedent.

The purpose of this paper is to examine the issues raised by the Consumers Union suit against the American Express Company and the subsequent out-of-court settlement. The important theoretical issues raised by the suit will be examined. Specifically, the question of the effects of credit card usage on pricing will be analyzed in detail. In the course of doing so, it will be argued that an important motive for using credit cards has generally been overlooked, and that this causal factor at least mitigates the effects of credit card use on prices.

Whose Monopoly?

The ability of a firm to sell at a price above the competitive level [or above marginal cost at the current output rate] is usually taken as evidence of the existence of monopoly power at some stage in the production process. The economist is naturally interested in the source of the monopoly power. Few would argue that the retailers are the source of the monopoly power in the American Express case. Most

6 Consumers Union apparently believes that the retailers do not possess monopoly power themselves. In their suit they assert: "But for the restrictive contract, sellers, including U.S. Shoe Retail Corporation, would be able to charge a different and lower price to cash customers than they charge to American Express card customers". The suit also speaks of the fact that: "Many of these sellers [the retailers] compete with each other in the sale of goods and services".
economists would agree that the thousands of retailers who accept credit cards are pure competitors. Even if these retailers did possess monopoly power, they would not need to make use of a credit card to exercise it.

The American Express Company must possess monopoly power, then, if anyone does. But over what good do they possess a monopoly? The name "American Express Card" is a registered trademark, of course. No other individual or entity may make use of the trademark. The American Express Company has then, in a trivial sense, a monopoly over the American Express card because of the laws respecting the use of brand names.

The existence of a brand name is surely not, _ipsa factum_, sufficient to demonstrate the existence of monopoly power. Brand name is a method of assuring quality. With no brand names, the unsatisfied consumer would not know to whom to complain about a faulty product. In a world with no brand names, a consumer would neither know who had produced goods, nor where he had bought them (the name of the retailer being a brand name of sorts). Such a world is inconceivable, of course, because it is inconceivable that an economy could be organized without some identification as to the source of the product (at minimum, the consumer can remember where he purchased a good). Brand names can have more or less significance. The less assurance as to quality that a consumer receives from brand names, the more he must engage in search activity on his own, and supply information as to quality himself. Brand names serve, in part at least, to lower costs of search and inspection.

If the existence of search and inspection costs helps to explain the economic service provided by brand names, then it must be acknowledged that some brand names may save the consumer more or less of these information costs than other brand names. The "same" physical good with one
brand name may then sell for a different price. But a competitive equilibrium of sorts can still result in that industry (recognizing the inherent difficulty of defining an industry now) if the price of each branded product equals the marginal cost (inclusive or establishing the quality of the brand name). Thus it may or may not be true that one credit card provides more brand name services than another. Indeed, it is an implication of this paper that some credit cards provide more of some kind of service than do others. But whether the American Express card is perceived to be the "same" card as the Diners Club card, etc. is not the point. For if American Express possesses monopoly power, it must have a monopoly in the supplying of the means of payment, record of payment, consolidated billing and other such services!

All credit cards, as well as cash and checks, are means of payment. At best, and only in certain circumstances, a credit card is a perfect substitute for cash at the margin. At best, then American Express is a competitor with the Federal Reserve System and the nation's commercial banks in supplying the media of exchange. Given the number of close substitutes for the American Express card, it would seem unlikely that American Express possesses significant monopoly power in the credit card industry. It might be argued that there are only a few national credit cards, and that we should, perhaps, treat this as an oligopolistic industry. This would, of course, mean treating the media of exchange "industry" as oligopolistic. More to the point, however, this taxonomy would overlook the fact that virtually every retailer is capable of

7 Cf. pp. 19-20 below.
8 Thus, monetary economists are used to treating credit cards as substitutes for money, and their use as increasing velocity.
providing the services provided by national credit cards himself, if not with his own credit card, then with a running account for those customers who would make use of this service. An investigation into the structure of the credit card industry would not seem to be a fruitful approach then. It would seem then that the contention that American Express possesses any monopoly power that would enable it to engage in any illegal price fixing is severely undercut.

