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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

May 28, 1982

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-207434



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The Honorable Ron de Lugo
House of Representatives

Dear Mr. de Lugo:

Subject: Reasons for High Food Prices in the U.S.
Virgin Islands (GAO/CED-82-93)

Your October 13, 1981, letter requested that we determine:

- Actual food price differences between the Virgin Islands and other specified locations, and whether any such differences have increased or decreased in recent years.
- Reasons for substantially higher food prices in the Virgin Islands than elsewhere if, in fact, that is what is found.

On December 16, 1981, we responded to the first part of your request in a report to you on high food prices in the Virgin Islands (CED-82-23). In that report we concluded that (1) Virgin Islands food prices were higher than in other specified locations, (2) the amount by which they were higher depended on the data and analytical approaches used to measure prices, and (3) food price differences between the Virgin Islands and Washington, D.C., had generally been increasing in recent years.

OBJECTIVES, SCOPE, AND METHODOLOGY

On December 17, 1981, we briefed you on the results of our initial efforts and on our report. During that meeting, you asked us to proceed further in determining why Virgin Islands food prices are so high. Since then we have held discussions with and obtained documentary information from officials of a number of different sources, including the (1) Virgin Islands Government's Bureau of Labor Statistics, Departments of Commerce and Consumer Services, and Cooperative Extension Service, (2) Federal Maritime Commission, (3) Special Trade Group-Caribbean Section, Office of the President, (4) Virgin Islands Federal Programs Office, and (5) World Bank. We also discussed high Virgin Islands food prices with an expert at the University of Notre Dame to whom we were referred. We met with and discussed grocery store operations,

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in general, with Washington, D.C., officials of Giant Food Inc., and Safeway Stores, Inc. We also held discussions with an owner of a Virgin Islands food distribution firm and with an official of Grand Union Supermarkets in New Jersey. Grand Union has two supermarkets in the Virgin Islands. Repeated attempts to talk with someone from Pueblo International, Inc., the major grocery chain on the Islands, failed.

Although our work centered on the relatively high Virgin Islands food prices, it came to our attention that prices on the islands for many other goods and services are likewise higher. The issue of high Virgin Islands prices goes beyond just food, and unquestionably, some of the causes of high food prices have the same impact on some other commodities.

Our interviews disclosed genuine concern on the part of most people we talked with regarding high Virgin Islands food prices, poor food quality, and a lack of sufficient food variety or choice. Several reasons for the relatively high Virgin Islands food prices were provided to us as were several suggestions for ways to improve the situation in the islands. The results of our work are discussed in the sections which follow. We made our review in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

VIRGIN ISLANDS' GEOGRAPHY, DEMOGRAPHY AND ECONOMY

To fully appreciate why Virgin Islands food prices are relatively high, one must first have some understanding of the islands' geographic, demographic, and economic settings.

The U.S. Virgin Islands consist of three major inhabited islands: St. Croix (84 square miles with a 1980 population of 49,280), St. Thomas (32 square miles with a 1980 population of 44,170), and St. John (20 square miles with a 1980 population of 2,480), plus some 65 smaller islands. These islands, collectively speaking, are located 1,100 miles southeast of Miami, Florida, and 40 miles east of Puerto Rico. Economically and politically, the Virgin Islands are predominantly influenced by U.S. economic patterns and conditions and Federal Government legislation and policies.

During the period from 1960 to 1980, the Virgin Islands population grew from 32,099 to 95,930. Rapid growth also occurred in the islands' tourism and manufacturing industries. Electricity production increased at an average annual rate of 14 percent. The number of registered vehicles in the islands in 1980 reached almost 38,000, compared to approximately 4,300 in 1960. Real estate values increased at average annual rates of

20 percent as land was converted from agricultural to residential, commercial, and industrial uses.

Nearly all products consumed, processed, and sold in the Virgin Islands must be procured from off-island areas. Such dependence on external sources of supply necessitates a heavy reliance on air and sea transportation. The inherent nature and economics of air transportation encourage the movement of only high value, low bulk cargoes. Consequently, the majority of Virgin Islands freight is transported by ship.

The Virgin Islands import most of their food from the U.S. mainland and from other Caribbean islands. In fact, the value of food products imported from the United States exceeds the value of any other commodities shipped to the islands from the U.S. mainland. In 1977, food represented \$73 million, or one fifth of all Virgin Islands imports. This situation contrasts with the fact that the islands' economy at one time was based on the production and export of sugar and the production for local consumption of other agricultural products. The importance of agriculture in the islands has faded with the decline of the area's sugar industry.

