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Book Review

G. A. (Sandy) Mackenzie, *The decline of the traditional pension: A comparative study of threats to retirement security*, Cambridge University Press, 2010, 279pp. (hardback), £55.00 (US$85.00). ISBN: 9780521518475

The book is a thorough survey of the rise in traditional (defined benefit) pensions, the economics behind them, the reasons for their decline and suggestions for reversing the decline.

The book compares defined benefit pensions and "first-tier" state pensions of 10 developed countries (Australia, Canada, Denmark, Germany, Japan, The Netherlands, Sweden, Switzerland, the United Kingdom and the United States) although there is a bias towards the Anglo-Saxon countries, in particular the United States, which is not surprising given the author's country of residence.

The book is split into two parts with the first part starting off as a description of how traditional pensions came to be the norm. The author states the three risks he believes a pension scheme should help mitigate for its members:

- The risk that workers save too little
- Even if workers save substantial amounts, financial markets or ill-considered investment decisions may prevent them from accumulating sufficient savings by the time they retire.
- The risk of outliving your savings in retirement (i.e. not having adequate longevity insurance).

From a scheme member perspective these three risks are why the author is such a fan of defined benefit schemes and less so of defined contribution schemes. The book then moves on to the economics behind the traditional defined benefit scheme both from the employer and employee perspective, utilising plenty of formulae, with a useful appendix going through the mathematics involved which should appeal to the actuarial reader.

The author then moves on to describe investment and regulatory issues with pensions in general and specifically in the 10 countries in focus. He describes the increasing use of risk based supervision using the Netherlands as a specific example of a country that has taken this approach in contrast to the "prudent person" style regulation that has been prevalent in many countries. This section of the book is supplemented by a very good appendix giving an overview of the situation in each of the 10 countries, in terms of current regulatory regimes and how each country got to the position it is currently in. The book also covers public sector pensions, both national state pensions and pensions for public sector workers.

Part two of the book moves on to the reasons for the decline in defined benefit pensions. The introduction to the book explains that the author believes the standard arguments of longevity risk and low interest rates to be much exaggerated. The book approaches the reasons for decline from an economist's view point, and does not go in to any detail on political factors and a company's desire to shift risk from itself to other parties (e.g. scheme members or insurance companies).

The author believes that to be a genuine reason for decline it must apply to all 10 of the countries he surveys. Whilst this may be partly true the vast differences in regulatory regimes, country traditions and political factors mean that reasons for decline in one country could have a very different impact in other countries, which is why I think he underestimates factors such as the short-termism of many people, including scheme members and those within companies who are in charge of arranging company pension schemes.

Towards the end of the book possible suggestions for reversing the decline are discussed along with changes to regulatory regimes that would help defined benefit pensions to flourish.

This is where I feel the book does not quite fulfil its potential, all of the suggestions made are sensible from a mathematically, actuarial and economic perspective but I felt it failed to look at all of the practical implications of imposing the changes on existing schemes. Considering wider issues in more depth would have improved this section. I think trying to survey 10 countries makes this more difficult, that is to say that to go in to more depth would have required specifically targeting a select few of those countries because differences in the regulatory regimes would make it difficult to come up with a one-size-fits-all solution. However the alternative would have been a considerably longer book if the author were to do justice to all 10 nations.

The suggested changes to the set up of pensions generally involve combining features of defined benefit and defined contribution schemes, such as sharing investment risk between scheme members and employers or buying deferred annuities with contributions to help mitigate the risk of poor annuity rates. The author does not consider defined contribution pensions in their pure form to be a suitable alternative since it fails to deliver longevity insurance and shifts investment risk to the scheme member, this is made particularly clear in the one mistake spotted in the book where the author describes them as declined-contribution instead of defined contribution.

Overall this is a good book, especially as a survey of the current and past situations in the 10 countries studied, with the detailed appendix being particularly useful for anyone needing a summary of how one of the 10 countries operates in the pension arena. However, when the book moves on to the reasons for the decline and ways to reverse this, it feels like the author has been too narrow in his thinking. It would have benefitted from some sharper analysis of how his suggestions could be implemented.

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