

services. For FYs 1996 through 2001, we found that case-mix constant intensity was declining and we established a 0.0 percent adjustment for intensity in each of those years. For FYs 2001 and 2002, we found that case-mix constant intensity was increasing and we established a 0.3 percent adjustment and 1.0 percent adjustment for intensity, respectively.

Using the methodology described above, as we discussed in the May 19, 2003 proposed rule (68 FR 27239), for FY 2004 we examined the change in total charges per admission, adjusted for price level changes (the CPI for hospital and related services), and changes in real case-mix for FYs 1998 through 2002. We found that, over this period and in particular the last 3 years of this period (FYs 2000 through 2002), the charge data appear to be skewed. More specifically, we found a dramatic increase in hospital charges for FYs 2000 through 2002 without a corresponding increase in hospital case-mix index. If hospitals were treating new or different types of cases, which would result in an appropriate increase in charges per discharge, then we would expect hospitals' case-mix to increase proportionally.

The timing of this increase in charge growth is consistent with the dramatic increase in charges that we discussed in the June 9, 2003 high-cost outlier final rule (68 FR 34494). As we discussed in that final rule, because hospitals have the ability to increase their outlier payments through dramatic charge increases, we have made several changes in our high-cost outlier policy at §§ 412.84(i) and (m) in order to prevent hospitals from taking advantage of our current outlier policy.

As discussed above, our intensity calculation relies heavily upon charge data and we believe that this charge data may be inappropriately skewed. Therefore, in the May 19, 2003 proposed rule (68 FR 22739), we proposed a 0.0 percent adjustment for intensity for FY 2004. As we explained in that same proposed rule, in past FYs (1996 through 2000) when we found intensity to be declining, we believed a zero (rather than negative) intensity adjustment was appropriate. Similarly, we believe that it is appropriate to apply a zero intensity adjustment for FY 2004 until we believe that any increase in charges can be tied to intensity rather than to attempts to maximize outlier payments. We received no comments on our proposed 0.0 percent adjustment for intensity. Therefore, in this final rule, we are making a 0.0 percent adjustment for intensity in the update for FY 2004.

Above we described the basis of the components used to develop the 0.7 percent final capital update factor for FY 2004 as shown in the table below.

CMS's FY 2004 UPDATE FACTOR TO THE CAPITAL FEDERAL RATE

Capital Input Price Index	0.7
Intensity:	0.0
Case-Mix Adjustment Factors:	
Projected Case-Mix Change	-1.0
Real Across DRG Change	1.0
Subtotal	0.0

CMS's FY 2004 UPDATE FACTOR TO THE CAPITAL FEDERAL RATE—Continued

Effect of FY 2002 Reclassification and Recalibration	0.0
Forecast Error Correction	0.0
Total Update	0.7

b. Comparison of CMS and MedPAC Update Recommendation

In the past, MedPAC has included update recommendations for capital PPS in a Report to Congress. As we discussed in the May 19, 2003 proposed rule (68 FR 27240), in its March 2003 Report to Congress, MedPAC did not make an update recommendation for capital PPS payments. However, in that same report, MedPAC made an update recommendation for hospital inpatient and outpatient services (page 4). MedPAC stated that hospital inpatient and outpatient services should be considered together because they are so closely interrelated. Their recommendation is based on an assessment of whether payments are adequate to cover the costs of efficient providers, an estimate of input price inflation (measured by the market basket index), and an adjustment for technological charges, which is offset by reasonable expectations in productivity gains.

2. Outlier Payment Adjustment Factor

Section 412.312(c) establishes a unified outlier methodology for inpatient operating and inpatient capital-related costs. A single set of thresholds is used to identify outlier cases for both inpatient operating and inpatient capital-related payments. Section 412.308(c)(2) provides that the standard Federal rate for inpatient capital-related costs be reduced by an adjustment factor equal to the estimated proportion of capital related outlier payments to total inpatient capital-related PPS payments. The outlier thresholds are set so that operating outlier payments are projected to be 5.1 percent of total operating DRG payments.

