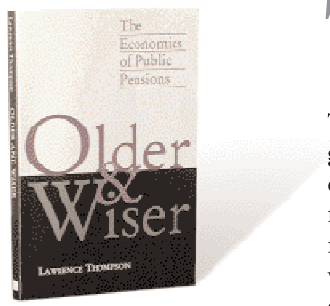
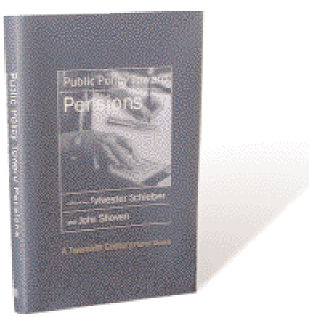


Lawrence Thompson

Older & Wiser

The Economics of Public Pensions
Urban Institute Press, Washington, DC, 1998, 192 pp., $59.50 (cloth), $23.95 (paper).



Sylvester J. Schieber and John B. Shoven (editors)

Public Policy Toward Pensions

MIT Press, Cambridge, Massachusetts, 1998, xiii + 338 pp., $40 (cloth).

THESE two volumes provide a stimulating, important, and complementary perspective on issues of pension reform. Lawrence Thompson's book can be seen as an elegantly clear and simply stated primer on the economics of public pension systems, clarifying the many misconceptions that have recently emerged as to the strengths and weaknesses of defined-benefit, pay-as-you-go schemes (under which current revenue is expected to finance current pension obligations and benefits are a function of salary and work history) compared with defined-contribution, fully funded approaches (under which benefits are not defined; upon retirement, participants get back their contribution plus their accumulated return).

In contrast, Sylvester Schieber and John Shoven's collection of essays focuses on the pension issues confronting the United States as its population ages and in the context of the policy developments that have influenced the public and private pension sectors over the past 25 years. Yet it sheds light on the tax policy and regulatory issues that countries undertaking overall pension reform need to address in shaping the development of the private sector pillar for retirement savings.

Thompson lays out clearly the micro- and macroeconomics of public pension reform. He examines the economic and social effects of alternative public pension approaches, explores their respective fiscal dynamics, assesses their effectiveness in ensuring adequate retirement incomes in a world of uncertainty, and identifies the various factors that determine whether a particular approach can prove viable in a given environment. Beyond economic considerations, he emphasizes that social, cultural, and institutional conditions play an important role in determining the resiliency and financial viability of a public pension scheme. He observes, for example, that "designs that appear to work fairly effectively in one institutional setting can easily prove to be a disaster in another setting." While noting that political considerations have had an adverse impact on defined-benefit, pay-as-you-go schemes in some countries, Thompson also states that the "dynamics of private sector operations" may prove equally adverse for new defined-contribution, fully funded schemes.

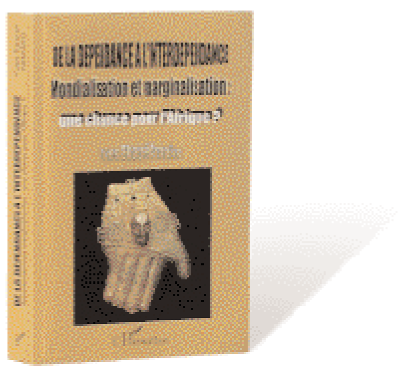
Thompson concludes with several important points: (1) although some of the criticisms directed at pay-as-you-go schemes are valid, others are either not supported by economic knowledge or are overstated; in particular, there is little evidence that advance funding will, by itself, increase a country's saving rate or reduce the economic costs of dealing with an aging society; (2) in the context of an aging population, policy adjustments will most likely require raising retirement ages and reducing retirement benefits; changing the way pensions are financed may change the distribution of costs but will not necessarily change their magnitude; (3) the impact of social security contributions or taxes on international competitiveness and on the supply of labor remains indeterminate; however, there is no evidence to suggest that how a plan is financed—whether it is fully funded or pay as you go—will alter the extent to which the labor supply is reduced or tax cheating is encouraged; and (4) inadequate attention has been paid to the shortcomings of the defined-contribution, fully funded model and, in particular, to the greater risk and uncertainty associated with the income stream that would be provided during retirement under such schemes, as well as the higher administrative costs of operating them.

