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FEDERAL TRADE COMMISSION
Washington, DC 20580

COMMISSION AUTHORIZED

BUREAU OF ECONOMICS

April 21, 1988

The Honorable Elizabeth E. Randall
Majority Whip
The Assembly
State of New Jersey
Trenton, New Jersey 08625

Dear Ms. Randall:

The staff of the Federal Trade Commission is pleased to provide the following comments[1] in response to your request of March 31, 1988, for our views on four bills[2] that would allow self-service gasoline marketing, currently prohibited under New Jersey law. We believe that New Jersey consumers stand to gain millions of dollars per year in lower prices if self-service stations, the predominant method of gasoline retailing in all but one other state, were legalized. The safety concerns that may have given rise to the prohibition of self-service four decades ago appear to have long been addressed through improvements in technology and government safety standards. Further, fire safety insurance rates do not appear to reflect any significantly increased risk from self-service outlets. Finally, there does not

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[1] These comments represent the views of the Federal Trade Commission's Bureaus of Economics, Competition, and Consumer Protection, and not necessarily those of the Commission itself or any individual Commissioner. The Commission has, however, with Commissioner Azcuenaga dissenting, voted to authorize the staff to submit these comments to you.

[2] These bills are Senate Bills 815 and 2321, and Assembly Bills 813 and 1385.

seem to be a good reason to limit the hours when self-service islands can be open, as one of the proposed bills would do.[3]

The Federal Trade Commission (Commission) is an independent agency with the responsibility for enforcing the Federal Trade Commission Act,[4] which prohibits, among other things, "unfair methods of competition." The Commission seeks to promote competition in energy markets, as evidenced by numerous law enforcement actions, and in statements filed with various government and regulatory bodies. For example, Commission comments as well as FTC staff comments and testimony have identified the costs of divorcement and "below-cost selling" laws before legislatures in Nevada, Georgia, Hawaii, South Carolina, North Carolina, Washington, and in the United States Senate and House of Representatives.[5]

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[3] Senate Bill 815 would not allow self-service between 9:00 a.m. and 5:00 p.m. Senate Bill 2321 would allow self-service at all hours, but would require all retailers to offer a full-service option between 9:00 a.m. and 5:00 p.m. The other two bills (Assembly Bills 813 and 1385) would not restrict self-service hours in any way.

[4] 15 U.S.C. 41 et seq.

[5] See letter to Nevada Chairman Randolph Townsend, Assembly Bill 420, "A Bill to Establish Divorcement by Gasoline Refiners of their Retail Gasoline Outlets," April 22, 1987; letter to Georgia Governor Harris on "Retail Gasoline Divorcement Bill," March 18, 1987; letter to Peter Apo, Hawaii House Bill 1376, "A Bill For An Act Relating to the Retail Sale of Gasoline," December 23, 1985; comments on South Carolina House Bill 2663, "Motor Fuel Marketing Divorcement and Below-Cost Sales Bill, May 14, 1985; comments on North Carolina "Motor Fuel Marketing Act," March 27, 1985; comments on State of Washington, Senate Bill 3418 and House Bill 329, "An Act Relating to Retail Practices in the Sale of Motor Vehicle Fuels," March 22, 1985; Testimony before the Subcommittee on General Oversight and the Economy of the United States House of Representatives on House Resolution 3824 "Motor Fuel Sales Competition Improvements Act of 1985," April 17, 1986; letter to Chairman Strom Thurmond, Committee on the Judiciary, S. 1140, "Motor Fuel Sales Competition Improvements Act of 1985," July 9, 1985.

In the comments below, we review evidence on a possible safety-related rationale for the existence of a self-service ban. We next discuss evidence that the ban on self-service imposes significant costs on New Jersey consumers, who annually pay millions of dollars more than necessary for the purchase of gasoline. Finally, we discuss policy options and present our conclusions.

Safety-Related Rationale

The current statutory prohibition on self-service gasoline stations in New Jersey was adopted in 1949, explicitly for fire safety reasons.[6] At that time only a few states permitted self-service gasoline sales and such sales represented a very small fraction of all gasoline dispensed. Since then, there have been significant technological and safety improvements in self-service dispensing. The number of states allowing self-service increased accordingly, and, at present, self-service retailing is permitted in 48 states and the District of Columbia. Consumer preference for self-service has increased dramatically as well, especially during the 1970's. It is estimated that 78 percent of all gasoline sold nationally is now sold through self-service.[7]

A government ban on an activity for safety reasons is only appropriate if the unregulated market fails to provide adequate safety protection, and if a ban is one of the least-costly and most practical remedies for the problem.

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[6] N.J.S.A. 34:3a-1 et seq.

[7] National Petroleum News Factbook, 1987.

