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Thank you very much for inviting me here today. The 2009 Aging Report, as in the past, provides an outstanding contribution, both in terms of coverage and of the quality of the analysis, to what is perhaps the key economic challenge that European countries will have to face over the next decades.

I will discuss two related issues in my comments. First, I will address one aspect of the projections, relating to health spending, that in my view requires further consideration. Second, I will discuss some economic policy challenges raised by likely expenditure trends over the next fifty years, again with specific reference to health spending.

Let me start from the projections. There is of course huge uncertainty in making these long-term projections, with various factors acting in opposite directions with respect to the baseline. One, for example, could note that the baseline projection implies a decline in population in Europe starting in 2035, something that never happened in the last few centuries excluding periods of war and diseases. This could perhaps be regarded as somewhat pessimistic. On the other hand, increases in life expectancy have in the past been typically underestimated, which of course would not be good news for pension and health spending. Many other factors are mentioned in the report and may offset each other.

There is, however, one aspect in the baseline projections—the so-called reference scenario— that in my view stands out as clearly too optimistic. The reference scenario assumes no impact on health spending from technological change, namely no increase in health spending per person of given age arising from the increased supply of better medical services. The issue of technological change is discussed in the report, but projections including technological change only appear in Annex II.

It is worth looking closely at these projections. Health spending in the reference scenario rises from about 7 percent of GDP in 2007 to about 8½ percent of GDP in 2060. However, the increase in much larger in a scenario where technological change is projected to operate through 2035. And even

larger in a third scenario where technological change continues through the end of the projection period. In the latter scenario spending rises to over 13 percent of GDP in 2060, over five percentage points above 2007, making it by far the largest driver of aging-related spending increases.

These spending increases arising from technological change may appear very high but are used as baseline in other countries. In the U.S., the Congressional Budget Office projects federal spending on Medicare and Medicaid to rise from 4 percent of GDP today to nearly 14 percent by 2060. Technological change explains over 60 percent of this increase.

Moreover, in the past, public health spending in Europe and elsewhere has indeed increased at much higher rates than in the reference scenario. Among the 12 OECD countries for which spending data are available in 1960, average public spending rose from little more that 2 percent of GDP in 1960 to almost 7 percent of GDP in 2008. This reflects to a large extent the effect of technological change It is true these trends may moderate over time, but it seems optimistic to assume, as a baseline assumption, that there will be no effect on spending due to technological change. In my opinion, the report's projections incorporating at least some significant effect of technological change should serve as the reference scenario.

Let me add that the health spending projections are particularly important because, as I will argue in a moment, this is an area where policy solutions are even more difficult to find than in the pension area, and challenges are therefore greater. This brings me to the question of how fiscal policy should respond to these spending pressures.

Prior to the current crisis, many advanced countries had followed a two-pronged strategy to address aging-related spending pressures. The first component was entitlement reform, primarily pension reform. The second component involved efforts to "preposition" the budget for the coming population ageing by increasing government saving and lowering debt. Even before the crisis, this prepositioning raised several questions. For example, it required a combination of higher taxes and reduced spending in non-aging related items that might not be justified on their own merits. However we might

view it, the prepositioning strategy has been significantly derailed by the crisis. For example, the fiscal balance of the five largest EU countries was projected to improve significantly before the crisis. It is now projected to be much weaker (see charts). As a result, and taking also into account the below-the-line outlays in support of the financial sector, public debt in these five countries is projected to increase from 63 percent of GDP in 2007 to 94 percent in 2014.

This failure of prepositioning puts more burden on the other component, namely pension and health reform, which have become more urgent.

These reforms will be challenging not only for policy-makers, but also for those belonging to the economist professions who will have to advise them, particularly when it comes to health sector reform. For pension reform, solutions are well-known. First and foremost, if people live longer, they have to work longer. The effective retirement age will have to rise further. This will certainly be politically difficult but is based on a stringent logic, something that it is difficult to argue with.

Unfortunately, we have far less understanding of how to pursue health reform. Technological change allows us to address health problems in manners previously unimaginable. But, these new opportunities are not without cost. The challenge is to balance these costs and benefits, and this balancing act will be very difficult, including to explain to voters. All health care can be rationed either through prices or through non-price mechanisms. How should governments ration access to future technologies that deliver improvements in health but are too expensive to be provided to larger segments of the population? Should rationing be provided by waiting lists and overall expenditure caps? Should patients privately finance a larger portion of health care themselves? These are *the* questions for health policy, and perhaps *the* questions for public finances in the coming decades. Answering them will not be easy, politically and technically. It will be a challenge for the politicians, as well, as I said, for those in the economic profession who will have to advise them. More work is needed in this area, and the weakening in public finances related to the crisis has made this work even more urgent.

Thank you very much.