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ATM surcharge bans and bank market structure: The case of Iowa and its neighbors

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Abstract

It is frequently claimed that high ATM surcharges actually attract customers to the banks that impose them, particularly if they operate large ATM networks. By exploiting as "natural experiments" two events associated with the lifting of surcharge bans in Iowa and in the states that neighbor Iowa, this paper seeks to test for the implications of this phenomenon as it applies to the market shares of banking institutions and to several aspects of market structure. Consistent with predictions, results of "difference-in-difference" analyses suggest that the retail account shares of larger market participants increased relative to those of smaller competitors, market concentration increased, and the number of market competitors decreased after the lifting of surcharge bans – all relative to what would have occurred had there been no change in authority to surcharge.
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1. Introduction

When a depositor of one depository institution (hereafter "bank") conducts a transaction using an ATM owned by another institution, the depositor may incur two fees: the so-called foreign fee, levied by the depositor's own bank, and another fee, known as a surcharge, levied by the institution that owns the ATM. This latter fee has been the subject of some

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controversy. In popular commentary in the press and on Capitol Hill, it has been referred to as "double charging", since it represents a second charge on the same transaction.

A more substantive allegation, and one of perhaps more interest to the economist, is the claim that the ATM surcharge provides an example of a price that can actually attract customers to the firm charging a higher price. The reason is that surcharges typically are not levied for the use of a bank's ATMs by the bank's own depositors. Thus, a higher surcharge levied by a bank, particularly one that operates numerous ATMs, provides an incentive for depositors of banks with fewer ATMs to switch their accounts to the bank to avoid the fee. Thus, while a bank's surcharge may discourage the depositors of other banks from using the bank's ATMs (the "direct effect" of surcharging), it may actually encourage them to switch their accounts to the surcharging bank, and there is reason to believe that this "indirect effect", as we will call it, is more pronounced, the larger the number of ATMs that the surcharging bank has to offer ATM users.

The existence of this "indirect effect" has been central to discussions regarding the desirability of bans on surcharges. Some of this discussion has focused on the impact of surcharging on small banks, presumably because of a concern for the state of bank competition in the long run. Because of the indirect effect, surcharging may harm small banks either because it provides an incentive for depositors of small banks to switch their accounts to larger institutions with large networks of ATMs, or because it induces smaller banks to reduce retail fees or increase deposit interest rates to prevent, at least in part, the loss of deposits. As discussed in more detail below, a few recent contributions have sought to assess the broader welfare implications of surcharge bans, taking into account this indirect effect.

This paper seeks to test for the existence of the indirect effect by examining the impact of surcharge bans on the market shares of banking institutions and on several aspects of market structure by exploiting as "natural experiments" two events associated with the lifting of a surcharge ban in Iowa and in the states that neighbor Iowa. The first of these events occurred on April 1, 1996, when the Cirrus and Plus national ATM networks modified their operating rules to allow ATM owners to impose surcharges. Surcharging thereafter spread steadily in the states that neighbor Iowa, but, because of state legislation, the ban remained firmly in force in Iowa. The second event occurred in March of 2002, when a court decision resulted in the lifting of the ban in Iowa as well.

The statistical approach employed is that of a "difference-in-difference" analysis, wherein changes in bank-specific market shares (as well as related measures of market structure) occurring over a period in which a surcharge ban was lifted are compared to equivalently measured changes occurring over the same time period in neighboring states where no change in surcharge restrictions occurred. This approach, though simple, avoids some potential problems inherent in, and at the very least provides a useful alternative to, the more commonly employed structural econometric analyses appearing recently in the literature. Consistent with the presence of an "indirect effect", results suggest that the retail account shares of larger market participants increase relative to those of smaller market competitors, market concentration increases, and the number of market competitors decreases after the lifting of surcharge bans – all relative to the case in which no change in surcharge restrictions occurs.

The plan of the paper is as follows: Section 2 discusses the relevant literature, while Section 3 outlines the "difference-in-difference" analysis employed. Section 4 discusses the empirical model, and Section 5 describes the data and variable measurement. Section 6 presents results, and a final section concludes.

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