

(ii) Professional Liability Expense

The weight for professional liability expense was derived from the 2003 AMA survey (2000 data) and was calculated as the mean professional liability expense expressed as a percentage of total expenses (physician earnings plus practice expenses). This calculation resulted in a 3.865 percent share of total costs in 2000 compared to a 3.152 percent share in the 1996-based index. The increase in weight for professional liability insurance represents the increases in premiums and increases in the amount of coverage purchased by physicians in 2000 compared to 1996. Since the data do not reflect any changes caused by increases in these expenses in 2001 and 2002, they do not take into account the recent acceleration in the growth in premiums that physicians have experienced and, therefore, the weights will not reflect these changes. However, the proxy that we currently use in the 1996-based index—and will continue to use in the proposed rebased and revised index—does reflect the price increases associated with the recent rise in malpractice costs.

(iii) Office, Medical Equipment, Pharmaceuticals and Medical Materials and Supplies Expenses, and All Other Expenses

The 2003 AMA survey provides less detail for expenses with respect to prior years' publications. Therefore, we calculated the share of each of the above categories by updating the AMA data for 1998 to 2000 using an appropriate price proxy. The primary reason for using the price proxy was that we lacked other data to develop cost weights for each of these categories. As stated previously, the main deficiency of this method is that it does not account for any changes in the quantity or intensity effects associated with these expenses. Our belief, however, was that it was important to continue using these detailed breakouts so that each would be proxied by an appropriate price index and that the quantity/intensity effects over a short period of time are not likely to be large. In fact, we have found that even over longer periods of time, the distribution of costs tends to be relatively similar.

Office expenses and medical equipment levels were moved to 2000 using the growth from 1998 to 2000 in their respective MEI price proxies. In the case of office expenses, we used the growth in the CPI-U Housing; for medical equipment expenses, we used the growth in the PPI for Medical Instruments and Equipment.

The share for pharmaceuticals (prescription drugs) and medical materials and supplies was calculated by separating out pharmaceuticals and other medical materials and supplies using 1997 BEA Benchmark Input-Output data. First, the sum of all the pharmaceuticals and medical supplies categories from the Benchmark Input-Output tables for 1997 was calculated. The share of pharmaceuticals and medical supplies was then calculated as a percentage of this total and applied to the 1997 AMA medical supplies data. These calculated levels were then inflated to 2000 using the growth in an appropriate price proxy. We thought it was important and appropriate to account for each of these categories separately so that differences in relative price growth between pharmaceuticals (prescription drugs) and other medical materials and supplies would be more accurately represented. The resulting 2000 data for the two separate categories were then aggregated (summed) together to form the overall total for the share for the pharmaceuticals and medical materials and supplies category in the rebased and revised MEI. The pharmaceuticals category was inflated using the Producer Price Index (PPI) for ethical prescription preparations and the medical materials and supplies category was updated using the PPI for surgical appliances and supplies.

Finally, the All Other Expense category was calculated as a residual (total expenses less the percentage of all categories currently accounted for). The additional detail for transportation expenses found in the prior MEI was removed because the data were not readily available for measurement of a cost share for 2000. The effect on the MEI of removing the detail is negligible.

4. Selection of Price Proxies for Use in the MEI

After the 2000 cost weights for the rebased and revised MEI were developed, we reviewed the current set of price proxies to determine whether they were still the most appropriate for each expenditure category. As was the case in the development of the 1996-based MEI (57 FR 55901), most of the indicators we considered are based on BLS data and are grouped into one of the following five categories:

Producer Price Indices (PPIs)

PPIs measure price changes for goods sold in other than retail markets. They are the preferred proxies for physician purchases at the wholesale level. These fixed-weight indices are a measure of price change at the producer or at the

intermediate stage of production, a more likely mode of purchase for physicians.

Consumer Price Indices (CPIs)

CPIs measure change in the prices of final goods and services purchased by consumers. Like the PPIs, they are fixed-weight. Since they may not represent the price changes faced by producers, CPIs were used if there were no appropriate PPI or if the expenditure category was similar to expenditure of retail consumers in general.

Average Hourly Earnings (AHEs)

AHEs are available for production and nonsupervisory workers for specific industries as well as for the nonfarm business economy. They are calculated by dividing gross payrolls for wages/salaries by total hours. The series reflects shifts in employment mix and, thus, is representative of actual changes in hourly earnings for industries or for the nonfarm business economy.

ECIs for Wages/Salaries

These ECIs measure the rate of change in employee wage rates per hour worked. These fixed-weight indices are not affected by shifts in industry or occupation employment levels and measure only the pure rate of change in wages.

ECIs for Employee Benefits

These ECIs measure the rate of change in employer costs of employee benefits, such as the employer's share of Social Security taxes, pension and other retirement plans, insurance benefits (life, health, disability, and accident), and paid leave. Like ECIs for wages/salaries, the ECIs for employee benefits are not affected by changes in industry output or occupational shifts.

When choosing wage and price proxies for each expense category, we evaluate the strengths and weaknesses of each proxy variable using four criteria. The first criterion is relevance. The price variable should appropriately represent price changes for specific goods or services within the expense category. Relevance may encompass judgments about relative efficiency of the market generating the price and wage increases.

The second criterion is reliability or low sampling variability. If the proxy wage-price variable has a high sampling variability or inexplicable erratic patterns over time, its value is greatly diminished, since it is unlikely to accurately reflect price changes in its associated expenditure category. Low sampling variability can conflict with relevance, since the more specifically a price variable is defined in terms of