The Framing Hypothesis: Is It Supported by Credit Card Issuer Opposition to a Surcharge on a Cash Price?

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1. INTRODUCTION

In the spring of 1984 the American Express Company mailed to 8 of its 13 million card holders an elaborate appeal urging them to send a card to their Congressman urging an extension of the then existing federal ban on credit card surcharges—additional charges imposed by the seller on purchases made with the use of a credit card. Some three million pieces of mail opposing surcharges were subsequently received on Capitol Hill. Federal law has, however, permitted cash discounts—a reduction from the price allowed by the seller on purchases made by cash rather than made with the use of a credit card. To that American Express made no objection.

Since a discount for cash is the equivalent of a surcharge for the use of a credit card, the American Express objection to the use of one but not the other seems puzzling. Why would American Express be more concerned about a surcharge for credit card use than a discount for cash?

One scholar who had offered an answer to that question a few years earlier is Richard Thaler (39). He says:

Credit cards provide a particularly clear example [of what Thaler calls an endowment effect, a distinction between an opportunity cost and a cost outlay]. Until

This paper has benefited from the comments of two anonymous referees. An earlier version was presented at a workshop at the George Mason University Law School. My colleague John Monahan drew the framing literature to my attention.

1. This mailing, which cost more than $1,000,000.00 for postage alone, is described in the New York Times, "Credit Card Lobbying," May 28, 1984, p. 34.

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recently, credit card companies banned their affiliated stores from charging higher prices to credit card users. A bill to outlaw such agreements was presented to Congress. When it appeared likely that some kind of bill would pass, the credit card lobby turned its attention to form rather than substance. Specifically, it preferred that any difference between cash and credit card customers take the form of a cash discount rather than a credit card surcharge. This preference makes sense if consumers would view the cash discount as an opportunity cost of using the credit card but the surcharge as an out-of-pocket cost.

Thaler’s casual attempt to explain this puzzle has been used by proponents of the framing hypothesis as a real-life example of a kind of behavior most commonly observed in questionnaires administered to college students, and has even received solemn mention in a research briefing prepared by a panel of the National Academy of Sciences.

This essay summarizes the regulatory history and institutional context in which the distinction between discounts and surcharges has been made by the law. The purpose is to provide a richer context within which the reader can assess the cogency of the Thaler example. The essay argues that the distinction has nothing to do with the likelihood that consumers will pay by cash when confronted with a surcharge for using a credit card but use a credit card when offered an equivalent discount for cash. The regulatory history does provide, however, ample evidence that the distinction has been used effectively by the participants in the political debate. The use and effectiveness of that rhetoric is consistent with findings by Thaler (and others) that framing affects the way people view the fairness of the way firms price (Kahneman, Knetsch, and Thaler, 1986).

2. "[Framing effects]... can... be exploited deliberately to manipulate the relative attractiveness of options. For example, Thaler noted that lobbyists for the credit card industry insisted that any price difference between cash and credit purchases be labeled a cash discount rather than a credit card surcharge. The two labels frame the price difference as a gain or as a loss by implicitly designating either the lower or the higher price as normal. Because losses loom larger [to the buyer] than gains, consumers are less likely to accept a surcharge than to forego a discount." (Kahneman and Tversky, 1994: 346).

The "framing hypothesis" is the hypothesis that human decision making is affected by the manner in which the issue is to be decided is formulated or "framed," and that some forms of framing will cause humans to make systematically irrational decisions. Experiments have demonstrated that this phenomenon can be replicated under restricted conditions.

3. "On the basis of these studies, some of the general heuristics, or rules of thumb, that people use in making judgments have been compiled—heuristics that produce biases toward classifying situations according to their representativeness, or toward judging frequencies according to the availability of examples in memory, or toward interpretations warped by the way in which a problem has been framed. These findings have important implications for public policy. A recent example is the lobbying effort of the credit card industry to have differentials between cash and credit prices labeled ‘cash discounts’ rather than ‘credit surcharges’" (National Academy of Science: 25). The panel was distinguished, to say the least, with Nobel Prize-winning economist Herbert A. Simon serving as its chairman. The thrust of the panel’s report was the need to spend more on support for research of this type because of its practical importance. The panel did not go on to explain what the connection between the findings and the distinction between discounts and surcharges might be. The passage from Thaler quoted in the text is the only discussion of the question I have been able to locate in the framing literature.
2. ISSUER OPPOSITION TO DIFFERENTIAL PRICING

The opposition by credit card issuers to either discounts or surcharges has its origin in the fact that the attractiveness of an issuer's card is based on the number of persons who carry it and the number of establishments that accept it. In order to increase the number of both, credit card issuers have never attempted to recoup a significant portion of the costs of establishing the system by lump-sum charges imposed either on the holder of the credit card or on establishments entitled to honor the card. Instead, they have imposed charges on each payment made by use of the card computed as a percentage of the payment. These have been collected in the form of discounts on the credit card paper when it was presented to the credit card issuer for collection by the honoring establishment. These charges were once as high as seven percent; they now are often below two percent.

