

COMMONWEALTH POLICY STUDIES UNIT: 4

**2000 Commonwealth Finance Ministers' Meeting:
Policy Brief**

Jeremy Scott-Joynt

Commonwealth Policy Studies Unit, Institute of Commonwealth Studies,
University of London, 28 Russell Square, London WC1B 5DS; fax 44-
207-862-8823; email ics@sas.ac.uk; website
<http://www.sas.ac.uk/commonwealthstudies>

Policy brief for the Commonwealth Finance Ministers' Meeting, 19-21 September, 2000, Malta

Executive summary

The most pressing issue facing this year's Finance Ministers' Meeting (FMM) is the ongoing question of debt relief, and the apparent inertia, not to say complacency, of rich countries in their response to it. Promises of reform of the HIPC initiative at G8 and OECD level in recent years have come to little, and Commonwealth finance ministers will be keen to press the issue ahead of the World Bank and IMF meetings immediately following the FMM. A linked question is how to confront a similar lack of urgency surrounding international financial architecture reform: the Asian currency crisis feels like ancient history, and ministers will discuss how to return it to the top of the international agenda. At the same time, the predicament of small states in a globalised economy will attract attention, and the problems of how to balance the need to fight tax evasion while holding open the door to offshore financial services, a vital source of foreign currency for poorer countries, will be debated.

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1 Status, representation, recent meetings

Among the numerous periodical ministerial meetings within the Commonwealth system, the Finance Ministers' Meeting (FMM) stands somewhat apart. Its deliberations and conclusions may sit within the context of other Commonwealth ministerial gatherings; but even more than its counterparts it takes place in a broad continuum of wider international discussions concerning economics and finance.

Of particular importance in this respect is the annual meeting of the world's two key international financial institutions (IFIs), the International Bank for Reconstruction and Development (the World Bank) and the International Monetary Fund (IMF). Given the mix of a minority of industrialised countries and a large majority of developing states which make up the Commonwealth — both with pressing, if sometimes divergent, reasons to take a keen interest in what the Bank and the Fund are up to — the unbroken norm is for FMMs immediately to precede the IFI meetings in late September. Also without exception, a closing press conference outlining a Commonwealth position on the Bank and Fund agenda takes place as the FMM ends and the IFI meetings begin: this year, the press conference and the IFI meetings will take place in Prague, in the Czech Republic.

This imperative dictates a key difference between the FMM and other ministerial-level gatherings: the timing. In contrast to the customary bi- or triennial pattern, FMMs are an annual event. The importance of presenting at least the appearance of a united Commonwealth front to the IFIs also means that the meeting is unusually well attended. Last year, 1999, a total of 220 delegates from 48 of the 54 member states attended the meeting in the Cayman Islands, including 42 ministers, one prime minister and one deputy prime minister. This year, two states remain suspended: Pakistan, which was taken over by a military dictatorship in October, and Fiji, which suffered a coup in May — the outcome of which is an interim government again put in place by the armed forces.

The chair is traditionally held by the Finance Minister of the host nation, meaning that this year Malta's Finance Minister, John Dalli, will be co-ordinating the discussions. The rule is not immutable: last year's Cayman Islands FMM should by custom have been led jointly by both the Caymans' financial secretary and, since the islands are a UK Overseas Territory, the UK Chancellor of the Exchequer. Unfortunately, a scheduling problem — according to the UK Treasury — meant Gordon Brown, the present Chancellor, was unable to attend. Some speculation as to whether that was the real reason arose from continuing allegations about the use by criminals of offshore financial centres including the Caymans as conduits for money laundering.

The scale and significance of FMMs means that playing host is a relatively expensive proposition in comparison with some ministerial meetings. Out of the last four meetings, two have been in British dependent territories (the other being Bermuda, in 1996); one in Canada, in 1998; and one in Mauritius, in 1997. Malta is by any definition a small state, but could get off reasonably lightly. Member states bear the brunt of the expense of their delegations, with just the head of state and spouse being supported by the host government.