Most of the chapters in the Schieber-Shoven book deal with the micro- and macroeconomic impact of current pension policies in the United States. Specifically, they examine the effects of the current tax treatment of pensions on individual and aggregate national saving rates as well as on the prefunding of defined-benefit schemes; the factors affecting employer decisions to continue a defined-benefit scheme or to shift to a defined-contribution plan; the impact of 401(k) plans (individual retirement plans) on household and aggregate saving rates; the impact of current government guarantees of private pension benefits on the government's aggregate contingent fiscal liabilities and on the prospect for continued employer participation in defined-benefit schemes; and whether current public sector pension schemes imply excessive unfunded liabilities for the public sector.

Other chapters examine whether the current U.S. pension policy framework is adequately suited to address the impact of a rapidly aging population. One assesses the sufficiency of the funding of private sector pension schemes. Another examines the adequacy of retirement income prospects for the baby boomers and the types of adjustment that will be necessary for this group, in terms of a reduction in either current wages or future retirement benefits.

Yet the central message of Schieber and Shoven's book is that government policies since the passage of the Employee Retirement Income Security Act (ERISA) of 1974 have been excessively directed toward minimizing the short-term fiscal consequences of the tax treatment of pensions. The result is that current pension schemes have become seriously underfunded, which could result in a drop in living standards for retired populations after 2010. Also, recent trends toward increased reliance on defined-contribution plans, while beneficial to some extent, have not encompassed a significant part of the working population, which may widen inequality among the retired population in the future. Thus, the authors emphasize the need to ensure that the tax and regulatory code provides an incentive for the growth of long-term savings, which are necessary in the context of an aging population. Tax policies should be redirected toward encouraging adequate funding of employer-sponsored pension plans and increasing incentives for household saving. Government policies toward the insurance of defined-benefit schemes will also need to be reformed if unfunded liabilities of the Pension Benefit Guaranty Corporation (PBGC) are not to skyrocket in the future, driving financially well-managed enterprises out of the PBGC's insurance net. The conclusion of Shoven and Schieber can be simply stated: "If the baby boomers reach retirement without adequately providing for their own retirement needs, they will likely exact a high price from the remainder of society as they attempt to maintain a level of consumption in retirement that they really could not afford even when they were working."

Peter S. Heller



Yves Ekoué Amaïzo

De la dépendance à l'interdépendance

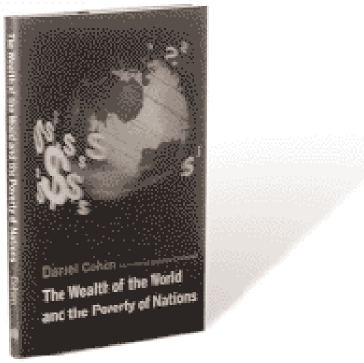
Mondialisation et marginalisation—une chance pour l'Afrique?
L'Harmattan, Paris, 1998, 431 pp., F 240 (paper).

NOTING that economic development in Africa has lagged behind that in other parts of the world, Yves Ekoué Amaïzo (a Togolese who has written extensively on investment in, and the competitiveness of, developing countries) sets himself the task of examining whether Africa could take off by catching the train of globalization. In the process, he reviews in detail the trade arrangements between the European Union and developing countries in Africa, the Caribbean, and the Pacific region; discusses the sociological and political factors bearing on most African economies; and examines the new world order characterized by generalized free trade.

