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PREM 19/1057

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PART 8

MT.

Confidential Filing

Future of Hong Kong  
New territorial leases

HONG KONG

Part 1 June 1979

Part 8 September 83

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
<del>30.9.83</del>							
30.9.83							
← Pt 8 ends →							
PREM 19/1057							

NOTE:

The future of Hong Kong

- Talks with the Chinese - August 1985

may be found in a separate folder  
at the back of this file.

Now incorporated in file

PART 8 ends:-

Hmt to AT + att 30.9.83

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PART 9 begins:-

SS/FCO to PM PM/83/15 1/10/83.

TO BE RETAINED AS TOP ENCLOSURE

## Cabinet / Cabinet Committee Documents

Reference	Date
CC(83) 28 <sup>th</sup> Meeting, Most Confidential Record	22/09/1983
CC(83) 28 <sup>th</sup> Meeting, item 1	22/09/1983

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed J. Gray

Date 21/5/2013

**PREM Records Team**

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Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

30 September 1983

Andrew Turnbull Esq  
10 Downing Street  
LONDON SW1

Dear Andrew,

HONG KONG

Since the discussion with the Prime Minister in Washington reported in Robin Butler's letter of 28 September the Chancellor has considered the Hong Kong situation further with officials and with the Governor of the Bank of England and has asked me to let you know the conclusions he has reached and the action he is now taking.

Although the problem is fundamentally a political one, and the recent crisis was precipitated by intensified Chinese propaganda and anxiety at the absence of any reassuring element in the official communique on the talks in Peking on 22 and 23 September, the Hong Kong government are proposing to take action on the monetary front to try to resist further pressure on the exchange rate. The Chancellor thinks this right, for although the rate now appears to have stabilised at just below 8 Hong Kong \$ to the US\$, the situation remains fragile, and there can be no confidence that the present stability will last. He therefore agrees that action must be taken quickly, particularly since expectations have been raised by the announcement by the Hong Kong authorities last week that they were considering possible revisions in the mechanics for backing the note issue.

As the Prime Minister knows, the Chancellor had instructed Treasury officials to consider, with the Bank, a number of alternative responses. These included schemes along the lines suggested by Sir Alan Walters, together with:-

- pegging the Hong Kong \$ against the dollar or sterling, with HMG being prepared to intervene heavily in support;

Annex 1

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- reimposition of exchange controls; Annex 2
- further action on interest rates (following the increase in prime rates to 16 per cent on 26 September); Annex 3
- removal of the 10 per cent withholding tax currently levied on interest paid on Hong Kong dollar deposits. Annex 4

... For background, short notes on these latter possibilities are attached at annexes 1 to 4. The Chancellor does not think that any of the last three, either alone or in combination, would be effective (and the Hong Kong government have also indicated that they do not regard exchange control or removing the withholding tax as feasible options). From the UK point of view the objections to the first, or any arrangement under which UK backing might be given to defence of the Hong Kong dollar are, at this stage, overwhelming. We could all too easily be drawn quickly into either committing our own - limited - dollar reserves to support the Hong Kong dollar, or allowing sterling itself to take the strain. The downward pressure on sterling could be substantial.

The proposal which the Hong Kong government have devised, and wish to implement, does not have this disadvantage. The scheme, set out in telegram No 1435 of 29 September attached at Annex 5, is a practical version of the most recent scheme proposed by Sir Alan Walters which was discussed in Washington. Indeed it has benefitted from discussion with Sir Alan's Hong Kong contacts. In brief, it entails setting the price of Certificates of Indebtedness (CIs) + the backing for the Hong Kong currency - in terms of US\$ at a fixed rate. This could, with the co-operation of the note-issuing banks, be implemented very quickly. Although the maintenance of the scheme might involve higher interest rates, it should stabilise the open market exchange rate in line with the CI rate.

Although on the basis of the knowledge available to us here it is not possible to evaluate the scheme thoroughly, and there are a number of points which we wish to clear up, it seems well worth trying, and quickly. But, arguably, the sooner an announcement of it is made, the better.

The Hong Kong authorities have however asked for technical advice on the implementation of their scheme. David Peretz from the Treasury (the Assistant Secretary in charge of the Balance and Payments Division) and Charles Goodhart from the

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Bank (whose economic advice the Hong Kong Financial Secretary himself has asked for) will therefore fly to Hong Kong over the weekend.

It is of course important that this visit should be conducted with the utmost secrecy and discretion. Any impression that HMG were now actively intervening in the management of the Hong Kong financial system could radically change the nature of the current political negotiations with China. However, if - as it is not unlikely - the presence of Peretz and Goodhart in Hong Kong is observed, the line to take in response to any enquiries would simply be that they are visiting Hong Kong to acquaint themselves with the current financial situation. As Mr Luce made clear in a public statement in his recent visit to Hong Kong, the action to defend the value of the Hong Kong dollar is a matter for the Hong Kong government.

I understand that the Foreign and Commonwealth Secretary agrees with the Chancellor's reactions to the Hong Kong proposal, and to the immediate visit by Peretz and Goodhart.

I am copying this letter and enclosures to Brian Fall (FCO) and John Bartlett (Bank of England).

*Yours ever,  
John Kerr.*

J O KERR

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Pegging the rate for the HK \$

This would involve an undertaking by the Hong Kong authorities, possibly with explicit or implicit backing from HMG, to fix the exchange rate at some particular level against the dollar or against sterling, or against a basket of currencies.

2. To meet such an undertaking the Hong Kong authorities would have to be prepared in principle to engage in unlimited intervention in support of their currency. All the experience of such intervention in sophisticated financial markets like Hong Kong's is that very large sums indeed have to be spent if the speculative pressures are strong; and that heavy intervention can itself increase those pressures if speculators believe the authorities will eventually give way. A month's leading and lagging on trade payments alone could cost the HK authorities \$2½ billion. If all or nearly all holders of reasonably liquid HK \$s sought to convert them into other currencies - an extreme but not inconceivable case - there would be an outflow of \$20 billion or so to meet.

3. Intervention would presumably, in the first case at least, be in US dollars, the currency that most sellers of HK \$s wish to hold. Hong Kong's own foreign currency reserves stood at around \$6 billion at the end of June and are probably still at a similar level. These might serve to hold the line for a while, but as they were depleted the Hong Kong authorities would have to consider the next step. In some circumstances they might be able to borrow in dollars on their own account, though in general one would expect it to be difficult to do so on any substantial scale, given the political uncertainties, without an HMG guarantee.

4. Beyond that, the only option would be, in effect, to begin to draw on the UK's reserves. Our own dollar reserves which currently stand at around \$4½ billion would not last for long in the face of severe pressure, either. We would then have to consider some combination of sales of other currencies from our reserves and/or gold; or we could seek to borrow dollars on Hong Kong's behalf.

5. Alternatively, at that stage intervention might be in sterling, the more natural course if the HK \$ rate were to be fixed in terms of sterling with explicit UK backing. In that case those who bought sterling as the HK authorities intervened could be expected to seek quickly to turn much of it into dollars. We would then have to choose between permitting the sterling exchange rate against the US dollar to take the strain, pulled down by the HK dollar; or intervening with our own reserves as in paragraph 4 above. It is difficult to judge how great the impact on sterling would be, but it could be quite substantial. Large holders of HK \$s, who hitherto have held back for fear of turning the rate too far against them, could be expected to take the opportunity of getting out while the going was good. And sterling would be affected not just by the direct impact of these flows, but also by the knowledge in the markets generally that we would be taking the strain.

6. However such intervention were carried out, in the end either the Hong Kong authorities or HMG or both would be acquiring a possibly very substantial volume of HK \$ claims - in return for the current Hong Kong reserves and some part of our current gold and dollar reserves, or financed by increased UK Government borrowing (either in sterling or dollars).

7. Perhaps, at first sight, the least unattractive form this option might take would be a statement that either we or the Hong Kong authorities would if necessary support the Hong Kong \$ against sterling at some rate well below the current market rate. But it seems very likely that in current conditions such a statement would in itself immediately drive the HK \$ down to the chosen level of defence. Investors and speculators would assume the authorities knew something they did not. It is arguably possible that if the chosen rate were low enough defending it might not prove too difficult. There might be enough buyers at that level to raise the HK \$ above the floor again, for a time at least. But the risks would be very great; at any moment some new political development could require massive intervention to support the rate we would then be committed to, as discussed above.

Exchange Controls

1. For a nation with as sophisticated a financial sector and as open a trading sector as Hong Kong's, exchange controls are unlikely to be effective - and all too likely to be counter-productive. That is no doubt why the Hong Kong authorities have not themselves considered this option. Complete controls could not be erected. Partial controls could simply damage confidence and lead to accelerating outflows. There is evidence that much of the pressure is coming from currency movements by small investors and traders rather than the large institutions, who might be simpler to control.
2. To the extent that some pressures are, however, coming from speculative currency transactions by Hong Kong registered banks there is one relatively minor measure that might be worth considering. In many countries, including the UK, there are rules governing the currency exposure of banks, for purposes of prudential supervision. There are no such rules for Hong Kong banks at present. They are able to take large open positions against the HK \$.
3. In the immediate circumstances, if a new rule were introduced to limit banks' exposed positions, or to prevent them changing, few would believe it was for prudential reasons. It would much more likely be seen as an exchange control measure and possibly the thin end of a wedge, encouraging preemptive sales of HK \$s by those not affected (ie all other than banks). But at some point in the future when markets had settled down it might be a possibility to consider and introduce as a prudential measure, to match similar restrictions on banks elsewhere in the world.

Action on Interest Rates

The extent to which changes in the structure of local interest rates in the recent past have influenced the exchange rate may be an indication of the likely effectiveness of this form of control on the exchange rate in future. Prime rates have moved this year as follows:-

<u>Date</u>	<u>Level</u>	<u>Exchange rate at time of change (HK \$/£)</u>
End-Dec '82	10.5%	6.50
19.4.83	11.5%	6.89
23.5.83	13.5%	6.99
6.7.83	12.5%	7.13
25.7.83	11.5%	7.20
9.9.83	13%	7.70
26.9.83	16%	8.25

2. Each change this year has apparently had only a small lasting effect on the exchange rate - though of course there is no way of knowing what would have happened had interest rates not risen. But certainly initial (reflex) reactions were generally shortlived. Following the 2 percentage point increase in May, for example, when the dollar parity was close to HK \$7.00, the exchange rate came back to around 6.90 initially but fell to 7.10 in under a week. More recently, the rate recovered slightly to 7.60 from 7.70 after the 9 September increase but rapidly resumed its downward trend, recording 8.00 on 17 September. The latest move included a more dramatic recovery from around 9.5 to above 8.00 - though it is not easy to judge the effect of the interest rate change in isolation from the other supportive measures. The rate has stabilised in the past two days at around 8.5 but it is too early to judge whether the immediate pressure is off.

3. The latest increase brings real interest rates in Hong Kong up to, or slightly above, prevailing levels elsewhere. The trend level of inflation is around 10%, indicating real rates of around 6% (compared on the same basis with 5.5% in Japan and 6.7% in the US). Changes earlier this year left real interest rates well below those of major trading partners. Even so, it may be the case that the current political uncertainty requires a premium over levels prevailing elsewhere although, in the light of the extreme fluctuations in confidence which are likely to continue, this cannot easily be quantified.
4. On the other hand, if a substantial premium is required, changes of 2-3% in nominal rates may be neither here nor there in the present climate of uncertainty. But higher nominal rates (of up to 20% or more) could be counter-productive, both through their effect on the local economy, and if they were taken to indicate desperation by the authorities. Certainly if rates were to remain very high for a period there would be worrying implications for the highly-g geared property market, already under considerable strain. The risks to the financial system of widespread failures in a sector which dominates the stock market and local activity, cannot be given too much emphasis.
5. On the other hand temporary movements in interest rate may in practice prove the only practical way of countering the periods of fluctuating confidence that can be expected from now on.

Removal of Withholding tax

At present withholding tax of 10% is levied on interest paid on Hong Kong dollar deposits. The rate was reduced in the 1982 budget from 15% to 10%, when a similar tax was removed altogether from foreign currency deposits held in Hong Kong; the latter move was designed to enhance Hong Kong's attractiveness as a funding centre - the government made no distinction between deposits held off or on on-shore - in relation to Singapore where the Asian Dollar Market was growing rapidly at the time.

2. It is argued that by keeping a withholding tax in place on HK dollar deposits only, with a differential (cet par) against local currency deposits, the government has encouraged the growth of a distinct US dollar-based economy in Hong Kong (eg exporters tend to keep earnings in US dollar accounts, even if held with local banks).

3. The US dollar transactions between Hong Kong companies have become commonplace - some companies keep their books entirely in US dollars - but it is debatable whether this trend has really been accentuated by the tax differential. Indeed as the differential is only equivalent to 1% of the value of a deposit (on an annual basis, where prevailing deposit rates are at 10%) a 1 percentage point different between nominal rates on US dollar and HK dollar deposits would be expected to compensate; the actual difference is currently of the order of 5 percentage points. This suggests that the benefit to the exchange rate would be, as the Governor argues, at best marginal. Banks may be discouraged from taking HK dollar deposits in the guise of US dollar deposits - a purely artificial book-keeping exercise to avoid the payment of withholding tax - but this is not likely to effect the volume of flows across the exchanges. Local dollar deposits would be recorded as such; any switching of these funds by the banks would have occurred whether or not the withholding tax were applied.

4. The main argument against the removal of the tax is perhaps not so much on the size of lost revenues (KS £0.6 billion in the current fiscal year, some 2% of projected recurrent revenues), as consideration of the equity of the tax base. At present, besides interest withholding tax the tax range comprises income tax, payable only by a minority of salary-earners (on account of the relatively high level of allowances) at the maximum effective rate of 15%, corporation tax of 16½% and a small contribution from excise and other taxes. However, the withholding tax is universally applied - virtually the only tax of this kind - and although a relatively small burden notionally affects all depositors equally.

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 FM HONG KONG 290515Z SEP 83  
 TO IMMEDIATE FCO  
 TELEGRAM NUMBER 1435 OF 29 SEPTEMBER

STRICTLY PERSONAL FOR CLIFT (HONG KONG DEPARTMENT) FROM BREMIDGE.

THE TWO PAPERS FROM MONETARY AFFAIRS BRANCH ARE AS FOLLOWS:

THE EXCHANGE RATE.

1. FIRST I DO NOT BELIEVE THAT THERE CAN BE ANY REAL DOUBT AS TO THE VALIDITY OF THE SCHEME (NEXT TWO WORDS UNDERLINED) IN PRINCIPLE. ALAN MCLEAN AND I HAVE INDEPENDENTLY SPENT A LOT OF TIME THINKING IT THROUGH, AND NOW STEPHEN CHEUNG APPEARS TO HAVE ACKNOWLEDGED THE THEORY. IN OTHER WORDS, THE SCHEME CAN "WORK". I UNDERSTOOD YOU TO SAY THAT PETER HAMMOND HAS SAID THAT IT WOULD NOT WORK, BUT IF HIS VIEW IS BASED ON ANYTHING LIKE THE SAME RATHER CONFUSED PERCEPTION WHICH APPEARED IN A LETTER FROM PETER WRANGHAM TO SMA YESTERDAY (WHICH I SAW ONLY VERY BRIEFLY), THEN HIS OBJECTION DOES NOT STAND UP. OF COURSE, THE CRUCIAL QUESTION CONCERNS THE (NEXT WORD UNDERLINED) PRACTICAL MANIFESTATION OF THE SCHEME IN TERMS OF MONETARY AND REAL ECONOMY CONSEQUENCES. IN THIS RESPECT CHEUNG'S WARNING COMES AS NO SURPRISE. THE POSSIBILITY OF A SEVERE CONSEQUENCES IS ADMITTED IN PARAGRAPH 14 OF MY PAPER, AND I SAID WHEN I SAW YOU YESTERDAY THAT THIS ASPECT REQUIRED STILL GREATER EMPHASIS. MCLEAN IS OF THE SAME OPINION. THE POINT IS THAT THE CONSEQUENCES COULD BE EXTREMELY SEVERE IF THE PUBLIC AND THE MARKETS DID NOT BELIEVE THAT THE RATE WOULD HOLD. IT IS PROBABLE, HOWEVER, THAT AFTER AN INITIAL SPELL OF UNCERTAINTY THE SQUEEZE WOULD QUITE SOON EASE, PROVIDED THAT WE HELD THE LINE. MONEY MIGHT REMAIN TIGHTER AND INTEREST RATES HIGHER (COMPARED WITH THE SITUATION WITHOUT THIS SCHEME), BUT NOT NECESSARILY TO AN INTOLERABLE DEGREE (ON THIS POINT GREENWOOD IS CONSIDERABLY LESS WORRIED THAN EITHER MCLEAN OR MYSELF).

2. AS I SEE IT, WE HAVE A STRAIGHT CHOICE BETWEEN ALLOWING THE EXCHANGE RATE TO SPIRAL DOWNWARDS INDEFINITELY, WITH REPEATS OF THE PANIC SEEN AT THE END OF LAST WEEK, OR INTRODUCING THIS SCHEME AND RIDING OUT THE MONETARY CONSEQUENCES. THESE CONSEQUENCES ARE LIKELY TO BE LESS SEVERE, THE LESS AMBITIOUS THE RATE WHICH IS SET. IN OTHER WORDS, IF WE ARE PARTICULARLY NERVOUS, WE MIGHT CHOOSE 8.00. EVEN THIS WOULD FULFIL OUR ANNOUNCED HOPE OF RESTORING STABILITY AT A RATE CLOSER TO THAT JUSTIFIED BY FUNDAMENTALS THAN WHEN THE STATEMENT WAS MADE ON SUNDAY.

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3. I AM VERY CONCERNED AT THE POSSIBLE CONSEQUENCES OF NOT PROCEEDING NOW. WE HAVE BUILT UP HOPES, AND EVEN THIS MORNING ON RTHK SMA IS QUOTED AS HAVING SAID THAT THE SCHEME WOULD BE READY SOON.

4. I HAVE BEEN THINKING OVERNIGHT ABOUT THE QUESTION OF CONSULTING THE BANK OF ENGLAND. I DO NOT BELIEVE THAT ANY FURTHER LIGHT WOULD BE THROWN ON THE PRINCIPLES OF THE SCHEME (SINCE FOUR ECONOMISTS HERE, CHEUNG, MCLEAN, GREENWOOD AND MYSELF) - OF WIDELY VARYING BACKGROUNDS - APPEARED TO BE IN AGREEMENT ON THE THEORY. WHETHER OR NOT AN OUTSIDER WOULD BE ABLE TO GIVE ANY FIRMER INDICATION THAN WE CAN AS TO THE PRACTICAL CONSEQUENCES MUST ALSO, I THINK, BE DOUBTED. HOWEVER, I EXPECT THAT AN AUTHORITY OPINION AND ADVICE WOULD CERTAINLY HELP TO SET OUR OWN MINDS AT EASE, WHICHEVER WAY THE ADVICE POINTED. I MYSELF WOULD CERTAINLY WELCOME THE OPPORTUNITY TO DISCUSS THE MATTER, BUT I THINK THAT MY MOTIVE WOULD BE TO SHARE THE BLAME FOR ANY EVENTUAL DECISION RATHER THAN HOPING TO RECEIVE MUCH ADDITIONAL ENLIGHTENMENT. THE PROBLEM IS, OF COURSE, THAT TIME HAS ALMOST RUN OUT.

### A PLAN FOR STABILISING THE EXCHANGE RATE.

#### INTRODUCTION.

FOR ABOUT A DECADE HONG KONG HAS HAD A FLOATING EXCHANGE RATE. DESPITE SOME LACK OF MONETARY DISCIPLINE DOMESTICALLY FROM TIME TO TIME, FLOATING IS GENERALLY JUDGED TO HAVE BEEN QUITE SUCCESSFUL: THE "AUTOMATIC ADJUSTMENT PROCESS" INHERENT IN FLOATING HAS PROBABLY CONTRIBUTED TO THE RAPID REAL ECONOMIC GROWTH THAT HAS BEEN ACHIEVED, ALTHOUGH INFLATION HAS OFTEN BEEN SOMEWHAT TOO FAST FOR COMFORT.

