

B. Geographic Practice Cost Index Changes

1. Background

The Act requires that payments vary among Medicare physician fee schedule (MPFS) areas according to the extent that resource costs vary as measured by the Geographic Practice Cost Indices (GPCIs). In general, the MPFS areas that existed under the prior reasonable charge system were retained under the MPFS from calendar years 1992 through 1996. We implemented a comprehensive revision in MPFS payment areas (localities) in 1997, reducing the number of localities from 210 to 89. Thirty-four states have a single statewide locality. In contrast, under the hospital inpatient prospective payment system (IPPS), costs are adjusted across more than 350 metropolitan statistical areas (MSAs).

A detailed discussion of the MPFS payment localities can be found in the July 2, 1996 proposed rule (61 FR 34615) and the November 22, 1996 final rule (61 FR 59494).

2. Implication of GPCIs for Rural Areas

The GPCIs do not affect total national payments under the MPFS, but instead distribute payments among areas according to area cost differences. In general, the data show that urban areas usually have higher costs, while rural areas have generally lower costs. Thus, on average the costs associated with operating a private medical practice, as measured by factors such as wages and rent, are higher in urban areas. Alternatively, the average costs associated with the operation of a private medical practice in a rural area are lower. Since the costs associated with operating a private medical practice are measurably different based upon geographic location, varying payments according to the GPCIs will benefit lower cost areas, usually rural, since the law provides that only one-quarter of the area cost difference in physician work, the largest of the three fee schedule GPCI components, be recognized. We believe this was an attempt by the Congress to shift

payments to rural areas. Thus, about 40 percent of MPFS payments ($.75 \times .52$) are by statute not adjusted for area cost differences. Additionally, one component of the practice expense GPCI, supplies, equipment and other, is also, by statute, not adjusted for area cost differences. Supplies, equipment and other represent about 13 percent of total physician resource costs. This means that, effectively, there is a nationwide MPFS for about 53 percent of the average physician payment (40 percent physician work, 13 percent supplies, equipment and other). That is, only about 47 percent of overall physician payment is adjusted for area resource cost differences. In addition, 34 states are statewide payment localities in which all physicians, whether urban or rural, are paid the same. All of these factors shift payments from higher cost, usually urban, areas to lower cost, usually rural areas.

3. GPCI Composition

Section 1848(e)(1)(C) of the Act requires us to review, and if necessary, adjust the GPCIs at least every 3 years. This section of the Act also requires us to phase in the adjustment over 2 years and implement only one-half of any adjustment if more than 1 year has elapsed since the last GPCI revision. The GPCIs were first implemented in 1992. The first review and revision was implemented in 1995, the second review was implemented in 1998, and the third review was implemented in 2001. The next GPCI review and revision is scheduled for implementation in 2004. However, as will be discussed in more detail, because the work and practice expense GPCIs rely primarily on special tabulations of U.S. Census data not yet available, review and revision of only the malpractice GPCI component will be implemented in 2004. Review and revision of the work and practice expense GPCIs will be implemented in 2005.

Currently, only one data source is available for the practice expense GPCI (relative cost of office rent space

collected by the Department of Housing and Urban Development (HUD)). Since we have not received the primary data upon which practice expense GPCIs are calculated and since the office rent component of the practice expense GPCI has proven not to be very substantial in past GPCI updates (it accounts for approximately 11.0 percent of the total GPCI calculation and is phased in over a two year period), we have decided not to revise the practice expense GPCIs for 2004. The work GPCI relies solely on data collected from the 2000 U.S. Census that is not yet available, so we are not able to propose updates to the work GPCI in this proposed rule.

Although there are general discussions of both the background and composition of all three GPCI components in this proposed rule, a detailed discussion of only the 2004 revised malpractice GPCI is included in this proposal while a detailed discussion of the revised work and practice expense GPCIs will be included in the 2005 proposed rule.

4. Development of the Geographic Practice Cost Indices

The GPCIs were developed by a joint effort of the Urban Institute and the Center for Health Economics Research under contract to CMS. The resource inputs and their weights are obtained from the AMA's Socioeconomic Characteristics of Medical Practices Survey. Indices were developed that measured the relative cost differences among areas compared to the national average in a "market basket" of goods. In this case, the market basket consists of the resources involved in operating a private medical practice. The resource inputs are physician work or net income; employee wages; office rents; medical equipment, supplies, other miscellaneous expenses; and malpractice insurance. Employee wages, rents, and miscellaneous expenses are combined to comprise the practice expense component of the GPCI. Table 2 below illustrates the cost share weights that have been utilized for each GPCI update:

TABLE 2.—GPCI (MEDICARE ECONOMIC INDEX) COST SHARE WEIGHTS

Expense category	1992–94*	1995–97**	1998–00**	2001–03***	2004–07****
Physician Earnings	54.2	54.2	54.2	54.5	52.466
Practice Expenses	40.2	41.0	41.0	42.3	43.669
Employee Wages	15.7	16.3	16.3	16.8	18.654
Rents	11.1	10.3	10.3	11.6	12.209
Equip., Supplies, Other	13.4	14.4	14.4	13.9	12.807
Malpractice Insurance	5.6	4.8	4.8	3.2	3.865
	100.0	100.0	100.0	100.0	100.000

*Weights from 1987 AMA survey.