mobility are considered, then the picture is not so clear, especially for middle-income developing countries. The experience of China, which has limited exchange rate movements through capital controls, is barely mentioned in the book.

As of the date when this review was written, it is not clear whether the Euro Area will evolve into a stronger fiscal union, break up, or somehow survive more or less unchanged. In retrospect, should the countries that now comprise the Euro Area have abandoned their national currencies in favor of the Euro? Would Greece have done better with a floating exchange rate with Germany? If yes, would the same answer apply to Italy? If still yes, what about France? While Gagnon makes an exception to his arguments in favor of floating exchange rates for countries that seek deep political and economic integration with their neighbors, the analysis in the book does not seem well-suited to answer these questions.

The final chapter in the book is on policy conclusions. After summarizing the arguments in favor of flexible over fixed exchange rates, Gagnon spends most of the chapter advocating a system of reference rates, which are wide target zones with intervention allowed only outside the band. These conclusions seem to be unrelated to the rest of the analysis, as the term "reference rates" does not even appear until the last chapter. The introduction of reference rates, however, provides a link between the beginning and end of the book. In the Mundell (2011) lecture that motivates the analysis, he does not advocate a return to fixed exchange rates. Instead, he advocates a Euro/Dollar rate with about an 8 percent band in each direction, although it could gradually be narrowed. While Gagnon does not specify the width of his reference rates, there may be more in common between his and Mundell's views than would be apparent at first glance.

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G Financial Economics

Guardians of Finance: Making Regulators Work for Us. By James R. Barth, Gerard Caprio Jr., and Ross Levine. Cambridge and London: MIT Press, 2012. Pp. xiii, 280. $27.95. ISBN 978–0–262–01739–8. *JEL 2012–0411*

In this provocative and stimulating volume, Professors Barth, Caprio, and Levine, three recognized experts on financial regulation, deliver a broad indictment of financial regulators and their role in facilitating the global financial crisis.[1]

The authors' premise is that the crisis was induced by a "colossal failure of financial regulation" (3) in which "Regulators enacted and maintained policies that encouraged excessive risk-taking even as they learned that their decisions increased the fragility of the system" (18). They trace the failure to a lack of accountability in the governance of the regulatory authorities in this country and around the advanced world. For the United States, they propose establishment of a sentinel mechanism made up of truly independent experts with the power to command information and issue annual reports to foster informed debate about regulatory decisions.

Barth, Caprio, and Levine start by acknowledging that financial regulation is challenging and difficult if the dynamism of financial innovation is to be preserved. They describe the political economy of financial supervision and regulation and associated incentives. Their central indictment of the U.S. precrisis regulatory regime is based on six examples: (1) the Federal Reserve's decision to allow banks to reduce their regulatory capital requirements through the use of credit default swaps; (2) the campaign by the Federal Reserve, Treasury, and Securities and Exchange Commission (SEC) to resist tighter regulations on over-the-counter (OTC) derivatives; (3) the SEC's nonimplementation of comprehensive supervision; (4) distorted policies toward credit rating agencies; (5) the Federal Deposit Insurance

[1] In the interests of full disclosure, Professors Caprio and Levine were once my colleagues in the Division of International Finance at the Board of Governors of the Federal Reserve System, and I teach periodically at the Center for Development Economics at Williams College, which Caprio now directs.

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Corporation's failure to implement prompt corrective action of weak banks; and (6) inadequate oversight of Fannie Mae and Freddie Mac.

Nevertheless, Barth, Caprio, and Levine debunk the view that the global financial crisis was entirely made in America. Their review of financial crises in Ireland, the United Kingdom (Northern Rock), Iceland, Spain, and Eastern Europe finds that each of those crises was home-made.

To set up their sentinel proposal, Barth, Caprio, and Levine review past, failed (in their view) financial reform efforts in the United States, with an emphasis on the savings and loan crisis, and globally via the Basel Committee on Banking Supervision and Regulation. They argue that the postcrisis Dodd–Frank legislation and Basel III reforms are more of the same, granting too much discretion to unelected and unaccountable regulators.

To ensure that financial regulators in the future act in the public interest, the authors propose a mechanism—the sentinel—that would be independent of short-run politics, independent of the financial services industry, have the power to demand information from the regulators, have the resources and expertise to process that information, and have sufficient prominence for their assessments to be heard.

This book should appeal to those who favor financial supervision regulation and comprehensive reform of financial supervision and regulation, in particular, in the direction of supervision and regulation that takes away the punch bowl early in the party. However, some who share this view may be disappointed and dissatisfied.

First, Barth, Caprio, and Levine are professional economists in the role of muckraking journalists. Many of their sources are journalists' accounts. They tend to bury qualifications in endnotes. Most disturbingly, they repeatedly brand the actions and inactions of regulators as "reckless," which my *Random House Dictionary* defines as "utterly unconcerned about the consequences of some action; without caution; careless." This is a strong charge. It is an incomplete syllogism to say that the regulators could have acted differently but consciously chose not to do so.