The book represents a commendable endeavor, and the author has taken great care to document his theses with ample statistics and textual references, including to publications from the United Nations Development Programme, the World Bank, and the IMF. However, the approach often suffers from insufficient rigor and tends to lack a sense of direction. The summary, introduction, and conclusion contain severe criticisms of mainstream free-market orthodoxy, referred to as "single-mindedness" (la pensée unique), as well as unqualified condemnations of the IMF's role in imposing structural adjustment policies and preserving the domination of industrial countries over the developing world. Yet, most of the book actually documents the need—indeed, the absolute necessity—for Africa to take on the challenge of globalization. It also makes the essential point that regional trading arrangements should be construed only as a transitional step toward greater integration with the world economy. At the same time, however, Ekoué Amaïzo seems to propound the old dirigiste approach (based on state economic control and planning), seeing a role for the UN system (presumably, the United Nations Industrial Development Organization, where he works) to identify the comparative advantages of developing countries and promote trade specialization in partnership with private companies.

In sum, while this book is a stimulating discussion of the economic challenges facing Africa at the end of the twentieth century, its message is both unclear and rather contrived. The author could have been more convincing had he provided a systematic analysis of what is meant by "globalization" (with or without quotes) and followed a more structured approach.

Philippe Beaugrand



Daniel Cohen (translated from the French by Jacqueline Lindenfeld)

The Wealth of the World and the Poverty of Nations

MIT Press, Cambridge, Massachusetts, 1998, xii + 136 pp., $27.50 (cloth).

COMPRESSING the essence of his extended essay into its title, Daniel Cohen roams through economic, sociological, and political disciplines in this provocative meditation on the seeming paradox of the current economic phenomenon—globalization. "The world," says Cohen, "is getting rich at a heretofore unknown pace." But while poor countries are getting richer, taking full advantage of the access to world markets that globalization affords, rich countries seem to be becoming poorer. The idea that one phenomenon is responsible for the other—that is, the trade that is enriching the poor countries is impoverishing the rich ones and globalization operates at the expense of workers in rich countries—is, according to Cohen, false.

The rich countries, he says, have wrongly convinced themselves that they are besieged by an external threat, and the remedy is to throw up protectionist barriers to shield their beleaguered labor forces. At the same time, the threat of international competition is weakening the welfare state, he claims, as governments, preoccupied with consolidating foreign-financed fiscal deficits, no longer seem able—or willing—to offer protection to society as a whole. A further misconception spawned by the specter of globalization is that democracies must "internationalize" political life. But, in Cohen's view, social and political issues remain stubbornly and intensely local.

The rich nations are indeed experiencing a crisis, but the real threat comes from within. In Europe, the crisis is manifesting itself in high rates of unemployment; in the United States, in a widening wage gap and the proliferation of the "working poor." But the blame for the forces that have led to this crisis cannot be laid at the feet of countries that have taken advantage of an accessible world market to finance their development. "Are we to believe," Cohen asks, "that trade with poor countries can be blamed for the impoverishment of the West when such trade represents less than 3 percent of the wealth produced each year by the richest countries?"

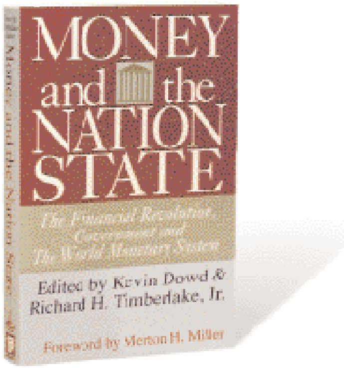
The true culprit, says Cohen, is the increasing segmentation and growing inequality that characterize social, political, and economic trends in the late twentieth century. The key to the labor crisis in rich countries is the steep, and probably irreversible, decline in the demand for unskilled labor. To meet the skill, training, and education requirements of the information revolution—Cohen calls it the "third industrial revolution"—labor has been engaged in an increasing upgrading. Globalization is only one element—if an important one—in the information revolution that rewards the highly skilled and the highly educated and sidelines those members of society who cannot fit in because they do not have the requisite skills. Whatever educational efforts might be made for future generations, says Cohen, the destinies of low-skilled workers have already been determined.

The segmentation in economic life is mirrored in a similar disruption at the national policymaking level. The Keynesianism that shaped the policymaking of rich countries after World War II, Cohen says, is now in crisis, and it is "very tempting," although wrongheaded, to blame globalization for current problems in this area.

