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TCCF POLICY BRIEFING

POLITICIANS AND BUREAUCRATS AND THE BABY FORMULA CRISIS

By Dr. Steven J. Allen • May 31, 2022

Thomas Jefferson noted that, “Were we directed from Washington when to sow, & when to reap, we should soon want [that is, lack] bread.” It’s the same for baby formula.

The federal government set up a system for baby formula that, in effect, imposes a huge off-the-books tax on consumers in order to provide the formula for half the population seemingly for free. It creates a near-monopoly shared by three companies that know how to game the political system in each of 50 states and the District of Columbia so as to enrich themselves and keep potential competitors out of the market. The system is sufficiently complex and sufficiently hidden from public view that, when it breaks down, no one actually responsible for the breakdown is held to account.

And, sure enough, when bureaucratic failure triggered a baby formula shortage with potentially life-threatening consequences, the first response of Democrats in Congress was to provide more money for the bureaucracy that screwed up.

The baby formula system has its roots in 1969, when President Nixon convened the White House Conference on Food, Nutrition and Health. Academics, businesspeople, activists, politicians, et al. – some 2,700 participants – gathered over three days to work to “put an end to all hunger in America . . . for all time,” as Nixon put it. (The Biden administration plans another such conference in September, to “end hunger . . . by 2030.”) The 1969 group made some 1,400 recommendations that led to expansion of the school lunch program and the Supplemental Nutrition Assistance Program (SNAP, “Food Stamps”), and, in 1972, to the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).

WIC was established under the U.S. Department of Agriculture. The program was intended to help farmers (who benefit when the government props up prices by buying commodities), and to help the ill-nourished children of poor people – children both born and unborn.

WIC provides healthcare and nutrition assistance for pregnant and breastfeeding mothers and for children under age five, if family income is below 185% of the “poverty level,” an amount set arbitrarily by bureaucrats. The “poverty level” typically grows about one percent a year, on top of inflation, which helps maintain the growth of the welfare system. In most states, eligibility is

automatic when family members are in other income-based programs such as Medicaid, Temporary Assistance for Needy Families, and SNAP.

Since 1988, baby formula companies have bid for state or multi-state “sole source” contracts – monopolies, typically lasting four years – in which all WIC participants are required to buy from that company. The bid sets a kickback to the state, and the lowest price-minus-kickback wins.

The kickback averages around 92 percent of the wholesale price. “The dirty little secret about WIC,” according to a former Democratic Senate aide, “is these formula companies actually lose money on formula that they sell through WIC.” Why do the companies practically give it away? Because they make big money in the part of the formula market that’s privately paid for.

When a company has WIC-monopoly status, doctors and hospitals in that state recommend and provide samples of that company’s product. Parents usually recommend that brand to friends and family. When parents buy formula to supplement the amount they get through WIC, they almost always buy the brand their babies are used to. Groceries and superstores, and especially smaller outlets such as convenience stores, give the government-monopoly brand high priority on shelf space and placement. Stores are required to keep supplies of that product on hand. WIC-monopoly manufacturers leverage their bigfoot status, getting economies-of-scale (because the more you produce of something, the cheaper the price per unit). They’re able to negotiate better deals on advertising and marketing.

Thus, WIC-monopolists’ advantage extends to the entire marketplace, not just sales to WIC customers. In California in 2007, when Abbott was outbid by Mead Johnson, there was a complete flip: Abbott’s share of the market for milk-based powder in standard WIC sizes dropped from 90 percent to five percent, while Mead Johnson’s share rose from five percent to 95 percent. A study looking at 30 states found that, when the contract holder changed, there was about an 84-point switch in the WIC-standard market and an 18-point switch even among container-sizes that weren’t WIC-eligible. In the baby formula market, winning or losing the WIC contract is almost a matter of life and death.

Even supporters of the welfare state recognize the problem. A group of almost two dozen “Progressive” members of Congress recently signed a letter noting that “a potential contributor to such alarmingly high concentration in the formula industry could be the Special Nutrition Program for Women, Infants, and Children (WIC). While WIC has been instrumental in increasing access to affordable formula options for low-income families, its competitive bidding process may be leading to corporate consolidation and higher formula prices for non-WIC families. This program is administered by states, where they can negotiate substantial discounts on formula in exchange for market exclusivity. Over time, these exclusive contracts have been going to a smaller number of large corporate manufacturers.”

Competition is kept out. Existing companies, which have mastered the countless regulations governing the business, have an overwhelming advantage. Any prospective entrant faces nearly insurmountable barriers, and the industry is shrinking anyway, so – other than in niche categories such as “organic” – why bother making the effort?