Second, Barth, Caprio, and Levine assert a focus on decisions or nondecisions made prior to the crisis, but much of their argumentation conflates crisis management with crisis prevention. For example, they repeatedly cite as a regulatory failure the Federal Reserve's resistance to releasing information about which institutions it was lending to during the crisis when, in fact, that had nothing to do with precipitating the crisis.

Third, Barth, Caprio, and Levine contradict themselves about the availability of information. Their implicit point is that not enough sunlight was shown on many aspects of supervision and regulation. That may be true, but it is not the same as saying there was no information available to experts, such as these three commentators, or to market participants. They note, for example, that everyone knew about the shadow banking system and the tendency for many institutions to rely excessively on short-term funding.

Fourth, the treatment of issues is often superficial.[2] It is not clear that the use of credit default swaps should not have been allowed to reduce regulatory capital charges. The battle over OTC derivatives was as much about turf as it was about substance. Everyone knew that the SEC had no capacity to exercise comprehensive supervision; the SEC's assumption of such authority was solely to prevent U.S. institutions from falling under European jurisdiction. Moreover, the authors dismiss financial innovations, such as credit default swaps and derivatives, and complexity in supervision as causes of the crisis.

Fifth, Barth, Caprio, and Levine do not distinguish between philosophy and policy. For example, they link (90) a quotation from Ayn Rand about an "absolute laissez-faire, free, unregulated economy" with a quotation from Greenspan (2007) expressing admiration for her mind and with a second quotation "I had long since decided to engage in efforts to advance free-market capitalism as an insider." If the authors had checked the original source, rather than relying on a journalist's version, they would have acknowledged that Greenspan went on to say that, as a public official, he would have to accept the constitution

[2] I am not as expert on financial systems as the authors. However, I write from the, perhaps biased, perspective of one who observed many of the developments that the authors' chronicle while I was at the Federal Reserve and U.S. Treasury from 1972 until 2001.

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and laws as they had been written and recognized that "Compromise on public issues is the price of civilization, not an abrogation of principle" (Greenspan 2007, 52). Greenspan is a pragmatist, not an ideologue.

Finally, the sentinel mechanism is politically naive, and the proposal reflects a lack of understanding of U.S. political history. It is naive because Barth, Caprio, and Levine never define what they mean by accountability. One suspects that they are applying a Barth, Caprio, and Levine standard of what makes good supervision and regulation. But, what makes them believe that a president will nominate and the senate will confirm truly independent and objective experts—philosopher princes and princesses—who satisfy Barth, Caprio, and Levine's implicit criteria?

The authors cite James Madison's Federalist Paper 51 to justify the sentinel mechanism. However, in that paper, Madison does not call for additional checks and balances, he defends the system of checks and balances in the proposed constitution. He also suggests that the very interests groups that Barth, Caprio, and Levine decry will act as a constraint on those interests. In Federalist Paper 10, Madison makes an even stronger case against the tyranny of interest groups, or factions, in the new republic: the size of the country and the diversity of potential interests will diffuse their influence. As Truman (1951, 535) wrote sixty years ago, "These memberships are the means of stability and peaceful change. In the future as in the past, they will provide the answer to the ancient question: *quis custodiet ipsos custodes?* [Who will guard the guardians?] Guardianship will emerge out of the affiliations of the guardians." It is possible that after 220 years Madisonian optimism is no longer justified. In that case, the United States will need a much more profound transformation than the proposed sentinel.

Despite these weaknesses, and partly as a consequence of them, this book provides useful insights into the complex political economy of financial supervision and regulation.

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H Public Economics

The Benefit and the Burden: Tax Reform—Why We Need It and What It Will Take. By Bruce Bartlett. New York and London: Simon and Schuster, 2012. Pp. xiii, 271. $26.00. ISBN 978–1–4516–4619–1. *JEL 2012–0445*

Bruce Bartlett's new book offers a highly readable overview of the federal tax system and key tax policy issues. While experts will already be familiar with most of the material in the book, readers with less background will be able to obtain helpful guidance on many aspects of the current tax system and reform proposals. Unfortunately, those readers will need to proceed with caution, as the book contains a significant number of factual and economic errors.

A key strength of the book is that Bartlett covers a lot of ground and avoids getting bogged down in intricate details. He summarizes the history of the federal tax system, describes the tax systems of other industrialized countries, and explains the tax legislative process. He devotes a short chapter to each of several major federal income tax preferences, explaining the likely effects of each provision and sketching possible alternatives to current law. He also discusses the arguments surrounding the appropriate degree of progressivity, the value added tax (VAT), and the 2001 and 2003 tax cuts.

In addition, at several places in the book, Bartlett succeeds in conveying important economic concepts in an accessible and jargon-free manner. He provides an exceptionally clear discussion of substitution and income effects, including an explanation of why the income effect roughly washes out for income tax increases that are used to finance increased transfer payments. He also offers a good explanation of how the possible crowding-out effects of budget deficits impact an open economy, carefully distinguishing the effects on output from the effects on income, and ably discusses the double taxation of

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