Strength in Numbers

Multi-State Cost Containment in the WIC Program

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Washington, D.C.

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About the Author

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Preface

The Center on Budget and Policy Priorities began work on this report in 1990. The report stems from the Center's work on infant formula cost containment, an issue of considerable significance for the WIC program.

The principal — although not the sole — focus of this report is on the opportunities that multi-state infant formula contracts can present for states. The report has been written with the idea that a growing number of states may be attracted to multi-state contracts on a voluntary basis.

While the preparation of this report was in progress, legislation was introduced in Congress in March 1991 to make sweeping changes in infant formula cost containment systems. The legislation would mandate that the U.S. Department of Agriculture administer regional multi-state bids for infant formula in which all or nearly all states are required to participate.

A number of states have raised concerns about this legislation. The Center on Budget and Policy Priorities, while believing that the multi-state approach has strong advantages and holds considerable promise, shares a number of the state concerns. The Center supports innovative approaches to cost containment but is not persuaded that mandating regional bidding represents the best approach. This report's enthusiasm for voluntary state action to establish multi-state systems should not be seen as an endorsement of the legislation.

We hope this report will provide useful information for WIC administrators and advocates who must grapple with the question of how to stretch limited WIC dollars so that the maximum number of women, infants, and children may participate in this important program.

Stefan Harvey
Bob Greenstein

Acknowledgments

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Figures & Tables

Contents

Introduction

Infant formula cost containment has become an important part of the Special Supplemental Food Program for Women, Infants, and Children (WIC). Despite the program's enormous success, federal WIC funding only serves slightly more than half of all eligible individuals. By reducing the infant formula costs that state WIC programs pay, cost containment has allowed WIC to reach hundreds of thousands of participants whose nutritional needs would otherwise be unmet. To reduce unmet need further, WIC agencies can explore methods to enhance and extend cost containment.

In June 1991, five states in the Northeast region of the USDA's Food and Nutrition Service — Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island — signed a joint cost containment contract with Mead Johnson. The contract culminated over a year of work to fashion a cooperative contract. This contract is the second joint cost containment contract. In 1989, Delaware, the District of Columbia, and Maryland implemented a multi-state cost containment contract.

These efforts are important because they pool the buying power of small and medium-size WIC states to leverage higher rebate levels. Furthermore, the Northeastern states' effort comes at a time when infant formula manufacturers have attempted to reduce WIC cost containment savings, especially in smaller states.

On April 29, 1991, the Northeastern states opened bids. Mead submitted a bid of $1.265 per can of 13 ounce liquid concentrated formula. Mead's net bid price (the difference between the company's wholesale price and its rebate offer) was $0.565. This net bid price was the third lowest offered by Mead since March

Glossary of Cost Containment Terms

Single-Source Rebate System: In a single source rebate system, only one manufacturer's infant formula products are used by the state WIC program. The manufacturer chosen is the formula maker offering the lowest cost to the state. The single-source system forces manufacturers to compete against one another to offer the highest rebate to states.

Open Market Rebate System: Open market rebate systems allow any manufacturer to participate in the WIC program, regardless of whether the manufacturer offers a rebate. Under this system, there are no limitations on which infant formula products are used. In an open market system, there is less competitive pressure on manufacturers to offer high rebates.

Multi-source Rebate System: Under a multi-source rebate system, more than one manufacturer is allowed to participate in the WIC program. However, this system differs from the open market approach in that only those manufacturers offering the most favorable rebates are allowed to sell their products through WIC. States use a variety of mechanisms to select the manufacturers offering the best prices. Some states award contracts to the two best bidders. Other states award contracts to any manufacturer that offers a rebate above a given threshold. In theory, this is a more competitive system than the open market approach. In practice, only Mead Johnson and Ross Laboratories have bid on multi-source contracts, and the competitive pressure is modest as a result. Wyeth does not bid because it cannot increase its market share through the multi-source system.

Net Price: The net price is the difference between a manufacturer's wholesale price and its rebate bid. This is a good approximation of the cost of infant formula to a state. The net price is useful to examine because it takes into account differences in wholesale prices between manufacturers, as well as differences in prices at differing points in time. A simple comparison of rebate levels fails to reflect these differences.

1990. Ross offered a rebate of $1.410 per can and Wyeth offered $1.216 per can. The net bid prices from Ross and Wyeth were $0.585 and $0.628, respectively. Because Mead's wholesale prices were significantly lower than Ross' at the time of the bid, the Mead bid offered the lowest cost to the Northeast states. (Mead Johnson has since raised its wholesale prices; as a result, the rebate level it provides to the New England states will be $1.365 per can.)

Multi-state bids entail more work to develop, but they should intensify competition for infant formula cost containment contracts. They hold promise of reducing WIC infant formula prices in a number of states.

This report examines multi-state contracts, along with other strategies to enhance state cost containment savings. The report also examines such other developments as Texas' effort to apply infant formula cost containment practices to the purchase of infant cereal. Several contract provisions that can enhance savings in infant formula cost containment contracts are also examined. This report builds

on the cost containment lessons learned by states over the past two years. Earlier cost containment efforts are described in *Saving To Serve More: Ways to Reduce WIC Infant Formula Costs,* published by the Center on Budget and Policy Priorities in 1988.

I. Cost Containment: Making WIC Even More Effective

The Special Supplemental Food Program for Women, Infants, and Children (WIC) is one of the most successful and cost-effective government programs. WIC provides food, health screening and nutrition education to at-risk, low income pregnant women, new mothers, infants and children under age five. According to a recent estimate by the Congressional Budget Office, 8.4 million women, infants, and children are fully eligible for WIC in FY 1991.[1] Yet funds will allow only 4.7 million to be served this year. Consequently, nearly 4 million children, pregnant women, and new mothers at nutritional risk are unable to receive WIC benefits and services.

A recent study has demonstrated that WIC is even more cost-effective than previously believed.[2] The U.S. Department of Agriculture evaluated the effect of WIC participation on Medicaid costs for newborns and their mothers within the first 60 days after birth. The health records of over 105,000 infants and their mothers in five states were studied. The report found that every $1 spent on WIC for pregnant women reduced Medicaid costs by $1.77 to $3.13. In addition, the study showed that prenatal WIC participation greatly increased the use of prenatal care and improved birthweights.

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[1] Congressional Budget Office, "Estimated Costs to Provide Full Funding for the Special Supplemental Food Program for Women, Infants, and Children (WIC)," March 13, 1991. (The 8.4 million figure does not include the approximately 152,000 WIC eligibles who are served through the CSFP.)

[2] U.S. Department of Agriculture, Food and Nutrition Service, Office of Analysis and Evaluation, "The Savings in Medicaid Costs for Newborns and Their Mothers from Prenatal Participation in the WIC Program: Volume 1", Prepared by Mathematica Policy Research, Inc.

To lower WIC costs and serve more participants with limited funds, Tennessee and Oregon in 1987 implemented the first infant formula cost containment efforts in states distributing WIC foods through retail stores. During FY 1988, cost containment savings totaled $30 million. As more states implemented rebate systems, savings climbed to nearly $300 million in FY 1989 and $500 million in FY 1990. USDA estimates that cost containment will save $600 million in FY 1991 and increase average monthly participation by 950,000 persons.

WIC is one of the few social programs that has been able to reduce program costs per participant so dramatically without reducing the amount or quality of benefits provided. Infant formula is the single most expensive item in the WIC food package, and infant formula prices have risen much faster in recent years than the prices of other foods. Without rebates, infant formula would have accounted for 42 percent of all WIC food costs in FY 1989.[3] Because of cost containment, only 30 percent of WIC food funds were actually used to pay for infant formula that year. Average WIC food costs per participant fell from $33.28 per month in FY 1988 to $30.15 in FY 1989, a 9.4 percent reduction. The average food cost per participant in FY 1989 was also lower than the cost in FY 1987. In contrast, the cost of the basic food items in USDA's Thrifty Food Plan rose 3.84 percent between FY 1987 and FY 1988 and another 7.66 percent between FY 1988 and FY 1989.

In 1988, Congress mandated that all WIC state agencies implement some form of infant formula cost containment. When WIC was reauthorized in 1989, Congress added a requirement that all states must use competitive bidding in their cost containment efforts. States are required to use a single-source rebate system unless an alternative system can be shown to save as much or more than a single source system. Congress adopted this approach because competitive bidding had consistently yielded greater rebates than had negotiation of rebate contracts on a non-competitive basis.

With the recent evidence of WIC's striking effect in lowering Medicaid costs and the continued presence of a large unmet need for the program, infant formula cost containment remains as important as ever. WIC programs need to maximize savings. Every dollar saved by cost containment is a dollar that can be used to serve more participants in need of WIC services. The failure to serve eligible pregnant women or children leads to needless health problems and preventable health care costs in the future.

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[3] U.S. Department of Agriculture, Food and Nutrition Service, Office of Analysis and Evaluation, "Fiscal Years 1988 and 1989 WIC Food Package Costs," October 26, 1990.

It would be ideal, of course, to reduce infant formula costs even more drastically through greater breastfeeding among new mothers. Breastfeeding is the best method of nourishing an infant. It is the most complete food an infant may receive and conveys important protections against disease. Breastfeeding also has important social and emotional advantages such as helping a mother bond to her child. Furthermore, breastfeeding is the most economical way to nourish an infant. If all WIC infants breastfed in FY 1989, about half a billion dollars could have been saved and nearly a million more participants served. Most WIC infants, however, still receive infant formula. So long as this remains true, cost containment will remain critical to lowering WIC food costs.