2 Record for policy

The Commonwealth's position as the only international body whose membership includes both industrialised and developing states, with the latter in a majority, gives it a unique role in economic policy making. While decisions — reached, of course, by consensus rather than by vote — may not necessarily have a direct impact on global economic policy, the fact that the results of FMM deliberations not only have the support of both two of the G8 countries (the UK and Canada) but a near-worldwide distribution of developing countries as well, and are announced right before the Bank and the Fund meetings, gives the gathering a weight beyond that of some Commonwealth meetings. Further weight comes from the presence of 10 Commonwealth members among the 41 countries in the Heavily Indebted Poor Countries (HIPC) initiative, which remains high on the IFI agenda.

The meetings of 1998, in Ottawa, and the meeting in Mauritius the year before, provide good examples. Ottawa saw a joint Commonwealth statement on the chaos caused in the global economy by the Asian currency crisis of 1997. It called for root-and-branch reform of the regulation of international capital flows. It proposed a supranational committee of all international financial institutions, to intervene when the balance of risk reached critical levels. The international community, the statement said, needed to rediscover the energy and commitment of the original Bretton Woods negotiators.

The statement received publicity at the time, belying the low profile from which the Commonwealth

countries most afflicted, such as Indonesia, where poverty levels practically doubled in just a few months. That situation helped catalyse a change of heart within the World Bank, redirecting the organisation's efforts much more towards both the vital importance of social safety nets and inclusive — that is, bottom up as well as top down — practices vis-à-vis development planning. This was codified in the Comprehensive Development Framework (CDF).

But since then, reform has ossified. Last year's FMM included an unequivocal call for concrete, deep-seated reform, bringing developing nations much closer to the heart of IFI decision-making. It arose partly from the perception that IFI firefighting, and the US's continuing consumer-led boom, had patched things up sufficiently to allow financial markets in the industrialised countries to go on generally as they had before, despite persisting collateral damage to some developing economies.

It also arose out of the establishment by the IFIs of the Financial Stability Forum, chaired by the UK's Gordon Brown. This — said the 1999 communiqué — went some way towards answering the questions posed by the inequalities inherent in globalisation and the fallout from Asian currency movements. But, it said, the forum had to retain a "sense of urgency" and should work harder to bring developing countries into the decision-making process, even though the immediate storm had passed.

The 1997 FMM in Mauritius has in some senses suffered the same fate. The question of debt refinancing and forgiveness remains a vital issue for a majority of Commonwealth countries, whether they are on the HIPC list, and is therefore a staple of FMM agendas. In 1997, the snail's pace at which the HIPC programme was proceeding was of great concern.

The outcome, arising from proposals brought to the meeting by Gordon Brown, was the Mauritius Mandate: a demand that the Paris Club of donors and those responsible for administering the HIPC initiative ensure that, by the year 2000, all HIPC countries should at least have embarked upon the process of examining and rescheduling debt. By the same deadline, 75% of the countries should have been able to settle the terms for forgiveness and repayment. At the same time, the Mandate called for gold sales by the IMF to fund the process (a requirement which has since been amended to protect gold-exporting countries from consequent price falls). It also urged HIPC assistance for additional categories of debt — that owed to multilateral bodies, as well as bilateral debt, for instance — which had been omitted from its terms of reference.

That the ambitious timescale of the Mauritius Mandate has — to put it generously — slipped comes as little surprise. In Ottawa, finance ministers called for the IFIs to extend the Mandate beyond the end of 1999, and to get over half the 41 HIPC countries to decision points by that time. It also demanded, by the midpoint of 1999, a thorough re-evaluation of the HIPC process to see how it could accelerate further.

In 1999, Ministers welcomed the greater emphasis on poverty reduction which the G8 nations agreed in their summer summit in Köln that year, but set a 2015 target for achieving this aim. They stressed that with time ticking by, sustainability was a key issue. They also reminded the Bank and the Fund that debt relief should not replace Official Development Assistance (ODA) which risked being subsumed into contributions towards debt relief programmes.

These issues are a fixture in international economic negotiation. The complexity of the issues and interests at hand, their global application, and the long-term nature of any solution or initiative, make that repetition inevitable. This reality lends added importance to the fact that recent FMMs have called for action which by IFI standards is fairly radical, partly thanks to the makeup of the only international body where Southern voices carry equal weight with their industrialised and post-industrial counterparts. A united Commonwealth voice cannot be ignored, even when those steering the global economy react with complacency, and unenlightened self-interest.

