Credit and debit card rewards

From their origin in the 1980s to today, payment card rewards programs in the United States have become more and more widespread. In addition, the types of rewards offered for using payment cards have become more diverse, and consumers' return on each dollar spent has been increasing. The word "rewards" implies that the programs are beneficial; nonetheless, one must ask, as economist Fumiko Hayashi does in a recent paper, "Do U.S. Consumers Really Benefit from Payment Card Rewards?" (*Economic Review*, Federal Reserve Bank of Kansas City, first quarter 2009).

There are two main payment structures for card transactions. In one, the card issuer bills the cardholder; pockets the "merchant fee," which averages 1.88 percent of the transaction; and sends the rest of the money to a "merchant acquirer." The merchant acquirer takes a smaller cut of the money and sends the remainder of the value of the purchase to the merchant. Debit cards that require consumers to input a PIN generally charge lower fees than other types of cards. The other type of payment structure is similar to the first but skips the step of the merchant acquirer.

The value of rewards for credit card users is typically around 1 percent of purchases. It is difficult to pinpoint a source of the money that funds rewards programs, but there is evidence suggesting that more generous card rewards lead to greater fees for merchants. If businesses pass on merchant fees to consumers in the form of higher prices, then in fact payment cards are not beneficial to consumers as a whole (because merchant fees are generally a larger percentage of the transaction than are rewards).

Even if more lavish rewards effect higher merchant fees and the elevated merchant fees lead to higher consumer prices, it is likely that some type of rewards structure for payment cards would still be beneficial to society. This is because cash and check transactions also cost money to process. The most efficient card programs likely would include transaction-based fees for cardholders in addition to rewards. The size of the transaction would help determine whether the cardholder pays a fee or receives an award for the transaction. Rewards only maximize efficiency when the benefit to the merchant for conducting the card transaction is superior to the cost of the transaction to the payment service providers. Hayashi acknowledges that more data are needed to make a strong case, but she concludes that available evidence and models indicate that payment card rewards programs currently are too generous and are therefore inefficient.

Regional effects of the most recent recession

What are the likely long-term economic effects of the most recent recession on the Nation's regions? In "How the Crash Will Reshape America" (Atlantic Monthly, March 2009), University of Toronto business professor and urban theorist Richard Florida offers some interesting and well-reasoned speculations in answer to that question. Professor Florida analyzes economic and demographic trends in the major regions of the United States and argues that in the long run, geographic location is still of primary importance to economic growth. For various reasons, which the author attempts to explain, some areas will be hit harder by the recession that began in 2007 than others. In addition, some areas are likely to recover more quickly than others—some will even be strengthened—while others might never fully recover.

Professor Florida begins with New York City, by most measures the world's largest financial center and the place where the financial crisis began. He makes the important point that, throughout modern history, "capitalist power centers" like New York have remained remarkably stable. Amsterdam was the leading financial center in the world from the 17th century to the early 19th century when it was displaced by London. Although the U.S. economy was larger than the British economy by 1900, New York did not surpass London to emerge as the world's largest financial center until after World War II. Because these centers tend to be densely populated urban areas, with high concentrations of educated professionals (financial specialists, accountants, lawyers, and so forth) from various industries, they are very difficult to duplicate elsewhere. As a result, these areas tend to be more economically stable and thus able to endure the effects of recessions better than other areas, where the economies are often more dependent upon just a few industries.

Florida predicts that New York will emerge from the most recent recession economically stronger that it was prior to the downturn. He argues that the portion of the New York economy represented by the financial sector had grown too large during the "recent bubble," and that the shift in jobs from the financial sector to other services will strengthen the economy in the long run. Moreover, the rest of the country will continue to be strongly influenced by the New York economy, and New York will remain the financial capital of the world for some time to come.

The areas of the country that are likely to suffer the worst effects of the most recent recession are the older manufacturing centers, such as the Rust Belt. The U.S. manufacturing sector has declined from about 30 percent of total nonfarm employment in 1950 to about 10 percent currently. Professor Florida argues that other areas, such as the Sun Belt, will also emerge weaker, in part because their recent booms were driven by "real-estate speculation, overdevelopment, and fictitious housing wealth." □