2. THE PROBLEM NOW IS THAT THE FUNDAMENTAL ECONOMIC FORCES OF THE ADJUSTMENT PROCESS ARE NO LONGER HOLDING SWAY. EXCHANGE RATE DETERMINATION HAS BEEN TAKEN OVER BY THE POLITICAL CONFIDENCE FACTOR. DESPITE THE PRESENT RESERVE THE POTENTIAL FOR DECLINE IN THE RATE APPEARS TO REMAIN BOUNDLESS. GOVERNMENT IS LOSING CREDIBILITY AND PEOPLE ARE THUS LOSING FAITH IN IT: RAMPANT INFLATION LOOMS; AND SOCIAL DISORDER IS BECOMING A VERY REAL THREAT. THE EXCHANGE RATE IS NOW (NEXT WORD UNDERLINED) THE CENTRAL ISSUE.

3. CLEARLY SOMETHING HAS TO BE DONE. EXCHANGE CONTROLS ARE RULED OUT ON BOTH POLICY AND PRACTICAL GROUNDS. EXCHANGE MARKET INTERVENTION HAS BEEN SEEN TO PROVIDE AT MOST TEMPORARY SUPPORT. INTEREST RATES CANNOT ULTIMATELY BE SET AGAINST MARKET FORCES.

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4. IT IS IMPORTANT TO DISTINGUISH BETWEEN LOSS OF CONFIDENCE IN HONG KONG'S FUTURE ON THE ONE HAND, AND THE VALUE OF THE CURRENCY ON THE OTHER. THE FORMER DEPRESSES THE PERCEIVED LONG-RUN (NEXT WORD UNDERLINED) REAL RATE OF RETURN ON ASSETS IN HONG KONG, AND CANNOT BE ARRESTED BY MONETARY POLICY. MONETARY POLICY OUGHT, HOWEVER, TO BE CAPABLE OF INFLUENCING THE VALUE OF THE CURRENCY - I.E. THE PRICE OF REAL ASSETS AND OF FOREIGN EXCHANGE IN TERMS OF THE DOMESTIC CURRENCY - INDEPENDENTLY OF THE CONFIDENCE FACTOR. THE QUEST FOR A MEANS TO STABILISE THE VALUE OF THE CURRENCY NEED NOT THEREFORE BE ENTIRELY HOPELESS.

THE PLAN.

5. THE EXCHANGE FUND WOULD SET THE PRICE OF CERTIFICATES OF INDEBTEDNESS IN TERMS OF FOREIGN CURRENCY (SAY U.S. DOLLARS). THIS WOULD BE INTENDED AS A FIXED PEG, ALTHOUGH IT WOULD BE UNDERSTOOD THAT THE PEG MIGHT BE ADJUSTED FROM TIME TO TIME IN ORDER TO MAINTAIN A STABLE TRADE-WEIGHTED INDEX. A SMALL SPREAD MIGHT BE ESTABLISHED BETWEEN THE PREVAILING BUYING AND SELLING RATES FOR C.H.S.

6. THE ABOVE WOULD BE THE SUBSTANCE OF THE SCHEME. NO OTHER EXPLICIT ACTION WOULD BE TAKEN BY THE GOVERNMENT. THE NOTE-ISSUING BANKS WOULD UNDERTAKE TO CONTINUE TO TREAT OTHER BANKS FAIRLY IN RESPECT OF NOTE TRANSACTIONS, BUT WHETHER THIS INVOLVED RETENTION OF EXISTING PROCEDURES, OR EXCHANGING NOTES AGAINST FOREIGN CURRENCY AT A RATE ALMOST EQUAL (ALLOWING FOR A SMALL SERVICE CHARGE PERHAPS) TO THE C.H. RATE, WOULD BE FOR THE BANKS TO AGREE AMONGST THEMSELVES.

7. THE POSSIBILITY OF THE EXCHANGE FUND GUARANTEEING THAT A C.H. ISSUED AT A PARTICULAR RATE WOULD BE REDEEMABLE AT THAT RATE HAS BEEN RAISED. THIS DOES NOT SEEM RIGHT IN PRINCIPLE. IT IS NOT USUAL FOR GOVERNMENT TO COMPENSATE FINANCIAL INSTITUTIONS FOR THE CONSEQUENCES OF MONETARY POLICY ACTIONS. AT PRESENT THE BANKS MAY SUFFER LOSSES WHEN, FOR INSTANCE, INTEREST RATES ARE ALTERED AT THE GOVERNMENT'S INITIATIVE, BUT THERE IS NO QUESTION OF COMPENSATION. UNDER THE PROPOSED SCHEME THERE WOULD PROBABLY BE FEWER OFFICIAL INITIATIVES ON INTEREST RATES, SO IT WOULD NOT BE UNREASONABLE TO EXPECT THE NOTE-ISSUING BANKS TO ACCEPT POSSIBLE RISKS ON C.H.S. INSTEAD. ANYWAY, THE RISKS WOULD BE TWO-WAY. MOREOVER, THE MAIN EXPOSURE OF THE BANKS WOULD BE THE EXISTING STOCK OF C.H.S, WHICH DO NOT CARRY AN ISSUE PRICE THAT COULD BE THE BASIS FOR A GUARANTEE.

EFFECT ON THE EXCHANGE RATE.

8. MARKET FORCES WOULD, THROUGH ARBITRAGE, TEND TO BRING THE EXCHANGE RATE IN THE OPEN MARKET INTO LINE WITH THE C.H. RATE. AN ILLUSTRATION OF THE CONVERGENCE PROCESS IS AS FOLLOWS.

9. SUPPOSE THE MARKET RATE WAS DOLLARS 8, BUT THE GOVERNMENT NOW ANNOUNCES A C.H. RATE OF DOLLARS 7. SUPPOSE A CUSTOMER WANTS TO BUY USD. SUPPOSE HE IS STILL QUOTED A RATE OF DOLLARS 8 BY HIS BANK.

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10. THE CUSTOMER WITHDRAWS HIS HKD DEPOSIT FROM HIS BANK IN CASH, BECAUSE HE KNOWS THAT THE NEXT BANK DOWN THE STREET WILL TAKE THE NOTES OFF HIM AT DOLLARS 7.10 IN ORDER TO REDEEM THEM AT THE EXCHANGE FUND AT DOLLARS 7, MAKING A NICE TURN. MEANWHILE THE FIRST BANK HAS HAD TO BUY CASH FROM THE EF AT DOLLARS 7 IN ORDER TO MEET THE CUSTOMER'S WITHDRAWAL. CLEARLY THE FIRST BANK WOULD HAVE BEEN BETTER ADVISED TO QUOTE THE CUSTOMER A RATE OF DOLLARS 7.10 IN THE FIRST PLACE.

11. THUS THE MARKET RATE TENDS TOWARDS THE CIB RATE. IN PRACTICE IT WILL NOT BE NECESSARY FOR CUSTOMERS TO CART LOADS OF BANKNOTES AROUND TOWN IN ORDER FOR THE ARBITRAGE PROCESS TO WORK. THE SIMPLE FACTS (1) THAT BANKS GUARANTEE THE CONVERTIBILITY OF DEPOSITS INTO CASH, AND (2) THAT THE EXCHANGE FUND GUARANTEES CONVERTIBILITY (LIMITED IN DIRECT ACCESS TO NOTE-ISSUING BANKS, BUT PRESUMED TO BE EASILY ACCESSIBLE FOR THE WHOLE BANKING SYSTEM) OF CASH TO FOREIGN CURRENCY, SHOULD BE SUFFICIENT TO MAKE THE PROCESS WORK.

12. INITIALLY WHEN THE SCHEME WAS INAUGURATED, ARBITRAGE MAY NOT BE PERFECT, SINCE THERE WILL BE A LEARNING PROCESS AND HENCE CAUTION, AND POSSIBLY SOME RIGIDITIES ON ACCOUNT OF LARGE DEALS COMING TO MARKET. EVEN SO, THE MARKET RATE WOULD TEND TOWARDS RATHER THAN AWAY FROM THE CIB RATE.

WHERE'S THE CATCH?

13. SO FAR, IT ALL SOUNDS TOO GOOD TO BE TRUE. WHERE'S THE CATCH? WHERE DO THE COSTS OF ACHIEVING STABILITY FALL?

14. UNDER THIS SCHEME, UNLIKE UNDER PRESENT ARRANGEMENTS, AN INCREASE IN THE DEMAND FOR FOREIGN CURRENCY WOULD TEND AUTOMATICALLY TO PUT A CONTRACTORY PRESSURE ON THE MONEY SUPPLY. THIS WOULD IN TURN, IN THE SHORT-TERM, TEND TO MEAN HIGHER INTEREST RATES AND SOME DEPRESSANT EFFECT ON ECONOMIC ACTIVITY UNTIL LOWER COST/PRICE LEVELS WERE ESTABLISHED. IF THE SCHEME SUCCEEDED IN RESTORING CONFIDENCE IN THE EXCHANGE RATE, THE PRESSURE OF DEMAND FOR FOREIGN CURRENCY WOULD SUBSIDE AND ANY MONETARY CONTRACTION WOULD BE ALLEVIATED. IT IS, OF COURSE, IMPOSSIBLE TO PREDICT THE IMPACT, BUT VIRTUALLY ANYTHING WOULD BE TOLERABLE FOR A SHORT WHILE IN THE INTERESTS OF STABILISING THE EXCHANGE RATE.

DECISIONS AND ACTION.

15. IF THE SCHEME IS TO BE IMPLEMENTED, THE CHIEF DECISION TO BE TAKEN CONCERNS THE CIB RATE. IDEALLY ONE MIGHT WISH TO RE-ESTABLISH IMMEDIATELY A RATE CALCULATED TO BE APPROPRIATE, SOLELY BY REFERENCE TO ECONOMIC FUNDAMENTALS. THIS WOULD PERHAPS BE IN THE RANGE 6.50 TO 7.00. HOWEVER, IF ONE FAILED TO WIN 100 PERCENT CONFIDENCE IN THE DURABILITY OF THAT RATE, THE PRESSURES OF MONETARY CONTRACTION MIGHT BE UNDULY SEVERE. A RATE OF 7.50 MIGHT BE MORE CREDIBLE, OR PERHAPS 7.25 ON THE GROUNDS THAT THIS WAS THE LAST RESTING POINT ON THE RECENT DOWN TREND.

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16. AS REGARDS OTHER PRELIMINARIES, FIRST IT WOULD BE NECESSARY FOR THE NOTE-ISSUING BANKS TO AGREE ANY REVISIONS TO THEIR ARRANGEMENTS FOR PROVIDING NOTES TO THE OTHER BANKS.

17. NEXT IT IS PARTICULARLY HARD TO PREDICT PUBLIC REACTION, SO ALL POSSIBLE CONTINGENCIES HAVE TO BE PROVIDED FOR. THE PUBLIC MIGHT SEIZE UPON THE ASSURANCE OF THE CONVERTIBILITY OF HKD NOTES INTO FOREIGN CURRENCY, BUT FAIL TO APPRECIATE THE CONTINUING CONVERTIBILITY OF DEPOSITS INTO NOTES. IF THIS HAPPENED THERE COULD BE, SOMEWHAT PERVERSELY, AN INITIAL, ALBEIT SHORTLIVED, SURGE IN DEMAND FOR HKD NOTES. ADEQUATE SUPPLIES WOULD NEED TO BE AT HAND.

18. MORE PROBLEMATICALLY, THE PUBLIC MIGHT TEST THE CONVERTIBILITY, AS THEY PERCEIVE ITS MEANING, OF THE HK NOTES BY DEMANDING FOREIGN NOTES IN EXCHANGE. THIS COULD BE DISCOURAGED TO SOME EXTENT BY PERSUADING THEM OF THE ADVANTAGES OF A FOREIGN CURRENCY DEPOSIT AS OPPOSED TO A BANKNOTE, AND BY DRAWING ATTENTION TO THE LAW CONCERNING THE USE OF FOREIGN NOTES IN HONG KONG. NEVERTHELESS, IT WOULD BE DESIRABLE FOR BANKS TO HAVE PLENTY OF U.S. NOTES AVAILABLE. IT WOULD BE IMPORTANT FOR THE SCHEME TO MAINTAIN MAXIMUM CREDIBILITY: ANY STORIES OF BANKS NOT BEING ABLE TO HONOUR THE SUPPOSED CONVERTIBILITY, AS INTERPRETED BY THE MAN IN THE STREET, WOULD BE MOST UNFORTUNATE.

### COST TO GOVERNMENT.

19. AFTER ANY SHORTLIVED INITIAL SURGE, IT IS LIKELY THAT THE NOTE-ISSUE WOULD CONTRACT (OR AT LEAST BE LESS THAN IT OTHERWISE MIGHT BE) DURING THE PERIOD OF ADJUSTMENT TO THE NEW RATE. THE WORST SCENARIO WOULD BE FOR THIS CONTRACTION TO CONTINUE, IMPLYING A CONTINUAL LACK OF CONFIDENCE IN THE STABILITY OF THE CURRENCY, UNTIL (IN THEORY ANYWAY) THE HKD MONEY SUPPLY (FOR WHICH CASH IS THE ULTIMATE RESERVE) DISAPPEARED TO ZERO, ALTHOUGH SUCH DEMONETISATION MIGHT BE NO BAD THING IF CONFIDENCE WAS INDEED SO PERSISTENTLY POOR.

20. THE COST OF ANY REDUCTION IN THE NOTE ISSUE IS THE LOSS OF SEIGNORAGE, WHICH IS ACCEPTABLE IF IT REFLECTS A RETURN OF MONETARY DISCIPLINE: ANNOYING, BUT ACCEPTABLE, IF IT SIMPLY REFLECTS MORE ECONOMICAL USE OF CASH: AND STILL MORE ANNOYING, BUT INEVITABLE, IF IT ARISES FROM A SHIFT TO USE OF OTHER CURRENCIES AND HENCE DIVERSION OF SEIGNORAGE TO ANOTHER GOVERNMENT (UNLIKELY UNLESS THE PROHIBITION ON USE OF FOREIGN NOTES IS REPEALED).

21. ADDITIONALLY, GOVERNMENT MAY RESENT REDEEMING CASH FOR FOREIGN CURRENCY AT A RATE LESS FAVOURABLE TO GOVERNMENT THAN THE LAST PRE-SCHEME MARKET RATE. HOWEVER, JUDGED OVER A LONGER PERIOD, GOVERNMENT WOULD PROBABLY FIND THAT IT HAD MADE HANDSOME EXCHANGE GAINS FROM INVESTING CASH PROCEEDS.

SECRET

22. ALL IN ALL, THE POSSIBLE COST TO GOVERNMENT IS STRICTLY FINITE, WITHIN A TOLERABLE BOUND.

POLITICS AND PRESENTATION.

23. THERE SHOULD BE NO POLITICAL PROBLEM IN IMPLEMENTING THIS SCHEME. CHINA HAS CONTINUALLY BEEN CALLING FOR ACTION ON THE EXCHANGE RATE AND CAN HARDLY BE CRITICAL OF THE FIXING OF THE C/R RATE BY REFERENCE TO THE U.S. DOLLAR - AND BY IMPLICATION AGAINST OTHER CURRENCIES - SINCE CHINA ITSELF QUOTES MOVABLE PEGS AGAINST THE U.S. DOLLAR AND OTHER CURRENCIES. IT CAN BE EXPLAINED THAT THE U.S. CURRENCY IS USED SIMPLY AS A VEHICLE AND REFERENCE POINT, AND NOT IN ANY CONSTITUTIONAL SENSE: IF NECESSARY IT CAN BE ARRANGED THAT THE EXCHANGE FUND WOULD ACCEPT OR PAY ANY OF A NUMBER OF LEADING CONVERTIBLE CURRENCIES AGAINST HKS, AT PREVAILING RATES BASED ON THE ANNOUNCED U.S. DOLLAR RATE.

24. IT HAS BEEN SUGGESTED THAT THE PEG SHOULD BE SET AGAINST STERLING, FOR CONSTITUTIONAL REASONS, BUT THIS DOES NOT SEEM NECESSARY AND MIGHT BE MISINTERPRETED POLITICALLY.

25. THE SCHEME WOULD HAVE TO BE VERY CAREFULLY PRESENTED SO AS TO ACHIEVE MAXIMUM IMPACT ON CONFIDENCE. AN OBVIOUS POINT OF EMPHASIS WOULD BE THAT THE FOREIGN CURRENCY RESOURCES AVAILABLE TO THE EXCHANGE FUND ARE VASTLY GREATER THAN THE LIABILITY NOW BEING EXPLICITLY ACCEPTED IN RESPECT OF C/Rs, AND THAT THESE RESOURCES ARE IN VERY LIQUID FORM. IT HAS BEEN SUGGESTED THAT, ADDITIONALLY, THE BANK OF ENGLAND SHOULD VOICE SUPPORT TO ASSIST WITH PROVIDING LIQUIDITY, IF NEEDED. IF POLITICALLY FEASIBLE, THIS WOULD CERTAINLY HELP, BUT IT IS NOT ESSENTIAL.

26. THE ANNOUNCEMENT WOULD HAVE TO STRIKE A CAREFUL BALANCE BETWEEN EMPHASIZING THE CONVERTIBILITY AND ASSET-BACKING OF THE HK DOLLAR AND AVOIDING ANY ENCOURAGEMENT FOR PEOPLE ACTUALLY TO CONVERT: AND IT WOULD HAVE TO BE MADE CLEAR THAT THE EXCHANGE FUND CONTINUED TO DEAL ONLY IN C/Rs WITH THE NOTE-ISSUING BANKS, SO THAT THE RATE OF EXCHANGE TO THE PUBLIC WOULD NOT NECESSARILY BE IDENTICAL TO THE PEGGED RATE (THOUGH IT WOULD IN ALL LIKELIHOOD BE CLOSE).

27. AS NOTED EARLIER THE SUCCESS OF THE SCHEME IN RESTORING THE STABILITY WITH THE MINIMUM OF MONETARY SQUEEZE DEPENDS ON ITS CREDIBILITY. THUS THE UTMOST CARE HAS TO BE TAKEN IN ITS PRESENTATION.

-6-  
SECRET

/CONCLUSION

SECRET

CONCLUSION.  
28. THIS SCHEME COULD, WITH THE AGREEMENT OF THE NOTE-ISSUING BANKS, BE IMPLEMENTED VERY QUICKLY. NO ALTERNATIVE HAS BEEN SUGGESTED. THE POTENTIAL COST TO GOVERNMENT IS NOT EXCESSIVE. AT BEST THE SCHEME WOULD SUCCEED IN STABILISING THE EXCHANGE RATE AT ONLY MODEST OR NEGLIGIBLE COST TO THE REAL ECONOMY. AT WORST, CONFIDENCE IN THE CURRENCY WOULD NOT BE FULLY RESTORED AND THE MONETARY CONTRACTION MIGHT CONSEQUENTLY BE INTENSE. AT THAT STAGE A DECISION COULD BE TAKEN EITHER TO ACCEPT AND INDEED ENCOURAGE DEMONETISATION, OR TO ABANDON THE SCHEME. EVEN WITH THIS WORST SCENARIO, IT IS DIFFICULT TO IMAGINE THAT WE WOULD BE IN A MORE PARLOUS STATE THAN WE ARE AT PRESENT.

YOUDE

LIMITED  
MD/HKD  
MR GIFFARD

-7-  
SECRET

CONFIDENTIAL



Foreign and Commonwealth Office

London SW1A 2AH

30 September 1983

*copy sent today.*

*Dear John,*

*A.J.C. 4/10.*

Hong Kong

As you know, we have run into a timing problem over the meeting the Prime Minister would like to have on Hong Kong prior to the arrival of the Unofficials next week. I understand that it is your strong preference to hold the meeting at 1630 on Wednesday. However, as you know, the Governor has to address Leg Co that day and cannot be back in London in time. The Foreign Secretary thinks that it would be very undesirable to hold this meeting without Sir E Youde. The main subject of discussion is likely to be how to handle ExCo and bring them into a more realistic position. The Governor's role in this is crucial and his advice is essential. There is, moreover, a risk that the preparatory meeting could leak, despite all our efforts. The news of a meeting on Hong Kong in the absence of the Governor could be taken very badly indeed in Hong Kong. The Foreign Secretary therefore very much hopes that the Prime Minister will agree, despite all the diary difficulties, to defer the preparatory meeting until Thursday.

If this is possible, he thinks it would be valuable if he could call on the Prime Minister on Wednesday (presumably at 1630) to go over the ground in advance and review the very difficult position we now find ourselves in. He would propose to be accompanied by Mr Luce, who has, of course, just come back from a week in Hong Kong.