3 Agenda for 2000

The current draft agenda, which will be confirmed or amended on the eve of the conference, is as follows:

1. Current world economic situation and prospects

Examination of the performance of the global economy in the year since the last meeting, and discussion of a Commonwealth Secretariat briefing on the prospects for the future. Key issues include:

- Debt, the HIPC initiative and the Mauritius Mandate
- Co-operation with World Bank and IMF

2. Special theme: new challenges for the international financial institutions in supporting growth and development

Discussion of how to adapt global economic governance to cope better with crises and maintain growth while strengthening a mandate towards sustainable development, including:

- The risks inherent in recent calls from the US for a radical redefinition of the IFIs' roles
- constructive proposals for moving the IFIs further towards an emphasis on development in the face of volatile capital flows
- Representation of developing countries in decision making

3. Implementation of the joint Commonwealth/World Bank task force on small states

With this project now complete, an examination of how to put into practice proposals by which small states can be safely and securely integrated into the global economy. Including:

- Practical application of the vulnerability index which arose from the task force
- Exposure to commodity markets and dependence on a narrow range of exports
- Exposure to volatile capital flows
- Strengthening the ability of small states to gain fair representation in international fora, particularly with respect to the global trade regime
- Mitigation of the effects of natural disasters on small states

4. Development co-operation within the Commonwealth

A range of development-related topics, including:

- The Commonwealth Fund for Technical Co-operation (CFTC)
- The Commonwealth Private Investment Initiative (CPII)

5. Other issues

- Implications of OECD activities with respect to offshore financial centres and harmful tax competition
- Progress report on money laundering, budget and gender initiatives, and the Commonwealth Business Council [a growing forum which brings together government and private sector players]

6. Any other business

Including:

- Papers for information
- Communiqué
- Acknowledgements
- Next meeting

4 Comments on numbered agenda items

1 If recent financial coverage in the press is anything to go by, one story — the new electronic and knowledge economy — is dominating all others. Article after article has analysed the wildfire growth of startup companies, the changes the Internet has wrought in old-world business practices, and the implications for the economy at large.

This much-lauded new wave is at the heart of concerns about the strength or otherwise of the US economy, after nearly a decade of apparently inflation-free growth. After a scare in April, when the price of shares in new technology companies in the US, Europe and Japan plummeted across the board, there are two questions on everybody's lips. Is there really a "new paradigm", overturning time-

honoured rules about valuing companies on profits? Or are the debt- and loss-ridden “dot-com” corporations simply riding a wave of optimism which, sooner or later, will engulf them?

Some distance behind, in terms of international media interest, has been the aftermath of the “battle of Seattle”: the debacle at the World Trade Organisation summit in December, where demonstrators thronged the streets amid black-clad, gasmasked police, and appeared to bring talks on tariff and trade barrier reduction to a grinding halt.

Seattle was hailed by some as the first faltering victory of those opposed to the North’s agenda of expanding its access to markets around the world. However the WTO’s New Zealand director general, Mike Moore, complained that the demonstrators had also effectively put the brakes on his agenda, which was to use the unstoppable march of globalisation to benefit the poorer countries as well as the rich.

But outside the stock exchanges of the developed countries, reality has appeared somewhat different. Aside from pockets in Southeast Asia, India, South Africa and the Caribbean, the “new economy” has passed most of the world by. As for the WTO, certainly some items on US and European wish lists, not least the inclusion of labour and environmental standards and a widening of the imbalance in power of transnational corporations vis-à-vis developing countries were slowed or hindered, partly thanks to pressure from developing nations. Nonetheless, essential and harmful elements of the WTO’s work programme remain in place. The key WTO doctrine of “reciprocity” continues to favour richer states, with the resources to use the system to their advantage. Developed countries are still not opening markets for key products, like textiles and agricultural produce. Commodity prices in all areas apart from oil continue to slide, which by definition hurts developing countries with less diversified economies

From the perspective of the South, these trends demonstrate a record of continuing complacency which the FMM will hope to address. How can reform of financial architecture be returned to the top of the world agenda?

More urgent still is what the Secretary-General of the Commonwealth — Don McKinnon, also a New Zealander — calls the “woeful lack of progress” made on international initiatives to tackle the debt burden. The HIPC initiative has stalled. Despite the promises made in Köln last year, this year’s G8 summit in southern Japan made more headlines for the near-\$800M cost to the Japanese government of staging the event than for substantive progress. Only \$12,000M of the \$100,000M of funding built into the scheme has been pledged; only nine states are within the system of the 25 countries meant to be on the road to “sustainable” debt positions by the end of this year; and, according to Christian Aid, \$21,900M a year is still being paid out in interest, more than \$60M a day.

