Price Regulation of UPI

Published On: 05-11-2022

What is Unified Payment Interface (UPI)?

The Unified Payments Interface (UPI) is a new system developed by the NPCI and the RBI to aid instant transfer of money using a cashless system. Using UPI services, one just requires a smartphone and a banking app to send and receive money instantly or to pay a merchant for retail purchase. In the long run, UPI is likely to replace the current NEFT, RTGS, and IMPS systems as they exist today. Objective is to provide an infrastructure for next generation payment option in Indian languages through Universal accessibility of Internet and data.

UPI is launched by National Payments Corporation of India (NPCI) for enabling swift payment of goods and services and fund transfer.

The interface is based on the Immediate Payment Service (IMPS) platform. The UPI app merges several banking features, facilitating seamless and secure fund transfer and merchant payments at single platform. It also allows Peer to Peer collection request.

What is Price Regulation?

Price regulation is the practice of governments dictating how much certain commodities or products may be sold for both in the retail marketplace and at other stages in the production process. Most common when monopolies or utilities are involved, price regulation sometimes occurs with other products or commodities, either as a specific measure of control or as an emergency economic measure. Supported by many who claim there are products that should be accessible by everyone, price regulation is opposed by others who claim that price regulation stifles investment and innovation. Most developed nations, then, regulate the prices of those commodities that are deemed essential, especially when their distribution is controlled by a small group of companies.

Why might a regulator want to intervene in the price setting of the payments market?

- Goals of financial inclusion or viewing digital payments as a public good.
- Addressing market failures such as the presence of dominant firms or externalities.

What are the challenges associated with intervention in the price setting of the payment market?

In the case of UPI, the government subsidises the operational costs of facilitating UPI transactions, which is reportedly inadequate. In January 2022, the Payments Council of India reported that the industry expected a loss of Rs 5,500 crore. This to be the best allocation of limited government resources.

Merchant discount rate on UPI payment is 0.25%. It is not reasonable. MDR cap is set at 0.9 percent for debit cards and an MDR of 2 per cent being proposed for RuPay credit cards on UPI.

There are behavioural challenges in moving from zero MDR to a positive MDR. Anchored at a zero MDR since January 2020, merchants with thin margins may hesitate to accept an increase in MDR.

What is Merchant Discount Rate?

MDR is charge or fee imposed on merchant by bank for accepting payment from their customers in credit and debit cards every time card is used for payments (like swiping) in their stores. MDR charges are usually shared in pre-agreed proportion between them and are expressed in percentage of transaction amount. MDR compensates bank issuing card, bank which puts up swiping machine (Point-of-Sale or PoS terminal) and network providers such as Mastercard or Visa for their services.

How Price Regulation Works?

In order to understand how and what to regulate, we borrow from the rationale followed for other two-sided markets that exhibit cross-platform externalities. Simply put, consumers benefit more if the size of the merchant network accepting a payment instrument (for example, debit cards) is larger and, at the same time, merchants benefit more if many consumers use debit cards. Card networks like Visa and Mastercard compete for banks, usually not too many, to issue their cards. Since the acquiring bank must pay the interchange fee, they recover these costs from merchants. In most jurisdictions, the interchange fee is regulated to prevent banks from charging exploitative rates and the MDR is left to be commercially determined. This is also done for administrative ease, since banks are fewer, while monitoring bank-merchant contracts can be onerous.