*Yours ever*

(J E Holmes)  
Private Secretary

A J Coles Esq  
10 Downing Street

CONFIDENTIAL



10 DOWNING STREET

Prime Minister - To note

The scheme now being  
worked on is set out briefly  
in paras 5-14 of Annex 5.

Current action is to  
refine scheme and eliminate  
possible snags.

We will have a further  
report after visit of Peretz  
and Goodhart.

AT

30/9

Noted but has not commented



File No. ....

OUTWARD

Security Classification

Department .....

Drafted by .....

(Block Capitals) .....

TELEGRAM

Precedence

Tel. Extn. ....

DESKBY .....Z

FOR  
COMMS. DEPT.  
USE

Despatched (Date) .....  
(Time) .....Z

POSTBY .....Z

PREAMBLE

(Time of Origin).....Z(G.M.T.)

(Restrictive Prefix).....

(Security Class.).....

(Caveat/  
Privacy marking).....

(Codeword).....

(Deskby).....Z

TO..... IMMEDIATE HONG KONG PERSONAL FOR (precedence) (post) GOVERNOR Tel. No. .... of .....

AND TO (precedence/post)..... IMMEDIATE

FOREIGN & COMMONWEALTH SECRETARY

WASHINGTON (FOR CHANCELLOR OF THE EXCHEQUER)

AND TO SAVING..... FCO, UKMIS NEW YORK, PEKING

INFO.....

INFO SAVING.....

tribution:-

[TEXT] FOR GOVERNOR FROM PRIVATE SECRETARY TO THE PRIME MINISTER

THE PRIME MINISTER HAS SEEN YOUR LATEST REPORTS AND IS OF COURSE VERY CONCERNED ABOUT THE CONTINUING AND RAPID SLIDE IN CONFIDENCE. WE REALISE THAT YOU, MR. LUCE AND SIR P. CRADOCK WILL BE CONSIDERING EVERY POSSIBILITY FOR STEMMING IT.

IT WOULD BE VERY HELPFUL TO HAVE YOUR JOINT ASSESSMENT ON THE FOLLOWING POINTS:-

A) WHAT SORT OF STATEMENT FROM PEKING WOULD CONTRIBUTE TO A STEADYING OF OPINION IN HONG KONG?

B) IS THERE ANY SUCH STATEMENT WHICH IN PRESENT CIRCUMSTANCES THE CHINESE GOVERNMENT COULD REALISTICALLY BE EXPECTED TO MAKE?

c)

pies to:-

c) WHAT MESSAGE SHOULD SIR P. CRADOCK TAKE BACK TO PEKING TO PERSUADE THE CHINESE LEADERS THAT THERE IS A GENUINE CRISIS OF CONFIDENCE AND NOT JUST AN ARTIFICIAL CREATION OF THE BRITISH ADMINISTRATION WHICH COULD BE STOPPED IF WE SO WISHED?

d) ARE THERE OTHER WAYS E.G. SPECIAL EMISSARIES OR MINISTERIAL MESSAGES WHICH COULD BE USED TO GET ACROSS THE GENUINENESS AND SERIOUSNESS OF THE SITUATION TO THE CHINESE LEADERSHIP?

NOTHING TO BE WRITTEN IN THIS MARGIN

SECRET/D E D I P

*Mr. Coles*  
*No 10*  
*Downing Street*

*54*

21865 - 1

*ADL 3/10*  
*p.a.*

DD 010100Z HONG KONG

GRS254

D E D I P

SECRET

DESKBY 010100Z

FM FCO 301645Z SEP 83

TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 997 OF 30 SEPTEMBER

FOLLOWING PERSONAL FOR GOVERNOR FROM GIFFARD

YOUR TELNO 1452 AND YOUR TELECON WITH CLIFT: FINANCIAL SITUATION

1. THE CHANCELLOR OF THE EXCHEQUER IS PROPOSING TO THE PRIME MINISTER, WITH THE SECRETARY OF STATE'S CONCURRENCE, TO ARRANGE FOR OFFICIALS FROM THE TREASURY AND THE BANK OF ENGLAND TO FLY URGENTLY TO HONG KONG TO DISCUSS THE PROPOSED CERTIFICATE OF INDEBTEDNESS SCHEME. THEY ARE GOODHART (CHIEF ECONOMIC ADVISER TO THE BANK OF ENGLAND) AND PERETZ (ASSISTANT SECRETARY IN CHARGE OF THE BALANCE OF PAYMENTS DIVISION, TREASURY). WE ASSUME THAT BLYE WILL THEREFORE NOT TRAVEL TO LONDON.
2. IT IS FULLY UNDERSTOOD THAT THIS VISIT SHOULD BE CONDUCTED WITH THE UTMOST DISCRETION. IF HOWEVER THE PRESENCE OF THE OFFICIALS IN HONG KONG BECOMES KNOWN IT HAS BEEN AGREED THAT THE FOLLOWING LINE MIGHT BE TAKEN IN RESPONSE TO ENQUIRIES: 'THE OFFICIALS ARE VISITING HONG KONG SIMPLY TO ACQUAINT THEMSELVES WITH THE CURRENT FINANCIAL SITUATION. AS MR LUCE MADE CLEAR IN A PUBLIC STATEMENT ON HIS RECENT VISIT TO HONG KONG, THE ACTION TO DEFEND THE VALUE OF THE HONG KONG DOLLAR IS A MATTER FOR THE HONG KONG GOVERNMENT.'
3. SUBJECT TO THE PRIME MINISTER'S AGREEMENT, GOODHART AND PERETZ ARE TRAVELLING ON FLIGHT BA003 DEPARTING LONDON 1700 ON 2 OCTOBER AND ARRIVING HONG KONG 1530 ON 3 OCTOBER. THIS WAS THE EARLIEST FLIGHT AVAILABLE. THEY WOULD BE GRATEFUL IF THEY COULD BE MET AND IF HOTEL

SECRET/D E D I P

21865 - 1

ACCOMMODATION COULD BE ARRANGED FOR THEM.

HOWE

LIMITED

HD/HKD

PS (2)

PS/PUS

PS/MALUCE

MREVANS

MR GIFFARD

MR DONALD

COPIES TO  
MR B UNWIN, TREASURY  
D HOLLAND BANK OF ENGLAND  
MR COLES, NO 10 DOWNING ST

IMMEDIATE

S E C R E T

*Please return to  
Robin Butler*

*53*

SECRET

DESKBY 291200Z

FM FCO 291130Z SEP 83

TO IMMEDIATE WASHINGTON

TELEGRAM NUMBER 1614 OF 29 SEPTEMBER

FOLLOWING TELEGRAM NOW REPEATED TO YOU AT REQUEST OF DEPT WAS RECEIVED FROM HONG KONG TELEGRAM NUMBER 1433 OF 29 SEPTEMBER.

AND TO IMMEDIATE UKMIS NEW YORK (PERSONAL FOR PRIVATE SECRETARY)  
INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

MIPT: FUTURE OF HONG KONG: DISCUSSION WITH EXCO.

1. FOLLOWING IS TEXT OF DRAFT PAPER.

BEGINS.

INTRODUCTION.

1. MEMORANDUM DESCRIBED THE MAIN ELEMENTS OF THE CHINESE POSITION AS REVEALED IN THE FIRST THREE ROUNDS OF THE TALKS IN JULY AND AUGUST. IT ALSO DISCUSSED THE SITUATION WHICH WE WOULD FACE SHOULD THE CHINESE PROVE IMMOVEABLE ON THE INDIVISIBILITY OF SOVEREIGNTY AND ADMINISTRATION. THIS PAPER SEEKS TO IDENTIFY THE OPTIONS NOW AVAILABLE TO HMG IN THE LIGHT OF THE LATEST ROUND OF THE TALKS ON 22/23 SEPTEMBER. MEMBERS WILL WISH TO REFLECT ON THESE OPTIONS AND THEIR IMPLICATIONS BEFORE DISCUSSING THE SITUATION WITH MINISTERS IN LONDON ON 7 OCTOBER. NO CONCLUSIONS ARE DRAWN AND NO RECOMMENDATIONS ARE MADE.

CHINESE POSITION.

2. IT IS CLEAR FROM CHINESE STATEMENTS AT THE FOURTH PLENARY SESSION OF THE TALKS ON 22/23 SEPTEMBER THAT THERE HAS BEEN NO CHANGE IN THE CHINESE POSITION AS SET OUT IN MEMORANDUM XCX(83)54. IF ANYTHING THEIR LINE HAS HARDENED. IN PARTICULAR:  
(A) THE CHINESE ARE ADAMANT THAT BOTH SOVEREIGNTY AND ADMINISTRATION WILL BE RECOVERED IN 1997 AND HAVE CHARACTERISED OUR INSISTENCE ON BRITISH ADMINISTRATION AS AN INSUPERABLE OBSTACLE TO PROGRESS. THEY HAVE HINTED STRONGLY THAT THEY WILL BREAK OFF THE TALKS IF THERE IS NO CHANGE IN THE BRITISH POSITION.

/(B)

DISTRIBUTION

SIR A ACLAND

MR BUTLER

SIR R ARMSTRONG

SECRETARY OF STATE

MR COLES

MR INGHAM

I.L. 2810 /PDG S E C R E T

(B) THEY HAVE REJECTED OUR PROPOSAL FOR A JOINT EXAMINATION OF THE FACTS ABOUT THE SYSTEMS IN HONG KONG AND HAVE DISMISSED THE FOUR PAPERS SUBMITTED BY THE BRITISH NEGOTIATORS AT THE 2/3 AUGUST SESSION OUT OF HAND. THEY TAKE THE LINE THAT THE FACTS IN THESE PAPERS WERE TWISTED TO SUIT THE BRITISH THESIS (WHICH THEY DO NOT ACCEPT) THAT CONTINUING BRITISH ADMINISTRATION IS NECESSARY TO MAINTAIN CONFIDENCE.

(C) THEY CONCEDE THAT THERE IS A PROBLEM OF CONFIDENCE IN HONG KONG BUT ATTRIBUTE THIS ENTIRELY TO BRITISH "RIGIDITY", ACCUSING US OF ATTEMPTING TO PLAY PUBLIC OPINION AND ECONOMIC "CARDS" IN AN ATTEMPT TO PUT PRESSURE ON THEM. THEY HAVE SAID THAT THEY WILL NOT BE SCARED BY SUCH TACTICS AND HAVE DECLINED TO DO ANYTHING TO HELP BOLSTER CONFIDENCE IN THE HONG KONG DOLLAR.

(D) THEY HAVE REITERATED THAT IF THERE SHOULD BE MAJOR DISTURBANCES IN HONG KONG THEY WOULD BE OBLIGED TO RECONSIDER THE TIMING AND FORMULA FOR THE RECOVERY OF SOVEREIGNTY.

3. IN THE LIGHT OF WHAT THE CHINESE HAVE SAID THE FOLLOWING GRAVE RISKS MUST BE TAKEN INTO ACCOUNT:

(I) THAT WITHOUT A SHIFT IN THE BRITISH POSITION THE CHINESE WILL NOT AGREE TO A FURTHER SESSION OF THE TALKS AFTER THE ONE SCHEDULED FOR 19 AND 20 OCTOBER.

(II) THAT A BREAKDOWN IN THE TALKS WOULD MEAN A CONFRONTATION BETWEEN BRITAIN AND CHINA OVER HONG KONG WITH RESULTANT GRAVE DAMAGE TO THE HONG KONG ECONOMY. THERE IS NO CHANCE THAT THE CHINESE WOULD AGREE TO A FRIENDLY PAUSE FOR FURTHER REFLECTION ON BOTH SIDES.

(III) THAT THE CHINESE WILL BE READY IF NECESSARY TO SACRIFICE THE ECONOMIC BENEFITS THEY OBTAIN FROM HONG KONG IN ORDER TO ACHIEVE THEIR POLITICAL OBJECTIVES. IT WOULD BE DANGEROUSLY WRONG TO ASSUME THAT THEY WOULD BACK DOWN IN A CONFRONTATION ONCE THEY SAW THE DAMAGE BEING DONE TO THE HONG KONG ECONOMY.

(IV) THAT A BREAKDOWN WOULD LEAD THE CHINESE TO TAKE INCREASINGLY HARD PUBLIC POSITIONS FROM WHICH THEY WOULD NOT BE ABLE TO WITHDRAW WITHOUT DAMAGING LOSS OF FACE. EVEN IF THE CHINESE DID NOT ANNOUNCE THEIR OWN PLAN UNILATERALLY AND WERE PREPARED TO RESUME NEGOTIATIONS THE TERMS WHICH THEY WOULD THEN BE WILLING TO OFFER MIGHT WELL BE SIGNIFICANTLY WORSE THAN THOSE WHICH COULD BE NEGOTIATED NOW.

/FUTURE

FUTURE STRATEGY.

4. DURING THE LAST ROUND OF THE TALKS THE CHINESE MADE IT PLAIN INFORMALLY THAT THEY WOULD NOT BE PREPARED TO EMBARK ON DETAILED DISCUSSION OF THEIR PLAN WITHOUT PRIOR BRITISH ACCEPTANCE OF THEIR PREMISE THAT BOTH SOVEREIGNTY AND ADMINISTRATION WILL PASS TO CHINA IN 1997. THE CHINESE FOREIGN MINISTER TOLD THE SECRETARY OF STATE ON 27 SEPTEMBER THAT THE CHINESE HAD IDEAS WHICH THEY WISHED TO DISCUSS BUT ONLY IF THE QUESTION OF SOVEREIGNTY WAS PROPERLY SETTLED FIRST. THE TACTIC DEPLOYED ON 22/23 SEPTEMBER WILL NOT (NOT) THEREFORE ACHIEVE ITS INTENDED PURPOSE OF PROVIDING FURTHER OPPORTUNITIES TO CONVINCING THE CHINESE THAT THEIR PLAN WOULD NOT WORK AND THAT CONTINUED BRITISH ADMINISTRATION IS ESSENTIAL.

5. THE CHINESE HAVE ALSO MADE IT CLEAR INFORMALLY THAT THE CONTINUATION OF THE BRITISH LINK THROUGH A GOVERNOR APPOINTED BY AND RESPONSIBLE TO LONDON WOULD BE TOTALLY UNACCEPTABLE TO THEM. IT IS THEREFORE IMPROBABLE THAT THEY WOULD REGARD THE KIND OF MODIFICATIONS TO THE PRESENT SYSTEM OF BRITISH ADMINISTRATION SET OUT IN PARA 10 OF MEMORANDUM AS AN ACCEPTABLE BASIS FOR DISCUSSION.

OPTIONS.

6. AGAINST THIS BACKGROUND THE FOLLOWING OPTIONS APPEAR TO BE AVAILABLE:

(A) TO CONTINUE TO PRESS THE CASE FOR THE CONTINUATION OF BRITISH ADMINISTRATION ON PRESENT LINES.

(B) TO ACCEPT BOTH THE CHINESE PREMISE THAT SOVEREIGNTY AND ADMINISTRATION MUST PASS TO CHINA IN 1997 AND THE PLAN WHICH THEY HAVE OUTLINED, AND TO NEGOTIATE THE BEST DEAL POSSIBLE FOR HONG KONG ON THAT BASIS.

(C) TO MAINTAIN OUR PRESENT VIEW THAT CONTINUED BRITISH ADMINISTRATION IS ESSENTIAL, BUT TO SEEK A FORMULA ON WHICH WE COULD EXPLORE WHAT FLEXIBILITY THERE MIGHT BE IN THE CHINESE CONCEPT OF ADMINISTRATION, AND WHAT GUARANTEES IN THE FORM OF CONTINUING BRITISH LINKS THE CHINESE WOULD BE PREPARED TO BUILD INTO THEIR PLAN.

DISCUSSION OF OPTIONS.

7. THE FOLLOWING POINTS SHOULD BE BORNE IN MIND IN CONSIDERING THE OPTIONS OUTLINED ABOVE:-

/OPTION

## OPTION A.

8. THIS COURSE WOULD SHOW OUR RESOLVE. BUT THERE WOULD BE A VERY STRONG RISK OF A BREAKDOWN AT THE NEXT SESSION OF THE TALKS AND OF SUBSEQUENT PUBLIC CONFRONTATION WITH THE CHINESE, <sup>AND</sup> THE SEVERE CONSEQUENCES FOR CONFIDENCE AND THE HONG KONG DOLLAR WOULD THEN HAVE TO BE ACCEPTED. IT MIGHT NOT BE POSSIBLE TO RESUME NEGOTIATIONS SINCE A BREAKDOWN COULD WELL BE FOLLOWED BY A UNILATERAL CHINESE DECLARATION. BUT IF THEY WERE RESUMED WE SHOULD HAVE TO FACE THE PROSPECT OF A HARDENING OF CHINESE ATTITUDES.

## OPTION B.

9. WHILE THIS COURSE WOULD OPEN THE WAY TO DETAILED DISCUSSION OF THE CHINESE PLAN, AND HOW THE TRANSITION SHOULD BE ARRANGED IT WOULD AMOUNT TO CAPITULATION TO CHINESE DEMANDS. IF THE CHINESE WERE TO LEAK THIS THERE WOULD BE NO EFFECTIVE ANSWER AND THE IMPACT ON CONFIDENCE WOULD AT THE LEAST, BE SEVERE.

## OPTION C.

10. THE CHINESE ARE INSISTING THAT THEIR PREMISE MUST BE CONCEDED BEFORE THEY WILL ENTER INTO ANY DETAILED DISCUSSION OF THEIR PLAN. THIS IS SIMILAR TO THE POSITION WHICH THEY TOOK ON SOVEREIGNTY IN THE MONTHS AFTER MRS THATCHER'S VISIT TO PEKING. IF HMG WERE PREPARED TO MAKE A BOW IN THE DIRECTION OF THE CHINESE PREMISE IT SEEMS LIKELY THAT THE CHINESE COULD BE LED INTO A DETAILED DISCUSSION OF THEIR PROPOSED ADMINISTRATIVE ARRANGEMENTS FOR HONG KONG AFTER 1997. [SUCH A MOVE WOULD INVOLVE ADDING TO THE CONDITIONAL ASSURANCE ON SOVEREIGNTY ALREADY GIVEN IN MRS THATCHER'S LETTER TO PREMIER ZHAO OF 10 MARCH, 1983 A SIMILAR CONDITIONAL ASSURANCE ON THE RIGHT OF ADMINISTRATION. IN EFFECT THE AMBASSADOR WOULD BE INSTRUCTED TO TELL THE CHINESE THAT IF, ON THE PREMISE THAT BOTH SOVEREIGNTY AND THE RIGHT OF ADMINISTRATION WOULD PASS TO CHINA IN 1997, ADMINISTRATIVE ARRANGEMENTS COULD BE DEvised WHICH WOULD IN HMG'S JUDGEMENT GUARANTEE THE STABILITY AND PROSPERITY OF HONG KONG, MINISTERS WOULD BE PREPARED TO RECOMMEND THOSE ARRANGEMENTS TO PARLIAMENT.] TO BE PRODUCTIVE A MOVE OF THIS KIND WOULD NEED TO BE ACCOMPANIED BY A READINESS TO DISCUSS THE CHINESE PLAN IN A POSITIVE SPIRIT I.E. A WILLINGNESS TO PROPOSE AMENDMENTS AND ADDITIONS TO IT.

11. SUCH A MOVE COULD BE MADE WHILE STILL MAINTAINING THE BRITISH VIEW THAT THE CHINESE PLAN IS NOT SUFFICIENT TO MAINTAIN CONFIDENCE AND THAT CONTINUING BRITISH ADMINISTRATION IS THE ONLY SAFE PREREQUISITE.

IF HMG,  
WITHOUT  
CONCEDING  
THE CHINESE  
PREMISE, WERE  
TO MAKE CLEAR  
THAT THEY  
WERE AT LEAST  
WILLING TO

Not consistent  
with 6(c)



12. THE OUTCOME OF NEGOTIATIONS ON THIS BASIS CANNOT OF COURSE BE PREDICTED. MOREOVER, THE PURSUIT OF OPTION (C) CARRIES THE RISK THAT THE CHINESE WOULD MISREPRESENT THE ASSURANCE AS AN UNQUALIFIED ONE. BUT IT SHOULD ENABLE THE NEGOTIATING TEAM TO DISCOVER, THROUGH DETAILED DISCUSSION OF PRACTICAL ARRANGEMENTS, THE MOST FAVOURABLE TERMS OBTAINABLE FROM THE CHINESE BEFORE THE PEOPLE OF HONG KONG ARE PRESENTED WITH A FINAL CHOICE BETWEEN COURSES OF ACTION.

