Economica (2007) **74**, 177–184

Book Reviews

Rethinking Bank Regulation: Till Angels Govern. By JAMES R. BARTH, GERARD CAPRIO, JR and ROSS LEVINE. Cambridge University Press, New York. 2006. xv + 428 pp. £35 (US$65).

This book makes uncomfortable reading for three parties: those institutions (such as the Basel Committee on Banking Supervision, the World Bank and the IMF) involved in the spread of Western-style 'best practice' in bank regulation and supervision around the world; those who work in official bank regulatory and supervisory agencies; and those, such as myself, who teach courses on bank regulation and supervision. The first group will be unhappy with the empirical findings that policy recommendations, no matter how well intentioned, will not produce socially beneficial change unless they incorporate an appreciation of the country's political and legal institutions and the cultural context within which they operate. In other words, 'one size most definitely does not fit all'. To be successful, reform generally requires aligning the interests of politicians with those of the public, which in turn requires political and legal institutions to control government officials and induce them to act in the best interests of society. Moreover, scant empirical support is found for the first two pillars (i.e. regulatory capital requirements and supervisory review) of 'Basel II', the extended and refined version of the famous capital accord of 1988 which is about to be unleashed upon the (developed) world—although, intriguingly, the Basel Committee's decision to incorporate increased disclosure requirements under its 'market discipline' proposals of Pillar 3 receives a ringing endorsement.

The second group, comprising the legions of bank regulators and supervisors toiling around the world, will also be disappointed to hear that much of their endeavours are wasted, if not counter-productive. Rather than empowering official agencies, the evidence suggests that most countries would benefit more from encouraging and facilitating private-sector governance of banks.

The final group, the educators, will perhaps not be too surprised to learn that the evidence provides ample support for the private interest view of bank regulation and supervision (mirroring the findings of utilities regulation in the United States), whereby government officials/bankers successfully increase their own private welfare rather than that of society as a result of political/industry 'capture', but little support for the public interest view (whereby officials strive to maximize social welfare in the face of market failure). But even they are likely to be shocked by the scale of the challenge posed to the conventional wisdom surrounding the teaching of what was previously believed to constitute a cost-effective bank regulatory and supervisory framework, notwithstanding the economist's knowledge of the 'theory of the second best'.

The overriding message that all interested parties must receive is that a comprehensive understanding of bank regulation and supervision must consider the political, legal and cultural context in which banks and their regulators/supervisors operate. Accordingly, banking policies need to be assessed within a broader political economy perspective to account for: the difficulty the public has in inducing politicians to behave in the best interests of society; the politicians' difficulties in controlling bank regulators/supervisors; the regulators'/supervisors' frequent lack of resources, expertise and will to supervise and discipline powerful banks; and the potential corruption that allows the economically and politically powerful to tip the 'financial' game in their favour.

The text is structured as follows. Chapter 1 sets the scene for the rest of the book, describing the motivation behind the study and the nature of the new (World Bank) database (encapsulated in a CD accompanying the book) used to carry out the empirical evaluation before summarizing the key empirical findings. Chapter 2 reviews the conceptual reasons for bank regulation/supervision, discusses the evolution of this thinking over time, and explains the international community's (especially the Basel Committee's) approach to the development of 'best practice' recommendations (e.g. the

'Core Principles for Effective Bank Supervision') in an attempt to secure regulatory convergence as a path to global banking stability.

Chapter 3 describes, in detail, how countries around the world actually regulate and supervise their banks, drawing on the new (2002/03) database constructed from replies received from government officials in 152 countries to a World Bank survey. (The authors' own views on China are included for good measure.) The raw data are used, in turn, to construct aggregate 'indices' to quantify the data in an intelligible manner, although, as recognized by the authors themselves, this is problematic; inevitably, there is a degree of arbitrariness involved in constructing the indices and weighting the individual components. This chapter also includes an interesting review of some current 'hot' topics of debate, including the involvement of central banks in banking regulation, single versus multiple bank supervisory agencies, and single versus multiple financial supervisory agencies.

The following chapter, Chapter 4, contains the empirical analysis of the authors. It seeks to identify those policies that promote social welfare—as measured by their enhancement of 'bank development' (proxied by bank lending to private sector firms as a share of GDP in 2001), 'stability' (i.e. avoidance of 'systemic crises', as defined), 'efficiency' (proxied by bank-specific indicators for 'net interest margin' and 'overhead costs') and 'integrity in bank lending' (i.e. the avoidance of 'corruption in bank lending', as measured by the extent to which firms are impeded in their ability to raise external finance)—and those that do not. The results are then used to provide strategic guidance to policy-makers about the general direction that policy should move in, rather than to provide a comprehensive list of 'best practice' rules that might allow for the optimal implementation of the strategy.

Chapter 5 then analyses, empirically, what factors determine bank regulatory/supervisory choices (possible contenders include the nature of the political system, historical accident, the influence of international advisers and the level of knowledge of officials) and assesses the implications of the findings for regulatory reform. Finally, Chapter 6 summarizes the key empirical findings and draws policy conclusions, as set out at the beginning of this review.

