

Review of Michael Otsuka's *How to Pool Risks Across Generations: The Case for Collective Pensions*. Oxford: Oxford University Press, 2023, viii + 109 pp.

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Pensions are not the sexiest ethical topic. They are neither immediately divisive nor obviously morally puzzling, like euthanasia or abortion. Everyone wants a generous retirement. Yet, given the proportion of years we are likely to spend in retirement and the effect of pensions on our welfare during these years, for many people, pensions are one of the most consequential topics in applied ethics. Michael Otsuka's *How to Pool Risks Across Generations* makes a case for collective pensions by appealing to reciprocity: "a form of cooperation between persons which is to the expected benefit of each" (2). Otsuka notes that while moral arguments for collective pensions can appeal to egalitarian redistribution, such principles are stronger than required. Even those who might not accept egalitarian redistributive principles have reason to endorse collective pensions on grounds of reciprocity since a failure to do so is "irrational because inefficient and wasteful" (2). In short, Otsuka argues that collective pensions offer the best way for workers to maximize their expected pension income and that they do so while respecting the freedom and equality of persons over time.

The first three chapters of the book cover three forms of pension: collective defined contribution pensions, funded defined benefit pensions, and unfunded pay as you go pensions respectively. Although these chapters include some philosophical argumentation, the majority is saved for chapter four, which offers an extended defense of collective pensions on grounds of reciprocity.

In chapter one Otsuka discusses collective defined contribution pensions, via an exploration of two fundamental puzzles. The first is longevity risk (8-12). Ideally, workers would save enough to fund their retirement and then would draw down on this savings at an even rate across their remaining years between retirement and death. If they draw down too fast, they risk running out of money; if they do so too slowly, they risk leaving money on the table. Yet, workers typically do not know how

long they will live, and so do not know the rate at which they should draw down on their savings.

The second is investment risk (8-12). Growth investments like equities and property have greater average returns than safer investments like bonds. However, growth investments are far more volatile than bonds, thus workers risk an inopportunistically timed market downturn wiping out their savings. In the long term, investment in bonds is safer, but bonds' lower returns means that savings risk being eroded by inflation and will be far lower than investments in equities.

Individual defined contribution pensions can solve these problems. Workers can initially take the higher average returns of growth investments when they have many years of savings ahead and then 'de-risk' their funds by shifting to bonds as retirement nears. On retirement, workers can sell their savings to purchase an annuity, which promises a steady income until death (12-13). De-risking solves investment risk; annuities solve longevity risk. The problem is: both are expensive. On average workers would have more savings if they could keep their investments in equities. And the expected value of the annuity over one's remaining years of life is far less than that of drawing down directly on one's savings.

Collective defined contribution pensions offer superior solutions. Although workers do not know how long they will live, a large collective's life expectancy can be known with high precision. Individuals might live 1 year or 35 years after retirement, but on average they will live around 20 more years. Individuals can enter binding covenants with others retiring at the same time, agreeing to transfer the savings of those who die early to those who die later, an arrangement known as a 'tontine'. Since the collective's life expectancy can be calculated, individuals can each draw down at a rate equal to the expected retirement years and the tontine ensures that those who live longer than average maintain retirement income. Such arrangements allow each member of the collective to enjoy greater retirement income from their savings than they would if they purchased an annuity.

Collective defined contribution pensions can tame investment risk in two ways. First, since roughly 50% of the collective's total pot will be invested for more than 20 years after retirement, de-risking need not begin prior to retirement (18). Individuals can invest in high growth assets until retirement, gradually de-risking across the collective's retirement years. Otsuka shows that this strategy results in a 70% increase in expected pension income compared to annuities (19). Some volatility will remain, but

contemporaneous collectives can further reduce this by transferring returns from cohorts whose investments earn above average returns to those whose returns fall short (19). Thus “such covenants are to the mutual [ex ante] benefit of each, as they pool and tame the longevity and investment risks that each faces as an individual” (23).

This collective arrangement serves as a model for Otsuka’s discussion of alternative pensions in chapters two and three. He shows that the best versions of funded defined benefit pensions and unfunded pay as you go pensions converge on approaches similar to the collective defined contribution approach. In chapter two he discusses defined benefit pensions, where entitlements are specified as a particular pension income and where risks are borne by employers who are liable to pay the pension incomes. There he focuses on debates about how a particular pension—the UK’s Universities Superannuation Scheme (USS)—is valued. He shows that legally binding promises to meet pension obligations have resulted in USS investing more in bonds, consequently eroding returns and requiring increased contributions from workers. Otsuka argues that USS (and its members) should relinquish legal guarantees to specified incomes in exchange for the expectation of higher returns and lower employee contributions (57).

In chapter three Otsuka discusses unfunded pay as you go pensions, where money is transferred from current workers to pay the pensions of retired workers. Examples include many state pensions and those of UK civil servants and NHS workers. Such pensions are highly redistributive since they are typically funded by taxes, of which high earners pay more, but paid (more or less) proportional to years of work. Consequently, there is a strong redistributive moral justification for such principles (60). But Otsuka’s goal is to show that there is a reciprocity-based justification as well (61). Here he argues that workers support such pensions because they conform to a norm of sharing that involves “the expectation of a reciprocity that is indirect, rather than bidirectional”; one generation contributes to the scheme on the “expectation that the next generation of workers will contribute during their retirements, and so forth” (68).

