

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

Maggie Shi *

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Abstract

This paper examines the extent to which government programs should monitor for wasteful expenditure when outsourcing to third parties, taking into account the costs and savings associated with monitoring. I use novel administrative data to study the largest Medicare monitoring program aimed at identifying and reclaiming payments for unnecessary inpatient admissions. I exploit plausibly exogenous variation across hospitals and across patients, and find that the majority of savings are due to the deterrence of future admissions. I do not find 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 the medical necessity of care. 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.

*Department of Economics, Columbia University. m.shi@columbia.edu