

Testimony of Mark D. Wenner

Before the Committee of the Whole,

36th Legislature of the USVI

Monday, March 3, 2025

12:30 pm

Earle B. Ottley Legislative Chambers on St. Thomas.

St. Thomas, VI

Good afternoon, Senate President Milton E. Potter and other members of the Committee of the Whole of the 36th Legislature, other testifiers, members of the Press, persons in the viewing and listening audiences, ladies and gentlemen, it is a pleasure to be here.

I am Mark D. Wenner, an Assistant Professor of Economics at the University of the Virgin Islands. It is a distinct honor for me to appear before this distinguished body to present testimony on the factors contributing to the high cost of living in the US Virgin Islands and highlight areas for policy action, including tax reform, that can ameliorate the situation. Please note that my testimony represents my views and opinions and not those of my employer or any other affiliated institution or organization.

Definition of Cost of Living and its Significance

Cost of living refers to the amount of money needed to sustain a certain standard of living by being able to afford basic expenses such as housing, food, energy, healthcare, transportation, childcare, and education. Cost of living indices or an estimated monthly figure are often used to compare the expenses of living in different cities, jurisdictions, regions, or countries. The calculated cost of living is frequently compared to the average salary to determine affordability.

A jurisdiction with a high cost of living but relatively high average salaries is more tolerable and preferable to a situation where the cost of living is high, but the average salary for the jurisdiction is lower. When this latter type of imbalance exists and persists for a long time, it generates social and economic tensions. Namely, it undermines economic competitiveness and growth, leads to critical skill shortages, and promotes migration and gentrification.

The cost of living in the USVI is higher than in other US jurisdictions, including some insular territories such as Puerto Rico and American Samoa, and Guam. It is most comparable to the Commonwealth of the Northern Marianas (CNMI) and the state of Hawaii. The US jurisdiction with the highest documented cost of living is Hawaii due mainly to its remote location in the middle of the Pacific Ocean. Nonetheless, Hawaii has two saving graces compared to CNMI and USVI, in that the median income levels in Hawaii are higher, and it has less food import dependence. According to government statistics for Hawaii, the median household income is \$43,944 compared to CNMI at \$31,362 and the USVI at \$40,408 for the USVI. In addition, Hawaii has a food self-sufficiency ratio (SSR) of 15.7%, whereas the SRRs for USVI and CNMI are minuscule, and both places import more than 90 percent of all foods.

Factors Contributing to the High Cost of Living in the US Virgin Islands

The US Virgin Islands (USVI) face a notably high cost of living, driven principally by six factors: (i) geographic isolation and insularity (ii) small market size and concentrated market structures; (iii) high utility costs; (iv) housing market pressures; (v) tax structure (vi) limited economic diversification. Understanding these factors and how they interact and interplay with each other will be essential for addressing the issues faced by residents and formulating policy actions and interventions to alleviate the burden.

1. Geographic Isolation: Insularity

The US Virgin Islands' insularity and thousand-mile distance from the continental United States, its principal trade partner and source of imported goods, significantly increases shipping costs. Bulk and containerized cargo must come by sea, and just two major maritime shippers serve the islands. The high reliance on imports result in substantially higher prices than continental areas. The problem is not unique to the USVI; most small island states suffer from high shipping costs. Average shipping and insurance costs as a percentage of the value of imports in Oceania (South Pacific) and the Caribbean, are as much as three times higher than the world rates. The determinants of higher shipping costs are a lack of economies of scale in ports, low degrees of competition, intermodal competition, long wait times in ports, and higher insurance costs.

2. Limited Economic Diversification

The economy of the US Virgin Islands heavily depends on tourism, and related jobs tend to be low-paying and marked with seasonal fluctuations in employment. The heavy reliance on one industry makes the economy vulnerable to external shocks such as natural disasters, pandemics, economic downturns and recessions in principal source countries for tourists, commodity price fluctuation, or disruptions in transportation links. As a result, economic growth tends to be volatile, and long periods are often needed for recovery and reconstruction after a shock, which generates upward pressure on prices.

3. High Utility Costs

Electricity costs in the USVI are the highest among the 56 US jurisdictions, and service interruptions are frequent and above average for most US jurisdictions. The unreliable and high electricity cost negatively impacts everyone. Local businesses are likely to increase prices of final goods and services to cover their higher operational costs. Consequently, households suffer doubly, first from having to dedicate a larger share of their budget to pay electricity tariffs and then secondly from facing the inflated prices for goods they consume due to businesses having to pass on the high cost of doing business in the Territory.

4. Housing Market Pressures

Real estate prices in the US Virgin Islands can be inflated due to limited land availability, strong demand for second homes, and short-term vacation rentals. A fair share of the population tends to be transient, primarily hospitality and construction sector workers, which can exacerbate competition for housing. This dynamic plus relatively low-density zoning regulations, the high costs of construction per square foot, an inability to quickly refurbish dilapidated and distressed housing stock due to probate issues and lack of financing or insurance, leads to a deficit of habitable housing stock and high rental and property prices. Residents with moderate to low average incomes find themselves with few options.

5. Tax Structures and Trade Regulations

The US Virgin Islands employs a taxing structure, including heavy reliance on a 5 percent gross receipt (a business turnover tax) and various excise taxes, that can increase the retail prices of goods. For example, gross receipts taxes instead of sales taxes, telescope a nominal 5 percent tax to an effective 15 percent tax, if the good in question was turned over three times.