In the past 15 years, only one domestic manufacturer with its own factory has entered the market in the U.S.

Virtually all baby formula purchased in the U.S. is produced domestically, even though formula from a number of other countries is as safe and nutritious as that produced here. There's a tariff (tax) on the imported formula that's as high as 17.5 percent, and the FDA blocks importations

mainly on the grounds that the labels, though approved by famously persnickety European bureaucrats, are insufficient for Americans. According to *Reason* magazine, the FDA last year forced a recall of 76,000 units from Germany because of a minor labelling issue, that the label didn't inform purchasers that the formula contained less than one milligram of iron per 100 calories.

There are minor differences between the U.S. and European rules. European regulators require less iron. European regulators, but not American ones, require DHA, a fatty acid considered important in brain development, and Europeans demand that 30 percent of carbohydrates come from lactose. Generally, European standards are considered the equal of U.S. standards, or higher.

The result of this system of monopoly and market barriers is what you'd expect. Today, three companies control over 90 percent of the market. Abbott has WIC-monopoly status in a reported 34 states (up from 23 in 2015) and in Washington, D.C., four territories, and seven Indian tribal organizations, accounting for 47 percent of infants under WIC. Mead Johnson has 15 WIC contracts, including large states like Florida and New York.

Manufacturers' revenue per can of formula is more than six times greater for non-WIC than for WIC sales. Non-WIC baby formula costs 50 percent more in the U.S. than baby formula in Europe – but, under WIC, is free to half the buyers – so those who buy baby formula with their own money are essentially paying for those who don't.

The USDA itself concluded in 2015 that “WIC essentially replaces price-sensitive consumers of infant formula with price-insensitive consumers.” To put it another way: People are less careful when spending other people's money, so any such system of cost-shifting causes prices to rise rapidly. That's why the availability of taxpayer-backed loans, which immature students treat as free money, caused the cost of college to triple. (Senator Debbie Stabenow, D-Michigan, has argued that we need such a system for drugs purchased under Medicare, that we should use large-scale purchasing power to get discounts for the government: “It's time to harness the bargaining power of 41 million American seniors to bring down prescription drug costs.” After all, what could possibly go wrong?)

With every purchase, middle-class Americans who buy baby formula pay a hidden tax. Perhaps it's a good idea to subsidize baby formula for the lower-income 42 percent of parents, those who make the majority of purchases. But this tax does not show up on any government budget. Consumers, taxpayers, and voters are unaware of it and thus have no say in the matter.

Matt Stoller, a liberal critic of monopolies, noted: “This whole scheme, done under the guise of welfare, is essentially a transfer of wealth from the middle class to the poor, done by enriching the baby formula cartel. The monopoly friendly program design was peddled by the anti-poverty group the Center for Budget and Policy Priorities, which is both on the center-left of the political spectrum and aligned with Wall Street.”

The opportunistic link between monopolists and the government causes all sorts of problems. Matt Stoller points out that “the relationship between the FDA and Abbott Labs was also behind the rapid Covid testing scandal, where FDA official Tim Stenzel, who had worked at Abbott,

then approved Abbott as one of two firms to make those tests, and blocked all other entrants. That’s why rapid Covid tests were both in shortage and much more expensive in the U.S. than they are in Europe.”

Most people become aware of the effects of this twisted system only in fleeting glimpses, when they hear of things that don’t seem quite right, as when it was revealed that detained illegal aliens at the border are guaranteed access to formula while Americans have no such guarantee. (I’m not against illegals getting the baby formula they need; I just think Americans should be able to get it, too.)

Add to the problem, a bureaucracy that can’t see past its nose. Before an inspection last September, the FDA had failed to inspect Abbott’s plant in Sturgis, Michigan for two years, although an annual inspection was required. The excuse: the pandemic. As one might expect regarding such a huge (700,000 square-foot) operation as the Sturgis plant, the FDA, by letting things slide, made it more likely that, when an inspection was eventually held, problems would be found. Complicating things, a purported whistleblower contacted the agency in October with claims of unsanitary practices at the plant, but was not interviewed until December. There was no follow-up inspection until January. The report on the supposed whistleblower didn’t make it up the chain to higher-ups for four months – due, we are told, to “mail room” and pandemic staffing problems.

The January inspection found violations such as a leaking roof, standing water in a few places, and one employee not washing hands or changing gloves after touching items in a non-product area. This was cited as not maintaining the plant in a “clean and sanitary condition,” with “voluntary action” needed on the part of Abbott. Inspectors said they found potentially dangerous deterioration in milk dryers, deterioration that had been going on for more than three years (meaning that that the inspectors should have detected it earlier).

