

Book reviews

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Workable Pensions Systems: Reforms in the English-Speaking Caribbean.
By P. Desmond Brunton and Pietro Masci, IDB Publications, 2005,
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This volume explores the potential for pension reform in the English-speaking Caribbean (EsC) region, focusing on the key building blocks of 'problem, policy, and politics'. Many of these notions apply differently to the small nations of the English-speaking Caribbean region, as compared to the developed world, since in the EsC region, demographic aging is less of a concern than are the needs to enhance system efficiency, take advantage of scale economics, and build more mature capital markets. Indeed, the relatively young demographics of the region and the strong financial situations of many countries in the zone, could induce procrastination and inertia, despite the clear need to move to better-financed old-age systems in the longer run.

The book begins with several chapters on specific EsC countries. In a well-researched overview chapter Kenroy Dowers, Steffan Fassina, and Stefano Pettinato offer a comprehensive analysis of the key drivers, the differing macro approaches taken, and the results of Latin American and Caribbean pension reforms over the last 25 years. This work sets the scene in the sub-continent, highlighting how the approaches taken were shaped by each country's demographic profile, its political economy, and its financial sector capacity. The authors then review challenges faced by reforms in Bolivia, Uruguay, and Nicaragua, all small economies following in the footsteps of their larger neighbors. In particular, the authors reflect concern over whether the respective financial sectors can 'deliver,' and they suggest that the EsC countries may do well to consider a regional approach to pension administration and investments. Similar themes are sounded by Stefano Pettinato and Javier Cassou, in their 'needs assessment' chapter, which contains detailed assessments of demographic and pension system conditions in each of the E-SC countries. The authors devote considerable attention to the differences across countries in terms of their scales, wealth levels, levels of coverage, and time-lines under consideration for pension reform. High administrative costs are flagged as a key concern, as are low coverage levels due to large informal and self-employed sectors.

Two chapters, one by Charles Herbert and a second by Olivia Mitchell and Derek Osborne, delve into more depth in pension systems in a systematic manner. Herbert focuses on Barbados, Grenada, Guyana, Jamaica, and St. Lucia, and he flags the enormous disparity in demographics (Grenada has 90,000 citizens, versus 2.7 million in Jamaica), as well as benefit conditions and wealth. He develops an econometric model to derive 50-year projections of likely pension expenditure and then estimates how this expenditure might respond to parametric changes (e.g. contributions, retirement ages, and benefit levels) as well as structural changes (e.g. adoption of a Chilean-style pension reform). While projected impacts vary by country, all the EsC countries studied are currently in cash-flow surplus but face baseline projections for deficits 10 to 25 years out (with the possible exception of Guyana). The Mitchell/Osborne chapter also finds that most of the EsC countries are not in immediate crisis, but they contend that reform process should begin now, as political debate and in-depth policy analysis requires lead-time and the demographic changes are not far off. They find fundamentally problematic the high administration costs (e.g. in excess of 15% of contributions) and overly-generous benefit formulas (e.g. based on average salary in the best 3/5 years prior to retirement); however good measures of future system deficits will require accurate independent actuarial projections of nation's pension assets and liabilities - which are currently lacking. Another key

concern is the fact that many EsC countries lack diversified investment opportunities, so most of pension reserves are inadequately diversified.

Marion Williams' chapter offers a skeptical view of the relevance of a fully funded model (a' la Chile) for the Caribbean region. This work devotes attention to parametric changes considered and introduced, including deferment of retirement ages and changes in benefits indexation. In the author's view, most of these nations will seek to strengthen publicly-funded programs, rather than eliminate them, and indeed the Caribbean Common Market is actively working to improve transfer rights across EsC nations, to enhance labor mobility. A different view of pension reform by Kyle Rudden takes a regulatory and supervisory approach. He underscores the various countries' historical ties to British legal and governmental structures, as well as the dominance of the tax office in most EsC countries. He worries that the reach of the national tax authority is eroding as financial services regulators are established to monitor off-shore dealings. At the same time, however, local residents are often prohibited to invest abroad due to currency controls and the desire to keep pension funds in the country for development purposes. Rudden suggests that a broader regional approach to pension regulation would encourage scale economies, facilitate labor mobility, and push legal harmonization in the region.

