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Book reviews

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Fewer: How the New Demography of Depopulation Will Shape Our Future. By Ben J. Wattenberg. Ivan R. Dee, 2004, ISBN 1-56663-673-6, 240 pages, $14.95. doi:10.1017/S1474747206212691

Not long ago, overpopulation was the source of demographic concern. Alarmists feared that the world's population explosion would wreak environmental and economic havoc. Some even predicted a near-global meltdown with famines stretching across our globe. But the chorus sings a different tune now, as global fertility rates have fallen at an astoundingly rapid clip over the last several decades. While fertility rates have slumped before in times of war, depression, and famine, Wattenberg points out that 'never have birth and fertility rates fallen so far, so fast, so low, for so long, in so many places, so surprisingly.' For instance, European fertility rates have dropped for 50 consecutive years. Further, this pattern is not limited to developed nations: for example, fertility in Mexico is on the verge of falling below replacement rate, and birthrates in many Arab and Muslim nations are sinking like a stone. Rather than worrying about running short of resources to support our ballooning populations, many experts now view world depopulation as our most urgent issue.

Ben Wattenberg's book responds to the United Nation's release of its *World Population Prospects*, which appeared in 2002. UN population estimates, updated biannually, are the 'bedrock of the field'. But Wattenberg notes that the 2002 UN publication was no ordinary tweaking of the estimates; rather, it marked a 'momentous' readjustment in the treatment of fertility rates. Previous UN reports assumed that total fertility rates in developing countries would fall to replacement level, about 2.1 children per woman. The UN's 2002 volume, however, assumed birthrates would converge to 1.85 children per woman. In particular, fertility patterns in less developed nations will track those in more developed societies. This finding was remarkable because it implied that the world's population would no longer continue its indefatigable climb; indeed global population decline will begin in the latter part of the present century.

Wattenberg equates this development to 'breaking the demographic sound barrier', and his book is an engaging discussion of the wide-ranging challenges this demographic revolution will pose. He cites numerous examples and a plethora of statistical information to document the population changes ahead, as well as the reasons for falling fertility rates. His list includes the usual suspects: feminism, more education for women, women working, contraception, abortion, and urbanization.

While the jury is still out on the precise factors driving the world's shrinking supply of babies, each is a likely culprit in getting us to where we are today. But the more important question is: What will the future look like if these trends persist? How will world depopulation affect societies? How will economies fare? What will be the effect of demographic imbalances between free democratic states and the rest of the world? Wattenberg offers several insights into the potential fallout from declining populations, including potential effects on pensions, business, the environment, geopolitics, and immigration. In one fascinating discussion he takes on the geopolitical implications of changing demographics for freedom and democracy. Fertility rates have declined sharply in the developed countries of the West over the last half-century. In fact, the Western share of the world's population will fall from one-third back in 1950 to about one-seventh by 2050.

Nevertheless, the author remains optimistic about the free world's geopolitical future, since less developed nations will face similar demographic challenges – particularly the non-democratic Muslim nations, whose fertility rates have been sharply declining for a number of years. In addition, his optimism relies heavily on the power and persistence of US prosperity. Throughout his book, he correctly identifies the United States as a nation whose demographics stand apart from the rest of the world. America enjoys the highest population growth and healthiest birthrate among industrialized nations and will continue to do so for some time, mainly because of its willingness to embrace immigration.

While bracing, Wattenberg's optimism may overlook some challenges that could erode the economic strength of the United States. All developed societies, including the US, are rapidly aging. For instance, despite robust fertility and immigration rates, the number of Americans 65 and older will more than double over the next half century. Spending for this elderly population under Social Security and Medicare programs will drain public coffers, and, unless voters surrender retirement benefits, current and future workers will have to shoulder increasingly heavy tax burdens. At some point, these legacy commitments to older Americans, combined with growing prosperity in many developing nations, may depose the United States as immigrants' destiny of choice.

In discussing demographics, it is also important to keep a close eye on more than fertility trends. Increasing longevity is just as critical to the demographic picture. This reader would have welcomed more scrutiny of the UN's life expectancy assumptions, which project rather modest advancements in longevity. If longevity gains continue at their current pace (or if they accelerate), the official projections might grossly miss their mark.

