

# 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 deter wasteful spending. However, this monitoring of third parties can also be costly. In this paper, I use novel administrative data to study the largest monitoring program aimed at detecting and reclaiming Medicare payments for unnecessary hospital admissions. I exploit plausibly exogenous variation in the intensity of monitoring across hospitals and across patients, and find that hospitals respond to it 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, hospitals incur compliance costs and adopt technology specifically for identifying unnecessary care. For every \$1,000 in savings to Medicare, hospitals incur \$216 in compliance costs. My welfare calculations imply that in spite of the costs, increasing monitoring improves welfare.

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