

A submission to the South African Reserve Bank, 31 March 2021
on the viability of a domestic credit card scheme for South Africa

The statutory implementation of a domestic credit or debit card scheme would not ensure that South Africans receive either better service or lower real costs.

Moreover, a card scheme that receives special regulatory treatment or implicit subsidies would not be a genuine low-cost operator. The incentive structures would run counter to market development and would harm users and competitors alike.

In contrast, a domestic card scheme that emerges naturally and that builds acceptance in a relatively freer market would rightly be beneficial to the finances and to the lives of South Africans.

In the absence of a specifically stated and associated national security concern, there is no compelling reason why a government agency or statutory corporation should wish to initiate the creation or development of a new consumer product. In any such case, the onus would be on the governmental actors to explain:

1. Why they believe such a service is needed.
2. Why that service has not already been offered by private businesses.

In the public interest, answers to both these questions are necessary before proceeding with any such policy action.

The answer to the first question, why they believe such a service is needed, requires also an explanation of how they came to that belief. Are there currently problems or reasonable complaints within the marketplace or with the government's interactions with that marketplace? Or have observers noted the existence of a product or service offered in another country and accepted that as a standard by which to judge the absence of that product from the South African market as a deficiency?

Each of these questions has potentially legitimate answers and, if a need for governmental action is deemed to be warranted, the next question would be whether the government's involvement in that market should be increased or decreased. In the case of the national payment system (NPS), the South African Reserve Bank already plays a central role in the settlement of payments between banks and other financial institutions. This includes a leading role in the prudential regulation and oversight of the operations of, and interactions between, specified categories of financial

institutions as well as their interactions with customers. In the context of this discussion then, the question would be whether a change to that relationship should entail an expansion or a lightening of the Reserve Bank's presence in that market.

The genesis of many public policy proposals can be traced to the lobbying efforts of directly interested parties who expect to be the primary beneficiaries of the policy change. While the promotion of these proposals by the interested parties can be a useful source of information to the relevant government departments or agencies, the expected benefits most often are too narrow to justify government action and would result in a net loss to society, that is, will result in bad public policy. This would likely also be the verdict, for example, if the Reserve Bank were to enter the payment card market as a new card scheme processor.

The direct entry to this market of a central bank, with its innate insensitivity to business costs (and therefore to social costs), would disrupt the market structure and innovative processes for all future card schemes, whether international or domestic.

Similar problems would arise were the Reserve Bank not to enter but to design, and thereby to overdetermine, the market structure of a domestic card scheme. Excessive involvement in market design by the regulatory power risks the proscription of better designs that emerge from entrepreneurial attentions. It would also risk the path-dependent lock-in of a business model that is potentially more dependent on regulatory processes than on market processes for its adaptation to a constantly changing economic environment.

The role of public policy should not be to design a credit card business model but rather to enable those with knowledge, market insight, and innovative drive to test the viability of their ideas in the marketplace. When such people choose not to bring a new product or product variation to market, that reflects their belief that consumers are not ready or willing to use such a product in the form, and at the price, envisioned. The fact that such innovators, along with their investors, must face the uncertainty and bear the cost of failure has caused them to hesitate and thereby to protect not only themselves, but also society, from a loss of resources. Good public policy would respect such decisions and recognize the value of the information generated in the marketplace.

From a policy perspective, the question should not be, "How can we create a domestic card system?" The question should be, "Does our current regulatory structure overburden or hinder the development of financial markets?" If the answer to the latter question is "No," then the marketplace has not recognized a viable demand for such a product, at least up to this time. But if the answer to the question is "Yes," then the appropriate course is to pare back and reform the regulatory system.

The fact that there is not currently a domestic card scheme operating in South Africa is not a sign of what is too often called "market failure". If the financial marketplace is reasonably free from regulatory restrictions, and there are no significant national security concerns, then the absence of a domestic card scheme is a market success. Resources are conserved and directed toward more promising projects that are likely to better serve the current needs of South Africans. But the option would remain, as economic conditions and technology change, for entrepreneurial financial institutions to recognise a nascent market opportunity.

If there truly remains a compelling national desire that there be a domestic card scheme in place, then the most beneficial path would be to remove regulatory and fiscal policy barriers to entry and competition. That is where the greatest gains in social welfare would be found. Reform of prudential regulation is within the purview of the Reserve Bank and reform of the tax system toward greater efficiency would be coordinated through the Department of Finance.

The fact that the card schemes most widely accepted throughout the world originated in, and continue to operate from the United States, suggests a direction (if not a minimum standard) for regulatory and tax reform in South Africa. Standardized measures of economic freedom consistently show that American businesses are less hindered by regulatory restrictions and compliance costs than are their South African counterparts. Similarly, Americans enjoy lower marginal tax rates and commensurately lower tax burdens. Even within the United States, significant numbers of Americans are moving their families out of states with higher state regulatory and tax burdens toward those states with lower burdens. The same response to such incentives applies worldwide.

Once implemented, there is also the distinct risk that the statutory body will:

1. Crowd out competition.
2. Be tempted to use its powers to regulate against or even outlaw competitors in order to “become more efficient” or “become more competitive”, etc.
3. Be tempted to abuse certain citizens or groups of citizens by misuse of the intensely personal information associated with the use of credit cards.

Once again, the statutory implementation of a domestic card scheme would not ensure that South Africans receive either better service or lower real costs. A card scheme that receives special regulatory treatment or implicit subsidies would not be a genuine low-cost operator. The incentive structures would run counter to market development and would harm users and competitors alike. In contrast, a domestic card scheme that emerges and builds acceptance in a relatively free market would rightly be perceived as beneficial to the finances and to the lives of South Africans.

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