

Appendix A—History of the WIC Infant Formula Rebate Program

Several States have engaged in infant formula cost containment practices since WIC's establishment in the early 1970s (Harvey et al., 1988). For example, Vermont, which uses a home delivery system to distribute WIC foods, has always used competitive bidding to purchase infant formula for its WIC program. Mississippi, which uses a direct distribution system for WIC foods, purchased infant formula in bulk in order to take advantage of available discounts.²⁵ However, the other States, all of which use retail purchase systems to distribute WIC foods, purchased infant formula at full retail prices prior to 1987.²⁶

In the mid-1980s several factors prompted the States with retail purchase systems to look into alternative ways to reduce infant formula costs: (1) nearly 40 percent of total WIC food costs were attributed to infant formula; (2) formula prices grew faster than overall food prices; and (3) the infant formula industry structure suggested that cost containment initiatives could be successful (GAO, 1990). Tennessee became the first State with a retail purchase food delivery system to implement a rebate system to control costs associated with infant formula when it awarded a competitively bid single-source exclusive contract in June 1987. Significantly, the contract was awarded to Wyeth Laboratories (the only company to submit a bid), who—since it accounted for only a small portion of the infant formula market—had the most to gain from winning a sole-source contract (Post and Wubberhorst, 1989). In December 1987, Oregon became the second State to implement a competitively bid single-source exclusive contract. The contract was awarded to Wyeth Laboratories, which was once again the only company to submit a bid (GAO, 1990).

In late 1987 and early 1988, Florida, Michigan, and Wyoming instituted an alternative infant formula cost containment strategy, known as the “open market” system. Under this system, there were no sealed bids or exclusive contracts. Rather, infant formula manufacturers voluntarily agreed to provide a rebate to the State

for their share of infant formula purchased through WIC (Center on Budget and Policy Priorities, 1995). However, WIC participants could still choose formula of manufacturers that chose not to provide a rebate. In spring of 1988, Texas awarded a competitive bid single-source exclusive contract, which was the first to be bid on by more than one manufacturer (GAO, 1990).

On October 1, 1988, P.L. 100-460 required that all State WIC agencies explore the feasibility of implementing cost containment procedures for acquiring infant formula, and if the procedures were determined to lower costs, begin implementing the cost containment system within a year. Although States had the option of using a home delivery system (Vermont) or direct distribution system (Mississippi) to reduce costs, most found these to be infeasible due to the costs associated with administering the program systems or because of their impact on participants (USDA, 1991). By late 1989, 57 State WIC agencies had implemented infant formula rebate contracts, 35 used the open market system, 19 used the competitive sole-source system, and 3 used a competitive multisource rebate approach (GAO, 1990).²⁷ Savings under the open market system, in which no sealed bids were submitted and the low bidder did not win an exclusive contract, resulted in lower savings than under competitive bidding.²⁸ The greater savings realized under the competitive bidding system were attributed to the lack of strong inherent pressure for price competition in the infant formula industry (GAO, 1990).²⁹

On November 10, 1989, P.L. 101-147 required States to use competitive bidding or an alternate method that yielded savings equal to or greater than that produced by competitive bidding to procure infant formula

²⁵In 1984, Mississippi began using competitive bidding (with the low bidder winning the contract) to purchase its infant formula for WIC (Harvey et al., 1988).

²⁶In the past, parts of Ohio and Maryland also used the home delivery system to distribute WIC foods. These areas used competitive bidding to award delivery contracts to the WIC vendors. These vendors in turn, tried to purchase the infant formula at the lowest cost (Harvey et al., 1988).

²⁷Under the competitive multisource rebate system, contracts were awarded to the best bidder and any other bidders who met specified minimum bid criteria (GAO, 1990).

²⁸An analysis by GAO found that after statistically controlling for other factors, competitive sole-source contracts resulted in prices (for a 13-ounce can of milk-based infant formula) that were \$0.36 lower than that of open market contracts (GAO, 1990).

²⁹GAO states that the natural pressures for price competition between infant formula manufacturers are limited in the absence of competitively bid contracts due to: (1) the small number of infant formula producers; (2) the difficulty new competitors face in entering the domestic market; and (3) consumer selection of infant formula brands that may be relatively unresponsive to price differences among the brands (GAO, 1990).

