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Abstract

Cash is still widely used in Colombia, even among merchants that accept payment cards. Indeed, 60% of these merchants use dissuasive strategies to make their clients pay with cash. This shows that merchant service costs (MSC) for cards are not optimal in the sense of the Tourist Test. We present estimates of MSC compatible with the Tourist Test, such that merchants are indifferent between being paid with cash or cards. We find that cash is less costly than cards at the average retail-sales transaction-value, hence there is no positive optimal MSC at this ticket value. For the average card transaction ticket, the optimal MSC would be positive but far below the rates charge by the industry (0.74% in a short-term scenario). Yet, the additional incentive that sales-tax evasion provides to cash payments reduces the Tourist Test MSC to 0.44%. Our estimates for long-term scenarios yield even lower optimal MSC. A reduction in MSC fees that strikes a middle ground between these figures should discourage merchant strategies that deter consumers from paying with cards. These results should be taken as a guideline as the estimations depend on the underlying assumptions and only consider the merchant's side of the card industry.