PUBLIC PRESENTATION.

13. WE WOULD NEED TO HAVE READY, AT LEAST FOR BACKGROUND BRIEFING PURPOSES, A CAREFUL STATEMENT OF THE REASONS FOR ADOPTING EITHER OPTION (A) OR OPTION (C). IN THE CASE OF OPTION (A), IT WOULD ALMOST CERTAINLY BE NECESSARY TO EXPLAIN PUBLICLY WHY A BREAKDOWN HAD OCCURRED. IF OPTION (C) WERE ADOPTED, WE SHOULD NEED TO BE READY TO CORRECT ANY PUBLIC MISREPRESENTATION OF OUR POSITION ON THE PART OF THE CHINESE, E.G. THAT WE HAD ACCEPTED THE CHINESE PLAN UNCONDITIONALLY. IT WOULD BE NECESSARY TO EMPHASISE THREE POINTS IN PARTICULAR:

(I) THAT HMG WERE RESERVING THE RIGHT TO REJECT ANY OUTCOME OF THE NEGOTIATIONS WHICH WOULD NOT IN THEIR JUDGEMENT GUARANTEE THE FUTURE PROSPERITY AND STABILITY OF HONG KONG.

(II) IN THE MEANTIME HMG WERE MAINTAINING THEIR VIEW THAT CONTINUATION OF BRITISH ADMINISTRATION IS THE ONLY SAFE WAY OF GUARANTEEING CONTINUED PROSPERITY AND STABILITY.

(III) WHAT HMG WERE DOING WAS WHAT ANY SENSIBLE NEGOTIATOR WOULD DO, NAMELY EXPLORING THE CHINESE POSITION FULLY IN ORDER TO FIND OUT WHETHER THEY WERE PREPARED TO COME TO A MUTUALLY SATISFACTORY AGREEMENT.

ENDS.

HOWE

SECRET

*Please return to Robin  
Butler 52*

IMMEDIATE

SECRET

DESKBY 291200Z

FM FCO 291130Z SEP 83

TO IMMEDIATE WASHINGTON

TELEGRAM NUMBER 1616 OF 29 SEPTEMBER

FOLLOWING TELEGRAM NOW REPEATED TO YOU AT REQUEST OF DEPT  
WAS RECEIVED FROM HONG KONG TELEGRAM NUMBER 1432 OF 29 SEPTEMBER

QUOTE

SECRET

DESKBY FCO 290600Z

FM HONG KONG 290505Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1432 OF 29 SEPTEMBER

AND TO IMMEDIATE UKMIS NEW YORK (PERSONAL FOR PRIVATE SECRETARY)  
INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

MY TELNO 1407: FUTURE OF HONG KONG: DISCUSSION WITH EXCO.

1. IN PARA 4 OF TEL UNDER REF I SOUGHT AUTHORITY TO PUT A PAPER  
TO EXCO SETTING OUT THE OPTIONS AS WE NOW SEE THEM BEFORE THE  
UNOFFICIALS VISIT LONDON NEXT MONTH.

2. AT THIS RATHER CRITICAL JUNCTURE I THINK IT ESSENTIAL TO  
FOCUS EXCO'S THINKING BY GIVING THEM A PAPER. IT IS THE PRACTICE  
TO DO THIS ON ALL IMPORTANT SUBJECTS AND IT WILL BE VERY  
DIFFICULT TO HAVE A PROPERLY STRUCTURED DISCUSSION UNLESS  
MEMBERS HAVE BEEN GIVEN SOMETHING IN WRITING BEFOREHAND. MOREOVER,  
RECENT DISCUSSION WITH MR LUCE SHOWED THAT SOME OF THEM SEE THE  
SITUATION IN BLACK AND WHITE TERMS: IF THEY ARE TO BE BROUGHT TO  
SEE THAT THERE IS A MIDDLE COURSE BETWEEN CONFRONTATION AND  
CAPITULATION IT WILL NEED TO BE EXPLAINED TO THEM VERY CAREFULLY.

DISTRIBUTION

SIR A ACLAND

SIR R ARMSTRONG

MR COLES

MR BURNE

MR INGHAM

1 COPY FOR S OF S.

IL 2807 PDG

/3. MIFT.....

3. MIFT CONTAINS A DRAFT WHICH I HAVE DISCUSSED WITH SIR P. CRADOCK. IN PUTTING IT TO THE COUNCIL I WOULD REMIND THEM OF THEIR STRONG WISH TO BE INVOLVED IN POLICY AT THE FORMATIVE STAGE AND BEFORE DECISIONS ARE TAKEN. I WOULD EXPLAIN THAT THE PURPOSE OF THE PAPER WAS SIMPLY TO HELP THEM PREPARE FOR THEIR DISCUSSIONS WITH MINISTERS BY ANALYSING THE PRESENT POSITION, SETTING OUT THE COURSES OF ACTION NOW AVAILABLE AND DISCUSSING THEIR IMPLICATIONS. I WOULD EMPHASISE THAT IT CONTAINED NO CONCLUSIONS OR RECOMMENDATIONS AND THAT NO MINISTERIAL VIEWS HAD BEEN EXPRESSED ON IT. THEY WILL BE FAMILIAR WITH OPTIONS (A) AND (B). ON OPTION (C), I WOULD RECALL THAT AT THE COUNCIL MEETING ON 27 SEPTEMBER 4 OR 5 MEMBERS TOOK THE VIEW THAT WE SHOULD STILL LOOK FOR WAYS OF EXPLORING THE CHINESE POSITION FURTHER IN ORDER TO FIND OUT WHAT FLEXIBILITY THERE MIGHT BE IN THEIR CONCEPT OF ADMINISTRATION AND WHAT LINKS WITH THE U.K. THEY WOULD ACCEPT (PARA 4 OF MY TELNO 1420). I WOULD SAY THAT OPTION (C) HAD BEEN INCLUDED IN RESPONSE TO THIS SUGGESTION FROM MEMBERS, AND THAT IT WAS INTENDED TO PROVIDE A MEANS OF GETTING DETAILED PRACTICAL DISCUSSION STARTED WHILE FULLY RESERVING HMG'S POSITION.

4. SINCE THE PRIME MINISTER HAS NOW AGREED TO SEE THE UNOFFICIALS ON 7 OCTOBER AND I WILL MYSELF NEED TO LEAVE FOR LONDON ON THE EVENING OF 5 OCTOBER I SHOULD LIKE TO PUT THE PAPER TO EXCO ON TUESDAY, 4 OCTOBER. IF THEY ARE TO HAVE AN OPPORTUNITY TO READ IT BEFOREHAND THE PAPER WILL NEED TO BE CIRCULATED ON THE AFTERNOON OF MONDAY, 3 OCTOBER. I SHOULD ACCORDINGLY BE GRATEFUL FOR AUTHORITY TO DO THIS TO REACH ME DESKBY 030100Z.

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UNQUOTE

HOWE

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H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000

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A Turnbull Esq  
10 Downing Street  
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51  
29 September 1983

Dear Andrew

HONG KONG

You asked Brian Unwin for notes on three points.

2. First, the proportion of Hong Kong's food that is imported. Around  $\frac{3}{4}$ - $\frac{2}{3}$  Hong Kong's food is imported, largely from mainland China. All of the territory's rice is imported, 60% of vegetables and 50% of poultry. Roughly  $\frac{1}{7}$  of the territory's HK \$150 billion import bill is for food. (Incidentally, much of the territory's water is also imported from China).

3. Secondly, the effect of exchange rate changes on domestic prices. This proves to be a rather difficult question to answer. Food (largely imported, see above) accounts for around half of the main consumer price index, and altogether the import content of the consumer price index would seem to be around 50%. So one would expect exchange rate movements to have a quite substantial impact on prices. On the other hand, there is little sign that the fall in the exchange rate since last December, approximately 30% on the effective exchange rate index, has yet led to any acceleration in the rise in prices in Hong Kong. There may of course be lagged effects still to come, or there could have been offsetting factors. But although the figures fluctuate from month to month the underlying rate of inflation in Hong Kong seems to have stayed at around 10% over the period since last December.

4. Thirdly, you asked about the mechanism connecting the Hong Kong currency issue and the official exchange reserves. I attach a separate note on this.

Your ever

David

D L C PERETZ

## THE HONG KONG EXCHANGE FUND/CURRENCY MECHANISM

Hong Kong dollar bank notes are issued by the Hongkong and Shanghai Bank and the Chartered Bank. The "authorised issue" is limited by law to HK \$95 million, and is backed by British Government securities. The balance of the issue is backed by Certificates of Indebtedness (CI) issued by the Hong Kong Government Exchange Fund (EF).

2. From 1935 to 1972 CIs, which are denominated in HK dollars, were issued or redeemed against payments in London to and from the EF of the sterling equivalent of their face value, at the fixed exchange rate of the time. The funds of the EF were then invested in British Government securities. This arrangement worked in a period of very limited flows of capital, and under the exchange control regime in force in Hong Kong until 1971.

3. It could not, however, protect the value of the currency in the face of heavy capital flows, particularly after the abolition of exchange control and the development of the local foreign exchange market. In June 1972, in a period of heavy capital inflows the HK dollar was linked to the US dollar instead of to sterling, and Certificates of Indebtedness were henceforth issued against payment in Hong Kong in Hong Kong dollars. Since November 1974 the Hong Kong dollar has floated freely.

4. The Hong Kong Government Exchange Fund is thus now something of a hybrid, holding some of its assets in Hong Kong dollars (around US \$900 million worth), and the balance in foreign currencies, mainly US dollars (around US \$6 billion worth, of which a little over 5% is in sterling).

5. The only control over the size of the note issue is the fact that issuing banks have to pay market rates of interest on the HK dollar counterpart of the CIs issued by the exchange fund.

6. The assets of the exchange fund exceed the size of the note issue which stands at around HK \$14 billion (that is about US \$1.6 billion).

In practice the significance of the exchange fund nowadays lies mainly in its use to intervene in foreign currency markets.

7. The Hong Kong authorities are now considering a change of arrangements, under which Certificates of Indebtedness issued by the Exchange Fund would in future be denominated in US dollars. The main purpose of this would, presumably, be to help boost the size of the foreign currency reserves, in effect representing a redistribution of Hong Kong's foreign currency reserves from the banks to the official Exchange Fund.

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TO IMMEDIATE FCO  
TELEGRAM NUMBER 1435 OF 29 SEPTEMBER

STRICTLY PERSONAL FOR CLIFT (HONG KONG DEPARTMENT) FROM BREMRIDGE.

THE TWO PAPERS FROM MONETARY AFFAIRS BRANCH ARE AS FOLLOWS:

THE EXCHANGE RATE.

1. FIRST I DO NOT BELIEVE THAT THERE CAN BE ANY REAL DOUBT AS TO THE VALIDITY OF THE SCHEME (NEXT TWO WORDS UNDERLINED) IN PRINCIPLE. ALAN MCLEAN AND I HAVE INDEPENDENTLY SPENT A LOT OF TIME THINKING IT THROUGH, AND NOW STEPHEN CHEUNG APPEARS TO HAVE ACKNOWLEDGED THE THEORY. IN OTHER WORDS, THE SCHEME CAN "WORK". I UNDERSTOOD YOU TO SAY THAT PETER HAMMOND HAS SAID THAT IT WOULD NOT WORK, BUT HIS VIEW IS BASED ON ANYTHING LIKE THE SAME RATHER CONFUSED PERCEPTION WHICH APPEARED IN A LETTER FROM PETER WRANGHAM TO SMA YESTERDAY (WHICH I SAW ONLY VERY BRIEFLY), THEN HIS OBJECTION DOES NOT STAND UP. OF COURSE, THE CRUCIAL QUESTION CONCERNS THE (NEXT WORD UNDERLINED) PRACTICAL MANIFESTATION OF THE SCHEME IN TERMS OF MONETARY AND REAL ECONOMY CONSEQUENCES. IN THIS RESPECT CHEUNG'S WARNING COMES AS NO SURPRISE. THE POSSIBILITY OF A SEVERE CONSEQUENCES WAS ADMITTED IN PARAGRAPH 14 OF MY PAPER, AND I SAID WHEN I SAW YOU YESTERDAY THAT THIS ASPECT REQUIRED STILL GREATER EMPHASIS. MCLEAN IS OF THE SAME OPINION. THE POINT IS THAT THE CONSEQUENCES COULD BE EXTREMELY SEVERE IF THE PUBLIC AND THE MARKETS DID NOT BELIEVE THAT THE RATE WOULD HOLD. IT IS PROBABLE, HOWEVER, THAT AFTER AN INITIAL SPELL OF UNCERTAINTY THE SQUEEZE WOULD QUITE SOON EASE, PROVIDED THAT WE HELD THE LINE. MONEY MIGHT REMAIN TIGHTER AND INTEREST RATES HIGHER (COMPARED WITH THE SITUATION WITHOUT THIS SCHEME), BUT NOT NECESSARILY TO AN INTOLERABLE DEGREE (ON THIS POINT GREENWOOD IS CONSIDERABLY LESS WORRIED THAN EITHER MCLEAN OR MYSELF).

2. AS I SEE IT, WE HAVE A STRAIGHT CHOICE BETWEEN ALLOWING THE EXCHANGE RATE TO SPIRAL DOWNWARDS INDEFINITELY, WITH REPEATS OF THE PANIC SEEN AT THE END OF LAST WEEK, OR INTRODUCING THIS SCHEME AND RIDING OUT THE MONETARY CONSEQUENCES. THESE CONSEQUENCES ARE LIKELY TO BE LESS SEVERE, THE LESS AMBITIOUS THE RATE WHICH IS SET. IN OTHER WORDS, IF WE ARE PARTICULARLY NERVOUS, WE MIGHT CHOOSE 6.00. EVEN THIS WOULD FULFIL OUR ANNOUNCED HOPE OF RESTORING STABILITY AT A RATE CLOSER TO THAT JUSTIFIED BY FUNDAMENTALS THAN WHEN THE STATEMENT WAS MADE ON SUNDAY.

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## SECRET

3. I AM VERY CONCERNED AT THE POSSIBLE CONSEQUENCES OF NOT PROCEEDING NOW. WE HAVE BUILT UP HOPES, AND EVEN THIS MORNING ON RTHK SMA IS QUOTED AS HAVING SAID THAT THE SCHEME WOULD BE READY SOON.

4. I HAVE BEEN THINKING OVERNIGHT ABOUT THE QUESTION OF CONSULTING THE BANK OF ENGLAND. I DO NOT BELIEVE THAT ANY FURTHER LIGHT WOULD BE THROWN ON THE PRINCIPLES OF THE SCHEME (SINCE FOUR ECONOMISTS HERE, CHEUNG, MCLEAN, GREENWOOD AND MYSELF) - OF WIDELY VARYING BACKGROUNDS - APPEARED TO BE IN AGREEMENT ON THE THEORY. WHETHER OR NOT AN OUTSIDER WOULD BE ABLE TO GIVE ANY FURTHER INDICATION THAN WE CAN AS TO THE PRACTICAL CONSEQUENCES MUST ALSO, I THINK, BE DOUBTED. HOWEVER, I EXPECT THAT AN AUTHORITYATIVE OPINION AND ADVICE WOULD CERTAINLY HELP TO SET OUR OWN MINDS AT EASE, WHICHEVER WAY THE ADVICE POINTED. I MYSELF WOULD CERTAINLY WELCOME THE OPPORTUNITY TO DISCUSS THE MATTER, BUT I THINK THAT MY MOTIVE WOULD BE TO SHARE THE BLAME FOR ANY EVENTUAL DECISION RATHER THAN HOPING TO RECEIVE MUCH ADDITIONAL ENLIGHTENMENT. THE PROBLEM IS, OF COURSE, THAT TIME HAS ALMOST RUN OUT.

### A PLAN FOR STABILISING THE EXCHANGE RATE.

#### INTRODUCTION.

FOR ABOUT A DECADE HONG KONG HAS HAD A FLOATING EXCHANGE RATE. DESPITE SOME LACK OF MONETARY DISCIPLINE DOMESTICALLY FROM TIME TO TIME, FLOATING IS GENERALLY JUDGED TO HAVE BEEN QUITE SUCCESSFUL: THE 'AUTOMATIC ADJUSTMENT PROCESS' INHERENT IN FLOATING HAS PROBABLY CONTRIBUTED TO THE RAPID REAL ECONOMIC GROWTH THAT HAS BEEN ACHIEVED, ALTHOUGH INFLATION HAS OFTEN BEEN SOMEWHAT TOO FAST FOR COMFORT.

2. THE PROBLEM NOW IS THAT THE FUNDAMENTAL ECONOMIC FORCES OF THE ADJUSTMENT PROCESS ARE NO LONGER HOLDING SWAY. EXCHANGE RATE DETERMINATION HAS BEEN TAKEN OVER BY THE POLITICAL CONFIDENCE FACTOR. DESPITE THE PRESENT RESERVE THE POTENTIAL FOR DECLINE IN THE RATE APPEARS TO REMAIN BOUNDLESS. GOVERNMENT IS LOSING CREDIBILITY AND PEOPLE ARE THUS LOSING FAITH IN IT: RAMPANT INFLATION LOOMS: AND SOCIAL DISORDER IS BECOMING A VERY REAL THREAT. THE EXCHANGE RATE IS NOW (NEXT WORD UNDERLINED) THE CENTRAL ISSUE.

3. CLEARLY SOMETHING HAS TO BE DONE. EXCHANGE CONTROLS ARE RULED OUT ON BOTH POLICY AND PRACTICAL GROUNDS. EXCHANGE MARKET INTERVENTION HAS BEEN SEEN TO PROVIDE AT MOST TEMPORARY SUPPORT. INTEREST RATES CANNOT ULTIMATELY BE SET AGAINST MARKET FORCES.



## SECRET

4. IT IS IMPORTANT TO DISTINGUISH BETWEEN LOSS OF CONFIDENCE IN HONG KONG'S FUTURE ON THE ONE HAND, AND THE VALUE OF THE CURRENCY ON THE OTHER. THE FORMER DEPRESSES THE PERCEIVED LONG-RUN (NEXT WORD UNDERLINED) REAL RATE OF RETURN ON ASSETS IN HONG KONG, AND CANNOT BE ARRESTED BY MONETARY POLICY. MONETARY POLICY OUGHT, HOWEVER, TO BE CAPABLE OF INFLUENCING THE VALUE OF THE CURRENCY - I.E. THE PRICE OF REAL ASSETS AND OF FOREIGN EXCHANGE IN TERMS OF THE DOMESTIC CURRENCY - INDEPENDENTLY OF THE CONFIDENCE FACTOR. THE QUEST FOR A MEANS TO STABILISE THE VALUE OF THE CURRENCY NEED NOT THEREFORE BE ENTIRELY HOPELESS.

### THE PLAN.

5. THE EXCHANGE FUND WOULD SET THE PRICE OF CERTIFICATES OF INDEBTEDNESS IN TERMS OF FOREIGN CURRENCY (SAY U.S. DOLLARS). THIS WOULD BE INTENDED AS A FIXED PEG, ALTHOUGH IT WOULD BE UNDERSTOOD THAT THE PEG MIGHT BE ADJUSTED FROM TIME TO TIME IN ORDER TO MAINTAIN A STABLE TRADE-WEIGHTED INDEX. A SMALL SPREAD MIGHT BE ESTABLISHED BETWEEN THE PREVAILING BUYING AND SELLING RATES FOR CHS.

6. THE ABOVE WOULD BE THE SUBSTANCE OF THE SCHEME. NO OTHER EXPLICIT ACTION WOULD BE TAKEN BY THE GOVERNMENT. THE NOTE-ISSUING BANKS WOULD UNDERTAKE TO CONTINUE TO TREAT OTHER BANKS FAIRLY IN RESPECT OF NOTE TRANSACTIONS, BUT WHETHER THIS INVOLVED RETENTION OF EXISTING PROCEDURES, OR EXCHANGING NOTES AGAINST FOREIGN CURRENCY AT A RATE ALMOST EQUAL (ALLOWING FOR A SMALL SERVICE CHARGE PERHAPS) TO THE CH RATE, WOULD BE FOR THE BANKS TO AGREE AMONGST THEMSELVES.

