Abstract:

Dynamic Selection Incentives in the Hospital Sector

This study investigates hospitals' incentives to select patients when hospitals are remunerated according to a prospective payment system of the DRG type. Given that prices typically reflect past average costs (e.g. with a delay of one or two years), we use a discrete-time dynamic framework. We assume that patients differ in severity within a DRG and employ a general objective function of the provider which allows for altruistic concerns. Hospitals' dynamic incentives to select patients are determined under a range of assumptions regarding the degree of providers' altruism and the relation between patients' severity and its benefit. In a steady state, DRG prices are unlikely to give optimal incentives to treat patients. It is even possible that in equilibrium the wrong patients receive treatment.