To take one example, Tanzania’s rescheduling reduced interest payments by just 20%, yet still demands repayments of \$146M a year — more than 50% higher than the country’s annual education budget for education of about \$85M a year.

Some progress has been made. Japan has joined the UK, the US, Italy, France and Canada in committing to 100% relief, and Italy has pledged a minimum of \$4,000M and a maximum of \$6,000M, as well as suggesting that the programme be expanded to 78 countries rather than the 41 included in the scope of HIPC to date.

The key advance agreed by creditor nations last year as part of the World Bank’s avowed new focus on tackling poverty is the inclusion of Poverty Reduction Strategy Papers (PRSPs) as a condition of faster relief, in an attempt to hasten payouts by committing debtor nations to use the proceeds for tackling the problems of their population.

But pressure groups and the affected countries themselves see PRSPs as a mixed blessing. The strategies are so wide-ranging, so complex, that producing them to the exacting standards of the IFIs is felt by some to be near-impossible in the timescales available. Anecdotal evidence suggests that some debtor states feel they must effectively take solutions “off the shelf” from the IMF. These may fail to meet the aspirations and local needs which the programme is meant for. There is also a suspicion that much of the privatisation and liberalisation included in the Fund’s traditional Structural Adjustment

Programmes makes its way virtually unchanged into the PRSPs, to the advantage mainly of large companies in the industrialised world.

An alternative has been suggested. Countries could simply guarantee to use the funds released by debt relief for poverty reduction, rather than having to map out the entire strategy in advance. Ministers may decide that this would be a workable compromise to suggest to the IFIs, even though it goes against the long IFI tradition of detailed plans and contractual relationships.

2 For the third year in succession, the future shape of the world's financial architecture is at the heart of the FMM agenda. The priorities outlined in the Ottawa Statement of 1998, which set the year 2000 as the target for full-scale reform and re-evaluation, seem to have been ignored by most developed countries.

The G8 summit in Japan made no substantive commitments on this question. It did call for a "new partnership with non-G8 countries, particularly developing countries, international organisations and civil society, including the private sector and non-governmental organisations (NGOs)" which would "bring the opportunities of the new century within reach of all". But it seemed as if the introduction of the Financial Stability Forum, introduced after the 1999 IFI meetings, was to be the last word on the subject: this Forum does incorporate some limited representation for developing countries.

Yet the dangers posed by volatile capital flows to emerging economies have not diminished, and the mandate for sustainable development, not to mention any real influence for the South within the decision-making of the IFIs, remain marginal.

Indeed, the sole concrete proposal on the table from the developed countries — emanating from the US and known as the Meltzer Report — is generally seen as, if anything, a thoroughly retrograde step. It would effectively curtail the lending capacity and role of the IFIs. It is largely the product of a Washington compromise, born of the deep suspicion within US political elites of genuinely multilateral action of any kind. Although it might finally free up money long promised to HIPC but blocked by the US Congress, many in the developing world feel that the cure would be worse than the disease. The report was discussed in June at a multilateral meeting in Marlborough House in London, and the anger expressed at that gathering will feed through into discussions in Malta.

The special theme this year speaks of "new challenges", and the pressure will continue to be on Canada and the UK, both G8 members, to follow through their Commonwealth colleagues' concerns at the highest level. To be fair, both countries have been at the forefront of action on the HIPC issue, but other Ministers will point out that, on the subject of reforming the IFIs' structures, loan practices, and remit, a more challenging agenda is urgently needed. Many suspect that the IFIs' goal of development remains conditional on there being no essential change in the way capital flows and investment strategies operate. They will want the Bank, Fund, and the WTO, to treat private sector practices and activities in the developed world less as an unassailable given, and more by the test of whether they help a developing country to progress or not.

3 For the last two years, a joint Commonwealth-World Bank taskforce has been examining the unique problems faced by small states, defined as those with a population under 1.5M. Typically they have a limited range of exports often based on commodities, debt problems and low GDP. The subject has a special resonance for the Commonwealth. Out of 54 member states, 30 count as small states, which was why the Secretariat's lobbying brought the taskforce into being in the first place.