7. THE POSSIBILITY OF THE EXCHANGE FUND GUARANTEEING THAT A CH ISSUED AT A PARTICULAR RATE WOULD BE REDEEMABLE AT THAT RATE HAS BEEN RAISED. THIS DOES NOT SEEM RIGHT IN PRINCIPLE. IT IS NOT USUAL FOR GOVERNMENT TO COMPENSATE FINANCIAL INSTITUTIONS FOR THE CONSEQUENCES OF MONETARY POLICY ACTIONS. AT PRESENT THE BANKS MAY SUFFER LOSSES WHEN, FOR INSTANCE, INTEREST RATES ARE ALTERED AT THE GOVERNMENT'S INITIATIVE, BUT THERE IS NO QUESTION OF COMPENSATION. UNDER THE PROPOSED SCHEME THERE WOULD PROBABLY BE FEWER OFFICIAL INITIATIVES ON INTEREST RATES, SO IT WOULD NOT BE UNREASONABLE TO EXPECT THE NOTE-ISSUING BANKS TO ACCEPT POSSIBLE RISKS ON CHS INSTEAD. ANYWAY, THE RISKS WOULD BE TWO-WAY. MOREOVER, THE MAIN EXPOSURE OF THE BANKS WOULD BE THE EXISTING STOCK OF CHS, WHICH DO NOT CARRY AN ISSUE PRICE THAT COULD BE THE BASIS FOR A GUARANTEE.

### EFFECT ON THE EXCHANGE RATE.

8. MARKET FORCES WOULD, THROUGH ARBITRAGE, TEND TO BRING THE EXCHANGE RATE IN THE OPEN MARKET INTO LINE WITH THE CH RATE. AN ILLUSTRATION OF THE CONVERGENCE PROCESS IS AS FOLLOWS.

9. SUPPOSE THE MARKET RATE WAS DOLLARS 8, BUT THE GOVERNMENT NOW ANNOUNCES A CH RATE OF DOLLARS 7. SUPPOSE A CUSTOMER WANTS TO BUY USD. SUPPOSE HE IS STILL QUOTED A RATE OF DOLLARS 8 BY HIS BANK.

## SECRET

10. THE CUSTOMER WITHDRAWS HIS HKD DEPOSIT FROM HIS BANK IN CASH, BECAUSE HE KNOWS THAT THE NEXT BANK DOWN THE STREET WILL TAKE THE NOTES OFF HIM AT DOLLARS 7.10 IN ORDER TO REDEEM THEM AT THE EXCHANGE FUND AT DOLLARS 7, MAKING A NICE TURN. MEANWHILE THE FIRST BANK HAS HAD TO BUY CASH FROM THE EF AT DOLLARS 7 IN ORDER TO MEET THE CUSTOMER'S WITHDRAWAL. CLEARLY THE FIRST BANK WOULD HAVE BEEN BETTER ADVISED TO QUOTE THE CUSTOMER A RATE OF DOLLARS 7.10 IN THE FIRST PLACE.

11. THUS THE MARKET RATE TENDS TOWARDS THE CIB RATE. IN PRACTICE IT WILL NOT BE NECESSARY FOR CUSTOMERS TO CART LOADS OF BANKNOTES AROUND TOWN IN ORDER FOR THE ARBITRAGE PROCESS TO WORK. THE SIMPLE FACTS (1) THAT BANKS GUARANTEE THE CONVERTIBILITY OF DEPOSITS INTO CASH, AND (2) THAT THE EXCHANGE FUND GUARANTEES CONVERTIBILITY (LIMITED IN DIRECT ACCESS TO NOTE-ISSUING BANKS, BUT PRESUMED TO BE EASILY ACCESSIBLE FOR THE WHOLE BANKING SYSTEM) OF CASH TO FOREIGN CURRENCY, SHOULD BE SUFFICIENT TO MAKE THE PROCESS WORK.

12. INITIALLY WHEN THE SCHEME WAS INAUGURATED, ARBITRAGE MAY NOT BE PERFECT, SINCE THERE WILL BE A LEARNING PROCESS AND HENCE CAUTION, AND POSSIBLY SOME REVERSALS ON ACCOUNT OF LARGE DEALS COMING TO MARKET. EVEN SO, THE MARKET RATE WOULD TEND TOWARDS RATHER THAN AWAY FROM THE CIB RATE.

WHERE'S THE CATCH?

13. SO FAR, IT ALL SOUNDS TOO GOOD TO BE TRUE. WHERE'S THE CATCH? WHERE DO THE COSTS OF ACHIEVING STABILITY FALL?

14. UNDER THIS SCHEME, UNLIKE UNDER PRESENT ARRANGEMENTS, AN INCREASE IN THE DEMAND FOR FOREIGN CURRENCY WOULD TEND AUTOMATICALLY TO PUT A CONTRACTIONARY PRESSURE ON THE MONEY SUPPLY. THIS WOULD IN TURN, IN THE SHORT-TERM, TEND TO MEAN HIGHER INTEREST RATES AND SOME DEPRESSANT EFFECT ON ECONOMIC ACTIVITY UNTIL LOWER COST/PRICE LEVELS WERE ESTABLISHED. IF THE SCHEME SUCCEEDED IN RESTORING CONFIDENCE IN THE EXCHANGE RATE, THE PRESSURE OF DEMAND FOR FOREIGN CURRENCY WOULD SUBSIDE AND ANY MONETARY CONTRACTION WOULD BE ALLEVIATED. IT IS, OF COURSE, IMPOSSIBLE TO PREDICT THE IMPACT, BUT VIRTUALLY ANYTHING WOULD BE TOLERABLE FOR A SHORT WHILE IN THE INTERESTS OF STABILISING THE EXCHANGE RATE.

DECISIONS AND ACTION.

15. IF THE SCHEME IS TO BE IMPLEMENTED, THE CHIEF DECISION TO BE TAKEN CONCERNS THE CIB RATE. IDEALLY ONE MIGHT WISH TO RE-ESTABLISH IMMEDIATELY A RATE CALCULATED TO BE APPROPRIATE, SOLELY BY REFERENCE TO ECONOMIC FUNDAMENTALS. THIS WOULD PERHAPS BE IN THE RANGE 6.50 TO 7.00. HOWEVER, IF ONE FAILED TO WIN 100 PERCENT CONFIDENCE IN THE DURABILITY OF THAT RATE, THE PRESSURES OF MONETARY CONTRACTION MIGHT BE UNDULY SEVERE. A RATE OF 7.50 MIGHT BE MORE CREDIBLE, OR PERHAPS 7.25 ON THE GROUNDS THAT THIS WAS THE LAST RESTING POINT ON THE RECENT DOWN TREND.

## SECRET

16. AS REGARDS OTHER PRELIMINARIES, FIRST IT WOULD BE NECESSARY FOR THE NOTE-ISSUING BANKS TO AGREE ANY REVISIONS TO THEIR ARRANGEMENTS FOR PROVIDING NOTES TO THE OTHER BANKS.

17. NEXT IT IS PARTICULARLY HARD TO PREDICT PUBLIC REACTION, SO ALL POSSIBLE CONTINGENCIES HAVE TO BE PROVIDED FOR. THE PUBLIC MIGHT SEIZE UPON THE ASSURANCE OF THE CONVERTIBILITY OF HKD NOTES INTO FOREIGN CURRENCY, BUT FAIL TO APPRECIATE THE CONTINUING CONVERTIBILITY OF DEPOSITS INTO NOTES. IF THIS HAPPENED THERE COULD BE, SOMEWHAT PERVERSELY, AN INITIAL, ALBERT SHORTLIVED, SURGE IN DEMAND FOR HKD NOTES. ADEQUATE SUPPLIES WOULD NEED TO BE AT HAND.

18. MORE PROBLEMATICALLY, THE PUBLIC MIGHT TEST THE CONVERTIBILITY, AS THEY PERCEIVE ITS MEANING, OF THE HK NOTES BY DEMANDING FOREIGN NOTES IN EXCHANGE. THIS COULD BE DISCOURAGED TO SOME EXTENT BY PERSUADING THEM OF THE ADVANTAGES OF A FOREIGN CURRENCY DEPOSIT AS OPPOSED TO A BANKNOTE, AND BY DRAWING ATTENTION TO THE LAW CONCERNING THE USE OF FOREIGN NOTES IN HONG KONG. NEVERTHELESS, IT WOULD BE DESIRABLE FOR BANKS TO HAVE PLENTY OF U.S. NOTES AVAILABLE. IT WOULD BE IMPORTANT FOR THE SCHEME TO WIN MAXIMUM CREDIBILITY: ANY STORES OF BANKS NOT BEING ABLE TO HONOUR THE SUPPOSED CONVERTIBILITY, AS INTERPRETED BY THE MAN IN THE STREET, WOULD BE MOST UNFORTUNATE.

### COST TO GOVERNMENT.

19. AFTER ANY SHORTLIVED INITIAL SURGE, IT IS LIKELY THAT THE NOTE-ISSUE WOULD CONTRACT (OR AT LEAST BE LESS THAN IT OTHERWISE MIGHT BE) DURING THE PERIOD OF ADJUSTMENT TO THE NEW RATE. THE WORST SCENARIO WOULD BE FOR THIS CONTRACTION TO CONTINUE, IMPLYING A CONTINUAL LACK OF CONFIDENCE IN THE STABILITY OF THE CURRENCY, UNTIL (IN THEORY ANYWAY) THE HKD MONEY SUPPLY (FOR WHICH CASH IS THE ULTIMATE RESERVE) DISAPPEARED TO ZERO, ALTHOUGH SUCH DEMONETISATION MIGHT BE NO BAD THING IF CONFIDENCE WAS INDEED SO PERSISTENTLY POOR.

20. THE COST OF ANY REDUCTION IN THE NOTE ISSUE IS THE LOSS OF SEIGNORAGE, WHICH IS ACCEPTABLE IF IT REFLECTS A RETURN OF MONETARY DISCIPLINE: ANNOYING, BUT ACCEPTABLE, IF IT SIMPLY REFLECTS MORE ECONOMICAL USE OF CASH: AND STILL MORE ANNOYING, BUT INEVITABLE, IF IT ARISES FROM A SHIFT TO USE OF OTHER CURRENCIES AND HENCE DIVERSION OF SEIGNORAGE TO ANOTHER GOVERNMENT (UNLIKELY UNLESS THE PROHIBITION ON USE OF FOREIGN NOTES IS REPEALED).

21. ADDITIONALLY, GOVERNMENT MAY RESENT REDEEMING CDS FOR FOREIGN CURRENCY AT A RATE LESS FAVOURABLE TO GOVERNMENT THAN THE LAST PRE-SCHEME MARKET RATE. HOWEVER, JUDGED OVER A LONGER PERIOD, GOVERNMENT WOULD PROBABLY FIND THAT IT HAD MADE HANDSOME EXCHANGE GAINS FROM INVESTING C.D. PROCEEDS.

## SECRET

22. ALL IN ALL, THE POSSIBLE COST TO GOVERNMENT IS STRICTLY FINITE, WITHIN A TOLERABLE BOUND.

POLITICS AND PRESENTATION.

23. THERE SHOULD BE NO POLITICAL PROBLEM IN IMPLEMENTING THIS SCHEME. CHINA HAS CONTINUALLY BEEN CALLING FOR ACTION ON THE EXCHANGE RATE AND CAN HARDLY BE CRITICAL OF THE FIXING OF THE C.H. RATE BY REFERENCE TO THE U.S. DOLLAR - AND BY IMPLICATION AGAINST OTHER CURRENCIES - SINCE CHINA ITSELF QUOTES MOVABLE PEGS AGAINST THE U.S. DOLLAR AND OTHER CURRENCIES. IT CAN BE EXPLAINED THAT THE U.S. CURRENCY IS USED SIMPLY AS A VEHICLE AND REFERENCE POINT, AND NOT IN ANY CONSTITUTIONAL SENSE: IF NECESSARY IT CAN BE ARRANGED THAT THE EXCHANGE FUND WOULD ACCEPT OR PAY ANY OF A NUMBER OF LEADING CONVERTIBLE CURRENCIES AGAINST HKS, AT PREVAILING RATES BASED ON THE ANNOUNCED U.S. DOLLAR RATE.

24. IT HAS BEEN SUGGESTED THAT THE PEG SHOULD BE SET AGAINST STERLING, FOR CONSTITUTIONAL REASONS, BUT THIS DOES NOT SEEM NECESSARY AND MIGHT BE MISINTERPRETED POLITICALLY.

25. THE SCHEME WOULD HAVE TO BE VERY CAREFULLY PRESENTED SO AS TO ACHIEVE MAXIMUM IMPACT ON CONFIDENCE. AN OBVIOUS POINT OF EMPHASIS WOULD BE THAT THE FOREIGN CURRENCY RESOURCES AVAILABLE TO THE EXCHANGE FUND ARE VASTLY GREATER THAN THE LIABILITY NOW BEING EXPLICITLY ACCEPTED IN RESPECT OF C.H.S, AND THAT THESE RESOURCES ARE IN VERY LIQUID FORM. IT HAS BEEN SUGGESTED THAT, ADDITIONALLY, THE BANK OF ENGLAND SHOULD VOICE SUPPORT TO ASSIST WITH PROVIDING LIQUIDITY, IF NEEDED. IF POLITICALLY FEASIBLE, THIS WOULD CERTAINLY HELP, BUT IT IS NOT ESSENTIAL.

26. THE ANNOUNCEMENT WOULD HAVE TO STRIKE A CAREFUL BALANCE BETWEEN EMPHASIZING THE CONVERTIBILITY AND ASSET-BACKING OF THE HK DOLLAR AND AVOIDING ANY ENCOURAGEMENT FOR PEOPLE ACTUALLY TO CONVERT: AND IT WOULD HAVE TO BE MADE CLEAR THAT THE EXCHANGE FUND CONTINUED TO DEAL ONLY IN C.H.S WITH THE NOTE-ISSUING BANKS, SO THAT THE RATE OF EXCHANGE TO THE PUBLIC WOULD NOT NECESSARILY BE IDENTICAL TO THE PEGGED RATE (THOUGH IT WOULD IN ALL LIKELIHOOD BE CLOSE).

27. AS NOTED EARLIER THE SUCCESS OF THE SCHEME IN RESTORING THE STABILITY WITH THE MINIMUM OF MONETARY SQUEEZE DEPENDS ON ITS CREDIBILITY. THUS THE UTMOST CARE HAS TO BE TAKEN IN ITS PRESENTATION.

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CONCLUSION.

28. THIS SCHEME COULD, WITH THE AGREEMENT OF THE NOTE-ISSUING BANKS, BE IMPLEMENTED VERY QUICKLY. NO ALTERNATIVE HAS BEEN SUGGESTED. THE POTENTIAL COST TO GOVERNMENT IS NOT EXCESSIVE. AT BEST THE SCHEME WOULD SUCCEED IN STABILISING THE EXCHANGE RATE AT ONLY MODEST OR NEGLIGIBLE COST TO THE REAL ECONOMY. AT WORST, CONFIDENCE IN THE CURRENCY WOULD NOT BE FULLY RESTORED AND THE MONETARY CONTRACTION MIGHT CONSEQUENTLY BE INTENSE. AT THAT STAGE A DECISION COULD BE TAKEN EITHER TO ACCEPT AND INDEED ENCOURAGE DEMONETISATION, OR TO ABANDON THE SCHEME. EVEN WITH THIS WORST SCENARIO, IT IS DIFFICULT TO IMAGINE THAT WE WOULD BE IN A MORE PARLOUS STATE THAN WE ARE AT PRESENT.

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MR GIFFARD

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TO IMMEDIATE FCO  
TELEGRAM NUMBER 1436 OF 29 SEPTEMBER

14101  
SOA

STRICTLY PERSONAL FOR CLIFT (HONG KONG DEPARTMENT) FROM BREMRIDGE.

IN THE LIGHT OF THE EXCHANGE RATE PROBLEMS EXPERIENCED AT THE END OF LAST WEEK, WE HAVE BEEN CONSIDERING A PROPOSAL FOR A SUBSTANTIAL REVISION OF THE MECHANICS FOR ISSUING AND REDEEMING CERTIFICATES OF INDEBTEDNESS TO THE NOTE-ISSUING BANKS IN SUCH A WAY AS TO PRODUCE AN EXCHANGE RATE WHICH WOULD MORE ACCURATELY REFLECT THE FUNDAMENTAL STRENGTH OF THE ECONOMY. A CHANGE OF THIS NATURE WOULD MEAN THE ASSUMPTION BY THE EXCHANGE FUND OF A MORE SIGNIFICANT ROLE IN THE EXCHANGE RATE DETERMINATION MECHANISM.

2. THE IMPLICATIONS OF SUCH A MAJOR CHANGE IN EXISTING PRACTICE NEED THE MOST CAREFUL EXAMINATION. THE DOWN SIDE RISKS MUST BE EVALUATED AND WE ARE PARTICULARLY CONCERNED THAT WE MAY TRANSMUTE A POTENTIAL RUNAWAY EXCHANGE RATE INTO A LEVEL OF INTEREST RATES WHICH WILL HAVE EQUALLY DAMAGING EFFECTS ON THE ECONOMY. POSSIBLE EFFECTS ON THE EXCHANGE FUND MUST ALSO BE EVALUATED AGAINST A BACKGROUND OF LOSS OF CONFIDENCE.

3. AFTER CONSULTATION, ADVICE IN HONG KONG IS CONFLICTING. THE HONG KONG BANK ARE NOT ENTHUSIASTIC, THOUGH THEY ACCEPT THAT IF THE EXCHANGE RATE AGAIN RUNS AWAY THE COURSE PROPOSED MAY CONCEIVABLY BE THE LESSER OF EVILS. MUCH WOULD DEPEND UPON THE CROSS-RATE TO THE U.S. DOLLAR INITIALLY SET.

4. I REPEAT HOWEVER THAT WE CANNOT RISK A LEAP IN THE DARK. NOR IS THERE A NEED FOR PRECIPITOUS ACTION AT THIS JUNCTURE, THOUGH CLEARLY THE SITUATION COULD CHANGE QUICKLY.

5. I AM CONSEQUENTLY SENDING YOU TWO PAPERS PRODUCED IN MONETARY AFFAIRS BRANCH WHICH EXPLAIN THEIR GENERAL THINKING.

6. WOULD YOU PLEASE IN THE PRESUMED ABSENCE OF THE GOVERNOR OF THE BANK OF ENGLAND IN WASHINGTON DISCUSS THIS TELEGRAM WITH KIT MCMAHON OR EQUIVALENT AND REQUEST THAT WITH THE MAXIMUM ACCEPTABLE DESPATCH CHARLES GOODHART OR A MAN OF EQUIVALENT STATURE SHOULD FLY TO HONG KONG TO ADVISE US ON THE SITUATION AS IT NOW PRESENTS ITSELF. THE PURPOSE OF TELEGRAMMING THE FULL TWO PAPERS IS INTER ALIA SO THAT THE BANK OF ENGLAND AND THE MAN WHO IS COMING OUT HAVE TIME TO REFLECT ON THE ISSUES EN ROUTE.

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MR GIFFARD

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FOAMCAST 012/29

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DD 291230Z UKMIS NEW YORK

GRS 75

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FM FCO 290945Z SEP 83

TO IMMEDIATE WASHINGTON

TELEGRAM NUMBER 1612 OF 29 SEPTEMBER

AND TO IMMEDIATE UKMIS NEW YORK (PERSONAL FOR PRIVATE SECRETARY)

PERSONAL FOR PRIVATE SECRETARY

HONG KONG TELNOS 1432, 1433 AND 1434.

1. WE ARE REPEATING ALL THREE TELEGRAMS TO WASHINGTON FOR YOU.  
THIS WILL ENABLE YOU TO SHOW THEM TO THE PRIVATE SECRETARY TO  
THE PRIME MINISTER IF THE SECRETARY OF STATE AGREES. WE THINK  
THERE WOULD BE ADVANTAGE IN THIS.

HOWE

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SIGNAL UNDER SERVICE  
MESSAGE ACTION BY THE  
COMMEN TO RECO  
GARBLED FORWARDING  
A FAIR COPY WILL  
FORWARDED AS SOON  
AS POSSIBLE.