The Information Problem

Why would retailers be willing to incur the costs of accepting a credit card? This is the question that must be answered in analyzing the economics of this suit. Economic theory tells us that producers are cost-minimizers. Costs are willingly incurred as long as they result in a revenue gain, which at least compensates the producer at the margin. Retailers presumably willingly incur the costs involved in accepting credit cards because they expect thereby to capture a revenue gain that at least compensates them at the margin.

I believe that a reasonable hypothesis, which helps to explain why a retailer enters into a credit card agreement, is that he is paying for advertising. That a major part of the costs to a retailer incurred in accepting a credit card as a means of payment is for advertising can be most readily seen in the case of the so-called luxury credit cards: American Express, Diners Club and Carte Blanche. Let us focus on the American Express card. This will be done both for the sake of concreteness in exposition, and because the suit in question was directed specifically against the American Express Co. As with Diners Club and Carte
Blanche, American Express publishes a magazine for its cardholders. Considerable space is devoted to "touting" establishments that accept the credit card in question. Moreover, most of the space in these magazines is devoted to attempting to stimulate the cardholders' purchase of those goods that are most likely to be paid for with a credit card: travel, dining out, etc. 9

American Express takes out full page advertisements in various national magazines, featuring and praising resorts, hotels and restaurants that accept the American Express card. In part these advertisements are seeking new cardholders. But they also appeal to current cardholders to patronize these establishments and to use their American Express card to pay for the goods and services purchased at them. The ads appear in magazines whose readers apparently possess an above-average income, and hence, a higher than average probability of being a cardholder, or being a potential candidate for an American Express card. Several of the credit card companies advertise jointly with airline companies to generate air travel business. 10

All of these activities are calculated to generate an increased demand for the products of companies that accept the credit card of the company doing the advertising. Advertising is, of course, a classic

9 The American Express cardholder magazine is called Travel and Leisure. In the April, 1974 issues, as an example, eight pages out of 74 were given over to plugging specific firms that accept the American Express card. Even the name Travel and Leisure is suggestive of the "message" being given in the magazine.

10 The author has seen joint advertisements by American Express and several different airline companies (including United and Delta), as well as advertisements by Carte Blanche and Delta. To cite another example, Master Charge pays for billboard, magazine and television advertisements suggesting the use of that credit card as a convenient means to pay for transportation, hotel and restaurant services.
example of a public good: it is relatively costly to make those who benefit from its production contribute a proportionate share of its production costs. Exclusion of non-payers is then relatively costly. Many of the practices of credit card companies seem to be directed toward circumventing the costs inherent in the private production of a public good.\textsuperscript{11}

The percentage charge on sales is thus seen as a method by which the credit card companies assess those who benefit most from the advertisements and other services for which the credit card companies have paid.\textsuperscript{12} There is at least some correlation between the use of a particular credit card (e.g., an American Express card) by a customer and the source of the information possessed by the customer about the existence of the establishment in question. \textit{Ceteris paribus}, the more of firm's sales that are generated by the advertisements, the larger will be the fees paid to the credit card company.\textsuperscript{13}


\textsuperscript{12}It is of course true that there are costs of collection involved in the use of credit cards, for which the credit card companies must charge (i.e., there are transaction costs involved in the lessening of other transaction costs). Nor is it being denied that the use of credit cards may involve the lowering of certain costs involved in the payments process. For example, individuals traveling to places where they are not already known might find it otherwise necessary to carry large amounts of cash, because of the costs incurred by retailers in cashing their checks in such circumstances. The use of credit cards is a means of avoiding both the carrying of large amounts of cash, which presumably is costly for the would-be customer, and the cashing of checks drawn on individuals of dubious stature. The existence of benefits of this kind are taken to be obvious. But there exist a number of other mechanisms for circumventing this particular payments difficulty: travelers checks and check-guarantee cards being two of these mechanisms. The intent of this paper is to focus on a benefit of credit cards to which little attention has been paid, and which, it is argued, is of importance for the case at hand.

\textsuperscript{13}But cf. the section below on the American Express fee structure for its retailers.
The credit card companies do not merely provide advertising services. To some extent they certify the quality of goods being sold by an establishment accepting the credit card in question. The very fact that an establishment accepts a particular credit card supplies information to the cardholder. The cardholder has a reasonable expectation that the credit card company would not permit its name to be displayed by a crooked business, or by a firm about which complaints are persistently received from cardholders. Some of the credit card company's own brand name is at stake in such a situation.