During 1992, cost containment contracts will expire in 20 states and the District of Columbia. These states, in order of the date of contract expiration, are: Illinois, New York, Tennessee, Virginia, Kansas, Oklahoma, Delaware, the District of Columbia, Maryland, Washington, Kentucky, Montana, Idaho, Colorado, Iowa, Nevada, Texas, Utah, West Virginia, Michigan, and Oregon. Between July and December 1991, contracts in several additional states expire. These contracts have either been rebid or are in the process of being rebid. As these states fashion new cost containment contracts, they can examine opportunities to enhance their savings. (Appendix A lists the contract expiration date for each of these states.)

II. Competition and the Infant Formula Industry

The infant formula industry is an oligopoly. Three manufacturers control nearly all sales of infant formula, and it has proven difficult for new manufacturers to enter the market. As a result, there has been relatively little competition among manufacturers over the price of formula. Over the last decade, the manufacturers' wholesale prices for infant formula have generally increased in lock-step (see Table I).

A key feature of the infant formula industry that discourages price competition is the marketing practice of pharmaceutical manufacturers called "medical detailing." Medical detailing targets physicians, hospitals, and health care providers rather than consumers. The largest manufacturers spend millions of dollars to promote infant formula in this fashion. By offering an array of incentives, educational materials, and free samples, the manufacturers seek to influence the recommendations made by health care providers to their patients. Because many consumers do not understand that standard infant formula products are essentially identical nutritionally, these consumers often choose a formula based on an explicit or implicit endorsement of a particular brand by a physician or hospital. Consequently, many families are currently price-insensitive when purchasing infant formula; they do not choose a formula primarily on the basis of the product's cost.

Medical detailing leads, itself, to higher costs. The millions of dollars spent on medical detailing are eventually passed on to consumers through higher prices. In addition, detailing places the decision of which formula brand to use in the hands of health professionals rather than parents. Families become less sensitive to price because they believe the formula recommended to them is medically or

nutritionally superior to the others. As a result, the manufacturers can increase prices without losing customers.

Furthermore, since medical detailing is so expensive, new manufacturers have great difficulty entering the market. With little competition, the current manufacturers can set prices without fearing another company will be able to offer a serious market challenge through lower prices.

Table I
Wholesale Infant
Formula Prices

Mead Johnson			Ross Laboratories			Wyeth Laboratories					
Date of Price Increase	Price Per Case	Price Per Can	Date of Price Increase	Price Per Case	Price Per Can	Date of Price Increase	Price Per Case	Price Per Can	Per Case Price Range	Per Can Price Range	Weeks To Align Prices
11/02/81	$21.74	$0.906	11/23/81	$21.72	$0.905	01/14/82	$21.72	$0.905	$0.02	$0.001	10.4
09/27/82	$23.63	$0.985	09/13/82	$23.58	$0.983	06/03/83	$23.02	$0.959	$0.61	$0.025	35.7
08/29/83	$24.81	$1.034	08/22/83	$24.67	$1.028	11/11/83	$24.17	$1.007	$0.64	$0.027	11.6
06/04/84	$26.48	$1.103	06/25/84	$26.48	$1.103	07/13/84	$25.98	$1.083	$0.50	$0.021	5.6
04/01/85	$28.25	$1.177	03/25/85	$27.82	$1.159	No Change			N/A	N/A	N/A
02/10/86	$29.66	$1.236	02/03/86	$29.26	$1.219	01/21/86	$29.00	$1.208	$0.66	$0.028	2.9
11/17/86	$31.44	$1.310	11/03/86	$31.01	$1.292	09/17/86	$31.03	$1.293	$0.43	$0.018	8.7
08/03/87	$33.33	$1.389	08/03/87	$32.88	$1.370	06/19/87	$32.88	$1.370	$0.45	$0.019	6.4
03/01/88	$35.04	$1.460	04/18/88	$34.85	$1.452	06/17/88	$34.69	$1.445	$0.35	$0.015	15.4
01/02/89	$37.20	$1.550	01/16/89	$37.99	$1.583	06/16/89	$37.12	$1.547	$0.87	$0.036	23.6
10/02/89	$40.68	$1.695	08/01/89	$40.66	$1.694	12/04/89	$40.46	$1.686	$0.22	$0.009	17.6
05/02/90	$43.92	$1.830	04/02/90	$43.92	$1.830	04/30/90	$44.26	$1.844	$0.34	$0.014	4.4
05/02/91	$46.32	$1.930	11/15/90	$47.88	$1.995	05/22/91	$47.54	$1.981	$1.56	$0.065	26.9

Source: Price data are from the manufacturers' wholesale pricing sheets for 40,000 pound truckload quantities. Compiled by the Center on Budget and Policy Priorities.

The infant formula makers have taken advantage of this situation by steadily increasing prices at rates far above inflation. On average over the last decade, the infant formula manufacturers have increased prices by nearly 11 percent per year. In contrast, milk and cheese prices have risen an average of two

percent and three percent per year, respectively, and fruit juice prices have increased less than six percent per year.

Competitive bidding for WIC contracts represents a threat to the manufacturers' oligopoly. Competitive bidding for single-source contracts forces manufacturers to compete against one another on the basis of price. In contrast, open market and multi-source rebate systems do not create substantial price competition among manufacturers. (See "Glossary of Cost Containment Terms" on page 10.)

Recently, the lack of competition in the infant formula industry has caught the attention of state and federal regulators. In May 1990, the Antitrust Subcommittee of the Senate Judiciary Committee heard testimony on questionable patterns in WIC rebate bids and infant formula pricing. The Federal Trade Commission testified that it, too, was concerned about recent industry actions, and in June 1990, the FTC launched an inquiry into possible antitrust violations. Since then, the FTC has subpoenaed information from at least three major manufacturers of infant formula, although no findings or conclusions have been announced yet. Moreover, in an unusual move, the Department of Justice's Antitrust Division, which prosecutes antitrust and price fixing cases, recently requested funding for potential litigation arising from the FTC investigation.

In addition, the Florida Attorney General's Office filed suit against the three major infant formula manufacturers in January 1991, charging they violated state and federal antitrust laws. Several other states are investigating the issue, as well.

Questionable Bidding Procedures by Manufacturers in 1990

The first indication the major manufacturers were beginning to engage in questionable practices designed to lower cost containment savings came in March 1990. On March 1, 1990, Ross offered a rebate of just $0.75 per can to Connecticut, the lowest rebate level Ross had ever offered for a single source contract. Ross had to know this bid had no chance of winning. Instead, Ross' bid may have sought to signal the other manufacturers that they should all reduce rebate offers to about the 75 cent level. Six days later, Mead Johnson responded by sending letters to several states with expiring contracts announcing its intention to offer just $0.75 per can for either open market or single-source contracts. In the 18 competitive bid openings during the rest of 1990, Mead submitted rebate bids of $0.75 per can for single-source contracts (or an equivalent bid in home delivery and direct distribution states) on 14 occasions and refused to bid in one instance. Ross bid $0.75 per can in eight instances and offered $0.757 per can once.

Mead's letter of March 6, 1990, was highly unusual because it was a public announcement of a rebate offer and was sent before these states had even requested rebate bids. It thereby undermined the sealed bidding procedures used in seeking cost containment contracts. Many industry observers believe that Ross and Mead were trying to arrange a truce over competition for WIC contracts. By consistently bidding low rebate amounts, they appear to have been signalling each other that rebates bids could be safely lowered.

The pattern of the manufacturers' bids during 1990 hints at an effort to undercut single source rebate systems. During that year, Ross and Mead began offering higher rebates for some open market or multi-source contracts than for single-source rebate systems. Even though a single-source system increases the market share for the winning manufacturer, the bids from Ross and Mead indicated they preferred open market and multi-source systems. Such a bidding practice is highly suspect because it means the individual companies were willing to pay a higher rebate under a rebate system that would result in fewer sales of their product.

III. Cost Containment Trends — A Net Price Analysis

Tracking bidding patterns over time is complex. Simply examining trends in rebate levels is not especially helpful, because that fails to take changes in wholesale prices into account. After all, the rebate level does not, itself, reflect the cost of infant formula to a state WIC program. If a state's rebate level increases, but not enough to keep pace with infant formula price increases, the cost the state pays for formula will rise.

