

Subsidy Design, Price Setting, and Quality Provision: A Study of Medicare Advantage

Abstract:

Public–private partnerships often feature imperfect competition, leading to distortions in prices and quality. This paper studies subsidy design in the Medicare Advantage market, focusing on the 2012 Quality Bonus Program, which linked key subsidy parameters to plan quality. We develop a stylized model showing that quality-linked subsidy pass-through can mitigate distortions in both pricing and quality incentives. We then estimate a structural model of demand and supply using plan-level and individual-level data from 2010–2017. We find that quality-dependent subsidies raise quality and welfare, and that linking the rebate rate to quality delivers the largest efficiency gains without increasing government spending.