

## Chapter 3

# The WIC Infant Formula Rebate Program

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In the mid-1980s, infant formula accounted for nearly 40 percent of total WIC food costs and infant formula retail prices were rising more quickly than prices for other foods (U.S. GAO, 1990). These factors led Tennessee and other States to look into cost-containment practices to reduce infant formula costs. In 1987, Tennessee became the first State to initiate a rebate contract system and other States followed soon after.<sup>1</sup> In 1989, P.L. 101-147 required State WIC agencies to use competitive bidding—or an alternate method that would yield savings equal to or greater than those produced by competitive bidding—to procure infant formula.

Current Federal regulations specify that all WIC State agencies must operate a cost-containment system for the procurement of infant formula except those States with home delivery or direct distribution food delivery systems or Indian State agencies with 1,000 or fewer participants (7 CFR 246.16a). Those State agencies required to operate a cost-containment system for infant formula must use a sole-source (i.e., single supplier) competitive system unless an alternative system provides savings equal to or greater than a sole-source competitive system.<sup>2</sup> Under the sole-source competitive system, a WIC State agency uses competitive bidding to award a contract to a manufacturer of infant formula in exchange for a rebate for each can of infant formula that is issued to WIC participants. (The State agency issues only the contract brand of infant formula except (1) when medical documentation supports the use of a noncontract brand of infant formula; or (2) if a noncontract brand of formula is needed for religious reasons.)<sup>3</sup> As a result, the brand of infant formula provided by WIC will vary by State according to which manufacturer holds the contract for that State. Generally, infant formula rebate contracts are for 3 years.

At the WIC State agency's option, solicitation for bids under the sole-source competitive system can take one of two forms: single solicitation or separate solicitations. Under single solicitation, the request for bids is for a single iron-fortified milk-based infant formula that is suitable for routine issuance to the majority of generally healthy, full-term infants.<sup>4</sup> This formula is referred to as the primary contract brand infant formula. The primary contract brand infant formula must be offered in all physical forms—liquid concentrate, powdered, and ready-to-feed—and it cannot be an exempt infant formula, which is defined as any formula that is represented and labeled for use by an infant who has an inborn error of metabolism or a low birth weight, or who otherwise has an unusual medical or dietary problem (exempt infant formula is not required to have a rebate). Manufacturers who submit bids for the WIC contract are required to specify a rebate amount for the primary contract brand infant formula for each of the three physical forms of infant formula.

The sole-source contract is awarded to the bidder offering the lowest total monthly net price, as determined by the submission of sealed bids, for a standardized amount of the primary contract brand infant formula by physical form.<sup>5</sup> WIC regulations define net price as the difference between

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<sup>1</sup> See appendix A for a more detailed discussion of the history of the infant formula rebate program.

<sup>2</sup> An interim rule, effective October 2000, strengthened and simplified the requirements for operating a sole-source infant formula rebate system (FR, Vol. 65, No. 164).

<sup>3</sup> GAO (2003) estimated that 90.3 percent of all WIC infants using formula in fiscal year 2002 received the contract brand.

<sup>4</sup> Only iron-fortified infant formulas are authorized for use in the WIC program.

<sup>5</sup> WIC State agencies can elect to award the WIC contract to the bidder offering the highest monthly rebate if the weighted average of retail prices for different brands of infant formula in the State vary by 5 percent or less.

an infant formula manufacturer's lowest national wholesale price per unit for a full truckload of infant formula and the rebate level offered by the manufacturer.

All the different types of infant formula (except exempt infant formula) produced by the contract-winning manufacturer are referred to as contract brand infant formula. Under single solicitation, the winning bidder is required to supply and provide rebates for all the different types of contract brand infant formula the WIC State agency chooses to issue, such as lactose-free formula and formula for older infants. Contract-winning manufacturers that do not produce soy-based infant formulas must subcontract with another manufacturer to supply a soy-based infant formula under the contract. The amount of the rebate on the contract brand infant formula is based on the same percentage discount for the particular physical form of the primary contract brand infant formula. For example, if the rebate offered for the primary contract brand of powdered infant formula was 85 percent of the manufacturer's wholesale price, then the rebate for all other powdered forms of the contract brand infant formula would also be 85 percent of its wholesale price.

Under the process of separate solicitations, solicitations for bids are issued for milk-based and soy-based infant formulas separately. Separate solicitations may increase competition for WIC contracts by allowing new or smaller infant formula manufacturers with a limited product line to bid on contracts (FR, Vol. 65, No. 164). Although States have awarded contracts to two different manufacturers in the past (i.e., one manufacturer held the milk-based contract and another manufacturer held the soy-based contract), in 2000, only one manufacturer in each State held the WIC contract.

