Foreword

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The current crisis is the first global recession of the latest phase of globalisation which began in the last quarter of the twentieth century. This phase witnessed a boom of 15 years from 1991 to 2007, one of the longest booms in the history of capitalism but is now going through one of its deepest crises. But, while deploring the cost of the crisis, it is well to recall that in the boom developing countries did benefit enormously. China and India emerged as powerful economies with a place at the top table. Asia in general became a dynamic part of the global economy thanks to the World Trade Organization (WTO) and the enhanced flow of private capital from the Organisation for Economic Co-operation and Development (OECD) countries to Asia. The flow of private capital, which was roughly around $200 billion in the early 1990s, had reached $900 billion by 2007. It has now dropped down to around $200 billion again. African countries which have been laggards in the globalisation race were catching up by the beginning of the twenty-first century – the growth rate of sub-Saharan Africa reached a respectable 5 per cent before the crisis hit.

Given this, the first task of any recovery programme is to restore the flows of trade and capital to respectable levels if we are to alleviate the suffering. There is a need for reform of the international economic order without doubt, but such restoration should not disrupt or diminish the flows of capital, commodities and indeed of labour. There is an urgent need to restore the levels of trade credit and some attempt was made at the G-20 in London in April towards this. It remains to be seen how soon it will take effect. There are also many reforms of the financial system which have to be undertaken at the national level in the OECD countries and these need to be coordinated so that there is no regulation arbitrage. But these reforms, including recapitalisation of banks, are primarily a rich country concern. Their impact on developing countries is felt primarily through a protectionist tendency for recapitalised banks to cut back on international lending. This has to be resisted.

Many of these reforms and recovery programmes are already underway. The urgent challenge now is to repair the international monetary order. As is now well known, the origins of the crisis lie back in the 1990s when many developing countries ventured into the global financial markets under the false notion that a dollar peg made their currency risk free. Thailand's Baht crisis, and the ensuing Asian crisis of 1997 was very damaging and countries began to adopt risk adverse behaviour accumulating large reserves. Among these countries were China, South Korea and Japan. Their surpluses were banked in US Treasury Bills and it is these that financed the double deficits during the Bush years from 2001 to 2008. The American economy enjoyed seigniorage benefits, and cheap credit. Inflation was averted because the Asian economies, especially China, could export manufactures at low cost. This was in marked contrast to the sixties and seventies, when the rising prices of manufactures were the main cause of inflation. Many Keynesian economists pointed out the effects of monopolistic practices in manufacturing at the time.

Globalisation removed this danger by relocating industry away from the metropolitan countries to the periphery. This gave Central Bankers the misleading impression that it was they who were keeping inflation low when it was the Chinese worker. But the wild gyrations of asset prices, the high leveraging of financial firms and the mismanagement of risks, due to a flawed understanding of the nature of the financial innovations, aided and abetted by cheap credit have led to the present meltdown. Like in 1971 and 1984 and 1991 we are learning the dangers of relying on the US dollar as the bulwark of the international monetary order.

The answer is to create an international reserve currency which surplus countries can put their foreign exchange reserves into and from which deficit countries can borrow. This reserve currency can be a combination of currencies and of commodities as Keynes had argued for the Bancorp. Despite its record in recent years at managing lending, the IMF may be the most suitable agency for this task if it is suitably reformed. Developing countries need the purchasing power provided by the surplus savings of China and South Korea *et al*. In the last ten years US excess consumption has been the source of demand for China's savings. We should facilitate developing countries to become the absorbers of China's surplus savings.

However, achieving major structural changes of this kind will be difficult because this phase of globalisation is quite unlike the earlier phase in the late nineteenth and early twentieth centuries. We now live in a world of independent nation states, not Empires as they were then; the world does not have a single currency – the Gold Standard – as it did then; and while the flow of capital is truly global the flow of labour is not as unimpeded as it was then. Policy responses to the crisis must reflect the new and rapidly changing realities.

To do so requires a detailed understanding of these realities. This *IDS Bulletin* presents a range of recent research about the impact of the crisis and the policy responses to it. It includes evidence about how the crisis is affecting the poor, the implications for social protection, and the new challenges facing international financial institutions. It also examines the impact of the crisis on global trade, and the provision of trade credit. And it touches on some of the key geopolitical debates – the role of China in Africa and the differing understandings of the crisis between richer and poorer countries. It therefore makes an important contribution to the key challenge and great opportunity that this crisis provides – to refashion economics itself to do a better job of serving humanity.