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Efficiency in the Swedish retail payment system

The project aims at studying the efficiency of the Swedish retail payment system. In the first study of the project, we focus solely on the end-user market where both consumers and merchants buy services from payment services providers.

We start with a simple approach where we assume that all other markets in the economy are perfect, e.g. the market for infrastructure services, i.e. for clearing and settlement of payments. Thus we can disregard second best theory and concentrate the efficiency analysis to the pricing of payment instruments.

A price structure that correctly reflects the underlying cost structure gives consumers correct incentives to use the most cost efficient payment instruments. The basic question then is "How well does the price structure reflect the underlying cost structure?" The question is not less relevant for merchants than for consumers since the price structure that merchants faces is an important factor determining the acceptance for a payment instrument through the size of the corresponding network.

The efficiency condition means that the variable fee associated with the use of a certain payment instrument equals the marginal cost of producing this service, corrected for eventual externalities. Thus our study will focus on the connection between variable fees and marginal costs. However market characteristics such as market structure, different types of externalities, economies of scale and scope, price transparency, service level and the consumers' ability to choose service level need to be considered. In particular, economies of scale in combination with marginal cost pricing may lead to negative profits. A two-part tariff may be called for where marginal costs are covered by variable fees and fixed costs by fixed fees. We are thus also interested in collecting data on fixed fees.

As regards prices to private customers, we have information on variable and fixed fees for the different payment instruments and channels in the major banks. Most of the data collection work will involve gathering information on fees to corporate customers and producer costs. As proxy for marginal cost, we ask for variable costs that arise in the different stages of production of each payment service. These may include for example transaction fees to a central switch network that transmits information on the initiation of a transaction from a payment terminal to the card issuer and acquiring bank, bilateral fees between the banks involved, transaction fees to a central clearing house, to an international clearing network or to the settlement system. They may also include mail costs and costs associated with transactions initiated over the counter. The data is collected separately for each payment instrument, e.g. debit, credit and charge cards, checks, credit transfers, e-money and cash withdrawals. We distinguish also between variable costs that arise in different payment channels in case the same instrument can utilise different channels. For example variable costs for credit

transfers are collected separately for paper based credit transfers, and for those that are initiated through the internet or other electronic media. Total variable costs and transaction volumes are reported for each payment instrument, channel and processing stage. We also ask for fixed costs associated with the production of each payment service or that are otherwise allocated to these payment products. Hopefully we will have collected all the necessary data and finished analyzing it before the end of summer. A preliminary study will then be available by September/October.