The WIC State agency may choose to issue all or some of the different types of contract brand infant formula. Any noncontract brand of infant formula (including exempt infant formulas and formulas not manufactured by the WIC contract manufacturer) may be issued only with medical documentation (provided by a licensed health care professional authorized to write medical prescriptions under State law) that an infant has a condition that dictates the formula's use.<sup>6</sup> The WIC State agency does not receive rebates from noncontract brand infant formula.

The WIC program usually issues infant formula to WIC participants in powdered or liquid concentrate forms. However, formula may be issued in ready-to-feed form in special situations, such as when the participant's household does not have an adequate and safe water supply or refrigeration, or if the person caring for the participant may have difficulty in correctly diluting concentrated liquid or powdered forms of infant formula.

As noted, most WIC participants receive food instruments, such as vouchers, that they transact for the contract brand of infant formula at authorized retailers. The WIC State agency then reimburses the vendor for the full retail price of the infant formula. The State agency, or the State agency's financial institution, then bills the contract-winning manufacturer for the rebate agreed to in the contract. As a result, the actual cost of infant formula to the State WIC agency equals the retail cost minus the amount of the manufacturer's rebate.<sup>7</sup>

In fiscal year 2000, 67 of the 88 WIC State agencies operated a competitive sole-source rebate system in conjunction with a retail food delivery system. The exceptions were Vermont, which used a home delivery system; Mississippi and parts of Chicago, which used a direct distribution system; and 19 Indian Tribal State agencies with participation of less than 1,000, which either

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<sup>6</sup> The only exception to this rule is that local WIC agencies may issue noncontract brand infant formula without medical documentation in order to accommodate religious eating patterns (FR, Vol. 65, No. 164).

<sup>7</sup> The net price, as defined in a WIC infant formula rebate contract, is wholesale price minus the rebate. Because the retail price is wholesale price plus the retail markup, the cost of infant formula to the WIC program—retail price minus the rebate—differs from the net price received by the manufacturer by the amount of the retail markup.

did not operate a cost-containment system for infant formula or else used a cost-containment procedure other than a competitive sole-source rebate system. Of the programs using retail food delivery systems, 7 were multi-State systems, involving 40 WIC State agencies. Under these systems, WIC State agencies join together in a single rebate agreement to obtain infant formula.<sup>8</sup> In this way, WIC State agencies with small- to medium-size populations can pool their buying power to leverage higher rebate levels (Liu, 1991).

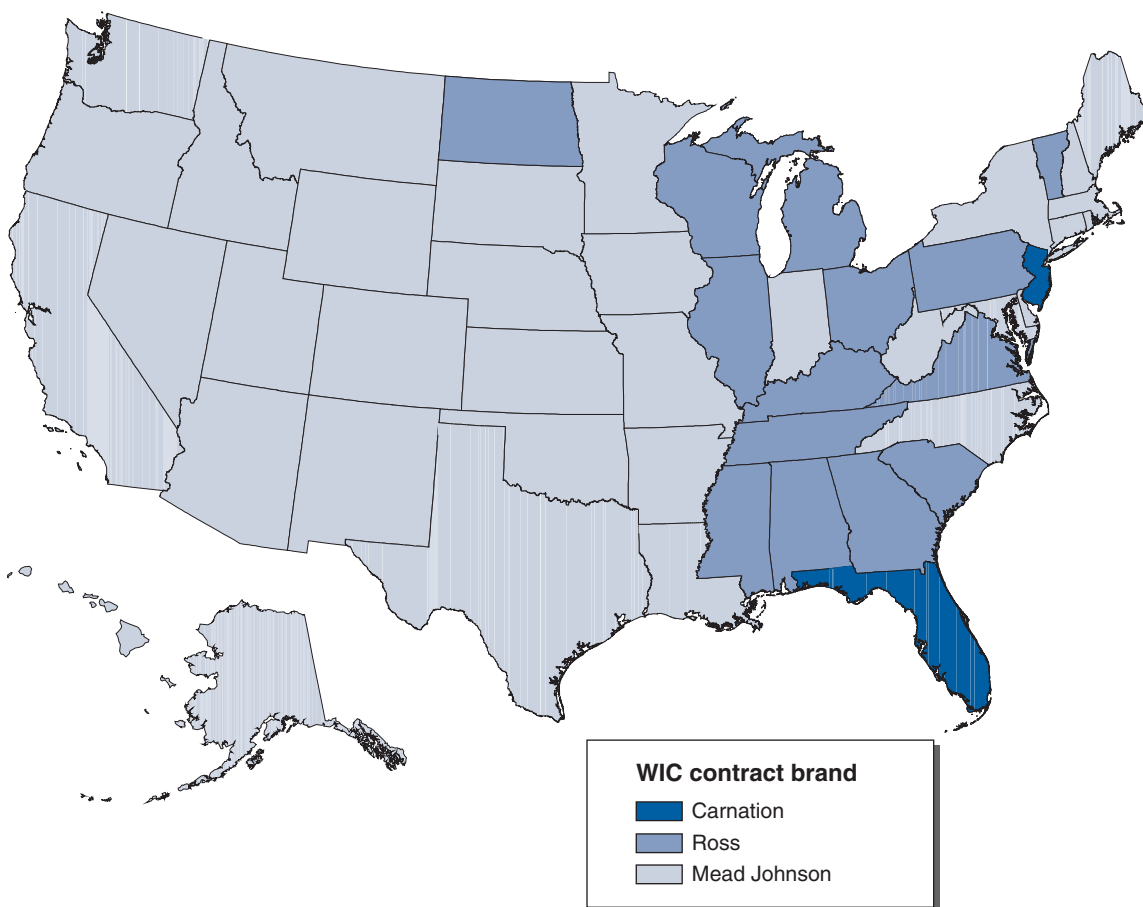
As of September 2000, only three manufacturers—Mead Johnson, Ross, and Carnation—held WIC infant formula rebate contracts. Excluding the Indian Tribal Organizations and Puerto Rico, Mead Johnson held the WIC contract in 35 States including the District of Columbia (fig. 3-1). Ross held contracts in 14 States (nearly all of which were in the eastern half of the country). Carnation held the WIC contract in two States—Florida and New Jersey.<sup>9</sup> Mead Johnson is estimated to have provided about 68 percent of all formula distributed through the WIC program in 2000, compared with 27 percent for Ross, and 6 percent for Carnation (USDA, 2000a.).

