Credit Cards and the Reverse Robin Hood Fallacy: Do Credit Card Rewards Really Steal from the Poor and Give to the Rich?
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Introduction

News consumers have been treated to a litany of stories in recent years highlighting the purportedly regressive nature of credit-card rewards programs. The coverage centers on a hypothesis about rewards credit cards: that because merchants pay higher interchange fees for credit cards with rewards and then pass those costs on to consumers, it must be the case that users of cash, debit, and non-rewards credit cards effectively subsidize users of rewards credit cards. This hypothesis presumes that users of rewards credit cards tend to be more affluent than those who pay with cash, debit, or non-rewards cards. It is therefore asserted that this arrangement constitutes a transfer of wealth from poorer consumers to more affluent consumers. As newspaper and website headlines declare:

- "The ugly truth behind your fancy rewards credit card: America's poor foot much of the bill for credit card points, miles, and cash back";
- "How credit card companies reward the rich and punish the rest of us";
- "America's poor subsidize wealthier consumers in a vicious income inequality cycle: the less money you have, the more you spend to just be able to use money";
- "How Much Credit Card Rewards Cost the Poor";
- "Payment Choices Reverse Robin Hood Effect";
- "The Credit-Card Fees Merchants Hate, Banks Love, and Consumers Pay: Growing and largely hidden interchange economy creates 'a giant reverse Robin Hood'".

It isn't just the consumer press that has explored this "reverse Robin Hood" hypothesis. Two working papers from authors at the Federal Reserve Bank of Boston, from 2010 and 2020, likewise argue that credit-card-rewards programs largely benefit higher-income consumers at the expense of lower-income consumers. In response, there have been calls for regulatory intervention in order to redress the harms felt by lower-income consumers due to these supposedly unfair practices.

It is a fundamental feature of retail consumer markets that not every consumer gains the same amount from every amenity or service offered by a merchant. For example, "free parking" at a grocery store or shopping mall benefits wealthier people who are more likely to own cars than lower-income people who do not. Higher-income people are more likely to earn free trips using frequent-flyer miles than lower-income people who travel less. Simply because higher-income people may benefit more than lower-income people from a retailer's loyalty program or some other benefit does not automatically suggest the presence of a market failure or a need for regulatory intervention.

This paper considers the evidence for and against the reverse Robin Hood hypothesis. Much like the original Robin Hood narrative, it is a moralistic story in which one income group benefits at the expense of another. In the original story, the outlaw Robin Hood and his Merry Men rob from the rich and give to the poor. In the "reverse Robin Hood" story, credit-card companies rob from the poor users of cash and give to the rich users of credit cards. But there are real problems with this story. Indeed, the reverse Robin Hood may be more mythical than the original Robin Hood.

Part I describes a strong form of the reverse Robin Hood hypothesis in more detail, focusing on studies published by the Brookings Institution and the Boston Federal Reserve Bank. Despite the popularity of this hypothesis, and the seeming endorsement from scholars, there are many problems with the reverse Robin Hood narrative that should be understood before it used as the basis for public policy. Part I breaks down the hypothesis into a series of conjectures which are considered later in the paper.

Part II subjects this strong form of the reverse Robin Hood hypothesis to economic scrutiny. First, the economics of multisided markets is introduced to provide a basic framework to understand the operation of credit-card networks and the roles played by interchange fees and rewards programs. This framework helps explain that all participants in the credit-card ecosystem benefit from its establishment of complex relationships. Sometimes, this means participants on one side of the platform, such as merchants, pay charges that are used to provide benefits to another side of the platform, such as consumers. But doing so often ultimately benefits participants on the side that pays—for example, by increasing their sales sufficiently that net income increases despite the additional cost. Mandating changes to one part of the system—for example, by capping credit-card interchange fees—could affect other platform participants in unexpected ways, including by reducing benefits to consumers, who make fewer purchases, which results in lower net income for merchants.

Second, the logic of the reverse Robin Hood hypothesis is analyzed in light of those economic principles, as well as the system's empirical realities. Implicit to the conjectures that make up the reverse Robin Hood hypothesis are a number of propositions that must be true for the hypothesis to be upheld. Two main observations falsify the hypothesis. First, merchants are not able to pass on all costs to consumers. Second, the availability of rewards cards is more tied to credit ratings than to income, which means that even those with lower incomes do benefit from the use of rewards cards.

Part III considers a weaker form of the reverse Robin Hood hypothesis from a 2020 Boston Fed Study. This study attempts to establish regressivity by positing a larger "net pecuniary cost" as a percentage of transaction value for lower-income consumers compared to higher-income consumers. But to do so, it must assume a pass-through rate of merchant costs that is inconsistent with known estimates from the empirical literature. While it may be the case that wealthier rewards-card users benefit even more from rewards than those who use them less, this hardly means that there is a harm that demands regulation, any more than it would make sense to regulate access to parking lots because car owners may tend to be wealthier on average than those who commute by public transportation.

Finally, the brief considers the likely distributional effects of proposed legislative or regulatory action to target credit-card interchange fees. Specifically, Part IV considers the evidence related to merchant pass-through of interchange-fee caps in the form of lower prices for consumers, as well as the likely ways banks and other card issuers would adapt to any such fee caps. If the experience with caps on debit card fees under the Durbin Amendment is any indication, the benefits of interchange-fee caps will be much smaller than the costs to consumers, especially lower-income consumers.

Read the full issue brief here.

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