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SENATE BUDGET & APPROPRIATIONS COMMITTEE
ASSEMBLY BUDGET COMMITTEE

TESTIMONY

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FY 2021 BUDGET

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SUBMITTED ELECTRONICALLY

Testimony of Sal Risalvato

Chair Sarlo, Chair Pintor Marin, members of the Committees, my name is Sal Risalvato, Executive Director of the New Jersey Gasoline, Convenience Store, Automotive Association (NJGCA), which represents nearly a thousand independent small businesses across this state. I have two important issues to address with you.

Firstly, I would like to address the Governor's proposed 61% increase in the cigarette tax, from $2.70 to $4.35 a pack.

This tax increase would be a huge hit to small businesses at a time when they are struggling to find the money to survive. Over 90% of our members have received federal Paycheck Protection Program (PPP) loans and about half have so far applied for Federal Economic Injury Disaster Loans (EIDL, which do have to be paid back). Our members have correctly been designated as essential businesses and most have kept their doors open throughout this crisis. Despite that, they have seen massive drops in business, and are barely surviving. Some have indicated to us that they may not survive. When we surveyed our members in mid-April, 61% of c-stores said they had seen at least half of their sales disappear, with many of those experiencing losses approaching 80%. When we surveyed them again at the end of June, 73% were missing at least 25% of their sales (which itself is normally a disaster) and a third were still missing the majority of their sales.

In addition to the pandemic, this increase will come on the back of the recently announced massive hike in the tax paid on motor fuel, which will jump 9.3¢ a gallon and make our tax rate higher than New York's and the fourth highest in the nation. These small businesses have been struggling to pay the ever-increasing minimum wage with a business model that can only exist on thin profit margins; margins which are constantly being pushed lower by aggressive competition from big corporate chains. Because of the aggressive price cutting from the big chains, small businesses make very little money per pack of cigarettes, often not enough to justify staying in business. They offer them for sale as a way to draw in customers and sell them higher margin items. This is not a small component of the business model either—tobacco products are the largest single category of sales at most of the nation's convenience stores. Data from the National Association of Convenience Stores shows they are often more than a third of a store's total sales.

The previous revenue estimate from Treasury included a prediction that this increase will lead to an immediate 12% drop in cigarette sales within the state's borders. Has the Treasurer also factored in the decline in sales tax and income tax that will result from these lost cigarette customers not also purchasing other items? I expect there even be a hit to lottery ticket sales as fewer customers make trips to NJ c-stores, which puts the State's ability to fully fund the public employee pension system into question.

This tax increase will create significant losses to the benefit of out-of-state retailers. For years we lost sales to Pennsylvania because of how much lower their cigarette tax was. Finally, in 2016 they raised their tax to be almost exactly even with ours. In the years since we have been able to pick up extra revenue from the cigarette tax as New Jerseyans near the PA border started making their purchases in NJ again. All those sales will be instantly lost again if we give PA back a huge price advantage. According to the Mackinac Center for Public Policy, Pennsylvania's net smuggling rate grew from -2.0% in 2015 to 14.7% in 2017. Delaware's outbound rate jumped from -20.3% to -40.6%.

Our businesses near the borders of New York will also see a steep drop if we raise our tax to be equal to New York's because New York state residents will no longer see any value in making their purchases here in New Jersey, where they support our small businesses and our state budget. In fact, the Mackinac Center has determined that the net smuggling rate for cigarettes in New Jersey is now effectively zero, meaning we sell as many packs of cigarettes to out-of-state residents as we lose from our residents buying packs in other states or packs smuggled in from lower tax jurisdictions. New York's smuggling rate (whose tax rate this proposed budget wants to match) is an astounding 55.4%, meaning a majority of the cigarettes smoked in New York come from out of state, and therefore that State collects $0 in taxes from them.

In Delaware the cigarette tax rate is just $2.10 a pack and their sales tax is zero, with this proposed increase every carton of cigarettes will be at least $29 less in DE than in NJ (and their gas tax will be 27.7¢ a gallon less than ours too). Drive a little further into Virginia and the tax advantage will save $45 per carton. I have no doubt that many will not need to make that drive, as there will be organized criminals willing to make it for you, with the profits they derive being used to fund all manner of illicit activities. These higher taxes will also stimulate demand for untaxed counterfeit cigarettes smuggled in from China, which have been found to be manufactured to such low quality that they are significantly more dangerous to the smoker's health than legitimate-brand cigarettes. Every cigarette sale made in another state hurts small business, hurts the state budget, and provides no benefit to the public health.