There are substantial benefits that accrue both to establishments honoring the card and to the persons who carry them other than the ability to actually make and receive payments through the card system. The ability of the establishment to honor the card reassures card holders that should they need to do so, they can use their card to pay. In addition, since credit card issuers have incentives to check the financial reliability of the establishments honoring cards because of their ability to put erroneous or even fraudulent paper through the system, the ability of an establishment to accept a credit card serves as some certification of financial reliability. The ability of the card holder to use the card provides the holder with another payment option. But in any specific transaction, the establishment and the card holder have an incentive to avoid the transaction charge and share the benefits of doing so—for instance, the card holder pays less and the establishment receives payment in the form of immediately available cash. The establishment can give the card holder a discount equal to the charge it would pay to the credit card issuer, or the establishment and the card holder might split the saving in some other way. A significant number of such avoidance arrangements, however, will decrease the transaction base on which the transaction fee can be imposed, and at the limit will increase the fee to a level that makes the credit card system unattractive to everyone.

As this analysis suggests they would, credit card issuers have structured the card systems to prevent transactions that avoid the transaction fee. This was done by including in the contract that permitted the honoring establishment to accept the card a clause that required that the same price be charged on card transactions as on any non-card transaction.\(^4\) In addition, the card

\(^4\) O'Driscoll (163) reprints the clause: "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." He explains the clause on the ground that it is necessary for the card issuer to obtain compensation for advertising services offered to the honoring establishment. Although I agree that this is part of the picture, particularly with card
holder was given an incentive to use the card because of the interest-free loan inherent in the delay in payment.

The issue of the regulation of either discounts or surcharges would never have been important if such contract clauses had remained in effect. They did not.

The consumer movement successfully attacked the clause. Consumers Union sued American Express in February of 1974 arguing that the clause was an illegal restraint of trade in violation of the antitrust laws. The theory of the lawsuit was that the clause injured consumers who did not use a credit card because merchants were forced to charge consumers who did not use the card the same price even though, as to those consumers, merchants did not face the cost of the transaction fee imposed by the credit card issuer. American Express settled the lawsuit in April by agreeing to abandon the clause and to permit honoring establishments to offer a discount for cash.\(^5\)

The basic theory of the lawsuit was flawed. The only condition under which credit card issuers could persuade merchants to agree to accept payment by use of their credit cards subject to a no price differential clause would be if the merchants concluded that they would be better off agreeing to accept the card, taking into account both the benefits and costs of doing so. If this condition is satisfied, then the merchants must have concluded that they were better off with the card, and the complaint was based on a faulty premise. The fact that the merchant permits some customers to pay by credit card leaves the other customers better, not worse off.\(^6\)

\(^5\) Details of the lawsuit are provided by O'Driscoll. The settlement was reported in the *Wall Street Journal* (April 13, 1974: 13) barely two months after the complaint was filed. Consumers Union was represented in the case by a then staff attorney for the reform-minded Center for Law and Social Policy, Paul Gewirtz, who is now a Professor of Law at Yale. Gewirtz testified in 1975 that similar settlements were reached with "other credit card issuers," but they were not identified (U.S. Senate, 1975: 10). The antitrust complaint presented a greater threat in the early 1970s than it would today, when the courts are more receptive to arguments about the economic reasonableness of nonhorizontal contract terms. *Cf. The Tennessee Truckstop, Inc. v. NTS, Inc.*, 1989 WL 51358 (6th Cir. 1989), holding that a truckstop lacked antitrust standing to sue a credit card system for enforcing a contract clause which forbid the plaintiff truckstop from imposing a surcharge in excess of five percent on users of the credit card. The settlement may have also reflected a prediction that Congress would impose the same limitation through amendment of the Truth in Lending Act, as it in fact did. See note 15, infra.

\(^6\) This point does not mean that in a particular transaction the merchant would not have an incentive to offer an incentive to a card holder not to use the card. The fact that the card system as a whole is advantageous to the merchant does not mean that he would not be even better off if he could simultaneously have the right to honor the card and to offer particular customers a discount.
The settlement of the Consumers Union case did not usher in an age of discounts. As American Express knew, the Truth in Lending Act (P.L. 90-321 (1968)) [hereafter TIL], passed to provide consumers with better comparative information about the cost of credit, made it difficult for an establishment to offer either a discount for cash or to impose a surcharge. Under the TIL any difference between a cash and credit price had to be disclosed to the credit purchaser in conformity with the requirements of the TIL, including the requirement that the charge be converted to an “annual percentage rate.” The regulations in force at the time required that this conversion for a lump sum imposed on a credit card customer at the point of sale be made on the assumption that the credit was for a period of thirty days. Thus, a five percent surcharge would have to be disclosed as an annual percentage rate of 60%. These high rates would in turn raise difficulties under state usury statutes. The consumer movement’s desire to have cash customers receive a cash discount was constrained by the consumer movement’s insistence that credit customers should know exactly what the credit cost and that credit customers should be protected from paying “too much” for credit. As a result of the antitrust settlement, the issue moved from the domain of private contract to the U.S. Congress in the form of proposals to amend the TIL. It is in that forum that the distinction between a discount and a surcharge emerged. And in that forum the credit card issuers have enjoyed nearly complete success in spite of a few apparent victories for the consumer movement.