FOWON 063/29

DD 291200Z WASHINGTON

GRS 450A

SECRET

DESKBY 291200Z

FM FCO 291130Z SEP 83

TO IMMEDIATE WASHINGTON

TELEGRAM NUMBER 1616 OF 29 SEPTEMBER

FOLLOWING TELEGRAM NOW REPEATED TO YOU AT REQUEST OF DEPT  
WAS RECEIVED FROM HONG KONG TELEGRAM NUMBER 1432 OF 29 SEPTEMBER

QUOTE

SECRET

DESKBY FCO 290600Z

FM HONG KONG 290505Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1432 OF 29 SEPTEMBER

AND TO IMMEDIATE UKMIS NEW YORK (PERSONAL FOR PRIVATE SECRETARY)  
INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

MY TELNO 1407: FUTURE OF HONG KONG: DISCUSSION WITH EXCO.

1. IN PARA 4 OF TEL UNDER REF I SOUGHT AUTHORITY TO PUT A PAPER  
TO EXCO SETTING OUT THE OPTION<sup>S</sup> AS WE NOW SEE THEM BEFORE THE  
UNOFFICIALS VISIT LONDON NEXT MONTH.

2. AT THIS RATHER CRITICAL JUNCTURE I THINK IT ESSENTIAL TO  
FOCUS EXCO'S THINKING BY GIVING THEM A PAPER. IT IS THE PRACTICE  
TO DO THIS ON ALL IMPORTANT SUBJECTS AND IT WILL BE VERY  
DIFFICULT TO HAVE A PROPERLY STRUCTURED DISCUSSION UNLESS  
MEMBERS HAVE BEEN GIVEN SOMETHING IN WRITING BEFOREHAND. MOREOVER,  
RECENT DISCUSSION WITH MR LUCE SHOWED THAT SOME OF THEM SEE THE  
SITUATION IN BLACK AND WHITE TERMS: IF THEY ARE TO BE BROUGHT TO  
SEE THAT THERE IS A MIDDLE COURSE BETWEEN CONFRONTATION AND  
CAPITULATION IT WILL NEED TO BE EXPLAINED TO THEM VERY CAREFULLY.



3. MIFT CONTAINS A DRAFT WHICH I HAVE DISCUSSED WITH SIR P. CRADOCK. IN PUTTING IT TO THE COUNCIL I WOULD REMIND THEM OF THEIR STRONG WISH TO BE INVOLVED IN POLICY AT THE FORMATIVE STAGE AND BEFORE DECISIONS ARE TAKEN. I WOULD EXPLAIN THAT THE PURPOSE OF THE PAPER WAS SIMPLY TO HELP THEM PREPARE FOR THEIR DISCUSSIONS WITH MINISTERS BY ANALYSING THE PRESENT POSITION, SETTING OUT THE COURSES OF ACTION NOW AVAILABLE AND DISCUSSING THEIR IMPLICATIONS. I WOULD EMPHASISE THAT IT CONTAINED NO CONCLUSIONS OR RECOMMENDATIONS AND THAT NO MINISTERIAL VIEWS HAD BEEN EXPRESSED ON IT. THEY WILL BE FAMILIAR WITH OPTIONS (A) AND (B). ON OPTION (C), I WOULD RECALL THAT AT THE COUNCIL MEETING ON 27 SEPTEMBER 4 OR 5 MEMBERS TOOK THE VIEW THAT WE SHOULD STILL LOOK FOR WAYS OF EXPLORING THE CHINESE POSITION FURTHER IN ORDER TO FIND OUT WHAT FLEXIBILITY THERE MIGHT BE IN THEIR CONCEPT OF ADMINISTRATION AND WHAT LINKS WITH THE U.K. THEY WOULD ACCEPT (PARA 4 OF MY TELNO 1420). I WOULD SAY THAT OPTION (C) HAD BEEN INCLUDED IN RESPONSE TO THIS SUGGESTION FROM MEMBERS, AND THAT IT WAS INTENDED TO PROVIDE A MEANS OF GETTING DETAILED PRACTICAL DISCUSSION STARTED WHILE FULLY RESERVING HMG'S POSITION.

4. SINCE THE PRIME MINISTER HAS NOW AGREED TO SEE THE UNOFFICIALS ON 7 OCTOBER AND I WILL MYSELF NEED TO LEAVE FOR LONDON ON THE EVENING OF 5 OCTOBER I SHOULD LIKE TO PUT THE PAPER TO EXCO ON TUESDAY, 4 OCTOBER. IF THEY ARE TO HAVE AN OPPORTUNITY TO READ IT BEFOREHAND THE PAPER WILL NEED TO BE CIRCULATED ON THE AFTERNOON OF MONDAY, 3 OCTOBER. I SHOULD ACCORDINGLY BE GRATEFUL FOR AUTHORITY TO DO THIS TO REACH ME DESKBY 030100Z.

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FM HONG KONG 290940Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1443 OF 29 SEPTEMBER

INFO IMMEDIATE HONG KONG GOVERNMENT OFFICE LONDON, PEKING,  
UKMIS NEW YORK (FOR S OF S PARTY), WASHINGTON (FOR PS TO PM)  
INFO ROUTINE HK GOVT REPS WASHINGTON, CG NEW YORK, UKMIS GENEVA,  
BRUSSELS

FUTURE OF HONG KONG: PRESS COVERAGE.

1. THE MAIN STORY IN TODAY'S INDEPENDENT PRESS WAS THE PRESS CONFERENCE GIVEN BY MR LUCE YESTERDAY EVENING. THREE POINTS WERE HIGHLIGHTED:

(A) MR LUCE'S REITERATION OF HMG'S FIRM COMMITMENT TO SEARCH FOR A SETTLEMENT ACCEPTABLE TO BRITAIN, CHINA AND THE PEOPLE OF HONG KONG.

(B) HIS REMARK THAT COMMENTS BY CHINESE OFFICIALS ON THE BRITISH POSITION WERE UNHELPFUL.

(C) HIS ANNOUNCEMENT THAT UNOFFICIAL MEMBERS OF EXCO WOULD ACCOMPANY ME TO LONDON NEXT WEEK.

2. THERE HAS SO FAR BEEN LITTLE COMMENT BY INDEPENDENT NEWSPAPERS. WAH KIU YAT PO REGARDED MR LUCE'S REMARKS AS A BOOST TO CONFIDENCE WHILST EDITORIALS IN THE FINANCIAL DAILY AND MING PAO URGED BRITAIN AND CHINA TO AGREE ON CONCRETE MEASURES TO RESTORE CONFIDENCE IN HONG KONG'S FUTURE.

3. THE LEADING COMMUNIST PAPERS (TA KUNG PAO AND WEN WEI PO) GAVE THE PRESS CONFERENCE ROUTINE COVERAGE ON THEIR BACK PAGES. THESE WERE LARGELY FACTUAL REPORTS. IN HIS EDITORIAL TA KUNG PAO ARGUED THAT MR LUCE'S VISIT WAS PART OF BRITAIN'S TACTIC TO PLAY THE 'PUBLIC OPINION CARD'. ALTHOUGH HE HAD MADE MUCH PLAY OF LISTENING TO THE VIEWS OF VARIOUS COMMUNITY GROUPS, THESE WERE ALL UNDER THE CONTROL OF OR SET UP BY THE HONG KONG GOVERNMENT. THE EDITORIAL DENIED THAT CHINA HAD BREACHED CONFIDENTIALITY IN THE TALKS SO FAR. A SHORT COMMENTARY IN WEN WEI PO SAID IT WAS THE BRITISH, NOT THE CHINESE, SIDE WHICH HAD TALKED TOO MUCH IN PUBLIC. IT CITED AS EXAMPLES REMARKS MADE BY HONG KONG 'COUNCILLORS'

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(NOT SPECIFICALLY IDENTIFIED BUT BY IMPLICATION, SIR S.Y. CHUNG AND THE URBAN COUNCIL CHAIRMAN, HILTON CHEONG-LEEN). THE COMMENTARY JUSTIFIED CHINESE STATEMENTS BY THE NEED TO DISTINGUISH "RIGHT FROM WRONG" WHICH HAD MADE NECESSARY "CLARIFICATIONS AND EXPLANATIONS".

YOUDE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

MR JAMES

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

MR BURROWS LEGAL ADVISER

MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

HONG KONG GOVT. OFFICE, LONDON

2  
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Hong-kong:

Text agreed  
~~the~~ reply sent via  
RMC/MZ

DRAFT PRESS NOTICE WHICH ROGER BONE WOULD LIKE JOHN COLES' APPROVAL ON -  
THE FOREIGN SECRETARY HAS ALREADY APPROVED IT

As a further step in the continuing process of consultation on the future of Hong Kong the Governor of Hong Kong, accompanied by the unofficial members of the Executive Council will visit London on 6 - 8 October. While in London they expect to call on the Prime Minister, the Secretary of State for Foreign Affairs and the Minister responsible for Hong Kong in the Foreign Office, Mr. Richard Luce.

28 September 1983

HK Antenna

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DESKBY 290100Z  
FM FCO 281700Z SEP 83  
TO IMMEDIATE HONG KONG  
TELEGRAM NUMBER 986 OF 28 SEPTEMBER  
INFO IMMEDIATE PEKING (PERSONAL FOR AMBASSADOR)  
YOUR TELECON WITH CLIFT: VISIT TO LONDON BY EXCO UNOFFICIALS  
1. NO 10 HAVE AGREED THAT YOU MAY MAKE THE FOLLOWING  
STATEMENT:

'AS A FURTHER STEP IN THE CONTINUING PROCESS OF CONSULTATION ON  
THE FUTURE OF HONG KONG THE GOVERNOR OF HONG KONG, ACCOMPANIED  
BY THE UNOFFICIAL MEMBERS OF THE EXECUTIVE COUNCIL, WILL VISIT  
LONDON ON OCTOBER 6-8. WHILE IN LONDON THEY EXPECT TO CALL ON  
THE PRIME MINISTER, THE SECRETARY OF STATE FOR FOREIGN AND  
COMMONWEALTH AFFAIRS AND THE MINISTER RESPONSIBLE FOR HONG KONG  
IN THE FOREIGN AND COMMONWEALTH OFFICE, MR RICHARD LUCE.'

HOWE

FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/PUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
MR WRIGHT

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MR COLES NO 10 DOWNING STREET  
SIR A PARSONS NO 10 DOWNING STREET  
MR WALKER RESEARCH D OAB 2/82

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10 DOWNING STREET

Willie, Thank you  
28/9

HONG KONG UNOFFICIALS  
PRE-MEETING.

The Prime Minister  
hopes that E. Y. will  
be able to change  
his engagement and  
attend the meeting on 5/10.  
If not it will unfortunately  
be necessary to go ahead  
without him. Thursday  
6 October is not possible.

Susan.

27.9.

FILE  
SECRET

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sent  
By Boq, Washington

10 DOWNING STREET

From the Principal Private Secretary

28 September, 1983

Dear John,

The Prime Minister held a meeting at the British Embassy in Washington this evening about the financial situation in Hong Kong. The Chancellor of the Exchequer, the Governor of the Bank of England, Sir Robert Armstrong, Sir Antony Acland, Sir Oliver Wright, Sir Terry Burns, Sir Alan Walters, Mr. Littler and Mr. Loehnis were also present.

The Prime Minister said that she had wanted an early discussion on measures which could be taken to stabilise the Hong Kong dollar since, even if there was no further fall in the meantime, there could be one following the next round of talks on Hong Kong with the Chinese government on 19 and 20 October. Sir Oliver Wright reported that the Foreign and Commonwealth Secretary had spoken to the Chinese Ambassador but had received only the response that the problems of the Hong Kong dollar had nothing to do with the actions of the Chinese government and were solely attributable to British intransigence.

The Chancellor and the Governor reported on the latest situation in Hong Kong, following the measures taken by the Hong Kong authorities earlier in the week. The Hong Kong dollar had now regained the ground which it had lost a week ago. This had been partly achieved by high interest rates and partly by intervention, believed to have been substantial at times, in a thin market. Such measures were bound to be a palliative since the origin of the the problem was political and the solution would also have to be political. Nevertheless, although measures of this sort involving high interest rates would be damaging if they had to be sustained, Hong Kong was a market-orientated economy and there was likely to be a point at which the market would take the view that Hong Kong's assets were worth holding even for fourteen years.

The Prime Minister said that she was concerned about the effect of a fall in the dollar on the ordinary people of Hong Kong, since so much of Hong Kong's food and other essentials were imported. Sir Alan Walters added that intervention to support the Hong Kong dollar did not reduce the money supply. To the extent that intervention was

/ successful

SECRET

successful, people were encouraged to convert more assets out of Hong Kong dollars and a vicious circle was created. One approach to the problem was through controlling the currency by means of a currency board or monetary base system. If the Hong Kong dollar was backed one for one by the United States dollar - and the Hong Kong reserves of the US dollars were big enough to make this possible - people would be willing to hold the Hong Kong dollar and confidence would be maintained.

In discussion it was argued that a scheme of this sort would not necessarily give adequate backing for banking deposits denominated in Hong Kong dollars, which were many times as large as the Hong Kong currency. A similar scheme in the United States in 1907 had led only to a very small discount on bank deposits, but this might not apply in the different circumstances which were causing the current fears in Hong Kong. It was inevitable that a Chinese takeover would ultimately lead to a substantial fall in the value of Hong Kong assets: nevertheless, it was right to look for a financial mechanism which would, if possible, prevent a precipitate collapse in confidence. But there was a distinction between action by the Hong Kong authorities and action directly involving Her Majesty's Government: the latter might be very expensive and the Foreign and Commonwealth Secretary had expressed concern about the effect that it could have on the Chinese Government.

Summing up the discussion, the Prime Minister said that it was necessary to consider the options urgently. The Hong Kong Executive Council would be making a further visit to the United Kingdom in the following week. She asked the Chancellor of the Exchequer, in consultation with the Governor, to consider the studies which were being prepared for their return and to let her have a paper on Tuesday, 4 October as a basis for a further meeting the following day.

I am copying this letter to Brian Fall, (Foreign and Commonwealth Office), Tim Allen (Governor of the Bank of England's Office) and Richard Hatfield (Cabinet Office).

GIVEN BY HAND 25/9

Yours ever,

Robin Butler

John Kerr, Esq.,  
HM Treasury



CONFIDENTIAL

FM FCO 281700Z SEPT 83

FLASH WASHINGTON

TELEGRAM NUMBER 1605 OF 28 SEPT

INFO IMMEDIATE UKMIS NEW YORK (FOR PRIVATE SECRETARY)

FOLLOWING FOR PRIVATE SECRETARY/PRIME MINISTER

FOREIGN AFFAIRS ROUND UP

1. FOLLOWING IS A ROUND UP OF DEVELOPMENTS FOR THE PERIOD 26-28 SEPTEMBER.

HONG KONG

2. SIR G HOWE'S MET THE CHINESE FOREIGN MINISTER IN NEW YORK ON 27 SEPTEMBER. WU REPEATED THE TOUGH CHINESE POSITION ON HONG KONG. THE CHINESE CONTINUED TO REFUSE TO MAKE A JOINT STATEMENT TO ASSIST CONFIDENCE WHILE THE UK POSITION REMAINED UNCHANGED. HOWEVER, WU REPEATED THAT THERE WERE MANY AREAS WHICH COULD BE DISCUSSED. HE MADE THE FIRST MENTION IN CONTACTS WITH HMG OF DENG'S SUGGESTION THAT HONG KONG'S AUTONOMY AS A SAR SHOULD LAST FOR 50 YEARS. (UKMIS NEW YORK TELNO 006 TO HONG KONG.)

3. MR LUCE MET EXCO IN HONG KONG ON 27 SEPTEMBER. EXCO WERE DIVIDED ON THE DANGERS OF A BREAKDOWN IN THE NEXT STAGES. UNOFFICIALS EXPRESSED READINESS TO VISIT LONDON AT ANY TIME. (HONG KONG TELNO 1420 TO FCO.)

4. THE HONG KONG DOLLAR HAS RECOVERED SLIGHTLY FOLLOWING LIMITED INTERVENTION BY THE HONG KONG GOVERNMENT. ON 28 SEPTEMBER IT CLOSED AT 8.32 TO US DOLLAR (UP 8 CENTS OVER THE PREVIOUS DAY). THE HANG SENG INDEX CLOSED AT 777.0 (DOWN 23.7).

FALKLANDS/ARGENTINA

5. ON 26 SEPTEMBER, THE ARGENTINE FOREIGN MINISTER, AGUIRRE LANARI, DELIVERED HIS STATEMENT TO THE UNGA. AS WELL AS REPEATING FAMILIAR DISTORTIONS OF EVENTS AND OF BRITISH POLICY, LANARI MADE LENGTHY ALLEGATIONS ABOUT 'BRITISH MILITARY EXPANSIONIST POLICY' INCLUDING INNUENDOES ABOUT THE ROLE OF NATO IN THE ISLANDS' FUTURE.

/6.

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ADVANCE COPIES TO  
MR COLES  
PRIVATE OFFICE  
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6. IN OUR BRIEF RIGHT OF REPLY, WE SAID WE WOULD REFRAIN FROM A POINT-TO-POINT REBUTTAL: THE FALKLANDS DEBATE IN THE UNGA WOULD BE THE APPROPRIATE PLACE FOR THIS. (IT NOW SEEMS VERY LIKELY THAT THIS WILL TAKE PLACE IN THE FIRST WEEK OF NOVEMBER.) WE EXPRESSED ASTONISHMENT AT THE ARGENTINE FOREIGN MINISTER'S OMISSION OF ANY REFERENCE TO ARGENTINA'S UNPROVOKED INVASION OR TO THE FALKLAND ISLANDERS' RIGHT TO SELF-DETERMINATION.

6. SIR G HOWE, IN HIS CONVERSATION WITH THE UN SECRETARY-GENERAL ON 26 SEPTEMBER, PICKED UP THE ARGENTINE ARGUMENTS ABOUT 'MILITARY EXPANIONISM' AND STRESSED THAT IT WAS OBVIOUS NONSENSE TO SUGGEST THAT WE HAD ANY WIDER PURPOSE THAN TO ENSURE THAT THERE WAS NO REPETITION OF THE EVENTS OF APRIL 1982.

7. SIR G HOWE TOLD THE PRESS IN NEW YORK ON 27 SEPTEMBER THAT THE ARGENTINE FOREIGN MINISTER'S SPEECH WAS 'A VERY DEPRESSING AND UNHELPFUL CONTRIBUTION TO THE DEBATE. IT REITERATED THAT THE RECOVERY OF THE ISLANDS WAS STILL THE PERMANENT OBJECTIVE AND PRIORITY OF THE ARGENTINE PEOPLE'.

#### SPAIN /GIBRALTAR

8. AT HIS MEETING WITH SIR G HOWE IN NEW YORK ON 26 SEPTEMBER, THE SPANISH FOREIGN MINISTER WAS UNYIELDING ON THE NEED FOR A QUID PRO QUO FOR LIFTING THE RESTRICTIONS ON GIBRALTAR.

SIR G HOWE AND MORAN AGREED TO MEET IN THE MARGINS OF THE NORTH ATLANTIC COUNCIL IN DECEMBER. MEANWHILE, CONTACTS SHOULD BE MAINTAINED THROUGH DIPLOMATIC CHANNELS, INCLUDING MEETINGS OF EXPERTS. THE TERMS OF REFERENCE OF THESE MEETINGS WILL NEED TO BE AGREED.

#### SHOOTING DOWN OF THE KOREAN AIRLINER

9. HMG'S SUSPENSION OF AIR SERVICES WILL END AT MIDNIGHT ON 28 SEPTEMBER BUT AEROFLOT FLIGHTS BETWEEN THE UK AND THE USSR ARE LIKELY STILL TO BE AFFECTED. ACCORDING TO BA THEIR TGWU WORKERS AT HEATHROW DO NOT INTEND TO HANDLE AEROFLOT FLIGHTS UNTIL 3 NOVEMBER. BA THINK IT WILL BE DIFFICULT FOR AEROFLOT TO FIND AN ALTERNATIVE HANDLER. TGWU STAFF AT GATWICK WILL NOT BE TAKING SIMILAR ACTION AND AEROFLOT WILL THEREFORE BE FREE TO RESUME THEIR CHARTER OPERATIONS ON 29 SEPTEMBER. BA EXPECT TO BE ABLE TO RESTART THEIR SCHEDULED SERVICES TO MOSCOW ON 7 OCTOBER WHEN THE BALPA BAN ENDS.