In summary, the book is extremely well written, is accessible to non-specialists, contains very few typographical errors (although the UK's Financial Services Authority is confused with Japan's Financial Supervisory Agency on p. 89), is comprehensive in its treatment of the subject matter, is incisive in its analysis, and makes a major contribution to the literature by broadening our understanding of the forces that are likely to determine the outcome of banking regulatory policy. Interested researchers will also benefit from the provision of the database, via the complimentary CD, even though this is already three years out of date!

Where I feel the book fails is in the message, or rather lack of it, it sends to governments (and their advisers) keen to engage in bank regulatory reform. Having identified weaknesses in their current regulatory/supervisory regimes, what are they to do? Wait until the financial infrastructure is complete and political institutions have become fully democratized and accountable before embarking upon reform, or attempt to encourage and facilitate the private-sector governance of banks, for example by requiring the dissemination of more high-quality information by banks, in the interim at the expense of further empowerment of official agencies? The former approach, emphasizing the need for 'prerequisites' to be satisfied before reform should commence, relies on a fine judgment being taken as to when it is safe to proceed—a difficulty faced, for example, by the Chinese authorities when contemplating implementation of a deposit protection scheme, a project on which I was personally engaged as an outside consultant—if delays are not to prove interminable. On the other hand, the latter approach fails to address the real-world issue of what to do with what you already have on the ground by way of official regulation and supervision and pools of regulators and supervisors. The knowledge that, at least outside the 'top 10' countries, boosting official supervisory power is *not* found to enhance bank development, efficiency, stability or integrity in lending, or that capital regulations are *not* positively correlated with either stability or performance, offers no guidance as to how to deal with the micro issues at hand. Scrap the regulations? Sack the regulators? Downsize the supervisory agency and refocus the staff's efforts on facilitating private monitoring of banks and verifying the veracity of information revealed? Do we really have nothing more to say about how we get from A to B with a view to promoting social welfare?

Abstracting this criticism, I thoroughly recommend the book to students of bank regulation and supervision and practitioners alike.

Loughborough University MAXIMILIAN J. B. HALL

Capitalism. By VICTOR D. LIPPIT. Routledge, London. 2005. xvi + 188 pp. £65.

This interesting and well written book aims to provide a comprehensive analysis of contemporary capitalist economies. With an appropriate mix of theoretical analysis and empirical investigations, the analysis is rigorous but the language is clear, and the book is accessible to non-specialists.

The first four chapters lay out the theoretical foundations of Lippit's analysis. Capitalism is viewed as a system having accumulation at its core. Yet different types of capitalism exist in every given period and across time. Each type is characterized by a Social Structure of Accumulation (SSA), which encompasses 'the full range of institutions that favours investment activity' (p. 23). The concept of SSA lies at the core of Lippit's analysis of the dynamics of capitalism as a system that undergoes recurrent crises but overcomes them by constantly reinventing itself. Chapters 2 and 3 contain vivid pictures of the evolution of the SSAs of Japan and the USA in the postwar period. Chapter 4 analyses the effects of globalization and technological progress (especially in IT) on contemporary capitalist economies, owing to the enhanced possibilities to outsource production to low labour-cost sites around the world. Lippit forcefully shows that capital–labour relations and the welfare state have been negatively affected in advanced countries, whereas there has been an increase in dependency and vulnerability in less developed countries.

The second half of the book focuses on the contradictions of capitalism. First, the author reviews two concepts that play an important role in radical approaches: surplus and classes. He defines surplus as 'that portion of national income that is not required for the essential consumption, both private and public of the entire population' (p. 93), and argues that it is indeed important to understand the dynamics of capitalism. The magnitude of the surplus and the way in which it is used define different economic systems. Classes and class struggle are not among the main engines of change within capitalism: instead, '[t]o ascertain the primary contradictions driving change . . . it is necessary to take a more structural approach, starting with the accumulation imperative that drives the system forward' (p. 127). Two types of contradiction can be identified. There are contradictions that drive the evolution of each SSA, and lead from one form of capitalism to another. However, there also exists a deeper contradiction, which is inherent in the functioning of *any* capitalist system and defines its ultimate boundaries. The defining feature of capitalism, according to Lippit, is profit maximization, that is revenue maximization and cost minimization. Since costs cannot go below zero, the functioning of capitalism requires a continual increase in revenues. This implies an increase in production and accumulation, which in turn leads to environmental devastation. 'The environmental contradiction posed by capitalism, a system that requires ever-growing throughputs in a constrained environment, is likely in the long-run to prove the most serious contradiction of the capitalist system' (p. 20). This contradiction will eventually lead to a post-capitalist system or to the end of the world as we know it.

Lippit's analysis is thought-provoking, and the effort to identify the contradictions of capitalism is an important point of the radical agenda. Yet the second half of the book—focusing on contradictions and long-run prospects of capitalism—is less convincing than the first. The analysis of counteracting forces, in particular technical progress, is not persuasive. For instance, Lippit acknowledges that productive activities are now much less environmentally intensive than in the past; yet he just stipulates that