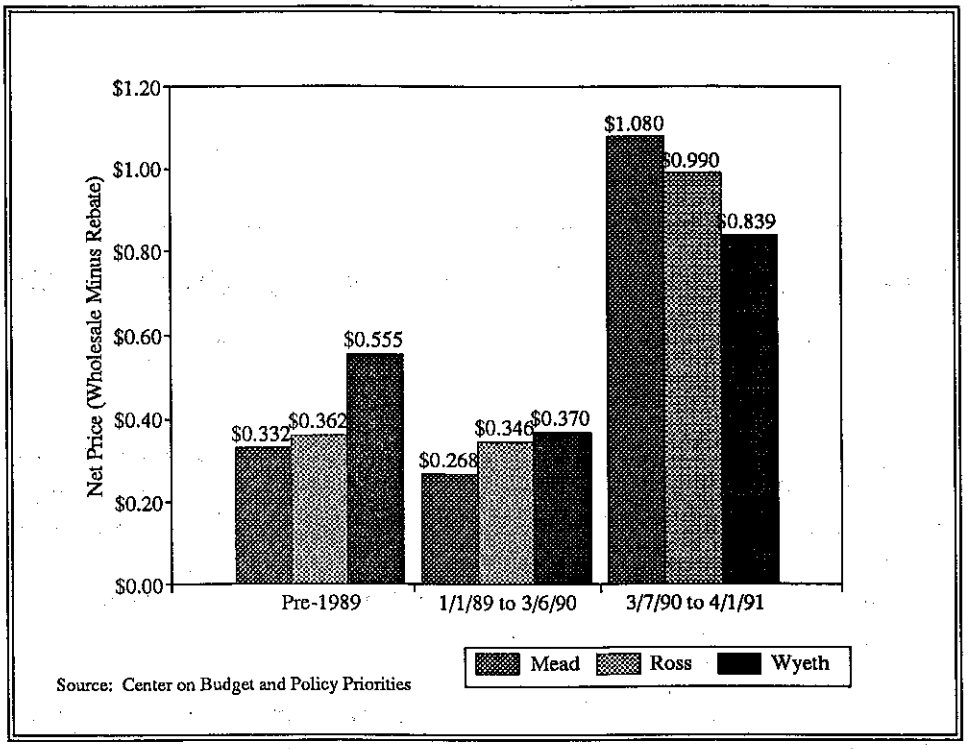
Consequently, a more useful comparative measure is the "net price" of formula. The net price of infant formula is the difference between the wholesale price of formula and the rebate the state secures from its cost containment contracts. Comparing differences in net prices over time takes into account both changes in wholesale prices and changes in rebate levels.

In addition, since the retail prices charged for infant formula are closely tied to the wholesale prices, the net price calculated for a state WIC program approximates the actual cost the program pays for infant formula. More important, the change over time in the net price for a particular state is the best indicator of the change in the amount the state actually pays for the formula products used in its WIC program.

The changes in the bidding behavior of the major manufacturers after March 6, 1990, can be seen by examining trends in the net prices the manufacturers offered in their rebate bids. Prior to 1989, the median net price reflected in Mead

Johnson's bids under single source rebate systems was $0.332 per can.[4] The median net price in Ross single-source bids was $0.362 per can. The median net price offered by Wyeth was $0.555 per can.

Figure 1
Median Net Prices Bid
for Single-Source Contracts, by Manufacturer



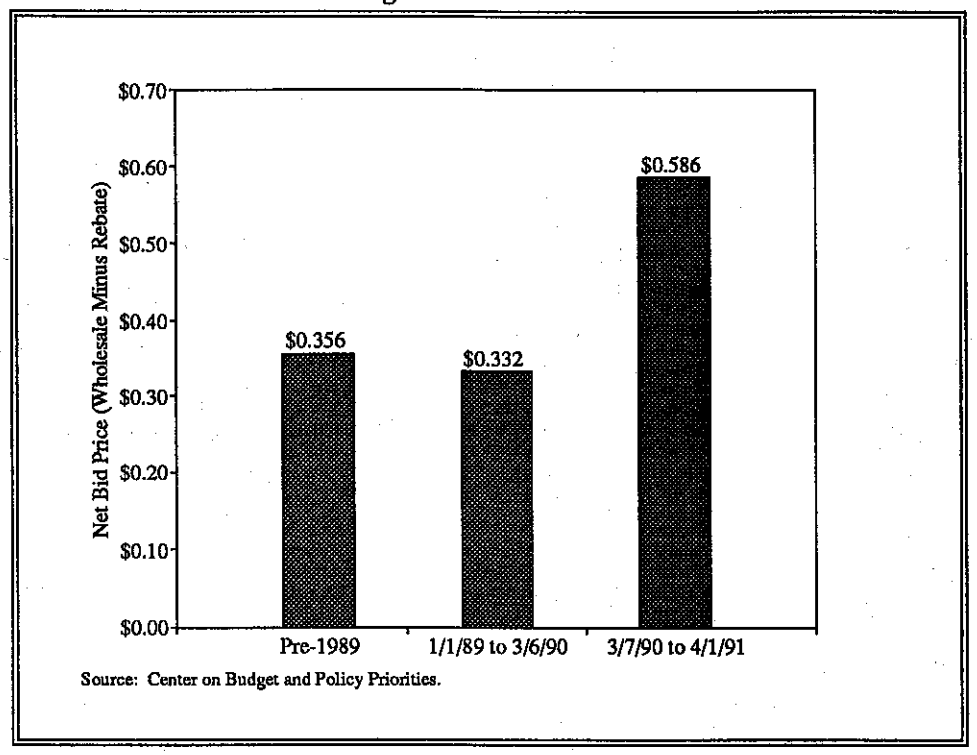
As competition for WIC contracts intensified during 1989 and early 1990, Mead lowered the median net price for its single-source bids to $0.268 per can, while the median net price offered by Ross edged down to $0.346 per can. The median net price in Wyeth's bids fell to $0.370 per can during this period.

After March 6, 1990, however, when the companies began to "signal" one another in an effort to reduce rebate levels, the net prices reflected in rebate bids rose substantially. The median net price in single-source bids submitted by Mead Johnson rose nearly four-fold, to $1.080 per can, during the period from March 7, 1990, through March 1991. The median net price reflected in Ross' single-source

[4] The median net price offered by a manufacturer during a particular period of time is the net price that falls exactly in the middle of all net prices the manufacturer offered during that period. In other words, half the net prices offered by the manufacturer would be lower than the median net price, while the other half would be higher.

bids climbed to $0.990 per can. The net price in Wyeth's bids increased to $0.839 per can (see Figure 1).

Figure 2
Median Net Prices for
Single-Source Contracts



Source: Center on Budget and Policy Priorities.

The result has been much higher net prices for many contracts signed since March 6, 1990 (see Figure 2). Since that time, the median net price reflected in *winning* bids for single-source contracts has been $0.586 per can. (This figure represents the median net price for winning bids submitted by all manufacturers.) In contrast, the median net price for winning single-source bids from January 1989 to March 6, 1990, was $0.332. Thus, the typical winning net price for single-source contracts rose more than 75 percent after March 6, 1990.

The effects of this change in bidding practices vary from state to state. Some states that have entered into new contracts since March 1990 have still been able to improve their cost containment savings. Texas and Florida captured lower net prices in 1990. They will save an additional $672,000 and $1.5 million, respectively, on an annual basis. A few states that had exceptionally low rebate levels under their previous contracts also secured gains in savings.

Table II
Increases in Annual Infant Formula Costs for Selected States

State	Increased Infant Formula Costs Under New Contracts Signed After March 1, 1990
Alaska	$33,000
Arizona	$367,000
Colorado	$820,000
Indiana	$3,729,000
Iowa	$539,000
Kentucky	$868,000
Minnesota	$1,811,000
Mississippi	$1,788,000
Montana	$324,000
Nevada	$872,000
Oklahoma	$1,474,000
Oregon	$867,000
West Virginia	$650,000

Note: The cost differential assumes that the average WIC infant receives 27.17 cans of 13 ounce iron-fortified, milk-based infant formula per month, the average reported in USDA's 1988 participant characteristics study. (The amount is less than 30 cans per month because not all WIC infants receive infant formula.) In addition, the calculation assumes market shares of 35 percent for Mead, 55 percent for Ross, and 10 percent for Wyeth.

But the majority of states seeking new contracts after March 1, 1990, have had to pay much higher infant formula costs than under their previous contracts. For example, the net price Indiana pays for infant formula jumped from $0.184 to $0.514 per can. The difference is costing Indiana approximately $3.7 million annually. (See Table II.)

Likewise, the price Mississippi pays to purchase formula rose from $0.332 to $0.515 per can, an increase in cost of nearly $1.8 million to the state. Under Minnesota's new contract, the net price of formula increased from $0.224 to $0.590 per can, an additional cost of slightly over $1.8 million a year. Oklahoma is paying an estimated $1.4 million more per year under the contract it secured during 1990. Formula costs have risen more than $800,000 in each of four other states that began new contracts during 1990: Kentucky, Colorado, Nevada, and Oregon.

If this pattern continues of lower infant formula rebates under new contracts than under contracts written before March 1, 1990, a growing number of state WIC programs will be faced with substantial increases in food package costs. Since so many participants are currently being served through savings generated from infant formula rebates, higher infant formula costs could lead to significant reductions in the number of women, infants and children reached by WIC. As a result, it is important for states to explore ways to reinvigorate competition for infant formula contracts and maximize cost containment savings.

IV. Multi-State Purchasing: Models for Intergovernmental Cooperation

One potential method of increasing competition for cost containment contracts is "cooperative purchasing." Cooperative purchasing refers to joint state efforts to procure products or services. The principle behind cooperative purchasing is that states can pool their purchasing power and leverage lower prices from suppliers. Cooperative purchasing also allows states to share expertise and, in some cases, may reduce administrative efforts needed to secure the best possible prices. Several states have purchased cooperatively for a variety of goods and services. State WIC programs of Maryland, Delaware, and the District of Columbia used a multi-state infant formula cost containment contract in 1989, a contract still in effect today, and five states in the Northeast region recently secured a joint contract.

Many states join together to take advantage of volume discounts.[5] Multi-state contracts have been signed with phone companies to leverage higher commissions for pay phones in public buildings. Delaware, Maryland, and Virginia have used cooperative purchasing arrangements to procure police vehicles, road salt, and street lamps. Lower prices have been negotiated through cooperative purchasing for drugs used in state health facilities in Minnesota, Wisconsin, and Colorado.