The welfare state is being replaced by a state burdened with debts. In most countries of the Organization for Economic Cooperation and Development, Cohen says, the cost of interest on the public debt is the main item of government spending. The pursuit of fiscal consolidation observed in many countries is not based on a fear of inflation or of external deficits, says Cohen; it is due entirely to the risk that public debt will impose a burden on government revenue. It is true that, thanks to financial globalization, governments can more easily finance their deficits, which makes them vulnerable to the positions of external investors. However, in the case of pay-as-you-go social security, which is prevalent in most of Europe, the creditors and debtors are both domestic agents: the working and nonworking populations. There is no place for "financial globalization" in this issue, and Cohen calls it "absurd and demagogic" to blame globalization for the difficulties rich countries have in resolving internal conflicts in the area of redistribution. Neither macroeconomic regulation nor the fight against inequality will be possible until government regains control of public spending, Cohen asserts.

Armed with an impressive and faultless grasp of economic theory and principle and a clear and eloquent style (Cohen is well served by his translator), Cohen offers a provocative and elegantly argued—and, it must be acknowledged, fervently idealistic—plea for democracies to reexamine their political foundations. Even in the "new world of contemporary inequalities," Cohen says, governments must not shirk their basic responsibility of providing universal (that is, nationwide) political and economic security. At a time when "economics has ceased to strengthen social bonds," Cohen says, with guarded optimism, perhaps Western countries will "start thinking in political terms again."

Sara Kane



Kevin Dowd and Richard Timberlake (editors)

Money and the Nation State

The Financial Revolution, Government, and the World Monetary System

Transaction Publishers, New Brunswick, New Jersey, 1998, viii + 431 pp., $39.95 (paper).

MONEY AND THE NATION STATE is a collection of essays covering topics in monetary and banking arrangements. It is divided into three sections: a history of the modern international system, modern money and central banking, and foundations for monetary and banking reform.

Of the five historical chapters, the first is the most interesting. In it, David Glasner argues convincingly that the production of money is not a natural monopoly and posits that state monopolies in this area evolved for security reasons: states with their own monopoly mints had a better chance of survival than states without. Indeed, governments that acquired a reputation for stable prices in peacetime could more readily increase their seigniorage earnings during wartime emergencies.

In the third chapter, Leland Yeager provides an overview of the international monetary system, from the gold standard era through the collapse of the Bretton Woods system to the post–Bretton Woods era. He concludes by noting an absurdity in today's system: national fiat moneys lack defined values. He is not necessarily proposing a return to a gold standard. Instead, he suggests a radical formula for privatizing the monetary system. The government would designate a new unit of account—defined by a bundle of goods and services—that would be comprehensive enough for the general level of prices quoted in it to be approximately stable, with private banks issuing notes and checkable deposits. It is not clear, though, that such a system could easily be made operational.

The second section of the book addresses some current issues. Of particular interest is Chapter 8, in which Alan Reynolds deals with a controversial subject in a way that is fairly persuasive, but not fully satisfactory methodologically. Drawing on episodes from various countries—the Asian "tigers" and Argentina, Bolivia, Chile, Colombia, Israel, Jamaica, Mauritius, Mexico, and the Philippines—he attempts to demonstrate that the IMF pushes a destructive recipe on its member countries seeking assistance: encouraging or pressuring them to raise taxes and devalue their currencies. At one level, his argument is sound. Countries with already high taxes can benefit from lowering them—they often collect more revenue because the willingness to pay taxes increases, while at the same time the incentive to work and produce increases, with a positive impact on GDP growth. As for currency depreciation, Reynolds argues that falling rates often aggravate inflationary pressures—for example, through increased budget deficits.

It is easy to dismiss such arguments by showing that they do not adequately control for other variables affecting inflation, real tax receipts, tax-GDP ratios, and economic growth. But when one combines the theoretical arguments for low taxation and stable nominal exchange rates with the historical evidence that Reynolds presents, his conclusions cannot be dismissed easily. It is reasonable to conclude that clear benefits await countries that improve their tax coverage and administration while keeping tax rates on the low side (which could sometimes mean lowering them from high levels), as well as countries that can maintain credible nominal and stable exchange rates. But Reynolds does not adequately and fairly explain why the IMF sometimes recommends increased taxation and currency devaluation. Hence, his characterization of the "IMF approach" remains incomplete.