There does not appear to be any safety-related "market failure"[8] that would justify continuing the present ban on self-service in New Jersey. Any potential under-provision of safety appears to have been remedied in other states through technological improvements[9] and through governmental regulations that are less restrictive than a ban on self-service.

The risk of fire does not appear to justify a prohibition of self-service retailing. The National Fire Protection Association (NFPA), a private standards setting organization whose determinations are used as the basis of most local codes, explicitly sets standards that allow self-service operations. A 1974 NFPA report found self-service establishments to be safe when certain basic procedures are followed.[10] Additional evidence of the safety of self-service stations is provided by the practices of liability insurers. Phone surveys[11] show that self-service stations do purchase insurance and,

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[8] A "market failure" would only exist if the free market, left to its own devices, would disregard or give inadequate consideration to safety.

[9] These improvements include: 1) dispensing pumps that cannot be turned on by the customer unless the cashier authorizes; 2) nozzles with automatic safety fill shut-off and a shear-off spout that provides additional spill protection; 3) hose break-away couplings, which protect against accidental drive-off spills, and 4) an "emergency stop" safety feature which provides for immediate gas shut-off in the event of an accidental spill that the customer fails to handle.

[10] Discussions with NFPA officials verified that NFPA had, in the early 1970's, dropped its previous position against self-service gasoline retailing in light of technological and safety-related improvements in dispensing. These conclusions are discussed in the 1974 NFPA report, which is currently unavailable.

[11] We received information about insurance rates for full-service vs. self-service gasoline stations from 9 insurance companies in the Washington, D.C. area. The companies contacted included Capitol Hill Insurance Agency, Genson Donald K. Inc. Insurance Agency, Selective Insurance Company of

further that insurance companies do not charge higher fire insurance premiums to self-service retailers.[12] Thus, it would appear that safety concerns that underlay the initial ban on self-service in New Jersey are not a significant problem today.[13]

In sum, the experience in 48 states and the District of Columbia offers little reason to believe that consumers are subject to significantly increased danger from self-service, provided proper rules and regulations are followed

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America, St. Paul Fire and Marine Insurance Company, Safeco Insurance Company of America, FSG Underwriters LTD, Cigna INA, Cartwright William T. & Associates, and Crawley and Thomas Insurance Inc. Individuals were contacted by phone on April 8, 11, and 12, 1988. Since firms in the insurance industry base their rates on information provided by the Insurance Service Office (ISO), Ann Lavy, an employee at the ISO, was contacted on April 12, 1988, to corroborate our findings. The ISO provides information to the industry on risk rates for different classes of customers.

[12] There is some indication from our survey that liability insurance rates do differ between full-service and self-service or combination stations. Two insurance companies charge liability insurance rates that are approximately 30 percent higher for self-service and combination stations than for full-service (although several other companies had no such rate differential). However, we were informed that these rate differentials are not based primarily on fire-safety concerns, but rather on more general risks. One such risk, for example, occurs because consumers might be injured when they get out of their cars. To the extent that such insurance rate differentials exist, they indicate that, although the market perceives some additional risk (and, therefore, cost) associated with self-service, these costs are low enough that self-service stations have been able to survive and prosper, as evidenced by their rapid growth in other states.

[13] There are also potential health-related aspects of self-service gasoline retailing. To the extent that breathing gasoline vapors represents a health hazard, the existence of self-service presumably increases the (occasional) exposure of consumers using self-service while decreasing the number of gas station attendants subject to constant exposure. The net health effect of such a redistribution of exposures is unclear.

by retailers. Therefore, a ban on this retailing option would appear to be excessive.

Effect of Self-Service Ban

Because the New Jersey ban does not appear to be necessary to correct any significant safety problem, the primary beneficiaries of the regulation apparently are incumbent gasoline retailers who are able to keep a proven efficient form of gasoline retailing out of the market. By contrast, New Jersey consumers and visitors are clear losers. They are denied access to a lower price service that is now preferred by most consumers across the country.

It is possible to approximate the added expenditures incurred by New Jersey consumers due to the self-service ban by examining the behavior of consumers in nearby northeastern communities where self-service is an option. The annual National Petroleum News Factbook(s) provides information on the percentages of retail gasoline purchases made on a self-service basis for the following five locations over the period 1983-1986: Baltimore, Boston, Long Island, Philadelphia, and Providence. Taking the simple average percentage for these five areas as an indicator of likely hypothetical New Jersey consumption patterns, we estimate that 59 percent of the gasoline purchased in New Jersey would be bought on a self-service basis if that were a permitted option.[14]

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[14] This may be a conservative estimate since it is well below the national average of 78 percent.