Cooperative purchasing has been most successful when applied to products and services with volume-sensitive prices. In other words, cooperative purchasing works best with items that are discounted when purchased in large quantities. By

[5] Council of State Governments, "CSG Backgrounder: Cooperative Purchasing: A New Trend in Interstate Relations," October 1990.

working together, states are able to multiply their buying power and command lower prices.

In addition, cooperative purchasing allows several states to take advantage of expertise in another state and to share administrative costs associated with product procurement. For instance, if one state has significant experience in purchasing a certain product or service, other states can use that state's knowledge by purchasing cooperatively. The other states would not have to develop their own RFPs or bid evaluation techniques. Instead, they would simply join in the first state's RFP. The first state benefits from lower prices than if it went alone, and the other states can save administrative time and effort, as well.

States must consider several factors when exploring cooperative purchasing. Every state's procurement laws define a range of technical requirements that government purchases must satisfy. Since cooperative purchases must fulfill every participating state's procurement requirements, cooperative purchasing arrangements need to be scrutinized by each state. Certain state requirements, such as in-state preferences, may conflict. Such preferences should not affect infant formula, however, because the industry is dominated by a few large corporations.

Many state procurement codes neither specifically authorize nor prohibit cooperative purchasing. In a handful of states, cooperative purchasing arrangements are not allowed. According to a survey by the National Association of State Purchasing Officers, Alabama, Florida, Nevada, Ohio, and Texas have statutes that prohibit cooperative purchasing.[6] Fifteen states and one territory have statutory language expressly authorizing cooperative purchasing: Arizona, Arkansas, California, Colorado, Connecticut, Guam, Illinois, Indiana, Kentucky, Maryland, Montana, New York, Oregon, South Carolina, Utah, and Vermont.

In states where legislation authorizes cooperative purchasing, there often are no regulations clarifying cooperative purchasing procedures, because the concept is so new. Other states do not have legislation either authorizing or barring cooperative purchasing. States without clear authorizing language should seek an opinion from their state attorneys before attempting a cooperative purchase. In any case, state attorneys' offices should be consulted to avoid legal obstacles.

Several efforts are under way to make procurement laws more uniform and remove obstacles to cooperative purchasing. The American Bar Association's Model Procurement Code includes provisions authorizing cooperative purchasing.

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[6] Ibid.

Article 10 of the Model Procurement Code for State and Local Governments spells out the legal and technical language needed. Thirteen states (Alaska, Arizona, Arkansas, Colorado, Indiana, Kentucky, Louisiana, Maryland, Montana, New Mexico, South Carolina, Utah, and Virginia) as well as Guam have enacted portions of the Model Procurement Code. While not all 14 jurisdictions ratified the provision authorizing cooperative purchasing, there may be fewer obstacles to cooperative purchasing in these states because their procurement laws are more alike. To facilitate cooperative purchasing, the National Association of State Purchasing Officers is developing model legislation to authorize cooperative purchasing explicitly and to simplify procurement requirements.

States without legislation specifically authorizing joint procurements should not be deterred, however. Several of the states with multi-state contracts in place do not have statutory language that speaks to this issue. In most states, it should not be necessary to have explicit authorizing legislation so long as the cooperative purchasing process meets state requirements.

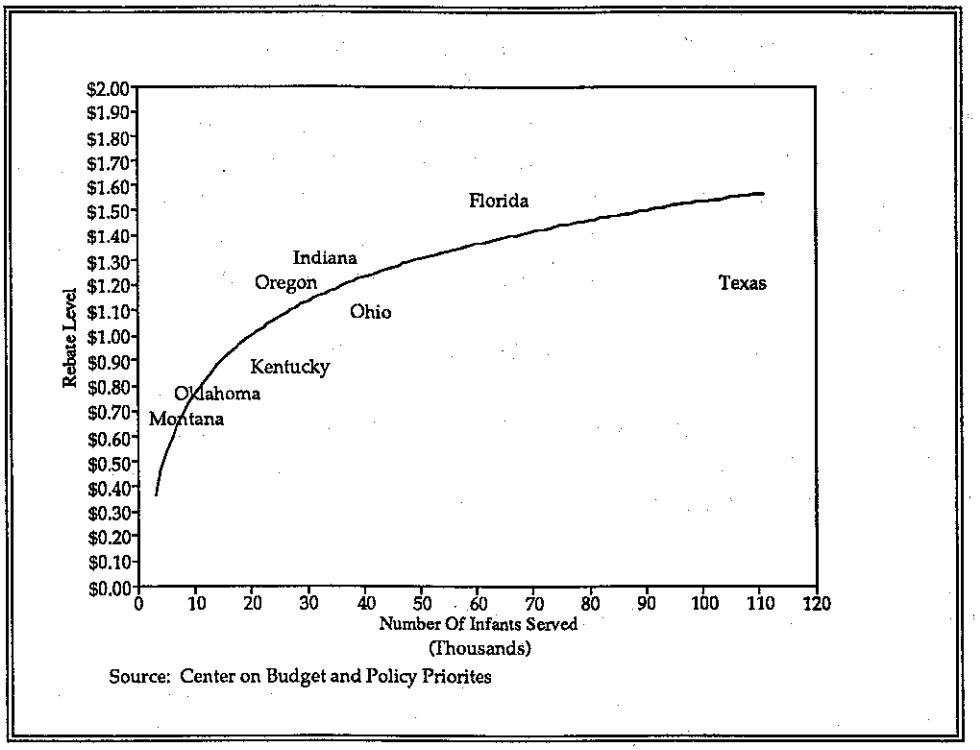
Infant Formula and Cooperative Purchasing

Cooperative purchasing is most successful when states are procuring goods and services that are less expensive if purchased in large quantities. Infant formula cost containment has already demonstrated that the purchasing power of state WIC agencies can generate large discounts. Furthermore, larger states have received the most favorable rebates. Consequently, cooperative purchasing appears to be a logical next step to maximize savings from infant formula cost containment.

Generally, under competitive bid systems, winning rebate amounts increase in rough proportion to the number of infants served. Historically, the largest states — California, Florida, New York, and Texas — have obtained the highest rebate amounts. While changes over time in bidding practices or infant formula prices may cause some shifts in rebate levels and other factors sometimes play a role as well, there generally is a relationship between the rebate amounts being offered by the companies and the number of infants served in a state.

Consider the period from April to November 1990. Montana, the state serving the fewest infants among those seeking bids during this period, received the lowest winning rebate bid. Florida, the second largest state to solicit bids during this period, received the highest rebate bid. The winning bids generally increased with the number of infants served. (See Figure 3.) The evidence suggests that as state size increases, the manufacturers bid more aggressively

Figure 3
Winning Competitive Bids
Received from April to November 1990



for WIC contracts. In large states, the sheer number of infants served may make the contract too valuable to ignore and force manufacturers to compete more actively.

The greatest deviation in the pattern during April to November 1990 occurred in Texas. While the winning rebate bid was not lower than the previous rebate level, it was lower than expected for a state the size of Texas. The lower-than-expected bids in Texas came at the time in the spring of 1990 when the infant formula manufacturers were making their most aggressive efforts to roll back rebate levels. Texas was the first large state to seek a new contract after the manufacturers instituted their questionable bidding practices in March 1990. Only two manufacturers submitted acceptable bids in Texas. Ross offered a rebate of just 50 cents a can — a level so low it would have failed to win any previous single-source contract, even in a small state — and also failed to meet the state's bid specifications; Ross effectively declined to compete. Still, the winning bid in Texas, submitted by Mead Johnson, was the highest of all bids opened by states during the spring and summer of 1990.

The disadvantage of small state size is also apparent in the low rebates generated by Native American state agencies (see Table III). In most instances,

USDA's Report on Infant Formula Rebate Systems

In May 1991, the Office of Analysis and Evaluation of the Food and Nutrition Service released *Cost Effectiveness of Infant Formula Rebate Systems in the Special Supplemental Food Program for Women, Infants and Children*. The report, mandated by Congress, provides information about cost containment.

Two of the report's principal findings are that competitive bidding has produced significantly higher rebate savings than other forms of cost containment and that larger states generally receive greater rebates than smaller states.

The report noted that based on data available as of May 15, 1991, states with competitive sole-source contracts receive a weighted average rebate of $1.58 per 13-ounce can of liquid concentrate formula. States with multi-source competitive systems receive a weighted average rebate of $1.30 per can, while states with open market systems receive a weighted average rebate of $1.10 per can.

USDA also reported that sole-source agreements yielded the largest savings for large, medium, and small states alike. "On average," the report said, "states with competitive sole source agreements obtained the largest per can rebates...This was true for states with large, mid-sized, and small WIC caseloads."

Another USDA finding was that the size of a state's program influenced the rebate savings it secured. The report divided states into three categories: those with total caseloads exceeding 150,000, those with caseloads in the 50,000 to 150,000 range, and those with caseloads below 50,000. Not surprisingly, the USDA data show that larger states received greater rebates, with the average rebate in large states being 48 percent higher than the average rebate in small states (other than small states using a multi-state contract).

"A key factor in achieving higher per can rebates appears to be the size of the WIC caseload," USDA concluded.

The report offers several observations on multi-state agreements, although this is the weakest part of the report and appears to be colored by the lack of success of the initial multi-state ITB in the Northeast. The USDA report was written after the first Northeast bid failed to lead to a multi-state contract — but before the five New England states successfully secured a multi-state contract in June.

The report concludes that multi-state contracts may boost rebates in states other than those with large programs. It also observes that multi-state systems are complex to develop and administer.