This certifying function is undoubtedly most important for the traveler visiting a strange city. The luxury credit cards appear particularly anxious to create the impression that only quality restaurants, hotels, etc. accept these credit cards. American Express, for instance, makes some attempt to supply additional information about places to eat and sleep in various guides to different cities, made available to cardholders. A gourmet meal is not promised, nor, one suspects, expected; an acceptable meal is strongly suggested at listed restaurants.

The important point is that viewed in this manner the contract between the credit card companies and the retailers is a solution to a

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14. Indeed, a clause in the contract between American Express and its retailers serves to raise the cost to a retailer of giving unsatisfactory service to a cardholder: "If the Cardmember should refuse to make payment in full because of any such claim or complaint, you will reimburse us for the amount which the Cardmember refuses to pay or we may deduct this amount from subsequent payment to you."

15. In the terminology adopted by Phillip Nelson, credit card companies (in this case, American Express) seem particularly prone to advertise "experience goods" (as opposed to "search goods"). Thus, the hypothesis of this paper is at least consistent with Nelson's fascinating hypothesis. Cf. Phillip Nelson, "Advertising as Information", Journal of Political Economy, 82 (July/August, 1974), 729-54.
genuine information problem. The consumer desires information about products and is willing to pay for this information. The retailer is willing to pay for low cost advertising to supply this information. The credit card company is willing to supply the advertising in which the desired information is conveyed, to the mutual benefit of all.

For cash-paying customers, the retailer has had to produce desired information himself. Thus, this hypothesis not only explains why retailers are willing to pay a fee to the credit card companies, but suggests that discounts for cash may be less widespread than is presently supposed, once the new decision has been fully adjusted to. **There are not quantitatively different costs in obtaining cash-paying and credit card-paying customers. The cost have merely been borne initially by different parties.**

The clause in question was an attempt to find a low cost way to avoid what might be termed "cheating" by the retailers. Let us take what is the prototypical case of this paper. An American Express cardholder discovers about the existence of an establishment because of an advertisement supplied by the American Express Company. Thus, American Express has incurred the cost of advertising for the retailer, in expectation of receiving payment via its taking a percentage of the retailer's sales paid for with an American Express card. The individual retailer has an incentive to offer a covert cash discount to an American Express cardholder, who, **ex hypothesi**, was attracted to that retailer by an advertisement for which the retailer did not pay. Thus, while **in general** it is not true that it is any cheaper to serve cash customers, in this case it is, precisely because the public good—advertising—has been produced already, and the retailer can "free ride" on its effects. One
can assume the clause in the contract prevented this happening in very many cases. But it is not difficult to see what the long run effects of this behavior on the part of retailers would be, in the absence of an alternative mechanism with which to supress such retailer cheating. In the long run (which would, I believe, be a comparatively short period of time), American Express would be compelled to curtail its advertising of particular retailers. Retailers would find that increasingly they would have to provide their own advertising services. Only if a customer is a cardholder (and then only to the extent it can be assumed he acquired his information about the establishment from American Express or another credit card company) is there a real saving to be effected by selling for cash. And that saving will, as we have argued, prove illusory. Yet, in the absence of a method of detecting and eliminating the kind of cheating described here, it will be in the interest of the retailer--in each individual case--to cheat, even though it is in the interest of retailers as a group to prevent cheating, and thus keep the advertising services of the American Express Company. This dilemma is the classic one faced whenever there is an externality.

If American Express had not forbidden the granting of cash discounts, then too many cardholders would have paid with cash in the absence of an alternative mechanism for making the beneficiaries of the advertising pay for the benefits received. Let us assume for a moment that no other mechanism is available. Then the credit card company would not, as we

16 Low cost enforcement of the contractual provision is assumed to have been the case.

17 Again, this is the case where a retailer receives the benefit of an American Express advertisement (in the form of a customer he would not otherwise have) but avoids paying for it by negotiating a cash sale instead.
have seen, be compensated for performing its middleman function, and would be compelled to curtail its advertising. In this case, a cut-back in advertising services provided by American Express (and other credit card companies, as they settle) would be a predictable result of the out-of-court settlement. If, as is reasonable to assume, the credit card companies were low cost producers of advertising services up to the quantity they supplied, then, on the face of it, an allocational inefficiency would result.