3. CREDIT CARD SYSTEMS

Before turning to this legislative and legal history, it is helpful to describe the structure of credit card systems. For this purpose we are able to draw on a study that Congress required the Federal Reserve Board to prepare: Credit Cards in the U.S. Economy: Their Impact on Costs, Prices, and Retail sales (Board of Governors). The purpose of the study was to find out whether, as the consumerists charged, cash customers were subsidizing credit card customers.

Credit card issuers fall into three major categories. First are the in-house credit card issuers. Prominent examples are the cards of the oil companies

7. Here and elsewhere I rely on Lobell and Gelb: “[A] discount for cash was deemed to be a finance charge and, as such, this charge was required to be disclosed to the consumer as part of the finance charge and also included in the calculation of the annual percentage rate. Further, merchants whose finance charge rates were already at the ceiling in a particular state would have risked penalties for exceeding such ceilings on finance charges by offering a cash discount program.”

8. Another source of background information on credit cards is DeMuth.

9. The study concluded that they do, but its analysis was confused and data spotty. Merchant accounting records could not contain data which would answer the question.
and the large retail chains such as Sears and J. C. Penney. These cards are successors to merchants’ in-house thirty-day credit account, and are offered without charge as an adjunct to the merchants’ selling effort. Second, are the travel and entertainment cards, focusing on providing open credit to businessmen and travelers in dispersed locations with the automatic generation of tax deduction records. Finally (and the most recent to appear) are the bank credit cards, MasterCard and Visa, offered to the general population as a substitute for payment by check and as an easily available form of consumer lending.\textsuperscript{10}

Each of these three major types of issuer has had different approaches to the marketing of and charging for their services. The in-house cards have generally not imposed a fee, and their cost has been recovered from the selling activities of the issuer. These cards have been marketed as an adjunct to the service or merchandise offerings of the issuer.\textsuperscript{11} The travel and entertainment cards have imposed a fee on the card holder and discounts on the establishments honoring the card. They have focused their marketing on higher-income card holders, and because of their success with this important consuming group, they have also been able to obtain relatively high discount fees from honoring establishments. The bank cards initially looked to a merchant discount and to interest charges imposed on outstanding balances to recover their costs, but later added a fee on card holders. Although each of these types of card systems competes with the other, they have had somewhat different interests in the controversy over discounts and surcharges.

A major focus of the controversy over discounts and surcharges has been the issue of whether payment by credit card “costs” merchants more than payment with cash. Complicating this question has been an ambiguity about what is meant by a “cash” payment. Is it a payment in currency or a payment by check? For purposes of clarity, this essay will use the term currency for payment by currency and use the term check for payment by check.

The principal cost to a merchant of accepting checks is the risk that the checks will not be paid by the drawee bank. Some evidence of the cost of bad checks is the fees charged by services that guarantee checks for merchants—presently one to three percent, about the same as for credit cards.\textsuperscript{12} Since

\textsuperscript{10} In recent years, these categories have blurred. American Express has promoted its highly successful Optima Card providing an extended payment with interest option, and Sears, an in-house card issuer, has offered the Discover Card, which has many of the attributes of a bank card.

\textsuperscript{11} The ability of the bank cards to offer a credit card service at lower cost to merchants than the costs of an in-house system has been their major selling point to merchants. But in-house systems offer benefits to merchants not offered by bank cards because they create a direct relationship between the customer and the seller, and those benefits appear to have been sufficient to allow for the survival of in-house systems.

\textsuperscript{12} The Federal Reserve Study reported an average check verification fee of 3.0 percent and an average credit card merchant discount fee of 3.1 percent (Board of Governors: 56, Table 4.9). This figure would be a maximum, since those merchants with lower costs of handling checks
any business must be prepared to accept payment in cash for some substantial share of its sales, it is plausible to assume that the marginal cost of accepting additional payments in cash is very close to zero. Thus, it seems reasonable to conclude that credit cards cost merchants about the same as checks and more than currency.

