

March 10, 1981

THE CASH DISCOUNT ACT (S.414)

BACKGROUND

On February 24, 1981, the U.S. House of Representatives, by a vote of 372-4, passed H.R. 31, a bill designed to encourage merchants to offer discounts for payment in cash. Two days later, the Senate Committee on Banking, Housing and Urban Affairs passed its version of the bill, S. 414, the Cash Discount Act, by voice vote. A floor vote, scheduled for March 5, was postponed a week at the request of Senators William Proxmire (D-Wis.) and John Glenn (D-Ohio), who plan to offer an amendment.

CASH DISCOUNT ACT

There are essentially two major provisions of the bill, which would amend the Truth in Lending Act. Title I would remove the existing 5 percent limitation on discounts from the "regular price" offered to cash customers. The "regular price" is defined as: 1) the posted price, if only one price is posted, or 2) the credit price, if no price is posted or two prices are posted. Payment by check is considered a cash transaction.

Title II extends the existing prohibition against merchants assessing a surcharge against credit card transactions until February 27, 1984. The Federal Reserve would be required to undertake a study of the effect of credit card transactions. The Proxmire-Glenn Amendment would strike Title II and permit a surcharge to be assessed.

ANALYSIS

The intent of this legislation is to create an environment in which cash customers are not forced to subsidize the purchases

of credit card users. Because merchants must pay credit card companies a portion of sales receipts, typically 3 to 5 percent, the cost of business is higher for merchants accepting credit cards. Since nearly all merchants engage in both types of transaction and offer only a single price, cash customers are often paying a portion of the cost of credit card transactions.

Theoretically, the credit card subsidy could be eliminated by either offering a discount to cash customers (as S. 414 would do) or assessing a surcharge against credit card users (which S. 414 specifically prohibits). In practice, the surcharge would prove more effective.

The preference for a surcharge is based on several considerations: 1) reservations about not only the legislative definition of "regular price" but also the propriety of the federal government establishing it; 2) the desire for the cost of credit, measured not only in finance charges but also in higher prices, to be more explicitly stated; and 3) a surcharge by making the cost of credit more explicit would foster competition within the credit card industry.

Regular Price

As defined in the Cash Discount Act, the "regular price" includes the merchants' cost of offering credit card transactions. The cash discount is subtracted from the regular price. It would be simpler if the merchants were to use the cash prices as the "regular price" (without the benefit of a government-established definition) and, if they choose, assess a surcharge for credit card users.

The "regular price" of S. 414 would rigidify the existing bias between credit cards. The price of a good purchased with a credit card would be the same, regardless of whether the card used was issued by a company charging the merchant three percent or five percent. Holders of more efficient or less costly credit cards would continue to subsidize users of more costly instruments. Such a result is a classic illustration of the pitfalls involved in economic legislation. The fact that the bill is intended to deregulate, or more explicitly assign costs, adds a particular irony.

Transactions Cost

The surcharge would also make credit card users more aware of the total cost of credit. Rather than viewing the credit costs as the opportunity for a discount foregone, a surcharge would present the credit user with an explicit addition to the posted price. Although the opportunity and explicit costs theoretically are equal, the latter would provide a more striking picture.

Competition

As mentioned earlier, the Cash Discount Act would continue or deepen the subsidization between credit card users. The outcome would not only be inequitable but inefficient. Since all credit card users would face the same price, the individual has no incentive to shift to a less costly or more efficient credit card issuer. Again, the result is not consistent with a deregulated, consumer sovereign economy.

CONCLUSION

The Cash Discount Act, as reported by the Senate Banking Committee, resolves only half the issue of the costs of cash and credit transactions. Eliminating the limitation on the size of the discount is a step in the right direction; extending the surcharge ban is not.

Proponents of the ban argue that it is necessary to protect consumers using credit cards. However, there is no evidence, either theoretical or practical, to suggest that merchants will be able to charge credit card users a price higher than that reflecting the true cost, including credit. The competitiveness of the retail industry will protect the interests of all consumers, cash and credit.

Opponents of the surcharge also claim that it is not known how much, if any, subsidization of credit customers by cash customers exists. Thus, the call for the Federal Reserve study.

The study is unnecessary because the market will provide the answer. If there is no subsidization and a merchant assesses a surcharge, his competitors will gain by not instituting a surcharge. If there is a subsidization, and a merchant fails to assess a surcharge, or assesses an inaccurate one, he will lose cash customers. Thus, there is a market incentive to seek out and assess an accurate surcharge.

To permit surcharges, as the Proxmire-Glenn Amendment seeks, would enhance the market's ability to explicitly assign the transaction costs. In conjunction with the unlimited discount, the surcharge would rightly create a two-tiered price system, cash and credit.

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