



# Distributional Effects of Payment Card Pricing and Merchant Cost Pass-through in the United States and Canada

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Low-income consumers in the United States and Canada pay the highest net transaction costs as a percentage of their purchases.

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Using data from the United States and Canada, we quantify consumers' net pecuniary cost of using cash, credit cards, and debit cards for purchases across income cohorts. The net cost includes fees paid to financial institutions, rewards received from credit or debit card issuers, and the higher retail prices passed on to consumers to cover merchants' payment processing costs. Even though credit cards are more expensive for merchants to accept compared with other payment methods, merchants typically do not differentiate prices at checkout but instead pass through their costs to all consumers. As a result, credit card transactions are cross-subsidized by cheaper debit and cash payments. Card rewards and consumer fees paid to financial institutions are additional sources of cross-subsidies. We find that consumers in the lowest-income cohort pay the highest net pecuniary cost as a percentage of transaction value, while consumers in the highest-income cohort pay the lowest net cost. This result is robust under various scenarios and assumptions, suggesting payment card pricing and merchant cost pass-through have regressive distributional effects in the United States and Canada.

JEL Classification: D12, D31, G21, L81

## Article Citations

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Fumiko Hayashi is a Vice President specializing in payments in the Economic Research Department at the Federal Reserve Bank of Kansas City. Since joining the Federal Reserve in 2001, Ms. Hayashi published studies on the ATM and debit card industry, regulatory developments around interchange fees and card network rules, consumer payment choice, various types of payment methods (including credit, debit, and prepaid cards, mobile and QR code-based payments, instant payments, and central bank digital currency), payment fraud and security, nonbanks and fintechs in the payment system. She is currently conducting research on undeserved consumers in payments, fraud and scams involving instant payments, role of intermediaries in the payment system modernization, among others.

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