companies are limited in the size of their personal and commercial lending, so they are inhibited from some competition with the banks. The banks do face reserve requirements, adding about 3/8 per cent to their cost of funds, but some trust companies and other small financial institutions can still undercut the credit card rates of the large banks by more than 2 percentage points.

The third reason Canadians might not switch is that they are relatively insensitive to the high interest rate on credit cards. This view is consistent with testimony by some of the non-bank, card issuers who appeared before the Committee. In 1983, Air Canada lowered the rate on its *en Route* card from 24% to 19% and "when we lowered our rate the number of people revolving [maintaining an interest-bearing balance] went down as well." Later, Air Canada added:

> I think it is fair to say that if we lowered our rate to 5% we would not see an upsurge in people revolving ... Similarly, I think if we raised it to 35%, I am not sure that hard core of people would go down.

The representative from Canada Trust, which in June 1986 lowered the rate on its MasterCard from 18.43% to 16.5%, also commented on the apathy of consumers with respect to the rates on credit cards: "... it is not the rate that seems to determine people's decision to carry one card or another. It is something else: convenience, loyalty, perceived value."

There may, of course, be a good reason for the apathy toward credit card rates. Although the rates are high, the dollar amounts of interest charges are small, especially when compared to the interest charges for car loans or mortgages. The most recent survey of Consumer Finance by Statistics Canada showed that the average debt on credit cards in 1984 was $869 . Lowering interest rates by 4 percentage points would save the average credit card debtor less than $3 per month. The average car loan is now about $13,000 and the average residential mortgage loan is about $56,000. A lowering of interest rates by only 1 percentage point would save the average borrower $10.83 and $46.67 per month on these loans.

Consumers are less sensitive to price changes for an item that makes up a small portion of their expenditure. As can be seen from the above, consumers would gain more from 0.25 percentage point drop in mortgage rates than from a 10 percentage point cut in credit card rates. This helps explain why consumers will shop around for the best mortgage deal and why banks follow closely any mortgage innovations by trust companies.

Whatever the reason that Canadians stick with Visa and MasterCard issued by the large banks, the banks can exploit the relationship and maintain high interest rates on credit cards. For those customers sensitive to interest rates changes the banks do compete with their premium or gold cards. Most bank card holders, however, can be treated as a captive group, and the banks will not lose these card holders by maintaining high rates. On the other hand, if the banks lower the rates by (say) 1 per cent they would not increase the number of new card holders or the use of cards by current holders by more than 1 per cent. Lowering rates would lead to lower revenue, not more business.

The banks have almost no incentive to lower their credit card rates. In fact, in May 1986 one bank increased its rate from 17.4% to 18.6%. Only if consumers begin switching from the large banks to other Visa and MasterCard issuers who offer lower interest rates will the banks be under any market pressure to lower their rates.

The Finance Committee grappled with the question: What would be an appropriate interest rate on the credit cards issued by the large banks? Using data supplied by the CBA and the six large banks, the Committee tried several approaches to answer this question. None of the approaches was ideal and the data, as mentioned above, are far from perfect. Nevertheless, the