

Do Premium Payment Methods Increase Effective Retail Prices?*

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January 14, 2020

Abstract

In this study we develop a tractable, yet general, framework to explain whether premium payment methods that impose no-surcharge rules are beneficial. This question is fundamentally related to policy and we provide a robust answer by considering how a variety of market structures are impacted by multiple payment methods. We find that the no-surcharge rule, which suggests uniform pricing to consumers, results in consumers paying different effective prices depending on their payment method. Instead, surcharging, which gives the impression of price discrimination, actually results in consumers paying the same effective price across payment methods. Most importantly, we also show that all consumers and all merchants earn greater surplus when surcharging is allowed. Furthermore, our results are robust across market structures suggesting that protected premium payment methods are generally harmful except for the credit card industry.

Keywords: Payment methods, credit cards, online shopping, merchant fees, consumer rewards, Ohio v.s. American Express, conduct parameter

JEL Classifications: L10, L20, L42

*TBW