The author would be the last to suggest that the supply of information about goods that is produced in this fashion is the same as would be produced in the construct of perfect competition in which information is costless to obtain. There are a number of obvious problems with the present system. Cardholders, having learned of a product from a credit card company, may pay with another instrument (i.e., a check or different credit card). Non-cardholders may discover a firm or product because of an advertisement by a credit card company, and purchase the product or patronize the firm without using the credit card in question. In the first case, a firm makes a sale as the result of information supplied by the credit card company, but does not pay for the cost of producing the information. Other things equal, this kind of situation would increase as retailers make cash discounts. In the second case, the effects are similar, though the settlement has no immediate impact on this class of freeriders.

If the credit card companies cannot prevent retailers from granting cash discounts, then a remarkably ingenious method for the private

\[18\] Significantly, the credit card companies make no apparent attempt to obtain subscribers to their magazines among non-cardholders.
production of a public good will have been thwarted. The adoption of the marketing technique in question would seem to have resulted in a greater supply of advertising than would otherwise be the case. Forbidding it may very well result in an undersupply of information.

It is, of course, true that some of the advertising of retailers by credit card companies is simply a method of stimulating the use of the credit card in general. That this type of general advertising occurs is in no way inconsistent with the hypothesis of this paper. Again, what is being argued is that the fee (a percentage of the sales) paid by retailers to the credit card companies is substantially for advertising services. Part of the demand by credit card-paying customers for the products of a particular firm may be the result of this general advertising. Another part of the demand for the firm's products is due to the firm-specific advertising, which this paper has focused on. There is no way for the firm to separate out the source of credit card customers' demand between general and specific advertising. Nor would there be any reason for the firm to do so. The results are the same, and the general advertising being equally a public good, the costs of producing it must be apportioned among the users of the good according to their relative intensity of demand for that good.

**The Fee Scale**

The hypothesis offered suggests that the fee charged by American Express is in large part intended to compensate for advertising services supplied retailers. The size of the fee paid by a retailer should then be proportional to the benefits received from this advertising. The size of the sales paid for with the American Express card (or any other credit card) is taken as an approximate measure of those benefits. Therefore,
one would expect that the size of the fee paid to American Express would be directly proportional to the sales on American Express cards. The fee is a proportion of sales. Yet there is a provision of the contract between American Express and its retailers, which, if it does not call into question the aforementioned implication, does seem to raise anew the question of whether American Express should be treated as having monopoly power. This provision allows for a sliding scale on the fees charged as a percent of sales, depending on the annual volume of charges: from 6% (0 to $10,000) to 4 1/2% ($500,000 and over). On the face of it, it does seem as if American Express might be engaging in price discrimination among buyers with different elasticities of demand for its advertising services. But there is an equally plausible interpretation that does not rely on the implausible assumption (for the reasons already adduced) that American Express possesses any monopoly power. I would suggest that American Express faces a different demand price from firms of different size for its advertising services. And that these different demand prices are a function of the greater availability of substitutes for American Express advertising facing firms of larger size (and, hence, of potentially larger sales on the American Express card).\footnote{It is as though American Express were a pure competitor in different markets. This, as opposed to their being in one market and separating out various buyers in that one market according to their elasticity of demand. This may seem a fine point, but in the absence of other evidence of American Express or the other credit card companies possessing monopoly power, an explanation in terms of classic price discrimination would seem to be ruled out.}

Recall that the advertising function of American Express has been taken to be most important for the cardholder possessing comparatively little information about the establishments in a given local (e.g., for
the business traveler in a strange city). The larger a hotel, restaurant, etc. catering to business travelers is, the more likely it is that it can profitably take advantage of national advertising media on its own (where this option would be all but closed to a smaller firm that nonetheless depends on business--and tourist--traffic). And the more likely it is that American Express cardholder already would know something of the larger establishment. American Express would be responsible for supplying less of the total information about the establishment that is possessed by a cardholder. It is true that American Express is more likely to run a full page advertisement in *Time* magazine praising the facilities of the New York Hilton. But Hilton Hotels' demand price schedule for additional advertising by American Express or anyone else would be expected to be lower because it has low cost alternatives, than would be the case if it could not take advantage of such alternatives. Thus the sliding fee schedule is explained without reference to monopoly.  

