

FACT SHEET – DRAFT – 08.04.06

EFFECT OF THE MEDICARE ECONOMIC INDEX (MEI) ON THE PHYSICIAN UPDATE

The Medicare Physician Fee Schedule (MPFS) is updated on an annual basis according to a formula specified by statute. The formula specifies that the update for a year is equal to the Medicare Economic Index (MEI) adjusted up or down depending on how actual expenditures compare to a target rate, called the sustainable growth rate, or SGR. The SGR in turn is calculated based on medical inflation, the projected growth in the domestic economy, projected growth in the number of beneficiaries in fee-for-service Medicare, and changes in law or regulation.

The MEI is a measure of inflation faced by physicians with respect to their practice costs and general wage levels. The MEI includes a bundle of inputs used in furnishing physicians' services such as physician's own time, non-physician employees' compensation, rents, medical equipment, etc. The MEI measures year-to-year changes in prices for these various inputs based on appropriate price proxies.

The economy-wide wage indices used in the MEI as a proxy for changes in the wages of physicians and their employees already include an adjustment for multi-factor productivity (MFP). If the MEI did not net out either the MFP in the wage index proxy or the MFP in the outputs furnished by physicians, it would effectively double-count productivity and result in an overstatement of the MEI.

Since its inception in 1975, the MEI has included a productivity adjustment. The recent rebasing of the MEI in 2004 included an adjustment that accounts for changes in multifactor productivity (MFP). The productivity adjustment has been based on private non-farm business multifactor productivity, as calculated by the Bureau of Labor Statistics (BLS). A 10-year moving average of MFP is used to minimize yearly fluctuations in multifactor productivity associated with normal business cycles.

The BLS recently converted from the Standard Industrial Classification System-based measure of MFP, to the North American Industrial Classification System (NAICS)-based measure. This new productivity data series replaces the previous data series. These represent the best available productivity data, and later years of the previous series are no longer available (the series ended in 2002). Consequently, CMS must use the new NAICS-based data.

The new NAICS-based series contains new data on multifactor productivity for 2003 and 2004, which were incorporated into the 10-year moving average for productivity used in this year's update. The two most recent years' MFP rates were among the highest in recent history and, as a result, the 10-year moving average MFP figure has increased.

The Mid-Session Review of the Budget contained lower projections of inflation, which will affect components of the MEI reducing the projected MEI for 2007. Based on lower projections and the new BLS MFP series, including use of actual rather than estimated data for 2003 and 2004, the 2007 MEI is now estimated to be 0.5 percentage points lower than the estimate contained in the President's Budget. The lower MEI estimate translates into a lower update and as a result, the latest estimate for the physician update for 2007 is negative 5.1 percent. This projection will be updated for the final rule, though we do not anticipate substantial changes.

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