Currency, however, presents special costs to the purchaser who must obtain, secure, and keep track of it. Currency increases the cost of record keeping for the purchaser, a particularly important factor when tax-deductible expenditures are involved. The attraction of a checking account or a credit card for the buyer is that they reduce these costs. One way to view the contract clause forbidding merchants from charging differential prices for payment by cash or check is that the clause effectively binds each credit card holder (who on average prefers payment by card to payment by cash) from dropping out of the system in particular transactions in which he would prefer to use currency or a check instead of the credit card.\textsuperscript{13}

This last point is an important one that has been confused and obscured in the limited analyses that have been done. Merchants claim that they offer credit cards because it increases their sales. The Federal Reserve Board found that that explanation made little sense. The Board study pointed out that credit cards could not, and did not appear to, increase total sales for all merchants since there is nothing about a credit card that increases the ability of consumers as a group to buy. However, from a particular merchant’s point of view, it can be true that a failure to offer a credit card would result in a lower level of sales. That would be true if the credit card is a more convenient (lower cost) way for purchasers to buy than is the use of cash. Thus, a credit card or account is just another seller service like showrooms, inventory, or informed sales persons, that the seller will provide whenever the seller can provide them at lower cost than the purchaser can provide them for himself.\textsuperscript{14}

\textsuperscript{13} Thus, it was rational for three million holders of American Express Cards to ask Congress to prohibit a price differential, even though in particular transactions they might benefit from a differential. As the group that already has found that the benefits of the card system exceed its costs, they have an interest in sustaining the system. Why, in the context of particular legislation, opposing a surcharge was the equivalent of opposing a differential is explained below.

\textsuperscript{14} Note that although these services may have different value to different purchasers, the seller does not impose differential charges for them, presumably because the complexity of differential pricing would not be worth the cost of administering it. The Federal Reserve Study was confused about the fact that credit cards provide services of real value to their holders. It

\textsuperscript{497} accepted credit cards, 41 participated in a check-verification service. \textit{Ibid.} A check-verification service guarantees the principal amount of checks that have been approved. See generally, \textit{64 Chain Store Age Executive} 59. Merchants honoring checks often free ride on the existence of credit card systems by accepting or sometimes even requiring "a major credit card" as a form of identification.

\textsuperscript{59} Merchants honoring checks often free ride on the existence of credit card systems by accepting or sometimes even requiring "a major credit card" as a form of identification.
4. THE LEGISLATIVE HISTORY

In Congress, the consumer movement followed the antitrust settlement with an apparent success. In October of 1974\textsuperscript{15} Congress passed an amendment to the TIL purporting to eliminate the obstacles created by the TIL to differential pricing of card and non-card sales. The amendment extended the principle of the American Express settlement to all credit card issuers by providing that “the card issuer may not, by contract or otherwise, prohibit any such seller from offering a discount to a cardholder to induce the cardholder to pay by cash, check, or similar means rather than use a credit card” (P.L. 93-495 § 306, § 167 (a) (Oct. 28, 1974)). The act provided that “any discount not in excess of 5 per centum offered by the seller for the purpose of inducing payment of cash, check, or other means not involving the use of a credit card shall not constitute a finance charge . . ., if such discount is offered to all prospective buyers and its availability is disclosed to all prospective buyers clearly and conspicuously in accordance with regulations of the [Federal Reserve] Board” (P.L. 93-495 § 306, § 167(b) (Oct. 28, 1974)).

The Act did not immediately authorize merchants to offer cash discounts. Apparently both the credit card issuers and the consumerists were able to agree that simply giving merchants the right to offer cash discounts, when and under whatever conditions they wished, would not be a good thing. Discounts were only to be offered with notice to all, and under carefully tailored regulations that the Federal Reserve Board would promulgate.

The requirement of Federal Reserve Board regulations meant that merchants could not offer discounts until the Board completed its work. And the requirement of notice meant that merchants could not experiment with discounts on a selective basis. If discounts were to be offered, they had to be offered to all customers, including the customers who would have paid by cash in any case. This greatly increased the cost to a merchant of adopting any discount policy. In addition, it appeared that if the discount was offered for payment by check, then that discount had to be offered to all customers, without providing any mechanism for separating customers who presented analogized credit cards to trading stamps, and it argued that once all merchants accepted credit cards, no merchant could gain sales from doing so and that the value of credit cards would disappear (Board of Governors: 34). The author of the study then saw the implication that credit cards, like trading stamps, would display the same pattern of fluctuating rates of use over time, but shrank from predicting the demise of credit cards, somewhat lamely observing that “[i]t may well be that the consumer benefits of credit cards—the ability to alter the timing of their purchases, to carry minimal amounts of cash, to borrow for short periods, and so on—are of more substance than the perceived benefits of receiving trading stamps from grocery stores, which was, in essence, an inefficient means for consumers to obtain price discounts” (Board of Governors: 35).

