

wholesaler. The PPIs we use measure price changes at the final stage of production and not intermediate production, however.

Professional Liability Insurance

It is vital that the MEI accurately reflect the price changes associated with professional liability costs. Accordingly, we continue to incorporate into the MEI a price proxy that accomplishes this goal by making the maximum use of available data on professional liability premiums.

Each year, we solicit professional liability premium data for physicians from a small sample of commercial carriers. This information is not collected through a survey form but instead is requested, on a voluntary basis, from a few national commercial carriers via letter. Generally between 5 and 8 carriers volunteer this information. For the CY 2004 update we were able to obtain data from 7 carriers, all of which were in the top 15 companies in 2001 in terms of market share. While the sample size certainly does not cover the entire professional liability insurance market, we have attempted to maximize the market share in terms of both national coverage and coverage within States.

As we require for our other price proxies, the professional liability price proxy should reflect the pure price change associated with this particular cost category. Thus, it should not capture changes in the mix or level of liability coverage. To accomplish this result, we obtain premium information from commercial carriers for a fixed level of coverage, currently \$1 million per occurrence and a \$3 million annual limit. This information is collected for every State by physician specialty and risk class. Finally, the State-level, physician-specialty data are aggregated by effective premium date to compute a national total, using counts of physicians by State and specialty as provided in the AMA publication, *Physician Characteristics and Distribution in the U.S.*

The resulting data provide a quarterly time series, indexed to a base year consistent with the MEI and reflect the national trend in the average professional liability premium for a given level of coverage. From this series, quarterly and annual percent changes in professional liability insurance are estimated for inclusion in the MEI.

Our research has indicated that the most comprehensive data on

professional liability costs are held by the State insurance commissioners but these data are available only with a substantial time lag and, therefore, the data currently incorporated into the MEI are much more timely. We believe that, given the limited data available on professional liability premiums, this methodology adequately reflects the price trends facing physicians.

Comment: Several commenters were concerned about the 6.6 percent increase in the PLI component of the MEI published in the proposed rule and felt that this did not represent the actual increase in premiums physicians are experiencing.

Response: We indicated in the proposed rule that the 6.6 percent increase in the PLI component of the index was based on a forecast. For this final rule we have incorporated actual data (through the second quarter of 2003) that indicates that the increase in the proxy for the PLI component of the MEI is 16.9 percent.

Medical Equipment

Medical equipment includes depreciation, leases, and rent on medical equipment. We will use the PPI for medical instruments and equipment as the price proxy for this category, consistent with the price proxy used in the 1996-based MEI and other CMS input price indexes.

Other Expenses

This category includes the residual subcategory of other expenses such as accounting services, legal services, office management services, continuing education, professional association memberships, journals, professional car expenses, and other professional expenses. In the absence of one price proxy or even a group of price proxies that might reflect this heterogeneous mix of goods and services, we use the CPI-U for all items less food and energy, consistent with the price proxy used in the 1996-based MEI. We also condensed the structure compared to that used in the 1996-based MEI because we lack the data to develop a representative weight for transportation, as discussed above. This change resulted in only a negligible effect on the overall MEI over the past 8 years; the average annual increase differs by less than a tenth of a percentage point over that time.

(b) Productivity Adjustment to the MEI

In the December 2002 final rule, we indicated that we were changing the

methodology for adjusting for productivity in the MEI. The MEI used for the 2003 physician payment update reflected changes in the 10-year moving average of private nonfarm business (economy-wide) multifactor productivity applied to the entire index; we had previously used economy-wide private nonfarm business labor productivity applied to the labor portions of the index. We will continue to use the new method, adjusting for multifactor productivity applied to the entire index, in the rebased and revised MEI.

As described in the December 31, 2002 (68 FR 9568) final rule, we use multifactor productivity because: (1) It is theoretically more appropriate to explicitly reflect the productivity gains associated with all inputs (both labor and nonlabor); (2) the recent growth rate in economy-wide multifactor productivity appears to be more consistent with the current market conditions facing physicians; and (3) the MEI still uses economy-wide wage changes as a proxy for physician wage changes. We also believe that using a 10-year moving average change in economy-wide multifactor productivity produces a stable and predictable adjustment and is consistent with the moving-average methodology used in the 1996-based MEI. The adjustment will be based on the latest available actual historical economy-wide multifactor productivity data, as measured by BLS. For the 2004 update, this means using the multifactor productivity data through 2001, the latest available information.

5. Results of Rebasing

Because the rebased and revised MEI is similar in structure to the 1996-based MEI, updating the MEI from a 1996 base year to a 2000 base year resulted in small changes in expense category weights. Physicians' earnings dropped slightly, from 54.5 percent of the index in 1996 to 52.5 percent in 2000. The expense shares for non-physician employee compensation, office expenses, professional liability insurance, and medical equipment all rose slightly, while expense shares for medical materials and supplies and other expenses declined.

The update using the rebased and revised MEI for the 2004 Physician Fee Schedule is an increase of 2.9 percent. This incorporates historical data through the second quarter of 2003.