

Assessing the impact of fair value upon financial crises

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Socio-Economic Review, Volume 5, Issue 4, October 2007, Pages 779–807,
<https://doi.org/10.1093/ser/mwm018>

Published: 16 October 2007

Abstract

This article challenges the notion that the reform of accounting principles in accordance with fair value would provide better information, and that more transparency would reinforce the resilience of the economy. Actually, fair value gives at each instant a seemingly relevant liquidation value, but obscures the value creation process by mixing present profit with unrealized capital gains and losses. This discrepancy increases with an increased degree of uncertainty, which is at odds with widely held beliefs about the efficiency of existing financial markets. Fair value introduces an accounting accelerator on top of the already present and typical financial accelerator. It extends to the entire economic system, the source of financial fragility typical of the 1990s. If fair value accounting is applied to banks, an extra volatility may be created unless a new wave of innovations introduces countervailing forces.

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