Last year's FMM in the Cayman Islands discussed progress, and the taskforce's final report is now available for debate.

From the start, the taskforce's remit has been to examine how small states are affected disproportionately by the imbalance, common to most developing countries, between their ability to affect the outside world and their susceptibility to being affected by it. Its answer has been to create a vulnerability index, to quantify the exposure of small states to external environmental and economic shocks and, more broadly, to the daily workings of the global market.

The task now is for the index and other research to feed into the deliberations of Bank, Fund, and WTO. The latter's doctrine of reciprocity impacts harshly on small states, since their limited institutional resources cannot easily tackle the complicated legal and treaty structures, not to mention the breadth of issues under negotiation at any time. All too often, such states cannot take advantage of the structures in the way their larger neighbours do, and thus end up interacting with the world economy on inequitable terms.

By working with the World Bank on this issue, the Commonwealth stands at least some chance of writing the vulnerabilities into the way the IFI system operates, and into the terms of trade. Vulnerability needs to be considered with reference to commodity prices; assistance in participating in global fora on terms small states can help dictate; and on developing regional groupings to present a larger, more united front. As the most effective transregional group below the UN, with access to the G8, the Commonwealth is ideally placed to pursue this campaign.

If the WTO had been required to consult the index before adjudicating the notorious banana dispute between Europe (whose clients were the small states in the Caribbean) and the US, the outcome might just have been different.

4 Discussion of development co-operation will follow broadly the same lines as last year. It will centre again on the small resources of the Commonwealth's main organ for offering development assistance, the Commonwealth Fund for Technical Co-operation (CFTC). The CFTC pays for hundreds of advisers each year to spend time in member states on missions mostly devoted to "capacity building": assisting with public and private sector economic and financial reform. But contributions to the CFTC have consistently failed to keep pace with need over recent years, although the last twelve months have seen a concerted push from the Secretariat and some governments to boost pledges. Once again efforts will be made to twist the arms of Canada, Australia, New Zealand and the richer developing countries. Under the funding formula each country has to make some contribution to receive a benefit, and as the UK has agreed to pay 30% of what the CFTC actually receives, every extra £ from other countries has a multiplier effect.

However it can be unfortunate that the CFTC's finances are denominated in sterling, and the weakness of the euro and the yen have seen the pound gain in strength. With no end in sight to the high level of sterling, and no sign that ministers will call for a re-evaluation of sterling's role in the CFTC, the fund may continue to face financial problems.

Faced with this situation, and the ongoing downward spiral in Official Development Assistance, the four-year-old Commonwealth Private Investment Initiative (CPII) has taken on a growing importance. The CPII, which generates private sector funds to be invested on a regional basis, will be called upon to extend the range of its activities. Its funds to date are almost fully committed. This year also marks the second year in which the Commonwealth Business Council has observer status at the FMM, and some ministers are thought to be keen to bring the Council closer to the deliberations of the FMM.

5 This year has seen the Organisation for Economic Co-operation and Development (OECD) put two unsavoury aspects of international financial activity under the spotlight. One, money laundering, was a focus for discussion at last year's FMM — the source of some controversy, not least because the host territory, the Cayman Islands, has long been thought to be a centre for the activity. Indeed, despite its own angry and public protestations, the Caymans were named in this year's report from the Financial Action Task Force on money laundering as one of 15 jurisdictions whose regulatory structures were least able to combat the issue.

The other, harmful tax competition — defined by the OECD as existing when tax regimes "are tailored to erode the tax base of other countries", attracting investment or savings originating elsewhere and facilitating the avoidance of other countries' taxes — came into focus when in June the OECD named a list of countries, including 16 members of the Commonwealth, as being "tax havens". At this year's FMM, senior officials meeting on the first day of the FMM will discuss the OECD's proposals, which include restricting the deductibility of payments made to entities incorporated in tax havens, and imposing withholding taxes on payments to residents of countries with harmful preferential regimes.