Using data from the same five areas, we can also estimate for New Jersey the likely premium that would be paid for full-service over self-service if self-service were not banned. A study of retail gasoline prices using the Lundberg Letter data,[15] adjusted for differences in gasoline taxes, has produced a data series on the full-service premiums for the five areas.[16] The study indicates that the full-service premium for New Jersey would be 17.0 cents for a gallon of leaded gasoline and 16.8 cents for unleaded. This implies that New Jersey consumers, as a result of the prohibition against self-service, pay more than 16 cents per gallon extra for 59 percent of the gasoline they purchase.[17]

Finally, using this data, we can estimate the total additional consumer costs attributable to the self-service ban. Taking 59 percent of the 3.5 billion gallons[18] of gasoline purchased in New Jersey in 1986 yields an estimate of over 2 billion gallons of gasoline that would have been purchased in New Jersey on a self-service basis but for the ban. The U. S. Department of Energy estimates that 69.1 percent of the retail gasoline

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[15] The Lundberg Letter is a privately published source of petroleum pricing information.

[16] Putnam, Hayes & Bartlett, Gasoline Prices in Maryland Following Divorcement (1987).

[17] The estimated 16 cents/gallon price premium may overstate somewhat the current price raising effect of the self-service ban in New Jersey if New Jersey's full-service stations presently enjoy economies of scale, due to specialization in full-service that are not possible in states that allow self-service.

[18] See 1987 National Petroleum News Factbook, which lists New Jersey as the ninth largest state in consumption of gasoline in 1986.

consumed in the United States is unleaded.[19] Applying this number to the 2 billion gallons, and then multiplying by the estimated leaded and unleaded full-service premiums yields an estimated increased payment by New Jersey consumers of $108.5 million for leaded gasoline and $239.7 million for unleaded. Taken together, we estimate that the self-service ban causes New Jersey consumers to pay an additional $348 million each year for the purchase of gasoline.[20]

Because full-service has some value even for potential self-service consumers in New Jersey, this sum cannot be regarded as a pure loss to these consumers. However, the fact that 78 percent of all gasoline is sold in other states on a self-service basis suggests that most consumers value the monetary savings of self-service more than the added convenience of full-service. Thus, it is clear that the ban does have a substantial impact on the gasoline retail market, and that it imposes a heavy monetary burden upon New Jersey consumers.

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[19] See 1987 National Petroleum News Factbook.

[20] An alternative estimate may be calculated using very conservative assumptions. Instead of using the five area averages, one may instead select the lowest full-service premiums (those of Long Island) of 8.35 cents for leaded gasoline and 8.62 cents for unleaded. One may also select Boston's percentage of self-service customers, which, at 44 percent, is the lowest of the five areas. Under these assumptions New Jersey consumers can be expected to pay an additional $131 million each year because of the ban on self-service. Thus, while the estimates are sensitive to the assumptions one adopts, the ban against self-service has a substantial negative impact on consumers even under extremely conservative assumptions.

Policy Options and Conclusions

The current ban on self-service stations in New Jersey appears to impose substantial costs on New Jersey consumers that are not likely to be offset by justifiable safety-related concerns. Thus, the net effect on consumers of Assembly Bills 813 and 1385, which would completely repeal the ban, should be positive.

Additionally, limiting self-service hours to the period between 5:00 p.m. and 9:00 a.m., as envisaged by Senate Bill 815, would reduce the advantages offered by complete repeal. Such a plan would deny a self-service option to all consumers during most of the daytime hours, imposing large consumer costs.

A possibly less restrictive alternative to Senate Bill 815 is Senate Bill 2321, which would allow self-service at all hours, but would require every dealer to offer a full-service option as well between 9:00 a.m. and 5:00 p.m. However, this alternative, relative to a repeal of the self-service ban, might raise the cost of a full-service station contemplating changeover to self-service, such that conversion would not be economic. Further, this alternative could impose an additional (perhaps substantial) cost on stations whose economic advantage lies in being low cost-high volume self-service-only outlets. The need to hire extra help and order additional supplies to maintain a service option for a few hours a day could be extremely burdensome and could raise the cost and price of gasoline (both for self-service and full-service retailing options) at such stations. It might be more economically efficient to permit stations to specialize according to their particular competitive strengths. This is particularly true since there is no reason to believe that full-service stations will disappear as long as there is a demand for them.[21]

Evidence indicates that safety problems associated with self-service stations do not appear significant, and that self-service gasoline retailing offers large potential savings to consumers. For these reasons, we believe that consumers and visitors in New Jersey would benefit substantially if the ban on self-service retailing were repealed.

Sincerely,

David T. Scheffman

David T. Scheffman
Director
Bureau of Economics

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[21] On the other hand, there might be a benefit to having every station preserve some service option to the extent that consumers cannot easily "search" for stations with their preferred option. Elderly or disabled persons, or tourists, may, for example, benefit from each station maintaining a service option. However, it is not clear that this would require maintenance of a full-service island reserved exclusively for that purpose.