A seemingly unimportant clause in the agreement between American Express and its retailers is of interest here as well:

> If your volume of charges in a full calendar year is under $1,000 (or $500 if open six months or less during the year) and you wish to continue your participation in our Money Card Service, an annual American Express endorsement fee of $25 (to offset partially the cost of administration, advertising and promotion) will be payable at the end of such full calendar year.

This clause in fact lends indirect support to the thesis of this paper: that a significant portion of the payment by retailers

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20 There may very well also be differences in costs involved in serving establishments of different size. A fixed cost of dealing with an establishment would produce this effect. Even if this were the sole reason for the sliding scale, the main thesis of this paper would stand unrefuted. On the influence of costs, see the discussion in the text following this paragraph.
to American Express is for advertising. One presumes that $60 (6% of $1000) does not cover the minimum level of advertising (plus administration costs) provided by American Express per year to its retailers. This would be the case if the mere listing of the establishment by American Express, plus the other setup costs amounted to at least $85 per year.

Alternative Mechanisms for Collection

Thus far it has been assumed that American Express and other credit card companies would find no new mechanism whereby they could profitably continue to provide advertising services at close to the current level, in the absence of the restrictive clause in their contracts with retailers. Realistically, one would expect the market to seek out alternative methods of continuing the current, hypothesized arrangement between credit card companies and retailers.

Currently the luxury cards charge the cardholder an annual fee, and an annual fee has been discussed for Bankamericard and Master Charge. This annual fee is at a flat rate. It might seem that one method that American Express could employ to collect for advertising information supplied would be to institute a percentage fee for its cards, to be paid by the cardholder, and to be geared to the level of his charges. While this method might seem to produce the same results as does the present method, it would not in fact. At present the compensation received by American Express from each retailer bears at least some proportion to the advertising services provided for that retailer. This would no longer be true if the charges were levied against the cardholder directly. For the charge in this latter case would be geared not to the level of advertising services provided various firms, but to the intensity of the individual cardholder's use of his card, which usage may be at firms for which relatively little
advertising is provided. In any case, there would seem to be no clear relationship between the advertising services provided individual firms, and the degree of the individual cardholders usage of their credit cards. The credit card companies would have to charge a different percentage fee depending on where the charge was made.

This method of billing would probably be a computational nightmare for the credit card companies, though it has been suggested to me that it is essentially the billing method followed by telephone companies. That is, the rate varies depending on where one purchases the services (in state, out of state, etc.). Of course, the number of possible establishments at which the American Express card could be used far exceeds, for instance, the number of long distance calling "zones" in the continental U.S. (there being but four such zones). Even if this alternative method of billing could be instituted, it would presumably be more costly than the current billing methods, which are universal and thus presumably present some cost advantage. How far the assumed cost disadvantage of the new system would affect allocation would depend on its magnitude. The new, hypothesized billing method, wherein the customer is assessed for each charge and at differential rates, would surely meet with customer resistance. It would prove difficult to explain to a customer why he must pay more for a charge at one establishment than at another. It is true that the phone company does this very thing, but it presents such a small problem to it precisely because it has an enforced monopoly. Further, if the hypothetical fee structure were adopted, someone would surely suggest price discrimination were being practiced. And, again, in the absence of a legal monopoly such as is possessed by the telephone companies, few companies would be likely to incur the sanctions of the
anti-trust laws to institute a new billing mechanism.

More to the point, however, the existence of an explicit charge to the cardholder would provide an incentive to pay cash. The incentive would be greater the greater the explicit charge. As the charges to the cardholder would vary, ex hypothesi, with the advertising services provided by the credit card company to the retailer, the incentive to "cheat" (i.e., to negotiate a cash sale) would be greatest where the credit card company's costs in generating the aforementioned sale had been greatest. All things considered, then, this would appear to be a most unsatisfactory alternative to the current billing mechanism.