The third section of the book focuses on even narrower and potentially more controversial issues. For example, free banking (the freedom of private banks to supply money, including the right to mint currency) has become topical in recent years, and Lawrence White (in Chapter 12) extends it to the international level. He argues for free banking with international branch banking—that is, international integration of free banks and an absence of central banks. Bank-created moneys would be international and banks, multinational. Each multinational bank would be responsible for its own cash reserves; its behavior would be constrained by the risk of failure. With all countries accepting common moneys, money flows (including banknotes and checks) between countries would constitute part of the international adjustment process. The trauma of a central bank losing reserves during adjustment and having to take discretionary measures—for example, raising interest rates and reducing imports—would be avoided. In White's view, monetary disturbances would not be disruptive in such a system and would certainly not require the accelerated destruction and creation of money that takes place in a world of national banking systems. A common international base money could emerge from countries' free acceptance of a common base money (for example, a commodity money like gold) supplied apolitically. However, White stops short of promoting any particular system of base money.

This book would be a valuable guide for general readers and students not well versed in money and banking history and principles. But even those who are fairly well read in these areas will find something of interest here, particularly in the introduction and the chapters by Glasner, Reynolds, and White.

Omotunde E.G. Johnson

Deepak Lal

Unintended Consequences

The Impact of Factor Endowments, Culture, and Politics on Long-Run Economic Performance
MIT Press, Cambridge, Massachusetts, 1998, x + 287 pp., $45 (cloth).

WHEN growth-promoting, liberal economic policies have brought such clear advantages to many countries, why haven't all countries adopted them? Why have countries with plentiful natural resources not always progressed faster than those that are less generously endowed?

In this stimulating, often provocative book based on lectures he delivered in 1995, Deepak Lal analyzes the role of factor endowments (land, labor, and capital) in explaining when and why intensive growth occurs and the role of individualism in promoting growth. He considers the often surprising repercussions that these two influences have had through the impact of the industrial West on the rest of the world, with its myriad religious and cultural beliefs.

Lal, a professor of international development studies at the University of California, Los Angeles, distinguishes *Smithian* growth based on the division of labor, which prevailed until the industrial revolution in Europe, from what he terms *Promethean,* or modern, technologically based growth. Unlike many authors who have addressed this issue from a narrow Western perspective, Lal's great strength—and the appeal of his comprehensive work—is that he takes his readers on an exhilarating, wide-ranging journey. He discusses with equal confidence the rise of Christianity in Europe, the Han and Sung dynasties of China, the Ummayad and Abbasid caliphates of the Middle East, and the emergence of Japan and the Asian "tigers." He may not always be an easy read; his reasoning is at times dense. But the effort is always worthwhile.

The ascendancy of the West, Lal asserts, was rooted in a package of beliefs based on political decentralization and the "inquisitive Greek spirit," which stimulated an era of Promethean growth. In contrast, neither Islam under the Abbasid caliphate nor Sung China was able to translate cultural progress into intensive growth owing to the domination of strongly orthodox clergy, which led inexorably to a closing of people's minds.

In Lal's view, the Christian church inadvertently promoted the individualism that is a unique feature of the Western value system. While the German sociologist and economist Max Weber attributed this individualism to the rise of Protestantism, Lal goes back to the eleventh-century papal revolution, when Pope Gregory VII declared the independence of the Church of Rome under the papacy. This provided the institutional infrastructure for the Western economic dynamic by establishing the roots of the modern system of government and law.

Once the instruments of Promethean growth were created, they were rapidly diffused worldwide, even to societies that did not accept the values that had led to their creation. As a result, the bases of the market economy and commercial law—the law of contract and incorporation—have been accepted globally. This unification has come about through interregional trade and investment in a globalized economy. In addition, competition between regions for the two most mobile factors of production—trade and investment—has begun to curtail the power of the state.