Even with no tax increase, I expect the State will see a meaningful drop in cigarette sales in the coming year because of the ban enacted earlier this year on all forms of discounts, coupons, rebates, and price promotions tied to tobacco products. The promotions have already resulted in higher prices for cigarettes and virtually all other tobacco products.

This tax increase, combined with the gas tax increase, will be a one-two punch to small retailers and the customers they serve. Both will fall hardest on those residents who can least afford to bear the added burdens leaching from their paychecks. If you cannot stop this gas tax increase, I ask that you at least stop this tax increase.

Motor Vehicle Inspections

The second issue I want to address is a request very different from just about everyone who has submitted testimony. Every year for the last several years I have testified about this issue and have done so after listening to hours of public testimony from advocates and parents pleading for tiny increases in funding to numerous worthy causes. I have been, to the best of my knowledge the only person to come before these committees as part of the budget process with a proposal to **SAVE** the state budget millions of dollars per year.

I am not asking you to increase funding for anything, I ask you to fight for a change that will **save the State over $35 million per year**, while also benefiting over a thousand independent small businesses statewide.

The change we would like to see is an alteration to the state's motor vehicle inspection program. Motor vehicle emissions inspections are mandated by the federal government for certain areas, including all of New Jersey. Over the last twenty years, almost all states have shifted toward a completely decentralized model, in which motor vehicle inspections are conducted by private independent businesses, overseen by a private contractor.

New Jersey operates the nation's only remaining "hybrid" program. If motorists go to a Central Inspection Facility (CIF), the inspection is conducted by the Parsons Corporation and the State is billed for the cost of the inspection. If the motorist goes to one of the state's 1,200 licensed Private Inspection Facilities (PIF), they are responsible for paying the shop for the inspection.

The chief purpose of a hybrid system is to gradually ease into creating a fully decentralized system. Today, almost all states operate decentralized systems, including our neighbors New York, Pennsylvania, Connecticut, Massachusetts, and Rhode Island. I propose that we follow the lead of our neighbors and adopt a decentralized program.

Over the last two years, we had a unique opportunity to restructure this program due to the flawed handling by the previous Administration of the transition from the contract currently in effect (a 5-year contract with an optional 3-year extension that started over 12 years ago) to a new contract and new program. When MVC testified to the Senate Budget Committee in May of 2019, they expected to unveil their new version of the contract by the end of that month. When the contract finally came out more than three months later, the "next-generation" program was almost completely identical to the current program. It called for bids from contractors to be submitted by November 7, 2019, a due date which has been extended seven times and currently sits at October 9, 2020.

Five years ago, MVC Commissioner Ray Martinez told the Assembly Budget Committee "I'm pleased to report that we are in the final stages of putting an RFP out. We don't anticipate a delay in that contract which will expire in 2016. There are no extensions available to us." In 2016 the Commissioner told this Committee that "hopefully Treasury will award a new contract in the coming weeks."

This entire experience has been extremely frustrating. For over a decade the last two Administrations and the last five sessions of the Legislature have been in a nonstop fiscal crisis squeezing funding from all the worthy causes that come before you at these public hearings, and from dozens if not hundreds of worthy causes who have given up hope and don't even bother to show up and complain anymore. Had my recommendation to close the CIFs (following the lead of almost all other states and the advice of virtually all experts on the issue) been followed back in FY 2010, the **total savings for the State of New Jersey would amount to approximately $450 million** through the end of the current fiscal year. Think of all the good causes that money could have gone to, instead it has flowed into the pockets of the multinational Parsons Corporation.

Recent events have only made the need for this change more apparent. The reopening of MVC facilities has been met with a pent-up demand that has completely overwhelmed the Commission. Motorists are literally camping out overnight in order to have a chance of getting serviced. Inspection stickers have been delayed by six months and still may be delayed again. If conditions worsen, either in the immediate future (as they have been in several southern states), or if there is in fact a "second spike" in coronavirus cases in a few weeks, then access to MVC may be even further restricted. Meanwhile the state's 1,200 private facilities are desperate for more customers in order to keep their doors open and continue to employ New Jersey citizens.