#### DIEGO GARCIA

10. THE PRIME MINISTER OF MAURITIUS ADDRESSED THE UNGA ON 27 SEPTEMBER. HE RAISED THE MAURITIAN CLAIM TO THE BRITISH INDIAN OCEAN TERRITORY BUT DID SO IN MEASURED TERMS IN KEEPING WITH THE MAURITIAN GOVERNMENT'S NEW, LOW-KEY APPROACH TO THE ISSUE.

#### ZIMBABWE

11. A DEMONSTRATION OF SEVERAL HUNDRED ZANU SUPPORTERS WITH ANTI-BRITISH PLACARDS WAS HELD OUTSIDE OUR HIGH COMMISSION IN HARARE ON 27 SEPTEMBER, BUT DISPERSED PEACEFULLY. THE HIGH COMMISSION'S USUAL CONTACTS AMONG ZIMBABWEAN MINISTERS AND

OFFICIALS REMAIN FRIENDLY.

NAMIBIA

12. THE AMERICANS ARE RELUCTANT TO CALL A MEETING OF THE FIVE FOREIGN MINISTERS TO DISCUSS NAMIBIA IN THE MARGINS OF THE UNGA, AND IT NOW SEEMS UNLIKELY THAT SUCH A MEETING WILL TAKE PLACE.

LEBANON

13. THE CEASEFIRE, WHICH CAME INTO FORCE ON 26 SEPTEMBER, HAS GENERALLY HELD ALTHOUGH THERE HAVE BEEN BRIEF EXCHANGES OF FIRE BETWEEN CHRISTIAN AND DRUZE MILITIAS IN THE SHOUF, AND THE LEBANESE ARMY AND SHIA MILITIA IN SOUTHERN BEIRUT.

14. THE SECURITY COMMITTEE (REPRESENTATIVES OF THE LEBANESE ARMY, AND THE CHRISTIAN AND MUSLIM MILITIAS) HAS ITS FIRST MEETING TODAY. AT DRUZE INSISTENCE BRITFORLEB PROVIDED AN ESCORT FOR THE DRUZE DELEGATION TO THE MEETING AT KHALDE (CLOSE TO BEIRUT AIRPORT). THE MOST URGENT PROBLEM IS TO DEPLOY OBSERVERS TO THE SHOUF TO UNDERPIN THE CEASEFIRE. IT IS NOT CLEAR WHETHER THE SYRIANS OR RUSSIANS WILL AGREE TO THE WIDER DEPLOYMENT OF THE 50 UN OBSERVERS WHO ARE ALREADY IN BEIRUT, SUPPLEMENTED BY OTHER UN OBSERVERS ALREADY IN THE MIDDLE EAST, AND CONTINGENTS FROM NEUTRAL COUNTRIES ACCEPTABLE TO ALL PARTIES. (AUSTRIA, YUGOSLAVIA AND INDIA HAVE ALL BEEN MENTIONED.) FURTHER ACTION IN THE SECURITY COUNCIL IS EXPECTED SHORTLY.

15. THE TIMING, VENUE AND AGENDA OF A 'NATIONAL RECONCILIATION' CONFERENCE TO ADDRESS THE LONGER TERM PROBLEM OF RESTORING PEACE IN LEBANON, HAVE YET TO BE AGREED. THE DIFFERENT FACTIONS ARE ALREADY STAKING OUT THEIR POSITIONS. THE LEBANESE FORCES (PHALANGE) HAVE SAID THEY WILL NOT ACCEPT ANY OUTCOME WHICH IS AGAINST THE HIGHER INTERESTS OF THE CHRISTIANS; THE DRUZE HAVE MADE CLEAR THAT THEIR MINIMUM DEMANDS WILL BE THE ABOLITION OF THE ISRAEL/LEBANON AGREEMENT AND MAJOR CONSTITUTIONAL REFORM TO GIVE THEM A GREATER SHARE IN THE NATIONAL POWER STRUCTURE.

16. MNF FOREIGN MINISTERS MET IN NEW YORK ON 27 SEPTEMBER (UKMIS TELNO 915).

IRAN/IRAQ

17. WE ARE TRYING TO CLARIFY WITH THE FRENCH REPORTS IN THE PRESS THAT THE SUPER ETENDARD AIRCRAFT MAY NOT NOW BE DELIVERED TO IRAQ, OR MAY NOT BE OPERATIVE, UNTIL THE END OF THE YEAR.

CHINA/US

18. US DEFENCE SECRETARY WEINBERGER ANNOUNCED IN PEKING TODAY THAT PRESIDENT REAGAN IS TO VISIT CHINA NEXT APRIL AND THAT PREMIER ZHAO ZIYANG PLANS TO VISIT TO WASHINGTON NEXT JANUARY.

19. THIS REPRESENTS A FURTHER STEP IN THE GRADUAL RESUMPTION OF THE DEVELOPMENT OF SINO/US RELATIONS WHICH BEGAN IN THE EARLY SUMMER WITH US AGREEMENT TO RELAX TECHNOLOGY TRANSFER RESTRICTIONS, AND THE SETTLEMENT OF DIFFERENCES OVER QUOTAS FOR US IMPORTS OF CHINESE TEXTILES. BOTH SIDES HAVE AVOIDED UNNECESSARY MENTION OF THE CONTENTIOUS TAIWAN QUESTION.

*There is separate information of the.*  
10/29/75

## THE PHILIPPINES

20. THE SITUATION IN THE PHILIPPINES IS CALM BUT UNEASY FOLLOWING THE RECENT LARGE-SCALE DEMONSTRATIONS BY OPPONENTS OF PRESIDENT MARCOS. PRESIDENT REAGAN FACES A DIFFICULT DECISION ABOUT WHETHER TO GO AHEAD WITH A PROPOSED VISIT IN NOVEMBER. NOT TO DO SO WOULD IMPLY A GRAVE LOSS OF CONFIDENCE IN THE MARCOS REGIME.

21. THE INTERNATIONAL EQUESTRIAN FEDERATION (WHOSE PRESIDENT IS THE DUKE OF EDINBURGH) HAVE DECIDED TO MOVE THEIR OCTOBER MEETING FROM MANILA.

## CENTRAL AMERICA

22. THE CONTADORA COUNTRIES (MEXICO, VENEZUELA, COLOMBIA AND PANAMA) ARE TRYING TO GET 5 CENTRAL AMERICAN COUNTRIES (HONDURAS, EL SALVADOR, COSTA RICA, GUATEMALA, NICARAGUA) TO RATIFY THE STATEMENT OF OBJECTIVES PRODUCED FOLLOWING THE MEETING BETWEEN CONTADORA AND CENTRAL AMERICAN FOREIGN MINISTERS IN PANAMA ON 7-8 SEPTEMBER. THE OBJECTIVES INCLUDE AGREEMENTS ON ARMS CONTROL, WITHDRAWAL OF MILITARY ADVISERS, TIMETABLES FOR ELECTIONS, ETC.

23. FOLLOWING MEETINGS BETWEEN PRESIDENT REAGAN'S EMISSARY, SENATOR STONE, AND REPRESENTATIVES OF THE EMIGRE SALVADOREAN POLITICAL AND GUERRILLA ORGANISATIONS, THE SALVADOREAN GOVERNMENT PEACE COMMISSION, ESTABLISHED EARLIER THIS YEAR TO PURSUE DIALOGUE IS TO HAVE A MEETING WITH THOSE ORGANISATIONS ON 29 SEPTEMBER.

24. STONE WILL VISIT LONDON ON 3-4 OCTOBER. HE IS CALLING ON SIR G HOWE ON 4 OCTOBER. HE WILL GO ON TO VISIT DUBLIN, BONN, PARIS, ROME, ATHENS, MADRID AND LISBON.

25. COUNTER REVOLUTIONARY ATTACKS ON NICARAGUA CONTINUE. THE NICARAGUANS CLAIM THERE HAVE BEEN FURTHER AIR RAIDS. FDN FORCES OPERATING FROM THE NORTH RAIDED A PROVINCIAL CITY IN NORTHERN NICARAGUA, BLEW UP A BRIDGE AND CAPTURED A BORDER POST. THEY SAY THEY INTEND TO STEP UP ATTACKS ON URBAN CENTRES.

INTERNATIONAL ECONOMIC ISSUES

26. INTERNATIONAL MONETARY ISSUES AND BRAZILIAN DEBT HAVE BEEN UNDER DISCUSSION THIS WEEK IN WASHINGTON. OUR INFORMATION ABOUT THE DISCUSSIONS IS INCOMPLETE. NO DOUBT WASHINGTON CAN BRIEF YOU.

HOWE

CONFIDENTIAL

GPS 1111

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CONFIDENTIAL

DESKBY HONG KONG 280100Z

FM UKMIS NEW YORK 272222Z SEP 83

TO IMMEDIATE HONG KONG

TEL NO 006 OF 27 SEPTEMBER 1983

INFO IMMEDIATE FCO PEKING WASHINGTON (FOR COLES IN PM'S PARTY)

AMENDED DISTRIBUTION

28/9/83

FOLLOWING FROM PRIVATE SECRETARY  
MEETING WITH CHINESE FOREIGN MINISTER

SUMMARY

1. SECRETARY OF STATE MET WU XUEQIAN FOR AN HOUR ON 27 SEPTEMBER. LENGTHY REHERSAL OF RESPECTIVE POSITIONS. NO GIVE ON CHINESE SIDE. NO WILLINGNESS TO MAKE A GESTURE TO IMPROVE CONFIDENCE IN THE ABSENCE OF A CHANGE IN OUR POSITION.

DETAIL

2. THE SECRETARY OF STATE STRESSED THE POSSIBILITIES FOR THE IMPROVEMENT OF BILATERAL RELATIONS IN TRADE AND OTHER FIELDS (GUANGDONG, OIL, ETC). THE LONG TERM PROSPECTS FOR COOPERATION WERE VERY GOOD. BUT HE WANTED TO DWELL ON A SUBJECT OF GREAT CONCERN TO BOTH CHINA AND BRITAIN. BOTH ATTACHED THE GREATEST IMPORTANCE TO THE MAINTENANCE OF HONG KONGS FUTURE STABILITY AND PROSPERITY. THIS SHOULD NOT BE PUT AT RISK BY ANY MISUNDERSTANDING BETWEEN THE TWO SIDES. WE HAD SET OUT OUR RESPECTIVE POSITIONS IN THE TALKS. IT WAS UNHELPFUL FOR EITHER SIDE TO TAKE THE LINE THAT UNLESS ITS OWN POSITION WAS ACCEPTED FIRST, TALKS COULD GO NO FURTHER. OUR POSITION REPRESENTED OUR HONEST VIEW OF THE BEST WAY TO MAINTAIN HONG KONGS STABILITY AND PROSPERITY. BRITAIN DERIVED NO DIRECT REVENUE FROM HONG KONG OR BENEFIT FROM HONG KONGS RESERVES. WE ADHERED TO OUR POSITION BUT WANTED TO KNOW ABOUT THE DETAILS OF THE CHINESE PROPOSALS. THAT SEEMED TO US THE MOST SENSIBLE NEXT STEP.

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/ BRITAIN

BRITAIN AND CHINA WERE SINCERELY PURSUING THE AIM OF FUTURE STABILITY AND PROSPERITY FOR THEM. WE THEREFORE HOPED THAT THE TALKS WOULD BE ABLE TO CONTINUE IN A MORE CONSTRUCTIVE ATMOSPHERE WITHOUT ULTIMATA FROM EITHER SIDE. THIS WOULD ALLOW CONFIDENCE TO RETURN.

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CONFIDENTIAL

/ 7. INVITED

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7. INVITED BY WU TO COMMENT, ZHOU NAN SAID THAT BRITAIN HAD EVADED THE CRUCIAL QUESTION IN THE TALKS SO FAR BY INSISTING THAT WHILE CHINA COULD HAVE NOMINAL SOVEREIGNTY, BRITAIN SHOULD RETAIN ADMINISTRATIVE CONTROL. THIS APPROACH VIRTUALLY CLOSED THE DOOR TO ANY DISCUSSION OF PRACTICAL ARRANGEMENTS TO MAINTAIN HONG KONGS PROSPERITY AND STABILITY AFTER 1997. THE CHINESE SIDE HAD BEEN SURPRISED AND DISAPPOINTED BY THE BRITISH POSITION. IF IT CHANGED, DETAILED DISCUSSIONS ON ALL PRACTICAL ASPECTS OF THE ISSUE COULD BEGIN IMMEDIATELY. CHINA COULD AGREE TO A STATEMENT AS WE WISHED BECAUSE WE HAD NOT CHANGED OUR UNACCEPTABLE POSITION. HE ADDED THAT THE CHINESE SIDE HAD BEEN PARTICULARLY DISTRESSED BY A RECENT STATEMENT BY SIR P CRADOCK THAT BRITISH ADMINISTRATION WAS THE ONLY WAY FOR HONG KONG TO REMAIN STABLE AND PROSPEROUS IN THE FUTURE.

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THOMSON

### FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/PUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
MR WRIGHT

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SIR A PARSONS NO 10 DOWNING STREET  
MR WALKER RESEARCH D OAB 2/82

3  
CONFIDENTIAL

SECRET



47

10 DOWNING STREET

*From the Private Secretary*

27 September, 1983.

This is just to confirm that the Prime Minister has agreed that Mr. Luce should be authorised to invite the unofficial members of EXCO to call on her at 0930 on 7 October. We have set aside 2 hours in the diary for this meeting.

This is also to confirm that the Prime Minister would like to hold a meeting with the Foreign Secretary and Defence Secretary at 1630 on Wednesday, 5 October, to prepare for the meeting with EXCO. No doubt you will be arranging for Sir Edward Youde and Sir Percy Cradock to attend this meeting as well.

I am copying this letter to Richard Mottram (Ministry of Defence).

W. F. S. RICKETT

R.B. Bone, Esq.,  
Foreign and Commonwealth Office.

SECRET



S E C R E T

DESKBY 271200Z OTTAWA

FM HONG KONG 271020Z SEP 83

TO IMMEDIATE OTTAWA

TELEGRAM NUMBER 12 OF 27 SEPTEMBER

AND TO IMMEDIATE F C O, WASHINGTON (FOR PRIVATE SECRETARY TO CHANCELLOR OF THE EXCHEQUER), UKMIS NEW YORK (FOR PRIVATE SECRETARY) AND PEKING.

SECRET 45

*P.N. has seen  
Apr 27/83*

IN

ACTION COPY

FOR PRIVATE SECRETARY TO THE PRIME MINISTER FROM GOVERNOR.

OTTAWA TELNO 6.

1. I HAVE VERY CAREFULLY CONSIDERED THE QUESTIONS POSED IN YOUR TUR, TOGETHER WITH MR LUCE AND SIR P CRADOCK. YOU WILL HAVE SEEN OUR ASSESSMENTS OF THE SITUATION WE FACE IN PEKING TELNO 937 AND HONG KONG TELNO 1407. IN THE LIGHT OF THESE ASSESSMENTS OUR ANSWERS TO THE QUESTIONS ARE AS FOLLOWS:-

2. YOUR QUESTION 2(A). IN OUR VIEW THE ONLY STATEMENTS FROM PEKING LIKELY TO STEADY OPINION IN HONG KONG WOULD BE EITHER:-

- (I) A STATEMENT SAYING THAT THE TALKS HITHERTO HAD MADE GOOD PROGRESS:
- (II) ONE INDICATING CHINESE WILLINGNESS TO MOVE FROM THEIR PUBLICLY PROPAGATED PLAN FOR HONG KONG IN THE DIRECTION OF WHAT IS CORRECTLY SURMISED IN THE PRESS TO BE THE BRITISH POSITION I.E. BRITISH ADMINISTRATION: OR
- (III) EXPRESSING THEIR UNDERSTANDING AND SUPPORT FOR THE HONG KONG GOVERNMENT'S EFFORTS TO STABILISE THE SITUATION, AND IN PARTICULAR THE DOLLAR.

3. NONE OF THESE STATEMENTS COULD BE REALISTICALLY EXPECTED. ON (I), THE CHINESE HAVE TOLD US THAT THE TALKS ARE STALEMATED AND THEIR FOREIGN MINISTER HAS PUBLICLY ATTRIBUTED THE LACK OF PROGRESS TO OUR "RIGIDITY".

ON (II), THE CHINESE ARE IMMOVABLE IN THEIR VIEW THAT BRITISH ADMINISTRATION IS UNACCEPTABLE: AND ON (III), AS ILLUSTRATED IN THE LAST ROUND OF TALKS, THEY TAKE THE LINE THAT THE DOLLAR CRISIS IS OUR AFFAIR AND IN FACT ACCUSE US OF FOMENTING IT IN ORDER TO BRING PRESSURE ON THEM.

4. YOUR QUESTION 2(C). THIS MESSAGE HAS ALREADY BEEN CONVEYED WITH CONSIDERABLE FORCE IN THE TALKS ON 22/23 SEPTEMBER. THE AMBASSADOR THEN SPOKE OF THE SERIOUSNESS AND GENUINENESS OF THE FINANCIAL SITUATION AND OF THE EFFORTS MADE BY THE HONG KONG

SECRET

FM HONG KONG 271120Z SEP 83

TO FLASH UKMIS NEW YORK

TELEGRAM NUMBER 12 OF 27 SEPTEMBER

AND TO IMMEDIATE OTTAWA (FOR PS TO PM), FCO, PEKING

FOLLOWING FOR PRIVATE SECRETARY TO SECRETARY OF STATE.

UKMIS TELNO 5 TO HONG KONG: BILATERAL MEETING WITH CHINESE FOREIGN MINISTER.

76  
SECRET

IN

ACTION COPY

P.N. has seen

WJ 29/9

1. WE HAVE REPEATEDLY EXPLAINED TO THE CHINESE IN THE TALKS IN PEKING THAT THE FOREIGN EXCHANGE RESERVES ARE FULLY UNDER THE CONTROL OF THE HONG KONG GOVERNMENT AND ARE USED SOLELY FOR PUBLIC PURPOSES IN HONG KONG. IN FACT (THOUGH THIS SHOULD NOT BE DISCLOSED TO THE CHINESE FOREIGN MINISTER) ONLY ABOUT 6 PERCENT OF THE RESERVES ARE HELD IN STERLING AND MARKET RATES OF INTEREST ARE PAID ON THEM. OUR PUBLIC POSITION IS THAT THE STERLING ELEMENT OF THE RESERVES IS SIGNIFICANTLY LESS THAN 10 PERCENT.
2. THE TOTAL OF FOREIGN EXCHANGE RESERVES CURRENTLY STANDS AT ABOUT US DOLLARS 5.6 BILLION. THE EXCHANGE FUND HAS EXPENDED SOME US DOLLARS 800 MILLION OVER THE PAST 12 MONTHS IN INTERVENTION TO SMOOTH OUT EXCHANGE RATE FLUCTUATIONS. OVER US DOLLARS 200 MILLION OF THIS HAS BEEN COMMITTED SINCE THE BEGINNING OF SEPTEMBER, INCLUDING US DOLLARS 90 MILLION IN THE PAST WEEK. THESE FIGURES SHOULD NOT BE USED PUBLICLY OR WITH WU. BUT THE SECRETARY OF STATE MAY WISH TO SAY, IN RESPONSE TO ANY CHARGE THAT WE HAVE BEEN NEGLECTING OUR RESPONSIBILITIES TO SUPPORT THE HONG KONG DOLLAR, THAT WE HAVE IN FACT BEEN INTERVENING ON THE MARKET. BUT INTERVENTION AND TECHNICAL MEASURES WITHING THE FLOATING EXCHANGE RATE FRAMEWORK AS OBSERVED IN HONG KONG AND WESTERN COUNTRIES CANNOT SUSTAIN THE EXCHANGE VALUE OF A CURRENCY AT ANY PARTICULAR RATE IN THE FACE OF MARKET SENTIMENT CAUSED BY ADVERSE POLITICAL FACTORS.

3. THE HONG KONG ASSOCIATION OF BANKS (HKAB) DEPOSIT INTEREST RATES WERE RAISED TWICE DURING APRIL/MAY 1983 BY A TOTAL OF 3 PERCENT. MARKET FORCES LED TO REDUCTIONS DURING THE SUMMER. AGAINST THE BACKGROUND OF THE RECENT DECLINE IN CONFIDENCE THERE WAS A HKAB INCREASE OF ONE AND A HALF PERCENT ON 9 SEPTEMBER, AND A FURTHER 3 PERCENT INCREASE EFFECTIVE TODAY, 27 SEPTEMBER. AGAINST A BACKGROUND OF GENERALLY LOWER INTEREST RATES INTERNATIONALLY, THE BEST LENDING RATE IN HONG KONG IS NOW AT 16 PERCENT, 4 PERCENT HIGHER THAN A YEAR AGO.