(Indian State agencies with 1,000 or fewer WIC participants are exempted from this requirement). Competitive bidding was defined as a procurement process in which the State WIC agency selects the single source (i.e., infant formula manufacturer) offering the lowest price for the infant formula, as determined by the submission of sealed bids.³⁰

Since the infant formula market was dominated by a small number of manufacturers, there was concern that coordination of pricing strategies between the manufacturers was leading to high infant formula prices and large profits for the producers. In May 1990, the Senate Subcommittee on Antitrust, Monopolies, and Business Rights held a hearing on the pricing behavior of infant formula companies. At the hearing, the Chairman, Senator Howard Metzenbaum, referred to the formula companies' "campaign to undermine cost containment efforts" in the WIC program as an example of the attempts of producers to "push prices higher" (U.S. Senate, 1990). At about that time, the Federal Trade Commission (FTC) began investigating potential anticompetitive practices in the infant formula industry. In June 1992, the FTC brought charges against the three largest domestic manufacturers of infant formula—Abbott Laboratories (parent company of Ross), Mead Johnson, and American Home Products (parent company of Wyeth)—alleging bid-rigging in connection with a WIC contract to provide infant formula in Puerto Rico (Federal Trade Commission, 1993). Mead Johnson and American Home Products agreed to settle charges by providing 3.6 million pounds of free infant formula to the WIC program (Mauskopf and Dean, 1990). In May 1994, the court ruled in favor of Abbott Laboratories (853 Federal Supplement 526, May 27, 1994).

The original cost containment regulations published in 1989 required States to use competitive bidding to obtain infant formula, with the manufacturer offering the "lowest price" being awarded the contract. Historically, States awarded infant formula contracts to the bidder offering the lowest net costs (that is, the difference between the manufacturer's wholesale price for infant formula and the rebate offered to the State).³¹ However, in the mid-1990s, several States began

³⁰The best bid was determined by either the lowest net cost of infant formula or the highest rebate.

³¹At the time the regulations were published in 1989, there were only relatively small differences in the wholesale price of formula across the different brands.

Table 5—Share of the WIC infant formula market by manufacturer, 1994-2001

Fiscal year	Ross	Mead Johnson	Wyeth	Carnation
Percent				
1994	54.2	23.0	17.8	5.0
1995	48.5	32.8	13.7	5.1
1996	22.3	62.4	13.2	2.0
1997	31.0	67.4	0	1.4
1998	31.6	65.5	0	2.9
1999	25.8	70.1	0	4.2
2000	26.8	67.6	0	5.6
2001	27.2	67.8	0	5.0

Source: USDA, Food and Nutrition Service.

awarding their contracts to the bidder offering the highest total rebate (Larin, 1996).³² Contracts awarded on the basis of highest total rebate favor manufacturers with high wholesale prices over those with low wholesale prices. P.L. 105-86, enacted in November 1997, requires that contracts be awarded to the bidder offering the lowest net price unless the average retail price for different brands of infant formula do not vary by more than 5 percent.

The two largest infant formula companies, Ross and Mead Johnson, have long dominated the WIC infant formula market. In fact, only two other infant formula manufacturers, Wyeth and Carnation, have ever won WIC sole-source competitive infant formula rebate contracts, and Wyeth stopped producing infant formula under its own name in 1996.³³ Since all WIC State agencies switched to sole-source competitive rebate systems in 1994 (excluding Indian State agencies with 1,000 or fewer WIC participants), Carnation has accounted for between 1 and 6 percent annually of the formula purchased in WIC (table 5). Mead Johnson has gained in market share over Ross in recent years and now accounts for over two-thirds of the WIC market.

³²The States contended that retail prices were not related to wholesale prices, and if retail prices for the different brands of infant formula were similar, then the State would realize the greatest cost savings by awarding the contract to the bidder offering the largest rebate (Larin, 1996).

³³Two small infant formula manufacturers, Loma Linda and Rimaco, participated in several open market contracts in the early 1990s. These companies have since exited the infant formula market.