When we surveyed our membership in mid-April, 74% of auto repair shops had seen a decline of at least 65%, and 40% of all shops reported a decline of 80% or more, despite the fact that these essential businesses were allowed to be open throughout the crisis. Even now their business is generally 30% lower than what they would normally expect.

The State is also about to take on a massive new load of debt, the annual interest payments of which will total in the hundreds of millions of dollars every single year. With the State in a structural budget crisis even before the pandemic hit, it is more important than ever that the action we are proposing be taken to save that $35 million per year.

When a new contract was finally released for public bid in August 2019, the only meaningful alteration to the cancelled contract of December 2015 was to cut out the only major change that would have actually saved the State money and benefited small businesses: a requirement that re-inspections and commercial vehicle inspections be directed to PIFs. **That change would produce an immediate savings of about $6 million per year,** but likely more since the bids for the new program would be substantially less if they did not have to perform any inspections on commercial vehicles.

Commercial vehicles must be inspected annually and must undergo a safety inspection, which is more time consuming and requires extra equipment that could otherwise be eliminated at the CIFs. That demand for those safety inspections would have been a big boost for the 1,200 small businesses who are currently PIFs. Some motorists whose vehicle fails the initial inspection have been known to abuse the "free" inspection program and take their car back more than once since there is no financial cost to them in doing so. Requiring re-inspections be performed only at PIFs would cut out this abuse while still allowing almost all motorists to get their car inspected without having to pay an immediate fee. This is a modest reform that if implemented ten years ago would have saved the State a cumulative $50 million through the end of FY20.

We were particularly surprised to see that this change had been removed from the contract since in the response to questions submitted by OLS last year (page 10) MVC explicitly said the this alteration to the current program would be included in the new contract and that it would result "in both a cost savings and reduced wait-times". Why has it been removed, dealing yet another blow to small businesses and the State budget? With extreme wait times dominating the news, this question is more important than ever.

With the budget process extended there is still time to make this change and to reap the savings in FY 2021, if there is the political will to do it. I am extremely confident that the various companies who bid on the last contract and may bid on this contract would prefer the decentralized program I am proposing. After years of delays, why not a shorter one in order to create a modern program that will benefit the State budget and hundreds of struggling independent small businesses?

Why Decentralize the Inspection Lanes?

The first beneficiary of a fully decentralized program is the State. Under the current program, the State is charged by Parsons $18.95 (a decrease of 99¢ as of November 2018) for every inspection performed at a CIF. MVC estimated that in FY20 the State will conduct just over 1.9 million inspections, amounting to a cost of $36.5 million the State will pay to a very large corporation for performing a very basic service.

While there still would need to be a contractor brought in to oversee the PIF network and collect the inspection data, the cost of that contractor could easily be borne by the individual PIF shops. All of those involved in the program currently pay a monthly fee to perform inspections, which covers the costs they incur upon the contractor. The new program had intended to switch that from a monthly fee to a per-inspection fee, either of which would function well.

The other big beneficiary to a decentralized program will be the shops which will be performing these inspections. Almost all of these facilities are independent small employers. They are the quintessential example of the American small business, and they struggle to stay open as much as every other small business even in the best of times.

Right now, the approximately 1,200 licensed PIFs must split about 13% of the total inspections performed per year (down from 18% in FY12). A fully decentralized system would increase their potential business more than seven-fold. This surge in business would have multiple positive effects. The cost per inspection would fall dramatically. Right now, these businesses are paying a monthly fee just to be able to perform any inspection at all. They also need to have paid for certification for the facility and for at least one of their employees to become licensed to conduct these inspections.

With the pool of potential clients so small, most charge a larger fee than necessary simply so they that can recoup their costs off what little business there is. With another 2 million annual potential clients added to the marketplace, they will be competing with every other PIF to bring in customers. Since every PIF will be offering what is effectively the same service as every other one, price will be a key motivator in bringing motorists in the door. I predict it will not be long before an inspection becomes a loss leader for many shops, in the way oil changes often are.

In the discussions we have had over the years, there are two concerns which are raised about a decentralized program. One is that there are an insufficient number of PIFs currently licensed to meet the increased demand that would arise. Broadly, I do not consider this a meaningful challenge. There are at least 1,400 mechanical repair facilities in this state right now which are not licensed PIFs but have the capability to become licensed. They hold off merely because there is insufficient demand to justify the investment. Increase demand by this degree and they would be lining up to perform inspections.