While no one can see clearly over the demographic horizon, this book provides a fascinating look at global demographic trends over the last century and prospects for the next. Some discussions seem ideologically charged, but there are enough facts and good ideas to appeal to a wide readership.

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Unconventional Success: A Fundamental Approach to Personal Investment. By David F. Swensen. Free Press, 2005, ISBN 978-0-7432-2838-1, 416 pages, $27.50. doi:10.1017/S1474747206222698

Thousands of books claim to unlock the 'secrets of investing': a quick scan of major online bookstores produced as many as 3500 monographs on the topic. Most of these merit and receive little attention. In fact, sound investment advice would not sell many books, as it would be predictable: one should make saving a habit, pay off high-cost debt, make full use of tax-deferred saving vehicles, invest in broadly diversified investment products, weigh cost and service when choosing where to invest, and comparison shop when using a financial advisor. David Swensen's new book takes a new tack, positioning his offering as a critical examination of the mutual fund industry. This is surprising given Swensen's background: he is the highly successful chief investment officer at Yale University and not a personal investment adviser. His investment advice, focused in the first part of his book, provides the reader with a useful set of investment rules. As with most good advice, however, it tends not to be very exciting. Indeed, press coverage of the book has largely ignored these investment recommendations, instead focusing on his criticisms of the mutual fund industry. Alas, this second portion of the book bears signs of a writer lacking strong command of his subject matter.

Swensen starts by offering a core set of investment principles that he believes will well serve the average, long-term, individual investor. These recommendations include an asset allocation strategy that has broadly diversified domestic and foreign stock index mutual funds at its core, around which are roughly equal weights of real estate, inflation-indexed bonds, and conventional bonds. While not the only path to success, these investment guidelines offer a sensible, straightforward, investing strategy. He also discourages investors from trying to time the market, encourages them to rebalance their portfolios regularly, and urges them to be attuned to the tax consequences of their investment decisions. All of these seem to be sound recommendations.

Unfortunately, the second half of this book seems to have been written to grab attention, and reflects a cursory understanding of the retail mutual fund market. To begin with, he fails to recognize that there are substantial differences between retail and institutional investors. A striking example appears in his discussion on 'marketing and distribution' fees. The critical fact that he ignores is that the vast majority of retail investors who invest outside a 401(k) plan – probably many of his readers – use a financial advisor. These advisors must be compensated for their services. Retail investors of no-load funds who want advice must pay financial advisors directly for these services. Retail investors of load funds pay for these services with loads or annual fees known as 12b-1 fees, which derive their name from Rule 12b-1 of the *Investment Company Act of 1940* that allows funds to pay for some or all of the services that financial advisers provide to their shareholders. Swensen views all loads and 12b-1 fees as a dead-weight loss, and he assumes that investors would be better off without them. Regardless of the form of payment, the cost of the services of financial advisors averages 1–1.5% of assets annually. Prohibiting these charges will reduce the level of service provided to most shareholders.

Swensen also fails to recognize other fundamentals of the marketplace. For example, he holds The Vanguard Group up as the standard for the industry to follow. He argues that because for-profit providers charge higher fund expenses (i.e., prices for their services) than Vanguard, there is a market failure. In my view, relatively lower expenses are not evidence of a market failure; rather it is just the opposite. Vanguard hires staff and services in the same labor and service markets as do the hundreds of for-profit fund sponsors. It also competes for investors in the same retail market, along with providers of other financial services. As a result of Vanguard's unique organizational structure, its funds and indirectly the funds' shareholders contribute capital to The Vanguard Group. Implicitly, the company pays a return on this capital to the funds and their shareholders, by providing at-cost investment advisory, corporate management, and marketing and distribution services.