The Sturgis plant’s problems came at a bad time. A shortage of baby formula had been developing since July. *The New York Times* reported on the problem in October, *The Wall Street Journal* in January. Anyone monitoring the baby formula discussion in the public parts of social media could see it coming. One might assume that the FDA would take the shortage into account

when shutting the Abbott plant down in February and would invoke emergency measures to head off a crisis.

You can't just shut down such a critical manufacturing operation without a plan. "Some industries are very good at ramping up and ramping down," Rudi Leuschner, associate professor of supply chain management at Rutgers Business School, told *The New York Times*. "You flip a switch and they can produce 10 times as much. Baby formula is not that type of a product."

On May 7, "several" U.S. Senators told *The Huffington Post* that they were hearing of the problem for the first time. The Biden administration claimed it had been working on the problem since February, but President Biden, addressing the matter for the first time May 13, responded this way to a question about whether the administration could have acted sooner: "If we'd been better mind readers, I guess we could've, but we've moved as quickly as the problem became apparent to us."

On June 1, after Biden met with some industry executives, he claimed: "I don't think anybody anticipated the impact of one facility — of the Abbott facility." He said that, "Once we learned of the extent of it and how broad it was, we kicked everything into gear." A CNN reporter noted that manufacturers said they knew immediately what the impact would be; Biden responded, "They did, but I didn't."

Under the radar of the Biden administration, this had happened: Five children had been hospitalized after reportedly consuming products from the plant. One of the cases involved the bacterium *Salmonella* Newport, which causes fever and gastrointestinal distress, but that illness was determined by authorities to be unrelated to the Sturgis plant. In four cases in September, November, December, and January, babies got sick from the bacterium *Cronobacter sakazakii*; two of the four infections were fatal. That pathogen can infect the blood, the intestines, and the lining of the brain and spinal cord, with a mortality rate in infants of perhaps 50 percent.

Cronobacter sakazakii is common in the environment. In studies, it was found in 3.6 percent of food items generally and in 12 percent of field vegetables. The microorganism has a strong tolerance for dryness, and often shows up in very dry products such as tampons and milk powder. Deadly infection from *C. sakazakii* is rare, resulting in an estimated two to four deaths per year.

There are big problems with the "Abbott did it" theory regarding the four infections. The pathogen was found at the plant, but in areas where it didn't come into contact with products, and the strains that were found were not the ones that made the babies sick. The two fatal cases involved two strains that were different from the strains found at the Abbott plant, and different from each other. No contamination was found in formula produced by Abbott. Nothing was found in the remaining samples of Abbott products in the homes. And, in one of the two fatal cases, the *Cronobacter* was found not in Abbott products but in the water that was mixed with the baby formula.

The babies got sick in three different states after consuming four different Abbott products that had been manufactured over the course of almost a year.

So we don't know the sources of the bacteria that made the babies sick. That lack of information didn't stop politicians from pouncing. House Speaker Nancy Pelosi declared that there might be "need for indictment," and she rammed through the House a quick \$28 million in additional funding for the FDA. Republicans joked that the money was a reward for a job well done.

Representative Rosa DeLauro (D-Connecticut), who chairs the House Appropriations Committee, scored the FDA for being too easy on Abbott: "Are they on the side of Abbott and industry, or are they on the side of the American consumer, in this case babies and their moms and dads?" I suppose the FDA didn't do *enough* to shut down baby formula production.

Brian Deese, director of the National Economic Council, explained that "The administration has been on this from the get-go. A lot of this emanated from a plant in Michigan that was producing formula that didn't meet safety standards." Transportation Secretary Pete Buttigieg declared: "Fundamentally, we are here because a company was not able to guarantee that its plant was safe, and that plant was shut down."

Said Buttigieg, "Let's be very clear. This is a capitalist country. The government does not make baby formula, nor should it. Companies make formula, and one of those companies — a company that seems to have 40 percent market share — messed up and is unable to confirm that a plant, a major plant, is safe and free of contamination." Given that there's no actual evidence that Abbott was responsible for the reported illnesses, one wonders how Abbott could guarantee that the problem has been fixed.

Buttigieg added that the government "probably should take a look at" how a few companies got control of the market. It's a mystery!

The baby formula crisis is the sort of thing we've seen many times, and will see again: Politicians and bureaucrats and their friends cause a problem, then demand that we do something about the problem, something that involves giving money and power to politicians and bureaucrats and their friends. It is, as they might say in the military, a SNAFU – Situation Normal, All (ahem) Fouled Up.

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