A relatively small amount of cargo (including food) moves directly from the U.S. mainland to the Virgin Islands. Most cargo passes through the port of San Juan, Puerto Rico, simply because the Virgin Islands market for imported goods is too small to warrant direct service from most stateside ports. Cargoes brought into Puerto Rico are generally off-loaded in San Juan and then reloaded on smaller vessels for shipment to Charlotte Amalie (St. Thomas) or Christiansted Harbor (St. Croix). Cargo between Puerto Rico and the Virgin Islands primarily moves in one direction only. The absence of backhaul cargo from the Virgin Islands to Puerto Rico means that sufficient revenue must be generated from the Puerto Rico to Virgin Islands portion of the trip to cover the costs of the round trip.

Pueblo and Grand Union are the two major supermarket chains in the Virgin Islands. Pueblo's warehousing facilities are located in Puerto Rico, but to stock these warehouses most products move to Puerto Rico from the U.S. mainland by ocean carrier. Grand Union's warehouses supplying the Virgin Islands are located in the New York/New Jersey area. The islands have several smaller supermarkets, family-run grocery stores, and convenience stores. A Virgin Islands Government official told us that some of the smaller grocery stores in the Virgin Islands buy much of their merchandise from Pueblo and Grand Union for resale to consumers.

VIRGIN ISLANDERS ARE CONCERNED
ABOUT HIGH FOOD PRICES AND POOR
FOOD QUALITY AND VARIETY

As we reported to you in December 1981, the Virgin Islands Bureau of Labor Statistics issued a July 1981 press release which stated that the retail prices of food commodities in the islands averaged 56 percent higher than in Washington, D.C., and 54 percent higher than in southwest Florida. Information we had obtained from the U.S. Department of Agriculture showed that in June 1981, the monthly cost of a thrifty food plan in the islands was 35 percent higher than in the United States; 6 percent less costly than in Honolulu, Hawaii; and 36 percent higher than in Puerto Rico. Information obtained from the U.S. Office of Personnel Management showed that 1980 Virgin Islands food prices were 32 percent higher than in Washington, D.C.; 11 percent higher than in Puerto Rico; and 5 percent lower than in Oahu, Hawaii.

More recently, the Virgin Islands Bureau of Labor Statistics reported that in December 1981, retail prices of selected food commodities in the Virgin Islands averaged 45 percent higher than in Washington, D.C. The Bureau noted that this 45-percent difference is lower than the 56-percent margin evidenced in July 1981. The Bureau attributed the decline to the fact that a "food price war" and a move toward efficient food warehousing for the consumer which were taking place in Washington during the summer of 1981 no longer existed in December.

Regardless of how much higher food prices are in the Virgin Islands than in other locations, the people we talked with overwhelmingly agreed and displayed a sense of concern that Virgin Islands food prices were high. An owner of a food distribution company on the islands said that food prices in Virgin Islands supermarkets were unjustifiably high. A government official on the Islands told us that high food prices were a serious problem faced by Virgin Islands consumers. Another official--an analyst in the Washington, D.C.-based Virgin Islands Federal Programs Office--said that high food prices in the Virgin Islands were of real concern to the people who live there.

Poor quality or lack of variety in much of the food sold in the Virgin Islands was also of concern to many living on the islands. One person we talked with said that produce in the stores (for example, grapes, apricots, plums) was often of such poor quality that he would taste it in the store before buying. The person said that time-dated items could often be found on grocery store shelves with dates that had either expired or were about to expire. Two people we talked with attributed the poor quality of food in stores to the fact that so much of it must pass through Puerto Rico and that it therefore experiences the rigors of more handling than

it would otherwise. Still another person told us that food in the Virgin Islands stores was of the lowest quality and often of the type not found in Washington stores.

The availability of food items on the islands is limited when compared to other locations. One island resident, in a recent trip to Washington, D.C., found grocery store shelves loaded with a variety of food items generally not available in the islands. Another person commented that the consumer often has very little choice when shopping for some food products.