The book also suffers from several other analytical problems. For example, the author erroneously states that industry assets grew 86-fold in the past two decades. He also says that market failure is evident because average fund fees are essentially unchanged despite asset growth. This argument ignores demand- and supply-side forces. On the demand side, the number of households investing in funds has grown five times during this period. Many of these new investors have relatively small initial account balances, and hence these are more costly for funds to administer. On the supply side, Swensen assumes that the structure of the industry has remained constant during the past 25 years. This is clearly incorrect: the range and quality of services has grown substantially, including fund websites, phone services, and more; also the types of funds available to retail investors have expanded to include many new international and other higher-cost funds. Finally, the author assumes that fund firms have continuously downward-sloping cost functions, but he provides no evidence of this.

All told, the investing public would have been better served if the book, and its marketers, had focused on Swensen's comparative (and arguably absolute) advantage as a superb institutional investment manager. His decision to focus on the perceived shortcomings of the mutual fund market significantly diminish the value of an otherwise useful guide to personal investing.

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Workable Pensions Systems: Reforms in the English-Speaking Caribbean. By P. Desmond Brunton and Pietro Masci, IDB Publications, 2005, ISBN 1-931003-777, 458 pages, $24.99. doi:10.1017/S1474747206232694

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 Stefanno 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 (Granada 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. Stefanno 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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Pension Funds Investments. By International Foundation of Pension Fund Administrators. Corporation of Research, Study and Development of Social Security, 2005, ISBN 956-7265-33-X, 254 pages. doi:10.1017/S1474747206242690

This book by the International Federation of Pension Fund Administrators explores several topics relevant to pension fund regulators, policymakers, market participants, and scholars interested in pension funds. It focuses on the Latin American experience with privatized pension funds and shows that these programs have contributed importantly to the development of financial instruments and economic activities by being important demanders of securities and bonds. But funded pensions alone are insufficient to create and deepen capital markets in developing countries; in addition, there must be investment opportunities of a quality sufficient to back these new instruments, regulators with the ability to create and adapt pension regulation, legal protection for the contracts, and clear rules for pension supervisors.

The contributors to this book review the investment positions of pension funds from Argentina, Chile, Colombia, Mexico, and Peru. With the exception of Chile and Peru, more than half of the funds in the other Latin America pension systems are invested in government instruments. This low diversification represents substantial risk exposure to participants. Turning to pension investment regulation in Latin America, regulators seem to agree that pension investments must provide adequate yield but with low risk. In the case of Argentina, this approach meant that pension fund administrators (PFAs) were required to invest in government assets in order to protect the funds. But the 2001 'tequila crisis' resulted in the government defaulting on its obligations, imposing substantial losses on pension participants. In Peru, the government restricts foreign investment, so as to ensure sufficient financing for domestic economic activities. The result is that the pension fund assets are increasingly held in public bonds, which gives the state resources at low interest, and in local companies, resulting in a situation where the PFAs now have the potential to take the control of the companies.

A related problem arises due to agency problems associated with possible conflicts of interest pertaining to the PFAs themselves. Often the PFAs control other financial institutions (e.g. banks, insurance companies) that may benefit from cross-selling, requiring pension regulators to mitigate such conflicts. This requires that the PFAs be required to make transactions in transparent markets under market conditions, value investments at market prices, and maintain an external system of custody of securities.

One of the most interesting chapters considers the multifund program under Chile's mandatory defined contribution pension system. Recognizing that all workers do not have the same yield/risk preferences, in 2002 Chile permitted workers to select from five different funds which ranged from the riskiest called Type A (heaviest in equities) to the safest Type E (where the latter holds only bonds). This was done because financial planners suggest that younger people may want to take on more investment risk, but less as they age. The book discusses the important question of how to automatically assign people to funds, which in Chile is done according their ages as a default. Younger people are assigned to Type B, and older people are assigned to Type D (capped at 20% in equities). The Chilean experience illustrates that a multifund structure can enhance affiliates' awareness of the accounts, develop the perception that the funds belong to them, and boost participation in the system. In 2004, Mexico also permitted PFAs to begin offering more than a single fund, and Peru moved to a multifund approach as well.

This book provides to pension scholars many useful cross-national insights regarding the diversity of and the challenges facing pensions in Latin America.

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