Our analysis indicates, however, that the USDA observation on the complexity of multi-state systems is something of an oversimplification. The three Mid-Atlantic states did not find their multi-state system overly complex to develop and administer. And while the Northeast states did put in considerable work in developing their multi-state system, in so doing they may have accomplished a substantial portion of the work for those states that come after them. The initial competitive bid contracts back in 1987 and 1988 involved a large amount of development work on the part of Tennessee and Oregon, but today competitive bidding requires much less work of states. In addition, there is little reason to believe that once a multi-state contract is in place, it entails substantial new administrative burdens. This has not been the experience of the District of Columbia, Maryland, and Virginia.

The USDA report raises some questions as to whether multi-state systems will be beneficial for large states. The questions are based largely on the fact that the original Northeast ITB produced a rebate offer lower than that which New York was currently receiving. New York's current rebate level, however, is the result of a contract signed before the infant formula companies began lowering rebates in March 1990. It is unclear what rebate level it would receive if it sought new bids today. Thus, the impact of multi-state contracts on large states remains an open question. The logic of USDA's basic finding that larger states secure higher rebates — as well as the $1.88 rebate level received by California, with the nation's largest WIC program — suggests that multi-state systems could prove beneficial to large states as well. This is a question only further experience can answer.

The disadvantage of small state size is also apparent in the low rebates generated by Native American state agencies (see Table III). In most instances, Native American agencies receive lower rebates than the state in which they are located. The small size of some Native American state agencies allows the manufacturers practically to ignore cost containment efforts. The current rebates received by many Native American agencies are modest compared with rebates secured by the states. The higher infant formula costs that Native American agencies must pay, while not large in total dollars, represent a loss of public funds that might be recaptured through use of cooperative purchasing mechanisms.

Table III
Rebate Secured by Selected Native American Agencies Compared with Geographic States, January 15, 1991

	Ross	Mead	Wyeth	Rebate System
Arizona	$1.185	$1.000	—	Multi-Source
Navajo	$0.813	$0.732	—	Open Market
ITCA	—	$0.732	—	Single-Source
Colorado	$1.135	$1.130	—	Multi-Source
Ute Mt.	$0.796	$0.732	—	Open Market
New York	$1.672	—	—	Single-Source
Seneca	—	$0.732	—	Open Market
North Carolina	$1.358	$1.098	—	Open Market
E. Cherokee	$0.740	$0.732	—	Open Market
North Dakota	$1.178	$1.098	—	Open Market
Stand. Rock	$0.664	—	—	Open Market
Oklahoma	—	—	$0.775	Single-Source
Cherokee	$0.895	$0.732	—	Open Market
Chickasaw	$0.796	$0.732	—	Open Market
Choctaw	$0.796	$0.740	—	Open Market
ITC-OK	$0.732	$0.740	—	Open Market
South Dakota	$1.358	$1.098	—	Open Market
Cheyenne	$0.796	$0.732	—	Open Market
Rose. Sioux	$0.796	$0.796	—	Open Market

Rebates presented are for 13 ounce cans of iron-fortified infant formula.

Center on Budget and Policy Priorities

Developing Cooperative Infant Formula Cost Containment Efforts

States can take advantage of the relationship between rebate levels and the number of infants served by developing cooperative cost containment strategies. While small and medium-sized states may be able to do relatively little to increase cost containment savings when they act individually, they can make infant formula contracts more attractive to manufacturers by joining with other states. Together, several small states can have the same buying power as a large state and generate increased infant formula savings.

The first multi-state WIC cost containment effort was developed by Delaware, the District of Columbia, and Maryland. The three states issued a joint invitation-to-bid for infant formula rebates in April 1989. This also represented the first attempt by those states to secure a rebate contract. The winning bid from Mead was $1.340, the second highest bid ever received at that time. It is difficult to estimate how much lower the rebates might have been if the three states had not joined together. The District of Columbia and Delaware are among the smallest state agencies, and they might have received significantly lower rebates.

Though the joint contract was their first attempt at cost containment, all three states characterize the effort as smooth. Since all three states had worked together extensively in the past, collaboration came easily. The cooperative effort was straightforward. The three states simply agreed to basic contract provisions, and the Maryland Attorney General's Office drafted the necessary legal specifications. After all three states inspected the invitation-to-bid and added any needed addenda, the invitation was released. The final contract does not differ significantly from competitive bid contracts used by individual states.

The cooperative effort among Delaware, Maryland, and the District of Columbia came during a period of rapid cost containment progress. At the time, the manufacturers were actively competing to gain market share and were offering high rebate levels. Since then, the environment for cost containment efforts has become more hostile. In this environment, new RFPs must be planned even more carefully than in the past, and technical provisions must be closely scrutinized before release.

The second multi-state cost containment effort was unveiled on January 3, 1991, when the seven Northeastern states released a joint invitation-to-bid. The ITB culminated over a year of planning and close collaboration by the seven states. The initial bids received in response to the ITB were rejected, and five of the seven states then released a new ITB with some modifications. A bid received in response to the ITB was accepted, and contracts have been signed. More information on the Northeastern ITB is provided below.

Considerations for Multi-State Cost Containment Efforts

While cost containment has become almost routine in most states, any cooperative effort must involve the attorney general's office in each state. Because of the special status of cooperative purchasing under state procurement laws, legal counsel is vital to assuring the integrity of the bidding process and contract awards. By planning ahead and involving counsel from the start, potential obstacles can be removed before they become problems.

States considering cooperative cost containment efforts need to consider several issues. First, which states should be included and how large a group should be formed to maximize savings? A multi-state rebate contract requires a high level of collaboration, and states in the same region tend to have had more interaction in the past. States within a region also have the advantage of sharing a single USDA regional office. Inter-regional efforts would require the involvement of more than one USDA office. On the other hand, other groupings of states may better parallel the distribution networks of some of the infant

formula companies. In any event, any combination of states should be able to work together. There is no reason why a Midwestern state cannot join with a Southern state or a Mountain Plains state in a multi-state contract.

In theory, the larger the grouping of states, the higher the rebate bids should be. But it may not be necessary to create a very large grouping of states. Once the difference between wholesale prices and rebate levels nears the actual cost of production plus a fair return on capital, increasing the size of the WIC contract may not produce dramatic improvements in the rebate level. Consequently, it may not be necessary to form a group of states serving more than 100,000 infants to pursue cooperative purchasing. In fact, any grouping of states may produce better rebate levels than if the states went out alone. In addition, the total number of infants that would be served by the contract is more significant than the number of states. It should not matter if the multi-state contract is composed of two states that serve 25,000 infants each or five states that serve 10,000 infants each. (Appendix B lists the number of infants served by each state and Native American program.)

States choosing to seek cooperative cost containment contracts must also consider how to choose a winning bid. The first ITB issued by the Northeast states specified:

- The NORTHEAST STATES will act as a *single entity*, accepting and implementing the most beneficial system. No individual rebate offers will be considered (emphasis added).

Under this ITB, all seven participating states had to agree to the winning bid. However, when the bids were opened, the rebates offered were lower than the current rebates in several of the states. As a result, not all of the participating states could agree on awarding a contract to the company offering the most favorable bid.

A provision requiring all participating states to agree on a winning bid has advantages — it locks in the size of the multi-state contract and makes it easier for the bidders to evaluate the contract's value. However, it also removes flexibility from the participating states and enables a single state to scuttle the effort by not agreeing to go along with a contract. If states choose to use this "single entity approach," the procurement process should start early enough to allow a second bid if the initial ITB fails to produce a contract.

When five of the Northeast states released a second joint ITB in March 1991, they removed the single entity provision, replacing it with a provision guaranteeing that no fewer than a specified number of infants would be included

because it was their first cost containment initiative. By contrast, the Northeastern states did have to grapple with this problem because each state had an existing contract. Rhode Island's contract did not end until September 30, 1991, while Connecticut's expired on May 31, 1991. To accommodate these differences, the Northeastern states included the following provision in their ITB:

- Any NORTHEAST STATE currently under an agreement for a rebate system reserves the right to continue that agreement until its expiration date and automatically assume the provisions of the new agreement at that time. Notwithstanding provisions of current agreements, NORTHEAST STATES reserve the right to cancel prior agreements and accept this new bid. If a NORTHEAST STATE elects to continue its current rebate system, that state will automatically assume the provisions of the agreement pertaining to this bid effective the day immediately following the expiration of the current agreement. All provisions of the new agreement will then be assumed.

Such a clause provides greater flexibility for the participating states. For example, if State X has a contract valid until December 31, 1991, but State Y's contract expires after July 1991, the multi-state contract would become effective in August in State Y and next January in State X. This provision also allows a state to implement the new contract sooner — and to cancel its current contract — if the winning rebate is higher than that received under its current contract.

A provision allowing flexible start dates is especially important for states currently operating an open market rebate system. A few open market states have a contract provision voiding the contract if the state awards a competitive bid rebate contract. Without a flexible start date, the manufacturers could void the current contract and cause disruption in the state's WIC program. The flexible start date used by the Northeastern states allows an open market state to delay awarding the new contract to assure continuity between its rebate contracts.

Since state procurement laws vary so widely, a multi-state cost containment contract must also reflect the special requirements set out in each participating state's law. Even though the states and the winning manufacturer sign a single contract, each state has its own unique set of standard contract provisions. In the case of Delaware, the District of Columbia, and Maryland, the three states were able to include all necessary provisions in a single invitation-to-bid and contract. In contrast, the Northeastern states attached separate appendices with each state's standard clauses to accommodate applicable state laws. The Northeastern states' ITB includes a paragraph for each state specifying that the state's standard clauses

are included in an appendix and are part of the agreement between the manufacturer and the respective state.

