Title: Voluntary Regulation: Evidence from Medicare Bundled Payments

Authors: Liran Einav, Amy Finkelstein, Yunan Ji, and Neale Mahoney

Abstract: Government programs are often offered on an optional basis to market actors. We explore the economics of such voluntary regulation in the context of a Medicare bundled payment model, in which medical providers receive a single "bundled" payment for all services, instead of separate payments based on the provider and the amount of care. We take advantage of a rare opportunity to assess a voluntary program while observing behavior under the program even for participants who eventually select out: it was originally implemented as a 5-year randomized trial, with mandatory participation by hospitals assigned to treatment, but after two years, participation was unexpectedly made voluntary for half of treatment hospitals. Using detailed claim-level data we document that voluntary participation is more likely for hospitals who can increase revenue without changing behavior ("selection on levels") and for hospitals that had large changes in behavior when participation was mandatory ("selection on slopes"). To assess outcomes under counterfactual regimes, we estimate a simple model of responsiveness to and selection into the program. We find that the current voluntary regime generates inefficient transfers to hospitals and reduces social welfare compared to the status quo, but that alternative (feasible) designs could be welfare improving. Our analysis highlights key design elements to consider under voluntary regulation.