In the August 1, 2002 IPPS final rule (67 FR 50129), we estimated that outlier payments for capital in FY 2003 would equal 5.31 percent of inpatient capital-related payments based on the FY 2003 capital Federal rate. Accordingly, we applied an outlier adjustment factor of 0.9469 to the FY 2003 capital Federal rate. Based on the thresholds as set forth in section II.A.4.c. of this Addendum, we estimate that outlier payments for capital will equal 4.79 percent of inpatient capital-related payments based on the capital Federal rate in FY 2004. Therefore, we are establishing an outlier adjustment factor of 0.9521 to the capital Federal rate. Thus, the percentage of capital outlier payments to total capital standard payments for FY 2004 is lower than the percentage for FY 2003. This projected decrease in capital outlier payments is mostly due to the changes in the IPPS outlier policy established in the June 9, 2003 high-cost outlier final rule (68 FR 34494).

The outlier reduction factors are not built permanently into the capital rates; that is, they are not applied cumulatively in

determining the capital Federal rate.

Therefore, the net change in the outlier adjustment to the capital Federal rate for FY 2004 is 1.0055 (0.9521/0.9469). The outlier adjustment increases the FY 2004 capital Federal rate by 0.55 percent compared with the FY 2003 outlier adjustment.

3. Budget Neutrality Adjustment Factor for Changes in DRG Classifications and Weights and the Geographic Adjustment Factor

Section 412.308(c)(4)(ii) requires that the capital Federal rate be adjusted so that aggregate payments for the fiscal year based on the capital Federal rate after any changes resulting from the annual DRG reclassification and recalibration and changes in the geographic adjustment factor (GAF) are projected to equal aggregate payments that would have been made on the basis of the capital Federal rate without such changes.

Since we implemented a separate geographic adjustment factor for Puerto Rico, we apply separate budget neutrality adjustments for the national geographic adjustment factor and the Puerto Rico geographic adjustment factor. We apply the same budget neutrality factor for DRG reclassifications and recalibration nationally and for Puerto Rico. Separate adjustments were unnecessary for FY 1998 and earlier since the geographic adjustment factor for Puerto Rico was implemented in FY 1998.

In the past, we used the actuarial capital cost model (described in Appendix B of the August 1, 2001 IPPS final rule (66 FR 40099)) to estimate the aggregate payments that would have been made on the basis of the capital Federal rate with and without changes in the DRG classifications and weights and in the GAF to compute the adjustment required to maintain budget neutrality for changes in DRG weights and in the GAF. During the transition period, the capital cost model was also used to estimate the regular exception payment adjustment factor. As we explain in section III.A.4. of this Addendum, beginning in FY 2003 an adjustment for regular exception payments is no longer necessary. Therefore, we are no longer using the capital cost model. Instead, we are using historical data based on hospitals' actual cost experiences to determine the exceptions payment adjustment factor for special exceptions payments.

To determine the factors for FY 2004, we compared (separately for the national capital rate and the Puerto Rico capital rate) estimated aggregate capital Federal rate payments based on the FY 2003 DRG relative weights and the FY 2003 GAF to estimated aggregate capital Federal rate payments based on the FY 2004 relative weights and the FY 2004 GAF. In the August 1, 2002 IPPS final rule (67 FR 50129) for FY 2003, the budget neutrality adjustment factors were 0.9885 for the national capital rate and 0.9963 for the Puerto Rico capital rate. As a result of the revisions to the GAF effective for discharges occurring on or after April 1, 2003 through September 30, 2003, the budget neutrality adjustment factor is 0.9983 for the national capital rate for discharges occurring on or before April 1, 2003 through September 30, 2003. The budget neutrality adjustment factor for the Puerto Rico capital rate remained