

# Summary

## What Is the Issue?

Over half of all infant formula sold in the United States is purchased through the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). Typically, WIC State agencies obtain significant discounts in the form of rebates from infant formula manufacturers for each can of formula purchased through WIC. In exchange, the manufacturer is given exclusive right to provide its product to WIC participants in the State. Contracts are awarded to the manufacturer offering the lowest net wholesale price (manufacturer's wholesale price minus the rebate).

Infant formula rebates totaled \$1.6 billion in fiscal year 2004, an amount that supported about one-quarter of all WIC participants. Since the establishment of the rebate program in 1988, rebates as a share of total pre-rebate WIC food costs increased rapidly, peaking at 33.5 percent in fiscal year 2000. In other words, without the rebates, WIC food costs would have been one-third higher. However, rebates as a share of WIC's food costs have fallen each year since 2000 (down to 31.6 percent in 2004). In recent years, some States awarding new infant formula rebate contracts have seen a marked increase in the net wholesale price for formula. Since WIC is a discretionary program with fixed funding, higher costs mean that fewer persons will be served (or that additional funds need to be appropriated).

## What Did the Project Find?

The cost that WIC pays for each can of formula provided through the program has two components: the net wholesale price that goes to the manufacturer and the retail markup that goes to the retailer. Both these costs have increased in recent years.

Prior to 2004, most infant formula rebate contracts were bid on by two manufacturers, usually Mead Johnson and Ross, with Nestlé bidding on just more than one-quarter of all contracts. Nestlé has since joined in bidding on nearly all contracts, which would seemingly make it less likely that a manufacturer would win a contract with an unusually low rebate (resulting in a high net wholesale price to the WIC State agency). However, the real net wholesale prices bid by all three competitors have increased in recent years. Of the 16 States that have awarded infant formula rebate contracts since 2003, 10 (63 percent) saw a net increase in real net wholesale price relative to their latest pre-2003 contract for powder and 13 (81 percent) saw an increase relative to their pre-2003 contract for liquid concentrate.

Some of this recent increase in net wholesale price can be attributed to the introduction of more costly formulas supplemented with DHA and ARA (two fatty acids found in breast milk). Although not all States currently offer these new formulas to their WIC recipients, recent legislation requires that all States offer the supplemented formula as of their next rebate contract, presuming that the manufacturers submit bids based on these supplemented formulas.

During the second quarter of 2004, the retail markup was substantially greater for the new DHA- and ARA-supplemented infant formulas than for unsupplemented formulas (retail markups for the new supplemented formulas were also found to exceed the markup of unsupplemented formulas from 1994 to 2000, indicating that retail markups to WIC have increased over time). The effect of the markup that States pay retailers can be substantial. In many cases, it is the largest component of the cost to WIC. However, it is because of the effectiveness of the rebate program that net wholesale prices are so low. If net wholesale prices were to increase to the level experienced in New York in 2003 (where net wholesale prices of powder were over three times the retail markup), total costs to States would increase significantly.

This analysis suggests that both cost components to WIC—net wholesale price and retail markup—have increased over time. However, much of the increase in costs is due to the higher priced DHA- and ARA-supplemented infant formulas. Because these supplemented formulas are relatively new to the market (first introduced in 2002), conditions observed in this study may change once the market reaches long-term equilibrium.

## **How Was the Project Conducted?**

This report examines trends in the factors affecting WIC infant formula costs from January 1998 to January 2006. The cost that WIC pays for each can of formula provided through the program after rebate has two components: a part that goes to the manufacturer and a part that goes to the retailer. The part that goes to the manufacturer is the net wholesale price (wholesale price minus the rebate); this has been the subject of most previous studies on WIC's infant formula rebate program. Retail markup—the part that WIC pays to the retailer (retail price minus wholesale price)—has not received nearly as much attention.

This study examines the cost of infant formula to the WIC program in light of recent changes in the infant formula market and in the program's authorizing legislation. It is the only study to examine the rebates associated with infant formula in both liquid concentrate and powdered forms. Powdered formula has not been the focus of most previous studies, yet it has become the most prevalent form of formula provided in WIC. Information comes from several sources—data on infant formula manufacturers' bids for rebate contracts, formula manufacturers' wholesale price lists, and scanner-based retail sales data from supermarkets.