But even if no new shops were to be licensed, I do not believe it would be an issue based on the experience of other states. Massachusetts, for example, performs about 5.1 million inspections per year at fewer than 1,800 locations, for a ratio of about 2,900 inspections per location. New Jersey currently performs a total of 2.2 million inspections per year. If all of them were performed at our 1,200 PIFs, that would equate to about 1,800 per location. Massachusetts also continues to perform safety inspections on its passenger vehicles, a more time-consuming process. Georgia's numbers are even more similar. They perform 2.5 million inspections per year at just 900 locations, and those are spread over a much larger geographic area. Neither of these states, nor any of the other decentralized states, have had meaningful problems with their inspection programs.

NJGCA would of course stand ready to work with the State and whatever contractor were hired to ensure a smooth transition, and to ensure that supply and demand were properly equalized. There are a few geographic areas that would likely start off with fewer PIFs than ideal, but that is a problem easily rectified.

The other concern raised is the cost to the consumer. As I already stated, I believe the cost for an individual inspection will come down significantly in a fully decentralized program. Beyond that, it is a cost that will only fall on individuals who own a motor vehicle, and they will only have to pay it once every other year, and only after their vehicle is more than five years old. The cost for the inspection, the only purpose of which is to protect our air quality, will work out to less than the cost of a tank of gas, and a fraction of what they are legally required to pay for their car insurance every single month. One potential option would be to simultaneously lower the cost of vehicle registration fees, at least on vehicles 5 years and older. This would of course reduce the savings the State would otherwise reap, although it would still provide a huge boost for hundreds of small employers.

With the state budget as stretched as it is, the Legislature and Governor are forced to prioritize where every single precious taxpayer dollar is spent. Is having the State pay for every vehicle inspection, a tab which almost no other state picks up, worth more to the general public than any of the requests you have heard over the course of these budget hearings, or any of the programs that will be reduced or eliminated by the coming budget cuts? I don't believe so, and neither should you. Even if there were no savings to the State, this would still be worth doing just to transfer these funds from one big corporation to over a thousand small businesses.

Further background on the inspection program over the last decade:
When the current contract (T-1628/NJ Start Purchase Order #71414) was awarded in May 2008, it was a five-year contract, with the potential for a three-year extension. In 2010 the new Christie Administration, against the advocacy of NJGCA, eliminated safety inspections for passenger vehicles as part of their first state budget. MVC budgeted a savings for the State of $11.5 million in FY 2011 based on the idea that they would no longer need to pay Parsons the $3.24 that Parsons had delineated as the cost of a safety inspection in their winning bid. This would have lowered the cost to the State of an inspection from $21.60 to $18.36.

This was the first of the many failures that would characterize the subsequent handling of this contract. In November 2012 State Auditor Stephen Eells filed a report detailing that the State had not seen anything close to the savings it was supposed to gain. While the elimination of safety inspections went into effect on July 1, 2010, the State did not negotiate changes to the contract until March 2011, three-quarters of the way through the fiscal year. The Auditor's report reads:

"The basis of the negotiations was not made available to the auditors by the Division of Purchase and Property in the Department of the Treasury. The amendments included a reduction in the inspection rate by $0.67 to $20.93 'in light of the changes in law', and a permission for Parsons to close three facilities and reduce their operating hours. However, no change to the rate was made due to the elimination of the safety inspection. Subsequent to the changes in the law and the contract, we noted that Parsons had an average monthly reduction in their lane technician staffing by 121 positions, or 26 percent."

Not only did the elimination of safety inspections lower road safety and hurt small businesses, it did not even produce the savings it was promised. The only beneficiary was Parsons, which no doubt profited handsomely from the reduction in labor costs, especially since the safety inspection was the most labor-intensive aspect of a motor vehicle inspection. More than 7 years after this report was published, the State still pays more per inspection than the $18.36 rate it should have. The State would have saved $40 million in total over the nine years since safety inspections were eliminated, (or $30 million in the time since the Auditor's report) if it had just been able to make the adjustments it was owed. Instead that taxpayer money has lined the pockets of the Parsons Corporation.