REASONS FOR HIGHER VIRGIN ISLANDS FOOD PRICES

The discussions we held and the information we otherwise obtained disclosed a multitude of reasons for the higher prices of food in the Virgin Islands. For example, Arthur D. Little, Inc., in an April 1974 report on "Inflation and Economic Growth in the U.S. Virgin Islands," stated that prices for supermarket goods in the islands were at that time an average of 20 percent higher than on the U.S. mainland. The report attributed this price differential primarily to the following factors:

<u>Reasons for higher prices</u>	<u>Percent of Virgin Islands/U.S. mainland price differential</u>
High transportation and related charges	12
Losses due to shrinkage (pilferage by transportation workers, employees, and customers; damage in transit; and spoilage)	1
Higher overhead costs associated with operating Virgin Islands stores	1
Higher utility costs on the islands	1
Monopolistic conditions, lack of price controls (mainland stores were subject to such controls during the time frame of the Little study), and consumer apathy	<u>5</u>
Total differential	<u>20</u>

Although we made no attempt to identify what the "true" price differential presently is, or to account for each factor causing such a differential, we did obtain during our interviews a variety of reasons for higher Virgin Islands food prices. These reasons

are similar to those disclosed in the Arthur D. Little report. We have categorized them in general terms as follows:

- High shipping charges.
- Price domination by the major supermarkets.
- High rates of shrinkage.
- Other reasons, including high operating costs, inefficiencies due to the small size of the market, affluence, tourism, a high incidence of food stamps in the islands, and little consumer resistance to high prices.

Each of these reasons is discussed more fully in the sections which follow.

High shipping charges

One reason for higher Virgin Islands food prices, and perhaps the reason that accounts for the largest part of the food price differential between the islands and elsewhere, has to do with the high shipping charges incurred in transporting food to the islands. The Virgin Islands Commissioner of Commerce stated in March 1981 testimony before the Federal Maritime Commission that the islands have always been dependent on waterborne commerce for their livelihood and their survival and that ocean freight increases have always had a significant effect upon the islands' cost of living, particularly for food, construction materials, and other necessities. He stated further that

"* * * the cost of ocean transportation--in addition to warehousing charges for transshipment through Puerto Rico--was the primary reason given by the manager of a large Virgin Islands supermarket to explain the present Virgin Islands/Puerto Rico food price discrepancy."

Another official in the Virgin Islands Commerce Department complained to us that the shipping companies--through Federal Maritime Commission oversight and regulations--have relentlessly been raising their shipping rates. He said the Commerce Department has been fighting the proposed rate hikes, but often to no avail. He said the whole subject of rate structure is very complex, that the shippers have accounting and legal technicians who effectively argue in their favor, and that there is some question in his mind as to how well the Federal Maritime Commission is doing in regulating the shipping rates. He further stated that 40 percent of the shipping charges from the United States to the Virgin Islands are attributed to the leg of the journey from Puerto Rico to the islands.

In this regard, the Federal Maritime Commission noted in its April 1979 "Virgin Islands Trade Study: An Economic Analysis" that although the distance from New York to San Juan is 15 times greater than from San Juan to the Virgin Islands, the ocean freight rates are only twice as high. The Commission commented that, as a first impression, the large differences in distance appear to make the rates between Puerto Rico and the islands seem excessive; however, the economies of ocean shipping must be considered. The Commission explained that the absence of backhaul cargo and the existence of certain fixed costs which do not vary with the distance cargo moves are factors contributing to the high freight rates experienced by the islands. The fact that many carriers have entered the trade only to subsequently go out of business is, the Commission believes, an indication that profitability in the shipping business is not great.

The owner of a Virgin Islands food distribution firm told us that high Virgin Islands food prices are often attributed to high shipping charges but that we should not be misled. He said that freight costs are indeed a factor, but not to the extent for which they are blamed. He further said that the supermarkets "hide behind" their freight costs and claim they are the reason for the high food prices.

Another individual--a professor at the University of Notre Dame--told us that according to work he did while living on the islands, high shipping charges would account for roughly 15 percent to 20 percent of the food price differential between Puerto Rico and the Virgin Islands.

Price domination by the major supermarkets

Another of the reasons most frequently cited to us as a cause of high Virgin Islands food prices had to do with the fact that food prices on the islands are dominated by the larger supermarket chains. Virgin Islands Government officials and others told us that food prices were high because of the limited competition in the islands. The Pueblo and Grand Union supermarket chains were said to control the market and set the prices. There was a perception, at least, that the grocery stores on the islands take advantage of the consuming public through higher prices and profits.