15. Bills to permit discounts were pending even before the antitrust case was filed. See S. 1630, 93rd Cong. 1st Sess. § 166, introduced April 18, 1973; S. 940 § 169 introduced Feb. 20, 1973. Both are reprinted in U.S. Senate, 1973: 250.
no check risk from those who did. As could have been predicted from a careful reading of the legislation, neither discounts for currency or for check flourished.

It was during Federal Reserve Board consideration of its regulations that the distinction between discounts and surcharges became important. In the statute the term "discount" was undefined, and nothing in the legislative history suggests that Congress had even thought about the possible distinction between a discount and a surcharge. Indeed, there is some legislative history that suggests that those affected assumed that the statute would legalize any form of differential pricing (Joint Statement of the American Bankers Association, the Consumers Bankers Association, Interbank Card Association, and the National BankAmericard, Inc., in U.S. Senate, 1973: 250).

The statute's use of the term "discount" made it impossible to argue that a discount was not to be permitted. Surcharges, however, might be distinguished. The industry went to work. The Federal Reserve Board first proposed regulations that distinguished discounts from surcharges (April 30, 1975), then proposed regulations that did not (July 30, 1975), and then issued final regulations on September 10, 1975 (40 Federal Register 43200) by a vote of 4–3 (Testimony of Jeffrey M. Bucher, U.S. Senate, 1975: 2) that permitted only discounts. The consumerists, displeased with the result, brought the issue back to Congress.

In the 1975 Senate hearings, Paul Gewirtz, lawyer for Consumers Union, explained why it was important that the law permit both discounts and surcharges. Merchants, he pointed out, would be more reluctant to adopt discounts than surcharges because under a discount system they have to advertise their higher credit card price, whereas under a surcharge system they can advertise their lower cash price. Second, surcharges, unlike discounts, might "lead to increased competition among credit card issuers." He explained:

Merchants who use surcharges may well add-on an amount equal to whatever they are charged by the particular credit card issuers whose card is being used. The charges imposed vary from issuer to issuer (and from merchant to merchant). If consumers are squarely faced with varying surcharges, they are more likely to use credit cards which will incur the least surcharge. This may well produce competition among credit card issuers to keep down their charges to merchants (U.S. Senate 1975: 17–18).16

16. Others made this point. Testimony of R. J. Megaro, Manager, Retail Credit System, Products Division, Atlantic Richfield Co. (U.S. Senate, 1975:36). It is notable that the witnesses for the credit card systems did not address this point, probably because they could not refute it. In 1984 Senator William Proxmire, the then ranking Democrat on the Banking Committee of the Senate and a sponsor of bills that would have legalized surcharges under state as well as federal law, was quoted as saying that "with legislation [permitting surcharges] surcharges would be more visible to consumers who would then begin shopping for the least expensive
The Federal Reserve regulations required that the availability of a discount be provided "to all prospective buyers, whether or not they are cardholders, and such fact is clearly and conspicuously disclosed by a sign or display posted at or near each public entrance to the seller's place of business wherein such discount is offered, and at all locations within the place of business where a purchase may be paid for," as well as in advertisements, telephone contacts, and other correspondence (12 C.F.R. § 226.4(i) (1975)).

Congress itself adopted the distinction between a discount and a surcharge in 1976 in the form of an amendment to the Truth in Lending Act tacked onto Public Law 94-222, itself a brief amendment to a brief technical amendment to the “State Taxation of Depositories Act.” Without any explanation in the committee reports, the Truth in Lending Act was amended to provide that “[n]o seller in any sales transaction may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means” (P.L. 94-222 § 3(c)(1) (Feb. 27, 1976)). This prohibition was to be effective for three years (P.L. 94-222 § 3(c)(2)).

Another provision of the same statute was designed to facilitate discounts. It provided that any discount imposed in accordance with the statute should not be treated as a finance charge under any state usury law or disclosure statute. Although the 1974 amendments had exempted conforming discounts from the Truth in Lending Act, it had done nothing to remove the obstacles of state laws. 17

The Federal Reserve Board promulgated conforming amendments to its regulations on July 20, 1977. They defined a discount as a reduction from a "regular price" and defined the "regular price" as the posted or tagged price. The age of discounts was set to begin. As the Federal Reserve later documented, it began and virtually ended at the gas station. 18

Congress returned to the subject when the surcharge ban expired on February 27, 1981. To quote Senator Proxmire, “Make no mistake about it, the heart and soul of this legislation is the demand of the credit card industry that the Congress extend the ban on credit card surcharges for another 3 years.” 19 The Cash Discount Act (P.L. 97-25, July 27, 1981) continued the 1976 policy of prohibiting surcharges and attempting to facilitate discounts.