6. Small Market Size/High Degree of Market Concentration/Lack of Competitiveness

The USVI has a small market size and, accordingly, a small private sector that tends toward oligopolies. Unfortunately, a handful of business operators dominate the sales in several industries and have commanding market shares. When the owners of businesses in the same sector are interrelated by marriage, family ties, or strong ethnic affinity, the possibility of tacit collusion increases. Some industries seem quite concentrated: supermarkets, construction materials/hardware stores, gasoline sales, wholesale food and beverage distribution, new auto and vehicle distributorship/sales, and banking. The concentration of market power tends to result in limited or no price competition and downwardly sticky prices. Prices for critical input for a particular product could vary over time. However, the end-user price in the Virgin Islands will move consistently upward but rarely downward. This is most visible in the retail gasoline market in St. Thomas. Despite the international price of a barrel of oil moving downward since the start of the Ukrainian-Russian War, from \$133 a barrel (Brent) in February of 2022 to approximately \$72 now, the retail price for regular gasoline on St. Thomas has been frozen at \$4.85-\$4.89 per

gallon while on the mainland, retail gasoline prices have dropped below \$3.00. Monopolistic and oligopolistic power in the local economy adds to a higher cost of living.

Policy Actions to Reduce the Cost of Living

To address the multifaceted challenges contributing to the high cost of living in the US Virgin Islands, several policy initiatives can be implemented:

1. Enhance Energy Efficiency and Invest in Renewable Energy

Reform or privatize the insolvent public utility, which is acting as an albatross on the economy and prevents the lowering of the cost of electricity. Promote investing in renewable energy projects (such as solar, wind, and tidal) to lower electricity costs and reduce reliance on imports. Tax incentives for renewable energy implementation and energy efficiency upgrades for residents can lower monthly expenses.

1. Encouraging Economic Diversification

Improve the business climate (lower energy costs, improve infrastructure, lower taxes, better trained and flexible workforce, faster permitting/licensing/registration, contract enforcement, dispute resolution, connectivity, etc.) Policy initiatives to attract investment in sectors such as technology, light manufacturing, agriculture, and sustainable fisheries that can reduce economic vulnerability and create a more resilient, high-paying job market need to be reviewed and revised. The current business attraction model based on 90 percent tax abatement is not yielding cost-effective results.

2. Supporting Local Agriculture

Encouraging local food production can reduce dependence on imported foodstuffs. Programs that support local farmers through subsidies, grants, and technical assistance can stimulate agriculture, which could decrease food prices. The promotion of vertical and greenhouse cultivation needs to be accelerated.

3. Creating Affordable Housing Initiatives

Developing affordable housing projects through public-private partnerships can alleviate pressure on the housing market. Offering tax incentives to developers focusing on affordable housing is a feasible approach to tackling housing shortages. In addition, more multifamily and hi-rise dwellings, can be promoted by change zoning regulations.

4. Tax Revisions

Revising the current tax structure, particularly the excise taxes on essential goods, can help lower consumer prices. Introducing measures to streamline the import process could create a more competitive retail environment. Adopting sales taxes and eliminating gross tax receipts would be advisable. However, given the falling revenues and financial imbalances in the local government, creative care would be needed to study and plan a changeover.

5. Promote More Business Competition

The best way to promote more business competition and prevent the exercise of oligopolistic price-setting powers would be to create a good business environment, create incubator programs, promote cooperative and social entrepreneurship, and access credit and business development services for local entrepreneurs.

Cost of Living Comparison with Other US Insular Territories and States

The cost of living is generally higher in insular jurisdictions than in continental ones. But much can be learned about what proactive steps other insular authorities are taking to ameliorate the situation in their islands.

For example, the cost of living in the US Virgin Islands can be compared with that of other US insular territories and states, including Puerto Rico, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and Hawaii.

- Puerto Rico: As of 2022, the cost of living in Puerto Rico was lower than in the US Virgin Islands. However, Puerto Rico's housing costs can vary significantly, especially in urban areas like San Juan.
- Guam: Guam typically has a similar cost of living to the US Virgin Islands, with higher costs primarily stemming from importation. However, its economy is more diversified, and its average income is higher, which can better buffer economic shocks.
- American Samoa: The cost of living is relatively lower than that in the US Virgin Islands but varies widely based on location and the availability of goods. American Samoa also contends with high import dependence, which drives prices higher.
- Commonwealth of the Northern Mariana Islands: Their cost of living is comparable to Guam and the US Virgin Islands. Challenges include a significant reliance on tourism, contributing to economic volatility.
- Hawaii: As a state, Hawaii has one of the highest living costs in the United States, influenced by geographic isolation and extremely high housing costs.

What should be important to note is that, in most places, substantial efforts are being made to increase renewable energy as a significant component in the energy matrix, the single most

noteworthy cost-of-living reduction measure. In the case of the USVI the share of renewable energy used by the public utility is still miniscule and far below the 25% target set in legislation years ago that should have been achieved by this time.

Conclusion

The high cost of living in the US Virgin Islands results from geographic isolation, limited economic diversification, high utility costs, pressures in the housing market, market power concentration, and specific tax structures. Targeted policy actions addressing these issues, such as promoting renewable energy, privatizing public utility, encouraging more agricultural self-sufficiency, and reforming housing and tax policies, could alleviate the cost of living.

Thank you for your attention.