<sup>8</sup> For example, Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and three Indian Tribal Organizations made up the *New England and Tribal Organization* multi-State group.

<sup>9</sup> Since September 2000, Carnation was awarded additional contracts in Virginia, North Dakota, and Kentucky, all of which were previously held by Ross.

Figure 3-1

**WIC infant formula rebate contract by State, September 2000**



Note: Vermont uses a home delivery system and Mississippi uses a direct distribution system to distribute WIC foods.

In September 2000, the wholesale prices for a 13-ounce can of milk-based liquid concentrate infant formula with iron varied by company—\$2.27 for Carnation, \$2.91 for Ross, and \$2.94 for Mead Johnson. The wholesale price used by WIC is the manufacturer’s lowest national wholesale price. Consequently, the wholesale price for an individual manufacturer, used for the determination of its net price, does not vary by State (U.S. territories and Indian Tribal Organizations are excluded from this discussion). On the other hand, the amount of the rebate, determined by the contract awarded by submission of sealed bids, varied by both manufacturer and State, ranging from \$2.06 in New Jersey to \$2.84 in South Carolina (fig. 3-2). Net price, defined in a WIC infant formula contract as the wholesale price minus the rebate, also varied greatly by State, ranging from only 6.5 cents per can in Florida, to 44.7 cents per can in Nebraska and South Dakota. The average net price among the States was 20 cents.<sup>10</sup> Rebates as a percentage of the manufacturer’s wholesale price ranged from about 85 percent in Nebraska and South Dakota to almost 98 percent in South Carolina. In other words, the infant formula purchased through the WIC program cost the South Carolina WIC program about 2 percent of its wholesale cost, plus the amount of the retail markup.

Several factors can influence the net price of formula. Through a variety of practices, firms in concentrated product markets that contain few manufacturers, such as the infant formula market, are often able to charge higher wholesale prices, relative to production costs, than firms in less concentrated product markets. On the other hand, WIC State agencies as large buyers can use their market power to obtain lower net prices for WIC formula through the use of rebates. In order to win a WIC contract, an infant formula manufacturer may choose to offer infant formula at low net prices or even at a loss in the WIC market by bidding a high rebate. To be profitable to a manufacturer, such a below-cost strategy requires that increased sales in the non-WIC market segment offset the loss in the WIC market segment. An increase in non-WIC market sales could take place if retail stores give more shelf space to the WIC brand of infant formula (since, on average, over half of all sales are through WIC) and non-WIC households’ brand choices are influenced by shelf space or if physicians or hospitals become more likely to recommend the WIC brand of infant formula to non-WIC consumers.<sup>11</sup>