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17. This was not inadvertent. See Joint Statement of the American Bankers Association et al. (U.S. Senate, 1973: 236, 251).
18. The Federal Reserve Study reported that in 1983 25% of gasoline stations and 6 1⁄2% of all other retailers provided cash discounts. The cash discounts among retailers other than gasoline stations were concentrated in the lumber and building supply industry, which has traditionally provided cash discounts to builders (Board of Governors: 91).
The surcharge ban was extended for three more years and the offering of discounts was further simplified.

The Senate Report offered a rather feeble explanation for the ban on surcharges.

The Committee believes that permitting unlimited cash discounts and prohibiting surcharges allows the competitive free market to operate. Merchants can utilize two-tier pricing systems and thereby price cash purchases lower than credit purchases, if they choose to do so.

But, they cannot implement two-tier pricing systems which deceive or mislead the consumer. By permitting only cash discounts, the Committee intends to assure that consumers will be seeing at least the highest possible price they will have to pay when they see a tagged or posted price. In other words consumers cannot be lured into an establishment on the basis of the "low, rock-bottom price" only to find at the cash register that the price will be higher if a credit card is used (U.S. Senate, 1981: 4).

The Committee did not explain why a disclosure requirement would not solve this problem.

Reflecting increased skepticism about the ban on surcharges, the Federal Reserve Board was instructed to prepare and submit to the relevant Congressional committees a study of the subject. Nancy Teeters, a member of the Federal Reserve Board of Governors, had testified against the surcharge ban.

The statute undertook to facilitate the offering of cash discounts in two ways. First, the statute removed the five percent limit on discounts. This was represented as the major improvement of the statute. "The Committee believes that if merchants are now permitted to offer discounts of whatever amount they choose, more merchants may offer discounts and the discounts that are offered may be more substantial . . . removal of the 5 percent ceiling should result in the availability of cash discounts" (Id. at 3). This provision responded to testimony that consumers would not accept discounts of five percent because such a discount was insufficient to overcome the advantages of using a credit card, and that merchants had no incentive to offer a discount consumers would not accept. It was not explained why merchants would have an incentive to offer a discount that would make currency (not to say check) purchases more expensive for the merchant than credit cards.

Second, merchants had complained that the Federal Reserve Board regulation requiring the posting of notice of the discount at each store entrance and each place in the store where merchandise could be purchased were too burdensome. The Act repealed the Federal Reserve Board regulations and simply required that "its availability . . . [be] disclosed clearly and conspicuously" (P.L. 97-25 § 101 (July 27, 1981), 15 U.S.C. 1666(f(b))). To preserve the

20. The advantage being the interest-free loan on payment. Interest rates were relatively high in 1980–81. Assuming a two-month float and an interest rate of twenty percent per year, the float is worth 3.33 percent of the purchase price.
Federal Reserve definition of discount, the definitions were incorporated directly into the statute (P.L. 97-25 § 102, 15 U.S.C. § 1602(x) ["regular price"], 15 U.S.C. § 1602(p) ["discount"], 15 U.S.C. § 1602(q) ["surcharge"]). In 1984 the surcharge ban expired. Congress again considered an extension of the ban, along with a bill to exempt a surcharge from the Truth in Lending Act and state usury laws. Both proposals failed to pass (U.S. House, 1984). It was during this consideration that American Express launched its massive mailing. The law as amended in 1981, with a lapsed surcharge ban, remains the law today.

5. CONCLUSION

It is clear that under this legal regime, neither surcharges nor discounts are common in the marketplace other than at the gas pump. Why are they not common? What about the gas pump is different?

As to surcharges, the answer is fairly easy. Although the surcharge ban expired in 1984, the expiration of the ban did not free merchants to offer surcharges. First, the statute prohibited card issuers from barring establishments from offering discounts, but not surcharges. Once the statute carefully distinguished between the two, the prohibition of discount restraints could be read to imply approval of contractual restrictions on surcharges. Second, the statute did not protect surcharges from state usury regulation. The statute does this for discounts, but not for surcharges. And, as if for good measure, some states have enacted explicit bans on surcharges.

21. My guess is that the issuers now impose this restriction on honoring establishments. Such clauses still face antitrust scrutiny, but such a lawsuit is much less likely to succeed now than in 1974, both because of changes in antitrust law, see note 6 supra, and because the subsequent federal and state legislative history would support the argument that there are special public policy concerns about surcharges. I have not found a public source of the contracts between credit card issuers and honoring establishments.

22. In 1984, bills were introduced which would have done this, but the Congressional response was to do nothing, neither extending the ban nor taking steps to facilitate surcharges. The TIL Simplification Act, passed in 1981, dropped the requirement that point-of-sale fees for the use of credit be converted to an annual percentage rate.


The New York statute prohibiting surcharges was held unconstitutionally vague as applied in People v. Fulvio, 136 Misc. 2d 334, 517 N.Y. Supp. 2d 1008 (Criminal Court of the City of New
But why are cash discounts uncommon, or at least why are legal cash discounts uncommon? The required notices of the availability of discounts are rare outside the gas station.