In general this is not a paper in marketing, and hence is not intended to suggest how in fact American Express will adjust, but only that costly adjustment may be called for. Some cheating will undoubtedly occur (the author has heard of cases already). This cheating will have a deleterious effect on the private provision of the public good in question. Any known alternative method of organizing payment for advertising services will not be cheaper, or it would already have been adopted. It could very well be considerably more expensive.

To sum up, then, at best the suit would seem to be pointless, because it will not in the end have accomplished what it set out to. This would be the case if a relatively cheap substitute method of collection is found, or if retailers quickly perceive the costs of cheating (i.e., that they must then provide more of their own, presumably higher cost advertising

21 Note that if the chief motivation for a customer's using a credit card (and a retailer's accepting it) were a cost savings, this explicit charge need not represent an impediment to the use of a credit card, if the charge reflected the convenience and cost saving (over paying cash or using a check) involved in the card's use.
services). Or, the suit may yet prove to have done a great deal of harm, if an unstable situation develops between the credit card companies and retailers, and persists over time. To the extent that charges come to be geared less to the advertising services provided, any existing inefficiencies would be intensified. A social loss would then have resulted.

On Credit Cards, Luxury and Otherwise

There is good reason to divide national credit cards into two distinct groups: American Express, Diners Club and Carte Blanche on the one hand, and Bankameriscard and Master Charge on the other hand. The first three credit card companies do more of the kind of firm and product specific advertising that I have described. The hypothesis perhaps best fits the case of these credit cards. Bankameriscard and Master Charge have no cardholder magazine. They do not advertise the benefits of using their respective credit cards to the extent that, say American Express does. They do some advertising of individual firms that accept their credit cards, but again not as much. All companies do some general advertising to encourage the use of their credit cards.

And the charges vary as the theory would predict. Retailers have informed me that if they pay 3 or 4 percent fee to Bankameriscard and Master Charge, they must pay 5 or 6 percent to American Express. In the absence of the kind of hypothesis such as is offered here, it would be

22 Presumably, if one wished to include other national credit cards, such as those of the various oil companies, one would include these in the second group.

23 Another factor relevant here is whether the "lesser" credit card companies exclude retailers to the extent the "luxury" credit card companies have been assumed to do. That is, is the brand name of Master Charge as important as that of American Express? It would appear that it is not, but this is more of a guess than a reasoned conclusion.
difficult to explain this behavior as rational, unless one were to maintain that American Express has a monopoly over the means of payment. But the argument of this paper suggests that proportionally more advertising and other services are provided by the luxury credit card companies, and their fees are consequently higher.

Implications

It has been argued that credit card companies provide advertising and "brand name" services, which generally reduce search and information costs for customer and retailer alike. Whereas other hypotheses for the use of credit cards focus almost solely on the motivation of the customer in using a credit card, this paper has suggested that one must also explain the motivation of the retailer in accepting credit cards. Moreover, it has been argued that there are benefits in the use of credit cards that do not result from the use of certain instruments (e.g., travelers checks) that also provide services that admittedly are provided by credit cards. Attention has been focused on the services broadly labelled "advertising", because they have been generally neglected.

The legal settlement in question has only occurred comparatively recently. The effects, if any, would not be expected to be particularly visible yet, as adjustment to a change takes time. One implication of this paper is that the widespread granting of cash discounts will not be a long-run response by retailers. Surely the future will provide opportunities for observing the changes wrought by this settlement.

Above all else economics teaches the interdependence of economic action, and the fact that a change in one part of the economy has pervasive effects, not apparent to the untrained (which here includes lawyers and jurists). It is not that economists can see all the effects, but
their theory enables them to perceive possibilities that would not be thought of by those untrained in economics. Indeed, one might say that economics teaches one to examine the unseen consequences of an action. Economics also teaches one to examine in detail allegations such as the one being examined here, viz, that American Express has been engaging in behavior that is economically (as opposed to legally) that of a monopolist. The analysis presented here casts doubt on this particular allegation. The most general conclusion that could be drawn is that our monopoly laws may permit the suppression of competitive behavior. This conclusion would not, of course, stand in contradiction to any claim that other monopolistic practices are being permitted or facilitated by existing laws on monopoly and monopolization. But that is a subject for a different paper.