The relevance of pension reforms in other countries is the focus of several chapters. Robert Palacios explores early experience in the Latin American region. His analysis offers a comprehensive and incisive review of the dozen Latin American pension reforms under evaluation, highlighting the relevance of scale economies, investment diversification, and supervision costs, as key drivers for the on-going success of these personal accounts-based systems. The primary structural issue he raises for the EsC region is the 'atomized' and geographically mobile population, which makes regional integration the only viable model for this region. Indeed, he believes that regional pooling is essential for providing insurance to the active (disabled/surviving) and retired participants in a personal accounts-type system. The chapter also identifies additional challenges in the EsC region, including the lack of reliable morbidity and mortality data, widely divergent socio-economic population groups, and the lack of inflation-indexed financial instruments. Giuseppe Pennisi summarizes the 'Notional Defined Contribution' model (NDC), where future benefits are directly tied to economic growth, contribution history, and life expectancies. The paper details the political process and the 6-8 year period over which this new plan was implemented in Sweden; in Italy, in contrast, reform plans have been underway for more than 20 years with no conclusion in sight. The author may understate the political risk inherent in setting the NDC conversion factors.

Turning to the Brazilian experience, André Medici outlines some of the challenges encountered in reforming that nation's public sector pensions. It would appear that this country's experience offers little in the way of role models and guidance for the EsC countries, though it does offer an understanding of how complex the political process can be in a largely decentralized federal system. Lawrence Thompson's work categorizes the different approaches to private sector reform found in Latin America, UK, Sweden, Switzerland and US, highlighting the difference in onus placed on individuals vs employers, decentralized vs centralized approach to collection and investment, and the compulsion to annuitize or not. The author advocates private sector involvement and the virtues of a funded defined contribution model over an unfunded program. He also outlines an econometric evaluation which produces a ranking in terms of political insulation, worker choice, cost, and predictability of pensions. He concludes that choice and political insulation are expensive, so the Swedish and Swiss models will lead to more predictable levels of pensions and at a lower cost than, say the UK model.

A diverse set of studies completes the volume. Euric Allan Bob and Pietro Masci discuss what roles multilateral development organizations might take in the pension reform arena, and they conclude that the highest priority area is education of the regulators - getting the leaders to come to terms with and understand the long-term strategic relevance of pension reform to EsC countries' institutional structures, economies and prospective development. Stefano Pettinato, Kenroy Dowers, and Pietro Masci focus on the payout phase of pensions, and they

do a good job describing the mechanics, longevity and investment issues inherent in this type of long-tail product. Their focus is on the conditions and attributes of the longevity-risk products found in five Latin American markets (Chile, Argentina, Peru, Colombia and Bolivia), and as noted by other authors, scale economics are again deemed central for a stable retirement pay-out market. So far, the most developed annuity markets are those where the State encourages (or obliges) participants to annuitize. In the EsC region, it is difficult to see how private annuity providers will be able to charge for added uncertainty and set aside the required capital for such long-tail risk business.

The papers in this well-researched contemporary collection reflect on the political and social challenges of pensions reforms. By focusing on scale and diversity this book highlights many of the as-yet unresolved practicalities of transitioning old-age security provision from a collective basis to one where the risks are predominantly borne by individuals. Most of the existing literature on the Latin American experience with DC plans has understandably focused on the accumulation phase, but this book shows up the pitfalls of going down this route without having assessed a solution for the pay-out phase. This collection of papers provides new research and modeling with general relevance, providing practical and far-reaching guidelines for policy change in the EsC countries.

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