

percent) was already included in the FY 2003 standard Federal rate and, therefore, needs to be deducted from the projected market basket increase for the 12-month period of July 1, 2003 through June 30, 2004 (3.3 percent) in order to account for the proposed change in the update cycle.

Consistent with our historical practice of estimating market basket increases, based on Global Insights' (formerly DRI-WEFA) fourth quarter 2002 forecast of the proposed rebased FY 1997-based excluded hospital with capital market basket, we are proposing an update of 2.5 percent, as shown in Table IV. below.

TABLE IV.—CALCULATION OF PROPOSED MARKET BASKET INCREASE FOR THE PROPOSED 2004 LTCH PROSPECTIVE PAYMENT SYSTEM RATE YEAR

	Percent
Proposed 2004 rate year full market basket with capital increase*	3.3
Adjustment for the proposed change in the update cycle**	-0.8
Proposed 2004 market basket increase	2.5

*Projected market basket increase for the 12-month period of July 1, 2003 through June 30, 2004.

**Projected market basket increase for the 3-month period of July 1, 2003 through September 30, 2003 already included in the FY 2003 standard Federal rate.

In addition, based on the best available data for 194 LTCHs, we estimate that LTCH prospective payment system payments would be \$1.960 billion for the proposed 2004 LTCH prospective payment system rate year. As indicated previously, we are proposing to update the FY 2003 standard Federal rate and wage index data 3 months early (July 1, 2003 instead of October 1, 2003). We are proposing that this change be budget neutral because, as we discussed in the August 30, 2002 final rule (67 FR 56027), total estimated LTCH PPS payments in FY 2003 will equal estimated payments that would have been made under the reasonable cost-based principles if the LTCH PPS were not implemented. Based on the most recent data, for the 3-month period from July 1, 2003 through September 30, 2003, the proposed increase in the standard Federal rate would result in an additional cost of \$5.66 million to the FY 2003 Federal budget. Accordingly, in order to maintain budget neutrality for the proposed change in the rate update cycle, under proposed § 412.523(c)(3)(ii), we are proposing to

adjust the standard Federal rate by a factor of 0.997 ((\$1.960 billion—\$5.66 million)/\$1.960 billion) or -0.003. Also, we propose to revise this adjustment factor in the final rule based on the best available data.

Therefore, we are proposing to update the current standard Federal rate (\$34,956.15) established in the August 30, 2002 final rule (67 FR 56033) by 2.2 percent (2.5 percent minus 0.3 percent) for discharges paid under the LTCH PPS that occur on or after July 1, 2003 through June 30, 2004. This proposed update represents the most recent estimate of the increase in the excluded hospital with capital market basket for the proposed 2004 LTCH PPS rate year, adjusted by the above described factor to transition to the proposed change in the rate update cycle to July 1, and is based on the best available data for 194 LTCHs.

2. Proposed Standard Federal Rate for the Proposed 2004 LTCH PPS Rate Year

In the August 30, 2002 LTCH PPS final rule (67 FR 56033), we established a standard Federal rate of \$34,956.15. For the proposed 2004 LTCH PPS rate year, we are proposing a standard Federal rate of \$35,726.64. Since the proposed standard Federal rate has already been adjusted for differences in case-mix, wages, cost-of-living, and high-cost outlier payments, we are not proposing any additional adjustments in the proposed standard Federal rate for these factors.

C. Calculation of Proposed LTCH Prospective Payments for the Proposed 2004 LTCH PPS Rate Year

The basic methodology for determining prospective payment rates for LTCH inpatient operating and capital-related costs is set forth in § 412.521. In accordance with § 412.515, we assign appropriate weighting factors to each LTC-DRG to reflect the estimated relative cost of hospital resources used for discharges within that group as compared to discharges classified within other groups. The amount of the prospective payment is based on the standard Federal rate, established under § 412.523, and adjusted for the LTC-DRG relative weights, differences in area wage levels, cost-of-living in Alaska and Hawaii, high-cost outliers, and other special payment provisions (short-stay outliers under § 412.529 and interrupted stays under § 412.531). In accordance with § 412.533, during the 5-year transition period, payment is based on the applicable transition blend percentage of the adjusted Federal rate and the TEFRA rate unless the LTCH makes a

one-time election to receive payment based on 100 percent of the Federal rate. A LTCH defined as "new" under § 412.23(e)(4) is paid based on 100 percent of the Federal rate with no blended transition payments (§ 412.533(d)). As discussed in the August 30, 2002 final rule and in accordance with § 412.533(a), the applicable transition blends are as follows:

Cost reporting periods beginning on or after	Federal rate percentage	TEFRA rate percentage
Oct. 1, 2002	20	80
Oct. 1, 2003	40	60
Oct. 1, 2004	60	40
Oct. 1, 2005	80	20
Oct. 1, 2006	100	0

Accordingly, for cost reporting periods beginning during FY 2003 (that is, on or after October 1, 2002, and before September 30, 2003), blended payments under the transition methodology are based on 80 percent of the LTCH's TEFRA rate and 20 percent of the adjusted Federal rate. For cost reporting periods beginning during FY 2004 (that is, on or after October 1, 2003 and before September 30, 2004), blended payments under the transition methodology will be based on 60 percent of the LTCH's TEFRA rate and 40 percent of the adjusted Federal rate.

1. Proposed Adjustment for Area Wage Levels

Under the authority of section 307(b) of Pub. L. 106-554, we established an adjustment to account for differences in LTCH area wage levels under § 412.525(c) using the labor-related share estimated by the excluded hospital market basket with capital and wage indices that were computed using wage data from acute care inpatient hospitals without regard to reclassification under section 1886(d)(8) or section 1886(d)(10) of the Act. Furthermore, as we discussed in the August 30, 2002 final rule (67 FR 56015-56019), we established a 5-year transition to the full wage adjustment. For cost reporting periods beginning on or after October 1, 2002 and before September 30, 2003 (FY 2003), the applicable LTCH wage index value is one-fifth of the full FY 2002 acute care hospital inpatient wage index data, without taking into account geographic reclassification under section 1886(d)(8) and section 1886(d)(10) of the Act.

In that same final rule (67 FR 56018), we stated that we would continue to reevaluate LTCH data as they become available and would propose to adjust the phase-in if subsequent data support