

## Summary

### Instability of the International Financial System

Olivier Davanne first of all describes the economic and financial sequence of events which are at the origin of the international financial crisis starting in the summer of 1997. Beyond major banking supervision questions, the exceptionally serious crisis which hits most of the emerging countries is to be understood above all as an international monetary crisis; it is a striking illustration of the serious inadequacies in exchange rate management. More than a year after the crisis began, calls for a new «Bretton Woods» underline the need for a strategic reassessment of exchange rate questions.

According to Olivier Davanne, the reference to the 1944 Conference should not add to one's nostalgia for fixed exchange rates, unfitted to a world where capital moves freely. Indeed, the determination with which fixed exchange rates were defended was paramount in the genesis of the Asian crisis. As far as principles are concerned, the report advocates adjustable «reference parities» for emerging countries open to international capital. Based on a dollar/yen/euro basket, they would be defended in a very flexible way with the aid of the international community whenever necessary. The method which is under consideration is inspired by the past years' French experience. The author also suggests several solutions for a particularly close supervision of the dollar/euro parity, the backbone – perhaps fragile – of the future international financial system.

For Olivier Davanne, the current crisis, at various degrees, also underscores the need to have financial institutions, both in industrialized and in emerging markets, taking more responsibility for their credit decisions. In practice, the fact that a bankruptcy code perfectly adapted to the characteristics of the banking sector is lacking, makes it difficult to find the fair sanction against risky behaviors. In the absence of such codes, the international organizations concerned (Basle Committee, IMF, World Bank) could prepare a «code of good conduct» for bank-restructuring in order to reduce as much as possible incentives for excessive risk-taking.

Generally speaking, the upheaval which started in Thailand during the 1997 summer shows how a financial shock originating in one country where huge economic and financial errors were being made, can have enormous repercussions in the rest of the world. Given economic and financial globalization, banking and exchange rates should be recognized as subjects

of common interest. Olivier Davanne pleads for a better access to national information for the IMF in these two key-subjects. Respecting «codes of good conduct» in matters of information or bank-restructuring, could be part of the elements to be taken under consideration for determining the extent of international aid in favor of the currency of a country facing financing difficulties. In extreme cases of panic which are not justified from the standpoint of the «economic fundamentals», as in the South Korean case for example, Olivier Davanne puts forward the idea that the IMF should exceptionally be able to have the support of the G7 and of Central Bank interventions.

According to the author, a suitable exchange rate regime, better banking supervision and transparency in monetary and financial matters should eventually enable emerging countries to take advantage of the capital market globalization. It would be cautious, however, to keep a close watch over short-term capital inflows for yet a long time.

Lastly, Olivier Davanne emphasizes the instability of large assets markets (shares, bonds, exchange rates) in industrialized countries. Major financial crisis of the 21<sup>st</sup> century may appear in these markets, rather than in emerging countries, according to Olivier Davanne, if nothing is done to try to improve the methods of valuation used by investors. The public sphere can help in this respect by improving markets' transparency and by providing more accurate economic, financial and statistical studies. For Olivier Davanne, this part of the reform agenda matters a lot, but he fears that it could be neglected in favor of questions directly related to the financing of emerging countries.

In the short term, alongside efforts to contain the crisis itself, Olivier Davanne insists on the need for the international community to look into the factors at the origin of international financial instability in a way which would be large, transparent and credible as far as the international public opinion is concerned. He suggests setting up a Committee with members who would be independent and of international reputation in economic and financial matters and where the «North», the «South» and the «East» would be represented in an equitable way. This Committee would examine the broad lines of the future architecture of the international financial system.