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Original Articles

Financial Health Economics

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PDF

Abstract

We provide a theoretical and empirical analysis of the link between financial and real health care markets. This link is important as financial returns drive investment in medical research and development (R&D), which, in turn, affects real spending growth. We document a "medical innovation premium" of 4–6% annually for equity returns of firms in the health care sector. We interpret this premium as compensating investors for government-induced profit risk, and we provide supportive evidence for this hypothesis through company filings and abnormal return patterns surrounding threats of government intervention. We quantify the implications of the premium for the growth in real health care spending by calibrating our model to match historical trends, predicting the share of gross domestic product (GDP) devoted to health care to be 32% in the long run. Policies that had removed government risk would have led to more than a doubling of medical R&D and would have increased the current share of health care spending by more than 3% of GDP.

Supporting Information

Filename	Description
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