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### **Members of the Committee,**

I am before you today to share my research and recommendations on measures that the Commonwealth of Pennsylvania can undertake to correct and avoid waste, fraud, and abuse in public programs. In my analysis below, I focus on major themes in public expenditure fraud and generalizable lessons that I hope will be useful in guiding future policy.

### **1. Deterrence, Whistleblowers, and a Pennsylvania False Claims Act**

When considering how the Commonwealth undertakes anti-fraud policy, it is critical to recognize the value of deterrence. By deterrence, I mean money that is saved by stopping or preventing fraud through the threat of being caught. The value of deterrence is not reflected in the current set of policies, which focus on catching fraud that has already occurred and recovering those dollars.

In my research, I have quantified the deterrence effects of anti-fraud policy and found that **deterrence can be much larger than the dollars recovered from enforcement.** In a set of case studies of federal False Claims Act lawsuits against Medicare fraud, I find that deterrence was

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<sup>1</sup> Conflict of interest disclosure: Dr. Leder-Luis receives compensation for expert work on False Claims Act litigation.

nearly ten times the amount of recovered funds. This paper, “Can Whistleblowers Root Out Public Expenditure Fraud? Evidence from Medicare,” is attached to this testimony.<sup>2</sup> While this work is focused on Medicare, its lessons are very relevant to state Medicaid spending as well, which is one of the largest sources of discretionary spending for the Commonwealth of Pennsylvania.

The value of deterrence highlights the importance of funding anti-fraud prevention measures, and properly staffing state anti-fraud agencies such as the Pennsylvania Medicaid Fraud Control Section. When considering return on investment from this funding, it is short-sighted to only consider the amount of money that these offices *get back*. Instead, optimal policy should be informed by the amount of money that these offices *save* the state government, which can be significantly larger, although more challenging to measure.

A related point is that whistleblowers are very valuable. Whistleblowers have information about fraud that cannot be easily obtained elsewhere. The federal False Claims Act empowers whistleblowers to file their own lawsuits and receive a share of recovered funds. Many states have also passed their own False Claims Act programs. In my opinion, a Pennsylvania False Claims Act would be an effective way to incentive whistleblowing and accomplish deterrence.

Importantly, any Pennsylvania False Claims Act statute should be modeled after the federal False Claims Act. It should include the payment of whistleblowers as an incentive and to offset the costs they face, such as professional retaliation. Moreover, like the federal False Claims Act, I believe that a *qui tam* policy that allows whistleblowers to file their own cases has increased value. It removes a bottleneck, the state-level investigation, and allows for the proliferation of detection efforts, which can have powerful deterrence effects. In addition, states that pass a False Claims Act that receives certification from the Office of the Inspector General of Health and Human Services for being substantially similar to the federal law receive additional funds from joint state-federal Medicaid anti-fraud whistleblower lawsuits.

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<sup>2</sup> Leder-Luis, Jetson. “Can Whistleblowers Root out Public Expenditure Fraud? Evidence from Medicare.” Working Paper, 2020. <https://sites.bu.edu/jetson/>

Finally, when considering deterrence policy, it is important to publicize these efforts. Economics research on governance has shown that, when rooting out bad behavior in the government budget, publicizing the results is an important component of improving government outcomes.<sup>3</sup> The federal Department of Justice deliberately publicizes its anti-fraud efforts, and I believe this has valuable deterrence effects. The Commonwealth of Pennsylvania should undertake similar efforts.

## **2. Ineffectiveness of Pay and Chase when Harm is Diffuse**

Current anti-fraud policy at both the federal and state level is focused on recovering fraudulent money after it has already been paid, which I will call “pay and chase.” An alternative to pay-and-chase is to use additional up-front screening measures to ensure that funds are not lost to fraud in the first place.

There are relative benefits to each of these systems. The primary downside to up-front regulation is that it adds a hassle cost for legitimate payments. In contrast, pay-and-chase requires less up-front regulation, but instead relies on the ability to catch bad actors after the fact.

In my paper “Ambulance Taxis: The Impact of Litigation and Regulation on Health Care Fraud,” attached to this testimony, we examine these tradeoffs using Medicare ambulance fraud as a case study.<sup>4</sup> This research applies to many circumstances where the government is setting anti-fraud policy and must decide between using pay-and-chase, the current norm, versus up-front regulation.

In general, our work finds that pay-and-chase is an ineffective system when the government is paying money in a diffuse way, to many firms or individuals. First, it is

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<sup>3</sup> Claudio Ferraz, Frederico Finan, “Exposing Corrupt Politicians: The Effects of Brazil’s Publicly Released Audits on Electoral Outcomes”, *The Quarterly Journal of Economics*, Volume 123, Issue 2, May 2008, Pages 703–745, <https://doi.org/10.1162/qjec.2008.123.2.703>

<sup>4</sup> Eliason, Paul, League, Riley J., Leder-Luis, Jetson, McDevitt, Ryan C., and Roberts, James W. “Ambulance Taxis: The Impact of Regulation and Litigation on Health Care Fraud.” NBER Working Paper #29491, November 2021. <https://www.nber.org/papers/w29491>

challenging to detect which individuals are committing fraud when there are many. Second, individuals and small firms are hard to hold accountable, as it can be challenging to recover stolen funds. In these circumstances, up-front regulation is a valuable tool to ensure payment integrity and prevent fraud. It is more important to regulate an ambulance company to avoid fraud than a large hospital chain, as the latter would be much easier to recover money from in court.