Lal's vision is not wholly optimistic. He warns against the excesses of individualism that he sees as affecting modern Western society. The decline of organized religion has, he fears, undermined the guilt that once sustained personal morality. An excess of democratization and individualism has weakened the traditional hierarchical basis of societies and forced the well-off to retreat into medieval-style gated housing communities and the insecure to take refuge in bizarre cults, which he, unfairly, calls "eco-fundamentalism." At its extreme, he writes, the U.S. promotion of human rights and democracy worldwide smacks too much of the nineteenth-century alliance of utilitarian administrators and missionaries in India and Africa, which sought simultaneously to save souls and to bring prosperity to the subjugated peoples.

In conclusion, Lal looks to the non-Western world to counter both these excesses and the Western tendency to contrast "modernization and Westernization" with "backwardness and tradition." He asserts that there is nothing universal about the notions of "rights" and "egalitarianism," nor is democracy essential for development. He envisages a future in which non-Western societies adopt the West's means to attain prosperity "without giving up their soul."

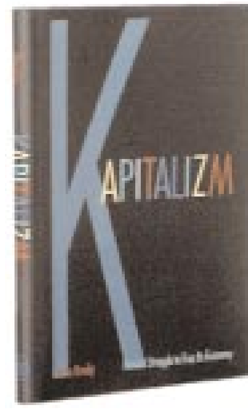
This may today seem slightly unfair to the West. Lal delivered his lectures when the Asian "miracle" was still in full flower. It is not Lal's fault that today this miracle looks somewhat tarnished. It would be interesting to see what lessons he would draw from the Asian crisis in a future revision of his thought-provoking book.

Ian S. McDonald

WHEN economists and scholars approach the task of explaining what went wrong in Russia, they will be looking for comprehensive descriptions of the seven years of reform. They may well turn to this timely book by Rose Brady, former Moscow Bureau Chief for *Business Week*. Such readers will find the book useful, but they must take seriously the author's warning that "if journalism is the rough draft of history, this book is an attempt at perhaps a second draft."

To be sure, this book is one step above journalism. The raw material consists of firsthand, contemporary accounts of developments in Russia during the early years of reform, together with numerous interviews with common people, key reformers, politicians, and businessmen. The material is well organized in seven chapters that deal, more or less chronologically, with the ups and downs of the reform effort from late 1991 to late 1997; a postscript contains the author's reflections on the August 1998 crisis. The book identifies turning points and major mistakes in the course of reform. As an example of good journalism, it also does an effective job of coloring events through the voices of both the major players, who were taking action in the corridors of power, and the minor players, who were reacting to that action.

Providing a mosaic of views is the author's objective and a chief virtue of the book. At the same time, the author warns that this mosaic "may contrast sharply with that of a professional economist or historian." Indeed, the reader will find that events are painted at times with too broad a brush and that detail and analysis are lacking, leaving a lot of work for economists and historians. Still, the book offers clues as to why the reform effort failed: the absence of a political consensus, the destructive opposition of the parliament, the fateful compromises and hesitations of the president and major reformers, the weakness of the central government, the failure to restructure industry, and the pervasive corruption and lawlessness. At the end, these elements led to a critical situation: "The reformers' inability to force Russian companies and citizens to pay taxes left the government with little choice but to keep borrowing to finance its budget. Like anyone living beyond his means, Russia had simply dug itself into a financial hole. In August 1998, the walls of that hole came crashing in."



Rose Brady

Kapitalizm

Russia's Struggle to Free Its Economy

Yale University Press, New Haven, Connecticut,1999, xv + 289 pp., $30 (cloth).

For the professional economist, the book highlights the importance of initial conditions for economic reform, the difficulty of quick institutional change, and the danger of exaggerating the payoff of policies. As the author says, in October 1991, "Yeltsin made a serious mistake. He pledged that after a rough, six-month transition, Russians would begin to see their lives improve. That prognosis turned out to be wrong. Economic reform would prove to be a far harsher and far longer process than Yeltsin and the reformers envisioned." Indeed.

Jorge Márquez-Ruarte