I am not fully convinced that such ‘indirect’ reciprocity merits the ‘reciprocity’ label. Otsuka’s defense of this classification is somewhat thin. That the justification of pay as you go pensions is a form of reciprocity matters for Otsuka since he wants to show that each of the pensions he discusses can be justified by this value. However, it is not clear why it ultimately matters that each pension is justified by the same value rather

than not requiring an appeal to egalitarian redistribution. Even if the justification of pay as you go pensions is ultimately only reciprocity-adjacent, it is clear that they can be justified without directly appealing to egalitarianism.

It seems that regardless of the details for how pensions are setup, we should all prefer pensions that take the form of a collective of collectives; that is, tontine and similar agreements taming longevity risk within cohorts and smoothing on investment returns across cohorts. The reason we do not in fact all have such pensions is partly political and partly due to institutional inertia. But are there moral reasons to think that we should not all have such pensions? In the final chapter Otsuka considers freedom-based objections from the right and equality-based objections from the left.

From the right, he references George Osborne (the UK Chancellor of the Exchequer) who argues that “individuals who have worked hard and saved responsibly throughout their adult life should be [...] free to make their own choice about how to use their savings. [...] [They should] be able to access their pension flexibly” (78). Otsuka responds that freedom of choice to withdraw from flexible schemes by taking their per capita share of the collective fund at point of retirement is really a “restriction on the freedom of workers to bind themselves on terms of their own choosing that will make them better off collectively” (78).

Collective pensions only work under the assumption that workers promise to abide by their terms. Suppose that after paying in during my working life on retirement I discover I have cancer and only a year left to live. If I am allowed to withdraw all of my contributions, then there will be less left to fund those who live longer. Because uncertainty about life expectancy reduces as we age, others may do the same. Yet if too many withdraw, the collective pension may offer a worse deal than an individual pension. The right to withdraw funds would thereby destroy the possibility of a collective pension. In this sense, Osborne’s freedom of choice is illusory since it will often deprive workers of the option of a collective pension.

Now, there is a sense in which Osborne’s proposal does not deprive workers of collective pensions. Although it threatens to undermine their value and so remove them as a de facto option, it does not amount to a de jure prohibition. But what is problematic about Osborne’s suggestion is that in many cases workers already have the freedom of choice he

champions. Workers can often simply choose not to contribute to collective pensions (though, doing so involves foregoing huge financial benefits in retirement). But once workers contract with others in a collective pension, such contracts should be enforced since allowing parties to renege on contracts effectively means there is no contract.

From the left, Otsuka notes that when pensions are proportionate to existing earnings, they mirror injustices in the actual distribution of earned income (83). If collective pensions perform better than individual pensions, they may even magnify these inequalities. Otsuka concedes that with respect to equality, “it will be difficult to make the case for collective occupational pensions proportionate to existing income as opposed to [those] sensitive only to numbers of years worked. [The former] might be defensible only after one has realized policies that redistribute the underlying income itself” (84). However, he argues that collective pensions proportionate to income do capture an important element of justice:

There is a justice-based case for collective pensions, because justice should be conceived of, not as fundamentally a matter of the elimination of the unfairness of unchosen, brute bad luck, but rather as fundamentally involving Rawlsian fair terms of social cooperation for mutual advantage in the division of the fruits of the labour of workers. (86)

Otsuka goes on at length to defend this claim throughout chapter four. Yet, this is an indirect response to his (luck) egalitarian opponent. The equality objection might be paraphrased as: ‘if (1) equality matters exclusively (or most) and (2) collective pensions proportionate to income do not advance it and might worsen it, then (C) they are morally inferior to alternatives’. Otsuka’s response denies the antecedent claim, without arguing that the conditional is false. This strategy makes the response depend on a broad conclusion about the nature of justice. And, importantly, it is a conclusion that his opponent’s objection is predicated on rejecting.

There is, I think, a more direct reply available that nevertheless moves in a similar direction as Otsuka’s response: inequalities resulting from collective pensions are simply a symptom of broader unjust inequalities. In non-ideal cases we should not be so concerned with pension inequalities as we should the underlying unjust inequalities of income. Even those who reject Otsuka’s reciprocity-based approach to injustice might accept

something like the above as an appropriate non-ideal response to the egalitarian challenge.

Overall, I found the book enjoyable and clearly argued, both as a work of applied philosophy but also, somewhat unexpectedly, as a practical guide to (aspects of) personal finance. Otsuka makes a clear case that collective pensions can be justified on grounds of reciprocity. Along the way he carefully explains how a variety of pension schemes work and what kinds of pensions workers have an interest in pursuing, making *How to Pool Risks Across Generations* an interesting read for both academic and non-academic audiences alike.

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