

The Costs and Benefits of Monitoring Providers: Evidence from Medicare Audits

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Abstract

Governments often outsource the provision of goods and services, and then set up mechanisms to detect wasteful spending. However, these monitoring procedures can be costly to implement or to comply with. I use novel administrative data to study the largest monitoring program aimed at identifying and reclaiming Medicare payments for unnecessary inpatient admissions. I exploit plausibly exogenous variation across hospitals and across patients, and find that hospitals respond to monitoring by reducing admissions. I find no evidence that the marginal patient denied admission is harmed, suggesting that hospitals fine-tune their response to target unnecessary care. But in doing so, they incur compliance costs and adopt technology specifically aimed at assessing medical necessity. For every \$1,000 in savings to Medicare, hospitals incur \$216 in compliance costs. My welfare calculations imply that despite the costs, increasing monitoring improves welfare.

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