As early as 2010 NJGCA began advocating that the State should cancel this contract and move to a system of PIFs only. Even with the cost of canceling the contract early, the State still would have come out ahead financially. With the contract due to reach its natural termination in May 2013, the MVC hired the Eastern Research Group (ERG) to conduct an in-depth study on what the future of the State's inspection program should be. To this day, the contents (and the cost) of that study have never been made public, despite repeated requests throughout the years and despite the fact that while the study was being conducted, we were regularly told that its findings would be given to us and the general public. (We strongly believe that the study performed by ERG, that has never been shared, states clearly that the most efficient method for the state to pursue motor vehicle inspections in the future would be to utilize a complete all PIF system, and to close the Parson's run Central Inspection Facilities).

In May 2013 the State announced that rather than heeding our advice to close the CIFs, they were extending the current inspection contract for the full three years allowed for in the contract. Over the ensuing three years we continued to work with MVC and the Administration to argue the benefits of a fully decentralized system.

As effectively the only trade association representing the PIF community, we also met with all four of the companies who intended to bid on the next inspection program. All of us had met with MVC individually, and all had recommended a fully decentralized program, yet we had heard nothing from anyone in the State about what the final product would look like. This despite being told for months (and in our case years) that a decision and announcement was due at any time.

Finally, in the last week of December 2015 the official Request For Proposal (RFP) was announced. With less than six months until the current contract was set to expire, and despite years' worth of study, planning, and preparation, the document that was ultimately published was riddled with flaws. Some of these, in our opinion, were substantive. The RFP largely kept in place the current system of inspections, with a few positive reforms thrown in. The RFP was also riddled with basic errors, such as claiming in different sections that certain reports would be due "within X days of". It referenced statistical data that was clearly a few years old even though newer data was available online. It gave the reader an impression that at least some of the document had been written sometime in the past, and that this RFP was thrown together late in order to meet a deadline that had already passed.

Despite only being given about two months to craft a bid to operate such a massive program, all four contractors submitted bids to operate the program. The winning bidder would not only operate the CIFs, but also manage the computer software and oversee the PIFs.

Three of the four bidders (Parsons, Opus, and Applus) submitted bids whose cost was largely in the same range. These are the three companies which already operate state inspection systems, with Opus and Parsons running almost all of them. The fourth bidder, SGS, submitted a bid that was fully half the cost to the State as the other three. Despite the fact that SGS had never operated a statewide inspection program on its own, the State announced their intent to award the contract to SGS. Opus and Parsons both decided to contest this award, saying it was impossible for SGS or anyone else to successfully operate the type of program the RFP was calling for at such a minimal price.

In May 2016 the existing contract was given a second extension, this time for six months. But once those six months were up, the contract was given a third extension, again for six months. Then a fourth extension, also six months, was added. Once that was up in November 2017, the contract was given a fifth extension of one year, until November 5, 2018. When that date hit, it was extended again until November 5, 2019, and has now been extended further. That means this contract will last more than twice as long as it was originally signed for, and a full four years longer than was ever allowed for in the 2008 contract.

In 2017, the Christie Administration announced that they were throwing out the bid from SGS on a technicality and awarding the contract to Opus. This awarding was then challenged by Parsons, who as much as anything else would no doubt like to keep being paid at the current exaggerated rate, rather than the lower rate they submitted in their 2016 bid (or nothing at all should another company take over management of the program). In May 2018 the Murphy Administration canceled this particular RFP (16-X-24049) entirely and said that a new RFP would be released very soon. It took more than a year for the new version of the contract to be released in August 2019, and the proposal was almost identical to the one thrown out. The only real difference being that re-inspections and commercial vehicle inspections will still be performed at CIFs, which will increase the cost to the State and remove the one benefit being given the small business community. The due date for this version of the contract has so far been extended seven times.

I am happy to work with you in whatever way I can to get this important change made. I know that there is a desire among legislators of both parties to find ways to help struggling small businesses survive the effects of the coronavirus shutdown, but the biggest problem has been a lack of state money to provide direct support. This plan here would not only help small businesses, it would do so at a **savings** to the State. Time is of the essence to get this done, please act now.

I am available to discuss this in further detail with you, your staff, or anyone else you recommend. Please reach out to me by cell at 201-745-1914 or email Sal@njgca.org

Sincerely,

Sal Risalvato
Executive Director
NJ Gasoline, C-Store, Automotive Association