These lessons extend beyond health care fraud. In the context of the pandemic Paycheck Protection Program, a significant challenge is that the fraud is very diffuse, and it is difficult to hold individuals and small firms accountable. There have been more than 300,000 PPP loans to borrowers in Pennsylvania. Similarly, unemployment fraud was widespread during the pandemic, and it is difficult to detect and prosecute fraud when so many different defendants would be involved. As the government of the Commonwealth of Pennsylvania designs anti-fraud measures, it should be sensitive to the value of pre-payment screening when the recipient of funds is a small business.

### **3. Firms Commit Fraud**

The previous topic focused on the necessity of different anti-fraud measures depending on who is committing the fraud. It is worth noting that, in the dozens of case studies I have examined regarding Medicare fraud, it is almost always **firms that commit the most fraud, not individuals**. Even in the case of pandemic unemployment fraud, evidence points to organized groups taking advantage of the system. When designing anti-fraud policy, it is worthwhile to consider who has the most money to gain. In general, the government spends money on third-party firms that provide health care services, build infrastructure, administrate projects, etc. Individuals usually receive small-dollar-value in-kind benefits.

### **4. Importance of Data**

One of the most powerful tools that can be used to prevent fraud in government expenditures is data analysis, especially using machine learning. Fraud is a “needle-in-a-

haystack” problem, where the issue is pinpointing which transactions to flag as fraudulent. In general, governments make too many payments to too many different parties to rely solely on manual detection. Machine learning and data analysis provide tools to assist investigators in detecting, measuring, and proving fraud against the government.

In preliminary research funded by the National Institutes of Aging and the National Bureau of Economic Research,<sup>5</sup> my coauthors and I find that it is viable to use machine learning to detect overbilling in large claims datasets. Similarly, in a newly forthcoming publication at a top finance journal, researchers at the University of Texas at Austin use simple metrics to detect PPP fraud.<sup>6</sup> Similar tools could be used for a variety of purposes at the state level, such as detecting beneficiaries who are ineligible for Medicaid, detecting physicians overbilling state Medicaid for services not rendered, and detecting firms that are receiving overpayments on state contracts.

In general, the government lags behind industry in the use of machine learning. Large firms use and develop machine-learning tools for a variety of purposes, including payment integrity on digital sales platforms. There are substantial gains to be made from even low-cost investments in improving anti-fraud technology, and it is my opinion that the Commonwealth of Pennsylvania should implement these changes.

## **5. Value of Privatization in Certain Circumstances**

One major issue in anti-fraud policy is that the government fails to invest in money-saving measures, such as increasing staff for audit teams, hiring additional litigators or investigatory staff, or developing new technical approaches. However, there is substantial money to be saved from these actions. One viable approach would be to outsource the process of recovering money to a firm that is paid based on how much money it saves the government. In

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<sup>5</sup> “Detecting and Analyzing Anomalies in Massive Medicare Claims Data: A Scalable and Interpretable Approach,” Data Pilot Grant, through the NBER NIA-funded Center for Aging and Health Research.

<sup>6</sup> Griffin, John M., Kruger, Samuel and Mahajan, Prateek. “Did FinTech Lenders Facilitate PPP Fraud?” Forthcoming, *Journal of Finance*. [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3906395](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906395)

new research, a colleague of mine has studied this approach in the context of Medicare audits, where the federal government outsourced auditing to firms called Recovery Audit Contractors that are paid a share of the money they recover. This works finds the program to have high cost savings.<sup>7</sup> Similarly, the federal False Claims Act works this way, with whistleblowers conducting privatized enforcement on behalf of the government.

The primary concern when outsourcing a public program is misaligned incentives. Privatizing an entire benefits program could potentially have unintended consequences, such as drastic cost saving by cutting quality of service or by imposing burdensome requirements on beneficiaries. However, outsourcing just the fraud enforcement element could be a viable strategy for improving spending outcomes. Importantly, this outsourcing can be paid as a share of the money saved for the government, and therefore does not require additional appropriations. In considering the design of such a system, it is important to ensure that the additional screening or enforcement conducted by the third party does not impose substantial hassle costs on beneficiaries, and that due process is maintained in circumstances where there is disagreement about overpayment.

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<sup>7</sup> Shi, Maggie, "Monitoring for Waste: Evidence from Medicare Audits." 2022, Working Paper. <https://www.maggie-shi.com/research>