A contract provision must also be added to specify governing law in case of contract disputes. Both the Northeastern states' ITB and the Delaware, District of Columbia, and Maryland contract state:

- This Agreement shall be deemed to have been executed and entered into separately in the [participating states] and shall be construed, performed, and enforced in all respects in the respective jurisdictions in accordance with the laws of the [participating states]. In [state 1], [state 1]'s law shall apply. In [state 2], [state 2]'s law shall apply... Each party shall perform it's obligations hereunder in accordance with the terms and conditions of this Agreement. All other provisions in the Invitation to Bid remain unchanged.

Though initial cooperative efforts can entail a substantial amount of work, once these efforts are established, subsequent efforts should be straightforward. In addition, once a standard cooperative contract is developed, the applicable parts can be replicated more easily by other states. While differing state procurement laws will make each cooperative effort unique, the key to success is the willingness of participating states to cooperate and undertake the joint effort. In the long run, more uniform state procurement laws may make cost containment still easier to conduct.

Native American Agencies

Because of the small size of Native American agencies and the limited administrative resources available to them, cost containment can be more difficult for these agencies than for states. As a result, cooperative purchasing may be a promising strategy both to simplify cost containment administration and to increase infant formula savings for Native American agencies.

Cooperative purchasing involving Native American agencies could take many forms. First, Native American agencies could simply join the rebate contracts of the state in which they are located. Another option is for Native American agencies to join together in a single cooperative purchasing contract. If some or all Native American agencies joined a single rebate contract, it would avoid much duplication of effort and would likely result in substantially greater infant formula cost savings. In addition, a cooperative cost containment contract covering some or all Native American agencies could generate savings for the first

The WIC Infant Formula Feeding Initiative Act of 1991 (S. 657 and H.R. 1441)

In March 1991, Senators Patrick Leahy (D-Vermont) and Howard Metzenbaum (D-Ohio) introduced a bill to require multi-state cost containment. Rep. Ron Wyden (D-Oregon) introduced a companion bill in the House of Representatives. The bill would make several sweeping changes in the way infant formula cost containment is conducted:

- USDA would assume the responsibility of administering the procurement of infant formula contracts. States would no longer conduct their own cost containment competitions. Instead, states would use the formula brand selected through the USDA's bidding process. (No changes would be required in how states process WIC checks or bill for rebates.)

- USDA would be required to conduct annual sealed-bid cost containment competitions for single source contracts. States would cease operation of open market or multi-source rebate systems after their current contracts expire.

- Under the bill, each of the seven FNS administrative regions would be covered by its own cost containment contract. This approach is aimed at pooling the buying power of the states in each region to make the contract more valuable to the manufacturers. The bill does not require a single national contract to avoid placing too large a share of the infant formula market with a single manufacturer.

- USDA would be authorized to permit manufacturers to submit bids for some but not all of the types of formula used in the WIC program. In other words, a bidder would be allowed to bid only on milk-based formulas or only on powdered formula. Thus, different manufacturers could win the competition in a particular region for different types of formula. The intent of this provision is to allow manufacturers that do not market an entire line of infant formula (e.g., Carnation, Gerber, and Loma Linda) to compete.

States that operate a direct distribution or home delivery system would be exempt from these requirements if they could demonstrate they would receive a discount equal to or greater than the anticipated regional discount or that the administrative burdens entailed would be too great.

The bill would also impose a stiff penalty for any manufacturer that announces what it will bid on a WIC contract before the formal bid opening. USDA could disqualify such a manufacturer from the WIC program for up to two years.

Finally, the bill would authorize USDA to mandate multi-state cost containment for other WIC food items. To do so, however, USDA would have to demonstrate that the savings would constitute a large percentage of the retail cost, the food item is produced by a very small number of manufacturers, and the administrative cost expended would not outweigh savings. The only product that appears to have the potential to fit this description is infant cereal.

time for agencies currently receiving no infant formula rebates at all because of their small size. (Native American agencies with fewer than 1,000 participants are not required to seek cost containment savings.) Any Native American cooperative effort would, however, need to conform to individual tribal procurement rules, just like state cooperative efforts need to accommodate state procurement requirements.

V. Effective Cost Containment Contract Provisions

Over the course of several years of cost containment activity, states have developed many creative contract provisions to maximize savings. Several contract provisions have proven particularly beneficial to states. Not all states have taken advantage of these provisions, however. Although the manufacturers may complain about such provisions, they have signed many contracts with them. States should include such provisions as long as the provisions continue to generate additional savings.

Every cost containment contract, whether for a single state or a cooperative effort, should contain three key provisions: 1) cent-for-cent inflation adjustments; 2) restrictions on use of alternate infant formula; and 3) full billing for all infant formula purchased.

Inflation Adjustments

For at least a decade, infant formula prices have increased at a rate far exceeding overall food price inflation. Over the last 10 years, infant formula prices have risen at an average of over 10 percent per year. As a result, cost containment savings can erode significantly if adequate inflation adjustments are not included in rebate contracts.

The preferred type of inflation adjustment is a "cent-for-cent adjustment." A cent-for-cent inflation adjustment provides that every increase in wholesale prices will result in an equivalent increase in the rebate level. It locks in the net price of formula over the life of the contract.

Not surprisingly, the manufacturers prefer inflation provisions that set the rebate at a constant percentage of the wholesale price. Such adjustments do not assure stable infant formula prices for states over the life of a cost containment contract. Moreover, since infant formula price increases come at irregular intervals and with little warning, a state without a cent-for-cent inflation adjustment can be subject to sudden increases in WIC food package costs. This can force unplanned participation reductions or food package adjustments.

In contrast, a state protected from inflation by a cent-for-cent clause will have constant, predictable infant formula costs. Consequently, every state should seek to include a cent-for-cent inflation adjustment in its cost containment RFPs. Currently, 27 states — including nearly all states with single-source contracts — have cent-for-cent inflation adjustments in their rebate contracts.

While the manufacturers may urge use of alternative inflation adjustments such as "a fixed percentage of the wholesale price" or the "Ross math formula," none offer the level of price protection of a cent-for-cent provision. Manufacturers may complain about cent-for-cent inflation adjustments in bid conferences, especially in states considering open market or multi-source bids. But since all states now must use a sealed bid process, the manufacturers must agree to state contract specifications. The manufacturers no longer have the same leverage over these contract provisions that they did when open market contracts were negotiated.

Consequently, there is no reason for a state not to write a cent-for-cent inflation adjustment into both the single source and multi-source (or open market) components of its RFP. Most states that have sought bids since federal law was changed to require competitive bidding have included cent-for-cent provisions in their ITBs and RFPs.

When designing an inflation adjustment provision, it is also important to specify the timing of the adjustment. Most states receive the rebate adjustment at the beginning of the first month *after* a price increase has taken effect. As a result, the rebate adjustment can be delayed up to 30 days after a price increase occurs, and a state may lose thousands of dollars in rebates. The manufacturers claim that this practice is fair because retail prices lag over a month behind wholesale price increases. However, wholesale price increases are often quickly passed along to consumers, especially in stores that depend on distributors not stocking large inventories of formula.

It is possible for states to secure contracts that adjust the rebate at the same time the price increase becomes effective. Montana, Nebraska, Oregon, Pennsylvania, and Texas have inflation provisions that adjust the rebate on the

same day as the price increase. The states of Indiana, Minnesota, and New Jersey have an even more attractive provision. In these states, the rebate is adjusted retroactively to the first day of the month in which prices are raised. This provision has merit: in the future, manufacturers may routinely raise prices at the beginning of the month to get close to a full month of higher prices before paying higher rebates. For example, the latest Mead price increase took effect May 2, 1991. Consequently, it is more important than in the past for states to address this issue in their new RFPs and contracts.

Alternate Formula Use

In some states with single source rebate systems, the use of alternate brands of infant formula (i.e. non-contract brands) remains an issue. It is important to distinguish "alternate formula" from specialized infant formula. Highly specialized infant formulas are prescribed for premature infants and for infants with certain metabolic disorders. Specialized formulas are rarely covered by cost containment contracts. By contrast, standard infant formulas include milk and soy-based products. As used here, the term alternate formula refers to non-contract brands of standard formula.

Because of federal regulations governing infant formula quality, standard infant formulas are essentially identical nutritionally. There is no evidence to suggest any one standard formula is nutritionally preferable to another. Unfortunately, marketing efforts by the infant formula manufacturers often obscure that fact. It is common practice for physicians to give a new mother a pre-printed form that looks like a prescription and that specifies a particular brand of infant formula. In addition, hospitals routinely distribute to new mothers "discharge packs" that include literature and samples from an infant formula manufacturer. These discharge packs are designed to look authoritative rather than commercial. Consequently, many families are persuaded to believe the product "recommended" by their physician or hospital is "better" than other infant formulas.

The use of alternate brands of formula under competitive bid systems is a concern because it reduces the rebate savings available to state WIC programs. Since there are few instances when alternate formula use is medically justified, its use usually represents an unnecessary loss of resources to the WIC program.

USDA has specified that when comparing the relative savings produced by different cost containment systems, states should assume that use of alternate formula will not exceed four percent under a single source system. In practice, even a four percent rate of alternate formula use is usually not justified. With

proper physician and participant education and formula prescription controls, use of alternate brands of standard formula generally can be reduced to lower levels. For example, Texas reports an alternate formula use rate well below two percent.

