Korea’s Experiment with a
Targeted Payment Scheme for Small Businesses

Gongpil Choi

The so-called “Zero Pay” is a state-promoted mobile payment system in Korea, designed to lower credit card processing costs for small merchants and business owners. The local government decided to roll out this scheme to support small vendors saddled with hefty payment processing fees from extensive use — perhaps too much — of the credit card. It also aims to usher in a new phase for Korea’s payment ecosystem which is currently structurally monopolized by a certain few. For so long, the consumers in Korea have been very much accustomed to using credit cards that provide various rewards and discount benefits, and this is hitting hard the small merchants and businesses with little market power. Against this backdrop, the government has stepped into implementing the mobile payment scheme.

There is no doubt that the proposed zero pay system is motivated with the good intention of the government, but public interest and consumer reaction remain weak. One reason behind is the fact that another form of socially motivated participation and cost are after all inevitably required when opting out VAN and PG that mediate the payment process. Cost reduction generated from ruling out traditional intermediaries is engineered by the authority, who can ask banks and other participants to bear the costs of running an alternative system. Essentially, zero-pay is a misnomer since costs cannot be zero, which are taken by other participants including customers. The proposed plan is a redistributive scheme to help benefit a specific group at the expense of other participants with possible erosion in social capital that gets unnoticed with public intervention.

The issue of government market intervention has stirred a quite severe controversy about the role of government in a market-driven economy. The point is: the market is operated based on participation and choice, and the involvement of “ultimate trustee” could bring about unexpected distortions and frictions that may well be greater than the benefits of the targeted group. That is, the question of incentives (e.g., income tax deduction) immediately arises, followed by the issue of Zero Pay’s overall impact on the payment service market regarding its
benefit and cost allocation structure. To be specific, the indirect benefit of Zero Pay entailed by its near-zero transaction fee is not entirely free from the issue of fairness, which would right away be problematic when direct benefit is targeted to a specific group or class; and its complicated cost allocation structure demands a pan-societal engagement by all users, taxpayers, direct and indirect participating entities.

Now is thus timely to ruminate whether continuing the effort for wider adoption of Zero Pay would be rational: the sources of cost reduction hinge on agreements by diverse market participants. The main issue here is that the cost reduction effect on small businesses is relatively modest compared to the excessive adjustment cost of the majority, and the 40% income tax exemption to offset those losses encounters the nontrivial matter of social fairness. Also, the cost allocation structure per se is so complex that it will significantly influence the overall payment and settlement system by distorting market incentives in one way or the other. On top of all, extra incentives that users mostly care about — convenience and fringe benefits — are hard to be found due to the nature of state-led service having the limited market link, which makes Zero Pay even less attractive.

With this backdrop, the stronger and compensatory promotion of Zero Pay after its dismal debut with poorly prepared incentive structure will end up being even more counterproductive, ironically separating the support target from the market. By acknowledging the reality that our market is an ecosystem built upon voluntary choice and self-interest, it is not difficult to see that the possible benefit from reducing transaction fees by removing the payment intermediaries is quite limited.

Nevertheless, payment eco-system needs to evolve to be more inclusive and open. In this context, the state-sponsored mobile payment system, whether successful or not, leaves us with some significant implications for the market turning more and more digitalized:

Public intervention in market functioning is only justified in extreme cases. Even with compelling needs to correct social problems with market underpinnings, public support should only be carefully used as a social policy tool because it involves many unintended distortions. The mentality or mindset that government has all the tools to correct market failures is wrong. In fact, participants in the private sector should be the primary one taking responsibility to deal
with market friction and failure by coming up with various incentives. Whenever a public agency steps in to address market failures or conflicts, the aspect of accompanying costs will not be reflected correctly in the process of resource allocation, and it is the general public and future generations that would have to take the consequences. Market frictions can be reduced not by public intervention but by fostering a competitive environment that introduces self-correcting and efforts to incentivize behavior compatible with an inclusive mechanism design.

Second, the QR code paying method of Zero Pay is undoubtedly simple, but its merit is not enough even considering the complicated tax benefit. Some privacy issues remain and supplier-oriented paradigm needs retooling on a grand scale, but convenience is also critical. Several simple payment services interworking with credit card services are already out in the market, and they are progressing every day for a more ultramodern UI and UX. Moreover, we should also leave space for a new payment service that mirrors the interest of elderly citizens, small merchants and business owners who are still at the other side of the digital divide, who prefer the use of cash over other means of payment.

Lastly, it is almost impossible for a government alone to cover all incentives for Zero Pay when credit card takes up a prodigious 80% of the total payment nation-wide. To breed it to a competitive payment service, public institutions such as banks and other institutions also need to participate in the scheme, providing additional incentives other than tax exemption. To be of practical help to the small merchants and businesses, the public sector should foster a market environment that encourages private players to develop more mobile payment methods. In that sense, it would be reasonable to reallocate the KRW9 billion budget for Zero Pay promotion as a government subsidy to social enterprises attentive to the advantage of small vendors.

Summing up, inclusive market development is possible when more private players voluntarily participate and compete. For that to take place, the public sector should create an open environment rather than directly get involved in the market through direct, targeted incentives. The government would instead pursue a paradigm shift from the existing legacy system, offering a hand to more new social ventures or start-ups to join the win-win competition with their payment services.