Arthur D. Little's April 1974 report discussed the fact that the Virgin Islands have historically been subject to monopolistic pressures in the import and distribution trades. It was suspected that during the 1960's the food retailing business may have shown signs of imperfectly competitive conditions and that to some degree the same conditions were prevailing into the 1970's. The report concluded that

"Given the prevalence of small retailing outlets, and the tendency for smaller business to need higher profit margins--and be able to achieve them in the absence of keen competition--it seems likely that the consumer was often paying significantly more than he would have under efficient and competitive circumstances."

There are signs that the degree of competition has been increasing in the retail food markets in the Virgin Islands. Arthur D. Little noted this back in 1974, and we were told that this is so by some of the people we talked to. One Virgin Islands Government official pointed out that before 1979 St. Thomas had only two supermarkets. He said that now there are two Pueblo stores, a Grand Union, a Superfoods (a warehouse store owned by Pueblo), two Lucy's, three or four convenience stores called Tri-Marts, and a couple of small, family-run stores. Another official told us that a minor food price war was going on in the islands. Apparently, one supermarket's reemergence into the market (after earlier having closed because of a fire) had recently spurred some competitive food pricing. We were told, for example, that the price of chicken had recently dropped from \$1.12 per pound to around \$0.65 per pound.

In response to the above comments on high food prices and the earlier ones we cited regarding poor food quality and variety, a Grand Union official we spoke with attributed the relatively high Virgin Islands food prices to the fact that so much of the islands' food must be imported. He said that the islands' market is too small to justify the kind of warehousing operations which might help to reduce costs. He further stated that the quality and variety of food in Grand Union's St. Thomas store would compare favorably with any of its stores on the U.S. mainland. In fact, he pointed out that consumers from surrounding islands go to the expense and effort of shopping Grand Union's Virgin Islands stores because of the quality, variety, and fair prices they receive.

High rates of shrinkage

Virgin Islands food costs more because of higher than usual losses sustained through shrinkage in the amount of food available for sale. Shrinkage occurs through internal and external pilferage, spoilage, damage to merchandise in shipment, and so forth. The owner of the Virgin Islands food distribution firm that we talked with said that pilferage in Virgin Islands supermarkets is extremely high and is due, in part, to (1) an unsophisticated market with inadequate controls and (2) the fact that those working in the stores have been known to "help out" their friends and relatives who come to the stores.

A Virgin Islands Department of Commerce official told us that pilferage in the Virgin Islands is higher than in the United States,

that food is lost in transit as well as in the grocery stores, that on St. Thomas a higher than usual incidence of pilferage may be attributed to the fact that some stores are located in poorer economic areas, and that some losses are due to food spoilage or damage incurred during handling.

Another individual told us that some shrinkage occurs because so much of the food imported by the Virgin Islands must first pass through Puerto Rico. The individual said that it is pretty well accepted that things frequently "come up missing" during such handling. The Federal Maritime Commission's April 1979 study echoed this comment. The study contained the following comments regarding transshipment service from Puerto Rico to the Virgin Islands.

- "Too many items moving from Puerto Rico to the Virgin Islands are 'lost' (pilferage)."
- "One of the big problems is damage to cargoes."
- "The pilferage has been most discouraging to say the least. We wait for an undue time for goods to arrive only to find that more than half has been stolen."

Other reasons for high
Virgin Islands food prices

Several apparently less important reasons for high Virgin Islands food prices were provided to us by those we talked with. For example, several people told us that high utility bills, frequent disruption in utility service (affecting the storage of perishable goods), the minimum wage requirement, a high incidence of vandalism at some stores, mismanagement at various levels in the food distribution process, and inefficiencies due to the small size of the Virgin Islands market contribute to higher food prices.

The professor at the University of Notre Dame told us that the Virgin Islands is a relatively affluent area with a per capita income level exceeding that of Puerto Rico. He believed that the Virgin Islands supermarkets feel they can--and therefore do--charge higher food prices. On the other hand, this individual and at least one other attributed a portion of high food prices to the fact that food stamp use on the islands creates a demand for food that might not otherwise be there. One Virgin Islands Government official stated that the high degree of tourism in the islands has an inflationary effect on food prices. She pointed out that food prices on St. Thomas are higher than on St. Croix because St. Thomas has more tourists. Another government official, while not concurring that tourism had an impact on food prices, did concede that more and more tourists are staying in condominiums and that

they are undoubtedly purchasing some of their food from local grocery stores. One other individual said that he believed high food prices are partially due to the fact that islanders show little resistance to high food prices. He said that most islanders have resigned themselves to the high prices and believe that there is little they can do about the situation.