One form of notice would be a notice that offered a discount to anyone paying by currency—the sort of notice one finds at a gas station. But consumers are only going to be able to take advantage of this offer for purchases of a size that can be paid for with currency. In stores that do not take credit cards at all for transactions under a minimum amount, this offer will only have meaning for transactions larger than the credit card minimum and smaller than the amount of cash the customer has in his pocket. This offer is unlikely to involve a large volume of sales, and adds to the complexity of computing charges and collecting payment.

Another form of notice would be a notice that offered a discount for payment by check. Although the statute, the regulations, and the legislative history do not address the problem, it is possible that such a notice could restrict the offer to customers who have satisfied the requirements of some check approval system. But the costs of operating a check approval system are very close to the credit card discount fee, so any discount offered under this system is going to be quite small. Only if the merchant could restrict the offer to customers who present no risk of bad check costs would it be possible to offer a significant discount under this system, but such an offer is hardly the offer "to all prospective buyers" that the statute requires. Need-

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York, Bronx County, 1987). The decision was not appealed, probably because the statute was held unconstitutional only as applied. Another judge had previously held the statute constitutional on its face (i.e., in general). People v. Pulito, 514 N.Y. Supp. 2d 594 (1987). In State by Abrams v. Camera Warehouse, Inc., 130 Misc. 2d 498, 496 N.Y. Supp. 2d 659 (Supreme Court, Duchess County, 1985), the attorney general of New York obtained an injunction and restitution against a mail-order business that had imposed a surcharge on credit card purchasers. The facts of the Pulito case closely parallel the hypothetical situation used by Atlantic Richfield Oil Company in the 1975 hearings to illustrate the lack of substance in the distinction (U.S. Senate, 1975: 35).

24. My experience is that discounts can be most easily obtained in the context of a large purchase where there is some price negotiation already present in the transaction with a person who has authority over price, where the purchaser is well enough known to the seller that there is no risk of a bad check, and where the seller due either to a low volume of business or a lack of sophistication pays a relatively high discount fee. These discounts are illegal because they are offered without satisfying the requirement that their availability be disclosed clearly and conspicuously.

25. It is a shortcoming of the Federal Reserve Study that it contains no data segregated by the size of payment. Board of Governors: 4, Table 4.5, which segregates data between gasoline stations and other retailers, reports a consistently higher percentage of payments in cash for gasoline stations, where average purchase transactions are probably smaller. The data is contaminated, however, by the number of gasoline stations offering discounts for cash in 1983.

26. If, as I suspect, the merchant fees fall as the transaction increases in size, then the saving will nearly disappear in the very transactions where the discount to the consumer might amount to something.
less to say, a notice that appeared to make the offer to all, but was in practice withheld from many would be a source of customer irritation.

Why then have discounts been common in the gas station? The gas station presents an environment where (1) the customer can predict the size of the purchase without initial shopping and (2) all purchases are less than the amount of currency customers commonly carry.\textsuperscript{27}

Based on this brief outline of the relevant legal history, what can be said about the reasons for the credit card industry's opposition to surcharges rather than discounts? First, the notice requirement would not work to constrain a price differential implemented through surcharges in the same way that it works to constrain discounts. A notice of a surcharge on credit card purchases would still leave the merchant free to exercise his traditional discretion over whether to accept checks. This would enable some merchants to offer the convenience of a credit card charge to customers willing to pay the surcharge while effectively reducing the merchant's revenue contribution to the credit card system.

Surcharges, as opposed to discounts, would (as Paul Gewirtz testified in 1975) also change the nature of competition in the credit card industry. Under a discount system there must be a single rate of discount between the price charged to all credit card users and those who pay by check or cash.\textsuperscript{28} Under a surcharge system, it would be possible for merchants to impose differential surcharges based on the particular card being used. Thus, a merchant could impose a six percent surcharge on the user of a travel and entertainment card such as American Express to reflect their traditionally higher discount fee, and a three percent charge on the user of a bank card. A pricing system that exposed this differential would cause charges to move from the higher priced to the lower priced systems. That by itself explains the American Express opposition to surcharges.

\textsuperscript{27} Both the gas station operators, the jobbers, and the oil companies favored making a surcharge legal even though they have been able to use discounts. The oil operators complained of pricing confusion when some but not all oil credit card issuers switched to a policy of imposing a separate discount fee for card paper, arguing that in this situation many stations did not offer a cash discount because they confronted no card fee, but consumers thought they were not offering a cash price. See Testimony of Vic Basheed, Executive Director, Service Station Dealers of America (U.S. House of Representatives: 202).