The key to reducing alternate formula use is education of health professionals and participants. The more that participants understand that different brands of formula are nutritionally identical and that use of an alternate brand means fewer people like themselves can get WIC benefits, the more comfortable they are likely to feel about using a WIC-designated formula. Participants also need to understand that problems like spitting up or irritability in an infant are unlikely to be related to use of a particular brand of formula. In addition, keeping health professionals informed about the loss of savings when the WIC program provides non-contract formula should reduce recommendations to use other formula brands.

In addition, states should institute various controls on alternate formula use. As a matter of policy, states using a single-source system of cost containment should not accept pre-printed forms specifying use of a particular brand of infant formula. In addition, use of an alternate brand of standard formula should be subject to prior approval by the state agency. A number of states have instituted this control process. Prior approval allows a central authority to weigh the merits of requests for alternate formula use on a case-by-case basis. Generally, the approval simply involves a local nutritionist calling the state WIC office and does not delay benefits for participants. Instituting such controls can reduce alternate formula use to nominal levels. Furthermore, prior approval allows a state agency to monitor accurately the number of cans of formula not subject to rebates and whether particular health professionals are prescribing unusually large amounts of the non-contract brands.

Billing for All Formula Purchased

State banking procedures provide accurate counts of WIC voucher redemptions. Many states, however, include a provision in their cost containment contracts for "exceptions," "substitutions," "errors," or "equity." These provisions discount the number of cans to be billed for rebates by a few percentage points (usually by two percent). In theory, the discount is designed to account for instances when a store might accept a WIC check for a non-contract brand of infant formula.

However, there is little reason for a state to lower the number of cans billed to a designated manufacturer. States should seek to bill for every unit of formula purchased. Automatically lowering the number of cans billed to the manufacturer

simply reduces the savings to a state. Since the deduction is not tied to any actual estimate of error or substitution, it is a "give-away" to the manufacturer. If the manufacturers truly felt such errors existed, they could simply reduce the rebate level they offer. Currently, 10 of the 28 states that do not operate open market rebate systems bill for all formula used by the WIC program.

Other Important Contract Considerations

There are a variety of other issues to consider in designing an infant formula cost containment contract. These include:

- *Products subject to rebates.* Cost containment efforts should include all milk and soy-based products, whether in liquid concentrate, powder, or ready-to-feed forms. However, Wyeth does not market an eight ounce can of ready-to-feed soy formula. Since the eight ounce can of ready-to-feed soy formula is seldom used in WIC, states should not include the product in their RFP. Otherwise, Wyeth would be disqualified from bidding and there would be less competition for WIC contracts.

- *Scheduling of payments.* Since so many participants are served with rebate funds, payment mechanisms are critical to program management. Monthly billing is important to assure adequate cash flow. Many states have also included provisions requiring manufacturers to make a number of advance rebate payments upon request. Advance rebate payments from the manufacturer to the state are essentially loans, and it is not unreasonable for the manufacturers to request a token fee or a discount as interest. Nevertheless, advance payments are often necessary to lessen the cash flow problems related to the added participation made possible by cost containment.

- *Provision of product samples.* Formula samples and educational materials from infant formula manufacturers can be useful to local WIC clinics. If these resources are necessary, contracts should include provisions requiring that specific quantities of formula samples and educational materials be made available to local agencies.

- *Duration of contract.* Multi-year contracts save administrative effort. In addition, if the contract includes cent-for-cent inflation adjustments, infant formula costs are locked in for the life of the contract. Some observers argue that manufacturers may also offer higher rebates for

longer contracts because such contracts provide a guaranteed WIC market for a longer period and allow time for the manufacturer to expand its market share. However, others point out that with cent-for-cent inflation adjustments, multi-year contracts may be less attractive to the manufacturers because profit margins will decline over the course of the contract. One-year contracts provide states both with greater flexibility and with increased administrative burdens and more uncertainty about future rebate levels.

Including a contract provision that allows the state unilaterally to extend the contract may be ideal. If rebate levels being secured in new contracts fall considerably, a state can protect itself by extending its contract when the initial contract period expires. At the same time, if rebate levels rise, the state can take advantage of the improved bidding climate, allow the contract to expire, and seek new bids. Arizona, Mississippi, Montana, North Dakota, Oklahoma, Oregon, and Vermont have unilateral options to extend their current contracts. Delaware, the District of Columbia and Maryland also have a unilateral option to renew contracts.

Some states have an option to extend that must be approved by the manufacturer. An option to extend that gives the manufacturer veto power over an extension provides no advantage to the state. Under such options, if the bidding climate favors the company, the manufacturer may simply not allow a contract extension.

- *Alternate Rebate Systems.* While single-source rebate systems generate greater cost-containment savings, some states prefer to seek rebate bids for alternate systems, too. Federal regulations allow states to choose an alternate rebate system if it generates savings equal to the single source system. If a state chooses to seek bids on an alternate rebate system, a multi-source system is far preferable to an open market system. The multi-source system is preferred because it provides savings on all infant formula products purchased by WIC. In contrast, the open market system allows use of infant formula products that generate no savings whatsoever.

Related Vendor Contract Provisions

Some states have included provisions in their contracts with WIC vendors to assure vendors do not mark up the price of the contract brand of formula by an excessive amount. For example, Texas' vendor contracts stipulate that vendors can mark up the wholesale price of the WIC contract brand — which is Mead Johnson formula — by no more than the percentage they mark up Ross products. Missouri, which recently signed a single-source contract with Wyeth, plans to include a similar provision in the standard Missouri vendor contract to ensure that vendors do not charge more for Wyeth products than they charge for other brands. Missouri also plans to protect against higher retail prices for Wyeth products by holding Wyeth responsible for guaranteeing that vendors can purchase Wyeth products from the same wholesalers from which they purchase other brands of formula. Presently, some retailers in the Missouri can not purchase Wyeth products from their normal wholesalers due to Wyeth's relatively small market share in Missouri.

Other states may wish to explore placing similar provisions in cost containment RFPs and contracts and in their standard vendor contracts.

VI. Beyond Infant Formula: Extending Cost Containment

Infant Cereal

Procedures developed to contain infant formula costs can be applied to some other WIC foods. In November 1990, Texas awarded the first rebate contract for a product other than infant formula. Texas signed a competitive bid contract with Gerber to supply infant cereal for the WIC program. Gerber will rebate $0.41 for every eight ounce box of infant cereal used by the Texas WIC program. The rebate is about 50 percent off the wholesale price. Gerber also agreed to a cent-for-cent inflation adjustment. Over the course of the 19-month contract, Texas expects to save between $550,000 and $600,000.

Like infant formula, infant cereal is a relatively easy target for cost containment. WIC food package regulations set basic nutritional guidelines for acceptable cereal. Unlike adult cereals, there is relatively little variety in infant cereal used by WIC programs. In addition, bidding administration is relatively simple because there are only a few infant cereal manufacturers. Gerber, Beech-Nut, and Heinz manufacture almost all the infant cereal consumed in this country. Gerber was the only manufacturer to respond to Texas' infant cereal invitation-to-bid. Afterward, however, Heinz told Texas it is very interested in bidding for WIC contracts in the future.

Texas' invitation-to-bid was patterned after its infant formula ITB. The state sought rebates on rice, barley, oatmeal, mixed, and high protein dry infant cereals. Bidders were required to offer rebates on at least four of the five types of infant cereal. The principal difference between the formula and cereal ITBs is a clause in the cereal ITB concerning product distribution. Since nearly all infant cereal purchased through the Texas WIC program is manufactured by Gerber, the state

was concerned about the ability of other manufacturers to distribute sufficient supplies to WIC vendors. Consequently, Texas required all bidders to describe their distribution network and list their wholesale distributors.

Texas' infant cereal cost containment effort merits examination by other states. While savings for infant cereal are small compared with those received for infant formula, cereal rebates can still be significant in medium and large-sized states. And by using infant formula contracts as models, even some small states may be able to achieve savings without significant administrative effort or cost.

Least Expensive Brands

Some states also require that participants select the least expensive brand of a particular product. In such circumstances, participants are usually required to select a store brand or a generic package equivalent rather than a national brand. Since the nutritional content of a carton of orange juice or milk is the same whether it is packaged with a national brand or a store brand, this requirement has minimal impact on participants. In Texas, a least expensive brand policy for milk, cheese, peanut butter, and juice saves the WIC program $200,000 per month. Texas vouchers are for specific WIC foods such as juice. In Texas, WIC participants must purchase the least expensive brand of whatever juice they prefer.

While the price difference can yield significant savings, states must evaluate if this approach is cost-effective for them. Administrative costs to enforce this practice, such as changes to vendor contracts and vouchers, may in some circumstances exceed the anticipated savings.

Competitive Vendor Agreements

A new cost containment idea was developed in Delaware last year. Delaware implemented a competitive bid procedure to select WIC vendors. Vendors in designated service areas bid against each other for all food items used in the WIC program. Only those vendors offering the lowest maximum prices in each service area are selected. To assure sufficient access to WIC vendors, the state matches the number of winning vendors in a service area to the number of WIC participants in the community. The maximum prices each vendor charges to WIC are locked in for the life of the contract. As a result of the procedures, the Delaware WIC program will experience far less food cost inflation during the term of these contracts than will other state WIC programs.

Under these procedures, the state agency still pays grocers the normal retail price. However, at the end of each month, the state reconciles the checks that have been redeemed with the contract prices. If the redeemed amount on a WIC check is greater than the contract price, the state bills the vendor for the difference. If food prices fall and the redeemed prices are less than the contract prices, the state does not pay the vendor an additional amount.