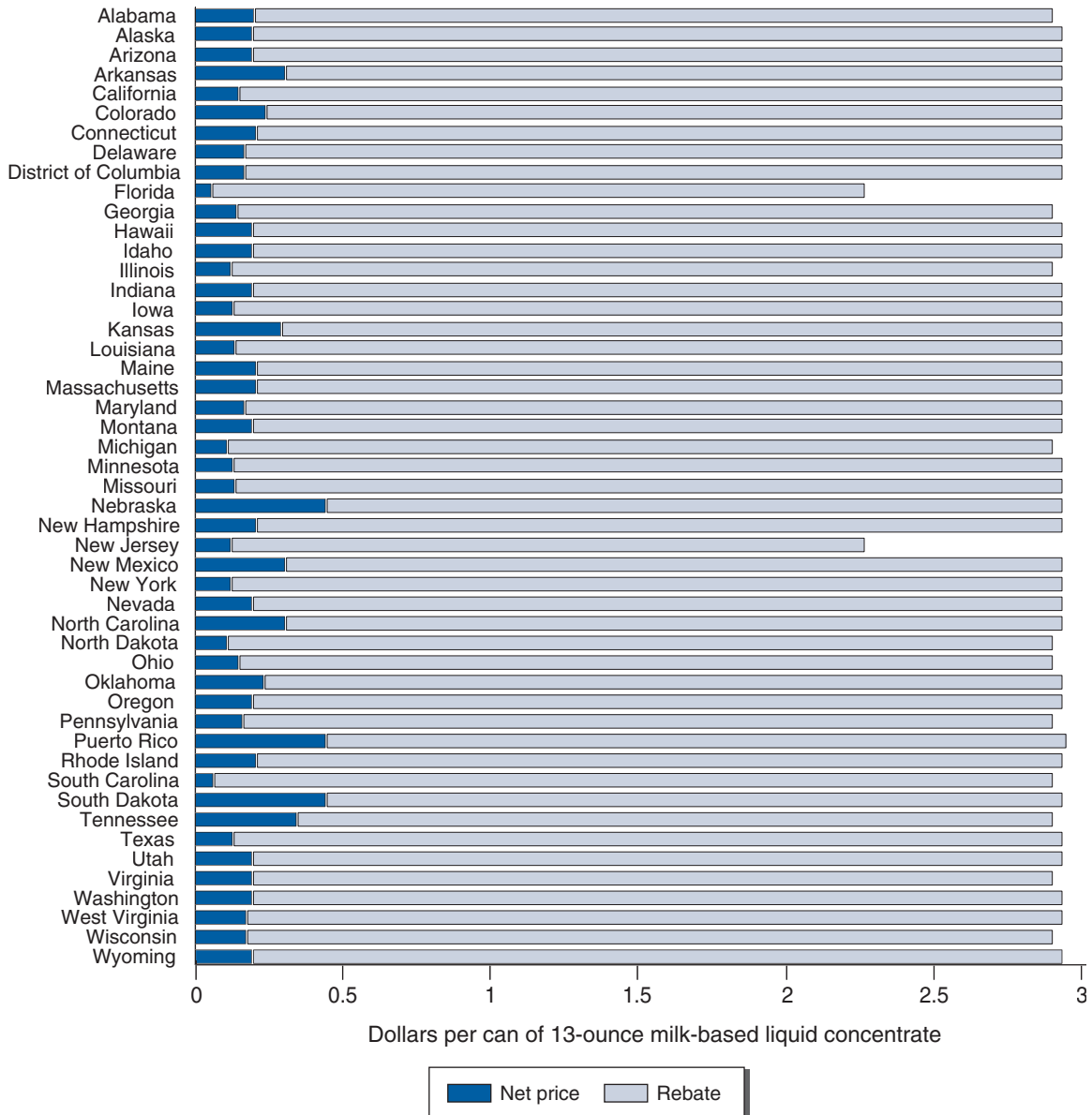
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<sup>10</sup> This estimate was based on unweighted data—i.e., each State had the same weight regardless of the size of its WIC population.

<sup>11</sup> The U.S. General Accounting Office (1998) concluded that, since WIC makes up over half of the market, it is unlikely that infant formula manufacturers sell their product at a loss in the WIC market.

Figure 3-2

**Wholesale price, WIC rebate, and net price of milk-based infant formula by State, September 2000<sup>1</sup>**



<sup>1</sup>Net price plus rebate equals the wholesale price.

Notes: Mississippi operates a direct distribution system, Vermont operates a home delivery system, and Kentucky uses a composite price for milk- and soy-based infant formula.

Source: USDA's Food and Nutrition Service, 2000.