\textsuperscript{28} That does not mean that a firm determined to undermine a ban on surcharges might not try to do so by—as the two anonymous referees suggested—setting the "tag or posted price" (which the statute defines as the "regular price") at the price charged to the purchaser using the credit card imposing the highest transaction charge, and then offering increasing discounts for other credit cards and then cash. Such a strategy could be challenged as a sham and would raise questions under federal and state statutes that prohibit deceptive methods of competition. See Federal Trade Commission v. Mary Carter Paint Co., 382 U.S. 46 (1965). The almost complete absence of litigation strongly suggests that merchants have not had a sufficient economic interest to challenge these constraints, and the issuers have only needed a plausible threat of legal trouble to suppress the public offering of differentials outside the gas station. The economic analysis in the text explains why merchants have had little to gain from publicly offering favorable differentials for either cash or checks.
But perhaps this explanation is too powerful. Should not the bank card issuers—who would benefit from direct discount rate competition with the travel and entertainment cards—have favored a surcharge, when, in fact, they opposed it? The answer is that the bank cards face competition from still lower priced cards—the in-house credit card. 29 Just as American Express does not want to confront a pricing system—"American Express, 6 percent, Visa 3 percent, 30—Visa does not want to confront a pricing system—"Visa 3 percent, our card 0 percent." 31 Not surprisingly, in-house issuers such as the oil companies supported a surcharge. 32

The other reason card issuers have opposed surcharges but not discounts with a posted notice is that they have been able to obtain some weak consumerist support on this issue. 33 The most favorable way to state the arguments against surcharges is to first argue that there is no difference between a discount and a surcharge, that they are functional equivalents. If this is so, there is no need for both. Instead, there is a need for a uniform convention or practice so that consumers know in any place of business what the posted prices mean in relation to various forms of payment. The focus on a uniform convention for the communication of price information is in harmony with the central idea of the TIL—to promulgate standard, uniform conventions for the communication of interest rates. 34 There was enough consumerist

29. And some of these systems are very big. For instance, in 1984 Sears had 10.7 percent of the total outstanding credit card balances, twice the amount of the next largest, Citicorp. Montgomery Ward was third, J. C. Penney fourth (DeMuth: 223, Table 2).

30. I am indebted to the Barracks Road Texaco Station, Charlottesville, Virginia, for posting such a sign. Until I saw it, I could not figure out why American Express wanted me to take a stand against surcharges.

31. Which is one reason why oil company credit cards cannot be used at the cash pump. In-house credit card systems are not costless, but they do confer benefits upon the issuing merchant. See footnote 11. Of course, there are other competitive options. Barred from competing for customer loyalty through differential discounts, some card systems have been rebating a portion of the merchant discount fee back to the card user through various kinds of premiums or even direct cash rebates.

32. Testimony of John C. Bergman, Amoco Oil Co. (U.S. House of Representatives: 224); Testimony of Milton Schober, Special Counsel on Credit, American Retail Federation (U.S. House of Representatives: 188).

33. In 1975, the Consumer Federation of America opposed surcharges as too confusing for consumers (U.S. Senate, 1975: 119). In 1981, however, not a single consumerist voice testified against surcharges, and the Consumer Federation of America had changed sides (U.S. Senate, 1981: 90). By 1984, when it was finally decided to leave surcharges as they were, i.e., to leave them as finance charges under the truth in lending act and de facto illegal (although at the same time to somewhat ostentatiously not extend the surcharge prohibition), an anti-surchARGE consumerist voice was heard. See Testimony of Carol Tucker Foreman, Chairperson, Consumers Against Penalty Surcharges (U.S. House of Representatives, 1984: 71); Testimony of Richard M. Kessel, Chair and Executive Director, New York State Consumer Protection Board (Id.: 67); Testimony of Maria R. Kaplan, Associate Director of Bankcard Holders of America (Id.: 254). Ms. Foreman did face the problem of explaining why, when she was with the Consumer Federation of America, it favored surcharges (Id.: 90).

34. The Federal Reserve Study cogently summarized these arguments (Board of Governors: 77).
support for this position that the issuers were able to win (or more accurately, preserve) constraints on surcharges. As to discounts, the strategy was similar and almost as successful. Discounts should be allowed, but only if they were fair, which meant that they had to be made available on equal terms to everyone. In none of this history, however, is there any indication that credit card issuers prefer discounts to surcharges. Indeed, the history is clear that when the issuers were permitted to do so, they used contract clauses to eliminate both.

The only evidence this history provides in support of the hypothesis that credit card holders react differently to surcharges than they do to discounts at the time of purchase is the fact that credit card issuers did oppose surcharges even when discounts were legal. However, that opposition can be more plausibly explained by a desire on the part of issuers to obtain a regulatory regime which would suppress any differential. The history does, however, provide support for the hypothesis that people can be persuaded that there is a distinction between discounts and surcharges because of a need to protect consumers by reducing the number of choices they confront, and because surcharges are unfair to credit card holders. In this episode, framing was important in political, not market, interactions.

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