WHAT CAN BE DONE TO IMPROVE THE FOOD
PRICE SITUATION IN THE VIRGIN ISLANDS?

This question was posed to the majority of the people we talked with. Several people commented on the complexities of the problem and the fact that there are no simple solutions. Nonetheless, the following thoughts were offered as ways in which Virgin Islands food prices might be better controlled and even driven down.

One Virgin Islands Government official, for example, believes that the legislature needs to put price controls on certain basic food necessities and that the Virgin Islands Government needs to be given the authority to monitor grocery store bills of lading on these items to ensure that retail prices for the items do not exceed prescribed levels.

Several individuals suggested that more competition is needed on the islands if food prices are to be appropriately set. Another individual, however, suggested that the islands' market is too small to accommodate the stores that now exist and that this creates certain inefficiencies.

One individual said that the food price issue needs to be discussed in some kind of public forum under the direction of a consumer advocate. Others suggested that the islands need better consumer services and that it would be helpful if consumers showed more resistance to high prices. We were advised in several interviews that consumers in the Virgin Islands need to "band together" if they, as a group, are going to have any impact on food prices. Consumers in Puerto Rico have formed a kind of cooperative union which apparently has had some impact on holding prices in line.

Several people we talked with mentioned the need for more agricultural production in the Virgin Islands. We were told that St. Croix has the potential to produce more food, thus making the islands a little less dependent on high-cost food imports. The Virgin Islands Governor, in a January 4, 1982, letter to the U.S. Department of Agriculture, requested assistance in developing the Virgin Islands agricultural industry (particularly in terms of marketing and distribution). The Governor sought the temporary services of a specific individual in the Department who was known to have a long career in agricultural marketing and experience in the Caribbean resulting from a 2-year agricultural project in

Puerto Rico. In a response dated March 26, 1982, the Department denied the Governor's request, citing manpower shortages as the reason. Other people told us of barriers to increased agricultural production--the high cost of land and equipment, a lack of fresh water, and an underdeveloped marketing system, among others.

Finally, we were advised that to bring down Virgin Islands food prices, shipping costs incurred in importing goods to the islands must be better controlled. One individual brought up the idea of an importers' cooperative which would, collectively, guarantee a certain level of business, ask shipping companies to bid on their business, and perhaps seek to increase the amount of cargo shipped directly from the U.S. mainland to the Virgin Islands--thus avoiding the costs of transshipment through Puerto Rico. Along these lines, the Federal Maritime Commission in its Virgin Islands trade study concluded that one of the main reasons for high freight rates is the lack of backhaul cargo. The Commission stated that:

"The severe trade imbalance makes it incumbent upon the Virgin Islands government and local businesses to, if at all possible, encourage some type of production that can utilize a portion of the containers that return empty to Puerto Rico and Florida. If this could be accomplished, all freight rates would be favorably affected."

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In summary, the information presented above and in our earlier report would indicate that:

- Virgin Islands food prices are high when compared with prices in other specified locations.
- The amount by which they are "too" high is difficult to discern.
- Virgin Islanders are concerned about not only high food prices but poor food quality and variety as well.
- There are a multitude of reasons for the islands' high food prices, some of which are due to the geographic, demographic, and economic characteristics of the islands while others are attributable to inefficiencies in the food marketing system and other problems.
- Although the entire issue of high prices is complex and there are no easy solutions, some actions could be taken to possibly reduce or hold food prices in check more so in the future than has been done in the past.

One might expect prices in the islands to be higher than on the U.S. mainland because of the islands' remote location, relatively small market size, and extreme dependence on food from outside sources. On the other hand, some portion of the high food prices appears to be within the bounds of better management practices and techniques as applied to transporting food to the islands, marketing the food once it is on the islands, increasing agricultural production, increasing the quantity and kinds of exports from the islands, and developing a higher level of consumer sensitivity and organization.

We plan no further distribution of this report; however, we will make copies available upon request to other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Henry Eschwege". The signature is written in black ink and is positioned above the typed name and title.

Henry Eschwege
Director