The Delaware vendor cost containment system has been highly successful. However, the system has required extensive changes in banking procedures and a great deal of time to administer. Simply designing the bidding procedures and selecting the vendors involved a substantial amount of effort. (The validity of the bidding process was challenged in court by a vendor, causing delays and additional burdens on the program.) While Delaware's system may not be easily replicated in large numbers of states, the principles behind it may warrant examination by other WIC programs.

VII. Conclusion

Cost containment has become more complex. Questionable patterns in bids submitted by infant formula manufacturers since March 1990 have resulted in lower infant formula savings under many recent contracts. To maintain high rebate levels and large infant formula savings, states need to continue their efforts to maximize competition for WIC contracts.

So long as WIC fails to serve every eligible women, infant, and child, state WIC agencies should aggressively pursue cost containment strategies. Inadequate WIC funding means that only slightly more than half of all eligible persons are being served. Currently, nearly 4 million eligible individuals are not being reached. Every dollar saved through cost containment is a dollar available to serve an individual who is currently excluded.

Moreover, WIC has been found to be even more cost-effective than previously believed. A failure to maximize cost containment savings thus leads to a double toll: through fewer individuals served by WIC; and through Medicaid expenditures that could have been averted by greater WIC participation.

Cooperative purchasing is a worthwhile model for WIC agencies to explore. By pooling resources, states can share administrative burdens, skills and expertise for cost containment efforts. More important, many states should be able to increase the attractiveness of their cost containment contracts and reinvigorate competition for these contracts.

Infant formula rebate levels appear to be related to the quantity of formula purchased. The manufacturers offer lower prices to buyers of trainload quantities of formula than to buyers of a few cases. In addition, infant formula cost

containment is established on the principle that WIC should receive a lower price for formula because it purchases it in large quantities. State WIC agencies that purchase the largest volumes of formula generally receive higher rebate bids than smaller states.

Applying cooperative purchasing to infant formula cost containment extends that principle. By developing multi-state RFPs and rebate contracts, smaller states can make their WIC contracts as valuable to the manufacturers as a larger state's contract. The size of a multi-state contract should make it too valuable to ignore. Consequently, the manufacturers should be forced to compete more vigorously, and the cooperating states should receive more favorable rebate bids and greater savings.

The smallest WIC agencies have the most to gain from cooperative purchasing arrangements. By joining in multi-state contracts, they may be able to leverage rebate levels similar to those being secured in states such as Florida or Texas. In addition, Native American agencies, the smallest of all WIC agencies, could gain additional funds without significant administrative burdens. By joining with each other or with states in which they are located, they could reduce administrative burdens and extend cost containment to the smallest Native American agencies.

As states consider their strategies and options during 1991 and 1992, cooperative purchasing efforts should be explored. Even if initial attempts at cooperation may require more administrative work, future cooperative endeavors should be simpler. Moreover, unless aggressive state action is taken on the cost containment front, states may confront lower rebate levels in the next few years, and more eligible individuals may be left out of the WIC program.

States should also carefully examine other cost containment bid and contract provisions as they prepare for a new round of bid solicitations and contract awards. The experience of the past few years suggests that certain provisions that have successfully been written into a number of state contracts should now be extended to most other states and have the potential to enhance cost containment savings further.

APPENDIX A

CONTRACTS THAT EXPIRE DURING 1992, BY DATE OF EXPIRATION

State	System	Manu-facturer	Length of Contract Start Date	End Date	Total Months
Illinois	Ill. Model (1)	Ross	02/01/89	01/31/92	36 mos.
		Mead	02/01/89	01/31/92	36 mos.
New York	Comp. Bid	Ross	02/01/89	01/31/92	36 mos.
Tennessee	Comp. Bid	Mead	03/01/89	02/29/92	36 mos.
Virginia	Open Market	Ross	03/01/89	02/29/92	36 mos.
		Mead	03/01/89	02/29/92	36 mos.
Kansas	Multi-Source	Ross	04/01/89	03/31/92	36 mos.
		Mead	04/01/89	03/31/92	36 mos.
Delaware	Comp. Bid	Mead	05/01/89	04/30/92	36 mos. (2)
D.C.	Comp. Bid	Mead	05/01/89	04/30/92	36 mos. (2)
Maryland	Comp. Bid	Mead	05/01/89	04/30/92	36 mos. (2)
Oklahoma	Comp. Bid	Wyeth	05/01/91	04/30/92	12 mos.
Washington	Open Market	Ross	06/01/89	06/30/92	36 mos.
		Mead	05/01/89	06/30/92	36 mos.
		Wyeth	06/01/89	06/30/91	25 mos. (3)
		Loma Linda	04/01/89	06/30/92	38 mos.
Kentucky	Comp. Bid	Ross	07/01/91	06/30/92	12 mos.
Montana	Comp. Bid	Wyeth	07/01/91	06/30/92	12 mos.
Idaho	Open Market	Ross	10/01/89	09/20/92	36 mos.
		Mead	10/01/89	09/20/92	36 mos.
Colorado	Multi-Source	Ross	10/01/90	09/30/92	24 mos.
		Mead	10/01/90	09/30/92	24 mos.
Iowa	Multi-Source	Ross	10/01/90	09/30/92	24 mos.
		Mead	10/01/90	09/30/92	24 mos.
Nevada	Open Market	Ross	10/01/90	09/30/92	24 mos.
		Mead	10/01/90	09/30/92	24 mos.
		Wyeth	10/01/90	09/30/92	24 mos.
Texas	Comp. Bid	Mead	10/01/90	09/30/92	24 mos.
Utah	Open Market	Ross	10/01/89	09/30/92	36 mos.
		Mead	10/01/89	09/30/92	36 mos.
		Carnation	10/01/89	09/30/92	36 mos.
West Virginia	Open Market	Ross	10/01/90	09/30/92	24 mos.
		Mead	10/01/90	09/30/92	24 mos.
		Carnation	10/01/90	09/30/92	24 mos.
Michigan	Comp. Bid	Mead	11/01/89	10/31/92	36 mos.
Oregon	Comp. Bid	Wyeth	12/01/90	11/30/92	24 mos. (2)

(1) The Illinois Model is a "competitively procured" open market rebate system.

(2) State has unilateral option to extend contract.

(3) Wyeth has verbally agreed to extend contract to 6/30/92; state is awaiting written confirmation.

APPENDIX B

Number of Infants Served
by the WIC Program in March 1991

The number of infants served by the WIC program in a state an indication of the potential volume of WIC infant formula sales in the state. (Breastfed infants are included in the numbers below, however.) States are listed according to the number of infants served.

1	California	208,056
2	Texas	109,640
3	New York	108,669
4	Illinois	71,911
5	Ohio	71,146
6	Florida	69,937
7	Georgia	52,884
8	Michigan	49,586
9	Pennsylvania	46,049
10	Puerto Rico	45,836
11	North Carolina	44,218
12	Tennessee	42,275
13	Indiana	35,562
14	Virginia	35,190
15	Alabama	34,506
16	Louisiana	33,983
17	New Jersey	31,367
18	Missouri	30,659
19	South Carolina	30,396
20	Mississippi	30,289
21	Washington	28,040
22	Kentucky	26,990
23	Maryland	22,486
24	Massachusetts	20,760
25	Wisconsin	20,712
26	Arkansas	18,850
27	Minnesota	17,998
28	Arizona	17,052
29	Oklahoma	16,457
30	Connecticut	12,632
31	Kansas	12,498
32	Oregon	12,417
33	New Mexico	11,575
34	Colorado	11,484
35	Utah	11,441
36	West Virginia	11,428
37	Iowa	11,322
38	Nebraska	6,891
39	Idaho	6,657
40	Hawaii	5,994
41	Maine	5,723
42	Nevada	5,161
43	District of Columbia	5,016
44	Rhode Island	5,001
45	New Hampshire	4,174
46	Navajo Tribe (AZ)	4,091
47	Montana	4,060
48	South Dakota	4,022
49	Delaware	3,870
50	North Dakota	3,338
51	Alaska	3,118
52	Vermont	2,898
53	Wyoming	2,446
54	Inter-Tribal AZ	1,651
55	Cherokee, OK	1,564
56	Virgin Islands	1,531
57	Guam	1,045
58	Choctaw, OK	725
59	WCD, OK	472
60	Chickasaw Nation, OK	452
61	Potawatomi, OK	300
62	Rosebud, SD	284
63	ITCN, NV	229
64	Otoe, MS	192
65	Pueblo of Zuni, NM	185
66	Shoshone/Arapahoe,WY	177
67	Stdg Rk Tr, ND	176
68	MS Choctaw, MS	162
69	E. Cherokee. NC	158
70	ALC, NM	139
71	Isleta, NM	126
72	Cheyenne River, SD	123
73	NE IITDC, NE	117
74	Ft Berthold, ND	108
75	Eight N. Pueblo, NM	107
76	Maniilaq Assn, AK	107
77	Inter-Tribal, OK	94
78	Five Sandoval, NM	58
79	Santo Domingo, NM	50
80	Seminole Tribe, FL	45
81	Seneca Nation, NY	44
82	San Felipe, NM	40
83	Ute Mountain, CO	32
84	Miccosukee, FL	15
85	Point Pleasant, ME	17
86	Indian Township, ME	14

Source: USDA, *State Agency Participation and Expenditure Report, Fiscal Year 1991*, March 1991.