On the face of it, there appears little problem with the OECD's proposals. After all, tax havens present individuals and companies with a way of legally avoiding or illegally evading tax in their home

countries, shrinking the tax base and laying an unfair burden on those who do pay tax. Oxfam, for instance, estimates that as much as \$50,000M is lost to poorer countries every year from a combination of tax avoidance by large corporations and rich individuals, the provision of a safe sanctuary for the proceeds of corruption, and the contribution of tax havens to the operation of global financial markets by making capital flight easier. Havens also force poorer countries into a “race to the bottom” of ever-lower tax rates for foreign investors.

But things are not quite that simple. In a small state, setting up shop as an offshore financial centre may be one of the few avenues open for earning foreign exchange, yet the familiar capacity constraints may militate against regulation of the quality required by the OECD. And there are suspicions that the OECD and organisations like it concentrate too much on small jurisdictions, and not enough on the tax avoidance that goes on under the auspices of the larger nations: in this case, particularly the UK. Six UK jurisdictions — Jersey, Guernsey, Gibraltar, the British Virgin Islands, Montserrat and the Turks and Caicos Islands — made it into the OECD hall of shame.

So when senior officials take the results of their deliberations to Ministers during the FMM, the latter will be looking out for proposals which safeguard the role of smaller states as financial centres by ensuring that they are not required to regulate solely for the convenience of their larger trading partners. And they will also want to make sure the OECD does not cherry pick its targets, and that the developed nations — especially, in this case, the UK — meets with treatment as severe as that meted out to its smaller Commonwealth partners.

5 Interactions with other bodies

The makeup of the Commonwealth and its explicit focus on development means the FMM is always popular with interest groups and other bodies. Aside from the World Bank, which this year is also playing an active part through its involvement in the Small States project, a raft of Commonwealth bodies including the Commonwealth Development Corporation, the Commonwealth Investment Guarantee Corporation, the Commonwealth Business Council and the Commonwealth of Learning, and other international representative bodies including La Francophonie (with which the Commonwealth Secretariat is actively building a working relationship), the importance of HIPC and debt relief is likely to attract interest from a number of lobby groups.

The relative proximity of Malta to mainland Europe, in which bodies like Jubilee 2000 — which has built a reputation in the last two years for being at the forefront of debt relief campaigning — and many other development-orientated groups are based, should make for a relatively high turnout compared with 1999.

6. Other issues

There may not be a place on the formal agenda for it, but the 25-year-old Lomé Accord will be present in the minds of a majority of ministers at this year’s FMM. The Accord — linking the European Union with 71 African, Caribbean and Pacific (ACP) countries — came up for renegotiation this year, and a new agreement was duly signed in Suva, Fiji, in February.

The Accord has historically given the ACP countries one-way preferential access to European markets, and has been a key driver in protecting many undiversified small economies from the totality of the economic buffeting they might otherwise have received. Of the Commonwealth’s 54 members, 39 — over two thirds — are ACP states as well, and so the negotiations in Suva were of absorbing interest to the Commonwealth as well as to the EU-ACP Secretariat itself.

The renegotiations took place in the aftermath of the dispute between the US and Europe over banana imports, which was won at the WTO by the US. The result was an agreement which according to many observers and participants committed the ACP countries to a radical curtailment of tariffs and protections, while giving the EU some major concessions including both guarantees that “economic migrants” from ACP countries would be returned home, and cross-conditionality stipulations about EU corporations’ access to ACP markets on rapidly-improving terms. Some even saw a resemblance in the new agreement to the now-defunct Multilateral Agreement on Investment, which died formally at the OECD in October 1998. The MAI’s aim for foreign companies to be treated equally to domestic ones

— innocent enough on the surface, but in fact posing a real risk to the development of indigenous industries in poorer countries — has been on EU and US agendas ever since.

While little can be done now about the outcome of Suva, the new agreement will nonetheless colour discussions in Malta. It may make the Commonwealth's ACP contingent push for a louder voice to emanate from the one grouping in which they retain a real say.

Author, Commonwealth Policy Studies Unit, acknowledgments

Jeremy Scott-Joynt is a staff correspondent for AFX News, the global financial newswire owned by Agence France Presse, for which he covers international regulatory issues and technology. He is formerly the editor of Gemini News Service, where he specialised in finance and economics, particularly with reference to trade and development. The Commonwealth Policy Studies Unit (CPSU), part of the Institute of Commonwealth Studies, London University, began work last year and is working on aspects of globalisation, and on a "Harare programme" for democratisation, civil society and human rights. The author would like to thank all those who helped him in preparing this document.