**SECRET**

4. AT THE CLOSE OF TRADING IN HONG KONG TODAY THE HONG KONG DOLLAR STOOD AT 8.10 AGAINST THE US DOLLAR AND 12.17 AGAINST THE POUND.

5. AS REGARDS THE OTHER CHARGES MADE BY THE COMMUNIST PRESS IN REACTING TO THE PM'S COMMENTS TO U.S. JOURNALISTS, THE MAIN POINT TO MAKE IS THAT ALL TAXES LEVIED IN HONG KONG, AND ALL OTHER REVENUES RAISED BY THE HONG KONG GOVERNMENT ARE USED IN HONG KONG FOR THE BENEFIT OF THE PEOPLE OF HONG KONG. THE BRITISH GOVERNMENT TAKES NO REVENUE FROM THE TERRITORY. NOR DO BRITISH FIRMS AND BUSINESSMEN ENJOY ANY SPECIAL STATUS IN HONG KONG. THEY COMPETE ON EQUAL TERMS WITH LOCAL AND OTHER OVERSEAS BUSINESSMEN IN WHAT IS PROBABLY THE MOST OPEN MARKET IN THE WORLD.

YOUDE

AND BRITISH GOVERNMENTS TO SUSTAIN CONFIDENCE. HE PROPOSED PRACTICAL CO-OPERATION WITH OTHE CHINESE IN THE SENSE OF A BEEFED-UP COMMUNIQUE. YAO GUANG ACCEPTED THERE WAS A PROBLEM OF CONFIDENCE BUT SAID WE WERE TO BLAME. HE REFUSED TO EMBELLISH THE COMMUNIQUE AND EVEN REFUSED TO INSERT THE WORD "USEFUL". ALTHOUGH REMINDED OF THE LIKELY IMPACT ON THE DOLLAR.

THE S OF S WILL NO DOUBT BE MAKING SIMILAR POINTS TO THE CHINESE FOREIGN MINISTER TODAY.

SECRET

4. YOUR QUESTION 2(D). I AM AFRAID WE DO NOT SEE ANY OTHER MEANS AVAILABLE AT THE PRESENT TIME OF GETTING OVER THE MESSAGE. THE CHINESE RECOGNISE THAT THERE IS A CRISIS BUT BELIEVE WE ARE TRYING TO USE IT IN ORDER TO BRING PRESSURE ON THEM AND ARE DETERMINED NOT TO GIVE WAY. THEY HAVE ALSO MADE PLAIN THEIR READINESS IF NEED BE TO ACCEPT CONSIDERABLE ECONOMIC DAMAGE IN PURSUIT OF THEIR OVERRIDING POLITICAL OBJECTIVE. THE ONLY WAY TO GET THEIR CO-OPERATION OVER THE IMMEDIATE FINANCIAL CRISIS OR TO EXPLORE WHAT THEY WOULD BE PREPARED TO GIVE TO ACHIEVE A SETTLEMENT ON HONG KONG IS TO MAKE A BOW IN THE DIRECTION OF THE PREMISE (SEE PARA 7 OF PEKING TELNO 937). SHORT OF SUCH A MOVE ON OUR PART, MINISTERIAL MESSAGES WOULD BE UNLIKELY TO HAVE ANY EFFECT AND SPECIAL EMISSARIES WOULD AROUSE PUBLIC EXPECTATIONS WHICH COULD NOT BE FULFILLED.

SECRET

YOUDE

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DESKBY HONG KONG 280100Z

FM UKMIS NEW YORK 272222Z SEP 83

TO IMMEDIATE HONG KONG

TEL NO 006 OF 27 SEPTEMBER 1983

INFO IMMEDIATE FCO PEKING WASHINGTON (FOR COLES IN PM'S PARTY)

FOLLOWING FROM PRIVATE SECRETARY  
MEETING WITH CHINESE FOREIGN MINISTER

SUMMARY

1. SECRETARY OF STATE MET WU XUEQIAN FOR AN HOUR ON 27 SEPTEMBER. LENGTHY REHERSAL OF RESPECTIVE POSITIONS. NO GIVE ON CHINESE SIDE. NO WILLINGNESS TO MAKE A GESTURE TO IMPROVE CONFIDENCE IN THE ABSENCE OF A CHANGE IN OUR POSITION.

DETAIL

2. THE SECRETARY OF STATE STRESSED THE POSSIBILITIES FOR THE IMPROVEMENT OF BILATERAL RELATIONS IN TRADE AND OTHER FIELDS (GUANGDONG, OIL, ETC). THE LONG TERM PROSPECTS FOR COOPERATION WERE VERY GOOD. BUT HE WANTED TO DWELL ON A SUBJECT OF GREAT CONCERN TO BOTH CHINA AND BRITAIN. BOTH ATTACHED THE GREATEST IMPORTANCE TO THE MAINTENANCE OF HONG KONGS FUTURE STABILITY AND PROSPERITY. THIS SHOULD NOT BE PUT AT RISK BY ANY MISUNDERSTANDING BETWEEN THE TWO SIDES. WE HAD SET OUT OUR RESPECTIVE POSITIONS IN THE TALKS. IT WAS UNHELPFUL FOR EITHER SIDE TO TAKE THE LINE THAT UNLESS ITS OWN POSITION WAS ACCEPTED FIRST, TALKS COULD GO NO FURTHER. OUR POSITION REPRESENTED OUR HONEST VIEW OF THE BEST WAY TO MAINTAIN HONG KONGS STABILITY AND PROSPERITY. BRITAIN DERIVED NO DIRECT REVENUE FROM HONG KONG OR BENEFIT FROM HONG KONGS RESERVES. WE ADHERED TO OUR POSITION BUT WANTED TO KNOW ABOUT THE DETAILS OF THE CHINESE PROPOSALS. THAT SEEMED TO US THE MOST SENSIBLE NEXT STEP.

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/IN THE

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H OF C  
MR COLES

I.L. 2621/PT

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THOMSON

PRIME MINISTER

HONG KONG

The news this morning is slightly better.

The exchange rate has stabilised at least temporarily.

On Friday the Hong Kong Dollar closed at 9 to the dollar.

On Monday it closed at 8.75.

Today it closed at 8.43.

The Hang Seng index has also risen a few points from 7.85 yesterday to 8.10 today.

The Foreign Secretary is seeing the Chinese Foreign Minister in New York this morning. He will explain firmly to him the reasons for the present situation and take him to task about the Chinese propaganda campaign and the Chinese refusal to agree, at the end of the last round of talks, to a formula which would have helped confidence.

A. J. C.

27 September, 1983



NTON

GRS 50

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FM OTTAWA 272000Z SEP 83  
TO IMMEDIATE EDMONTON  
TELEGRAM NUMBER OF 27 SEPTEMBER

PLEASE PASS FOLLOWING TO PS/PM ON ARRIVAL AS FCO TELNO 530  
TO UKMIS NEW YORK (FOR PRIVATE SECRETARY):

HONG KONG TELNO 12

1. WE HAVE NOTHING TO ADD AT THIS STAGE TO THE GOVERNOR'S  
COMMENTS, WITH WHICH WE FULLY CONCUR.

HOWE

MORAN

NNNN

PSE CONFIRM 27

Subsequently passed over telephone verbatim. at Request of Duty Clerk (1 del) (12 del) (13 del) (14 del) (15 del) (16 del) (17 del) (18 del) (19 del) (20 del) (21 del) (22 del) (23 del) (24 del) (25 del) (26 del) (27 del) (28 del) (29 del) (30 del) (31 del) (32 del) (33 del) (34 del) (35 del) (36 del) (37 del) (38 del) (39 del) (40 del) (41 del) (42 del) (43 del) (44 del) (45 del) (46 del) (47 del) (48 del) (49 del) (50 del) (51 del) (52 del) (53 del) (54 del) (55 del) (56 del) (57 del) (58 del) (59 del) (60 del) (61 del) (62 del) (63 del) (64 del) (65 del) (66 del) (67 del) (68 del) (69 del) (70 del) (71 del) (72 del) (73 del) (74 del) (75 del) (76 del) (77 del) (78 del) (79 del) (80 del) (81 del) (82 del) (83 del) (84 del) (85 del) (86 del) (87 del) (88 del) (89 del) (90 del) (91 del) (92 del) (93 del) (94 del) (95 del) (96 del) (97 del) (98 del) (99 del) (100 del)

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Seen 0630

Passed gift to No 10 office, Toronto, without mentioning Bank's name or details in para 2 of 0635, suggesting not write special agency. Someone there will receive message at about 0730 and phone if they want complete text copy.

SECRET

DESKBY FCO 270930Z

DESKBY OTTAWA, UKMIS NEW YORK AND WASHINGTON 271030Z

FM HONG KONG 270850Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1418 OF 27 SEPTEMBER

AND TO IMMEDIATE OTTAWA (PERSONAL FOR PUS AND PS TO PM), UKMIS NEW YORK (PERSONAL FOR PS TO S OF S), WASHINGTON (PERSONAL FOR PS TO CHANCELLOR OF THE EXCHEQUER)

PERSONAL FOR CLIFT.

27/9

HAWK.

1. THE EXECUTIVE COUNCIL ADVISED THIS MORNING THAT THE HANG LUNG BANK (ACQUISITION) BILL 1983 SHOULD BE INTRODUCED INTO THE LEGISLATIVE COUNCIL AT A SPECIAL SITTING WHICH WILL TAKE PLACE AT 1800 HOURS HONG KONG TIME TODAY.

2. THE BANK AND ITS AUDITORS HAVE NOT YET REACHED AGREEMENT ON THE FINAL FORM OF THE ACCOUNTS, PARTICULARLY WITH REGARD TO THE QUALITY OF MANY OF THE BANK'S LOANS AND ADVANCES, IMPLYING THAT THE ACCOUNTS WHEN PUBLISHED AT THE END OF SEPTEMBER WILL BE SUBSTANTIALLY QUALIFIED, WHICH WOULD HAVE LED ALMOST CERTAINLY TO A RUN IN A FEW DAYS TIME. BUT IN ANY CASE THE BANK REPORTED TO THE COMMISSIONER OF BANKING THIS MORNING THAT THEY WERE OVER DOLLARS 50 MILLION OVERDRAWN ON THEIR CLEARING ACCOUNT WITH THE CHARTERED BANK. AT BEST THEY THOUGHT THEY COULD CLEAR HALF OF THIS LATER IN THE DAY. THE CHARTERED BANK THEN INFORMED US THAT THEY WERE NOT PREPARED TO OFFER COVER AND THAT THEY INTENDED TO INFORM THE CLEARING HOUSE THAT THE HANG LUNG BANK WAS UNABLE TO MEET THEIR CLEARING. TO AVOID THE INEVITABLE CONSEQUENCES THE GOVERNMENT HAS COVERED THE HANG LUNG BANK'S CLEARING FOR TODAY. SUBJECT TO THE LEGISLATIVE COUNCIL PASSING THE BILL THIS AFTERNOON THE BANK WILL BE ACQUIRED BY THE GOVERNMENT AND WILL BE OPENED UNDER A MANAGEMENT CONTRACT ENTERED INTO WITH THE HONG KONG BANK TOMORROW MORNING (WEDNESDAY).

**SECRET**

3. EXECUTIVE COUNCIL ADVICE WAS UNANIMOUS. MEMBERS WERE CONCERNED THAT THE PUBLIC RELATIONS ASPECTS WERE HANDLED IN SUCH A WAY AS TO STRESS THAT THIS SITUATION HAD ARISEN NEITHER FROM POLITICAL FACTORS, NOR AS A RESULT OF THE PRESENT DISTURBED STATE OF THE FOREIGN EXCHANGE MARKET. IT WILL BE STRESSED THAT THE SITUATION HAS ARISEN AS A RESULT OF MISMANAGEMENT AND THE POOR QUALITY OF THE BANK'S LOANS PORTFOLIO AND THAT, ALTHOUGH THE SITUATION HAS BEEN MONITORED CLOSELY FOR THE PAST 12 MONTHS, THE TAKEOVER SCHEME IS NOW NECESSARY TO SAFEGUARD DEPOSITORS.

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SECRET

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RESTRICTED

DESKBY 270900Z

FM HONG KONG 270850Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1417 OF 27 SEPTEMBER

INFO IMMEDIATE HONG KONG GOVERNMENT OFFICE LONDON PEKING  
UKMIS NEW YORK (FOR S OF S'S PARTY), OTTAWA (FOR PS TO PM),  
INFO ROUTINE HK GOVT REPS WASHINGTON, CG NEW YORK, UKMIS GENEVA,  
BRUSSELS

**IN**

**ACTION COPY**

*P.N. has seen*

*cf 27/9*

**FUTURE OF HONG KONG: PRESS COVERAGE.**

1. ALL NEWSPAPERS ON 27 SEPTEMBER COMMENTED ON THE HONG KONG GOVERNMENT'S EFFORTS TO STABILISE THE FOREIGN EXCHANGE RATE OF THE LOCAL CURRENCY AGAINST THE BACKGROUND OF SINO/BRITISH TALKS ON THE FUTURE OF HONG KONG. THERE WAS A GENERAL WELCOME FOR THE STEPS TAKEN, WHICH THE COMMUNIST PRESS DESCRIBED AS "BETTER LATE THAN NEVER", BUT WHICH MOST INDEPENDENT NEWSPAPERS REGARDED AS TEMPORARY MEASURES TO SEE THE HONG KONG DOLLAR THROUGH A CRISIS.

2. THE MAJOR COMMUNIST NEWSPAPERS ALL POINTED TO THE IMMEDIATE IMPACT OF THE ANNOUNCEMENT OF THE GOVERNMENT'S MEASURES AND SAID THAT THE RAPID RECOVERY OF THE HONG KONG DOLLAR DEMONSTRATED THAT THERE WAS NO FUNDAMENTAL LACK OF CONFIDENCE IN THE LOCAL UNIT AND THAT THE HONG KONG GOVERNMENT WAS NOT POWERLESS TO INTERVENE IN THE MONEY MARKETS. INDEED, THE GOVERNMENT SHOULD HAVE ACTED EARLIER. TA KUNG PAO SAID THAT THOSE WHO HAD "TIED THE KNOT" (I.E. THE HONG KONG GOVERNMENT) SHOULD BE RESPONSIBLE FOR UNTYING IT. THE NEW EVENING POST SAID THAT THE ROYAL INSTRUCTIONS REQUIRED THE GOVERNOR TO SEEK THE APPROVAL OF THE BRITISH FOREIGN SECRETARY ON THE ISSUE OF BANKNOTES AND ANY QUESTION OF EXCHANGE CONTROLS. SUCH COLONIAL REGULATIONS SHOULD BE ABOLISHED BECAUSE HONG KONG NEEDED FLEXIBILITY AND AUTONOMY IN STABILISING THE EXCHANGE RATE.

3. THE EXPRESS (INDEPENDENT) COMMENDED THE GOVERNMENT FOR ITS TIMELY INTERVENTION. THE MEASURES HAD ACHIEVED INITIAL SUCCESS AND HAD DISCHARGED THE GOVERNMENT'S IMMEDIATE RESPONSIBILITY FOR STABILISING THE DOLLAR. IT WAS NOW UP TO THE CHINESE GOVERNMENT TO DO ITS PART. THE EXPRESS SAW THIS AS AN OPEN TEST AND CHALLENGE TO CHINA. THE ORIENTAL DAILY AND THE FINANCIAL DAILY (BOTH INDEPENDENT) HOPED THAT INTEREST RATES WOULD BE LOWERED ONCE THE HONG KONG DOLLAR HAD "RETURNED TO NORMAL". A COLUMNIST IN THE INDEPENDENT MING PAO EVENING NEWS SAID THAT CHINA'S LEADERS SHOULD REVIEW THEIR PROPAGANDA CAMPAIGN WHICH HAD CAUSED THE HONG KONG DOLLAR TO PLUMMET, HARMING NOT ONLY THE PEOPLE OF HONG KONG BUT ALSO CHINA'S OWN FOREIGN EXCHANGE EARNINGS.

4. ALL PAPERS CARRIED YESTERDAY'S ANNOUNCEMENT OF SIR P. CRADOCK'S NEW APPOINTMENTS. THE COMMUNIST PRESS ACORDED THE NEWS ROUTINE COVERAGE WITH NO COMMENT. THE INDEPENDENT PRESS, HOWEVER, COMMENTED FAVOURABLY ON WHAT IT SAW AS AN EXPRESSION OF HMG'S FIRM COMMITMENT TO THE INTERESTS OF HONG KONG AND SINO/BRITISH RELATIONS GENERALLY. THE APPOINTMENTS WERE SEEN AS AN INDICATION THAT THE TALKS ON THE FUTURE OF HONG KONG WOULD CONTINUE FOR SOME TIME.

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DESKBY UKMIS NEW YORK AND OTTAWA 271200Z  
 FM HONG KONG 271020Z SEP 83  
 TO IMMEDIATE FCO

IN  
 ACTION COPY

TELEGRAM NUMBER 1420 OD 27 SEPTEMBER  
 AND TO IMMEDIATE UKMIS NEW YORK (FOR PRIVATE SECRETARY),  
 OTTAWA (FOR PS TO PRIME MINISTER), PEKING (PERSONAL FOR CHARGE)

FUTURE OF HONG KONG: DISCUSSION WITH EXCO.

*P.N. has seen.*

*W.D. 27/9*

1. MR LUCE ATTENDED A TWO AND A HALF HOUR MEETING OF EXCO THIS MORNING. SIR P. CRADOCK WAS ALSO PRESENT.

2. AT THE OUTSET OF THE MEETING MR LUCE INFORMED THE COUNCIL OF YOUR MEETING WITH THE CHINESE FOREIGN MINISTER IN NEW YORK AND SAID THAT YOU WOULD BE SPEAKING VERY ROBUSTLY ABOUT THE BRITISH POSITION AND THE EFFECTS OF THE CHINESE STATEMENT ON CONFIDENCE AND THE HONG KONG DOLLAR. I THEN INVITED THE AMBASSADOR TO GIVE HIS IMPRESSIONS OF THE CHINESE POSITION. HE MADE THE FOLLOWING MAIN POINTS:-

(A) THE CHINESE WERE ADAMANT ON RECOVERING BOTH SOVEREIGNTY AND ADMINISTRATION IN 1997 AND CHARACTERISED OUR INSISTENCE ON BRITISH ADMINISTRATION AS AN INSUPERABLE OBSTACLE TO PROGRESS:

(B) THERE WAS A CONSIDERABLE RISK THAT WITHOUT A SHIFT ON OUR PART THE CHINESE WOULD NOT AGREE TO A FURTHER ROUND AFTER THAT ON 19/20 OCTOBER:

(C) THE CHINESE HAD BEEN UNWILLING TO HELP OVER THE HONG KONG DOLLAR AND CLAIMED WE WERE SIMPLY TRYING TO PRESSURISE THEM. THEY DECLARED THEY WOULD NOT BE INTIMIDATED:

(D) IT WOULD BE DANGEROUSLY WRONG TO ASSUME THE CHINESE WOULD BACK DOWN IN A CONFRONTATION WHEN THEY SAW THE DAMAGE DONE TO THE HONG KONG ECONOMY. THEIR POLITICAL OBJECTIVES WERE PARAMOUNT:

(E) A GENTLEMANLY AGREEMENT TO PAUSE FOR FURTHER REFLECTION IN THE TALKS WAS NOT A REAL OPTION. A BREAK IF IT CAME WOULD BE PUBLIC AND UNPLEASANT:

(F) THE CHINESE HAD INFORMALLY SAID DISCUSSION ON FURTHER DETAILS OF THEIR PLAN WOULD BE UNPROFITABLE UNLESS WE ACCEPTED THEIR PREMISE AND WOULD BE LIKELY TO SAY SO FORMALLY AT THE NEXT MEETING.

3. TOOK THE VIEW THAT THE CHINESE WERE STILL TESTING HMG'S RESOLVE: THAT THERE WAS A CHANCE THAT THEY MIGHT COME TO THEIR SENSES AND CHANGE THEIR POSITION WHEN THEY SAW THE EXTENT OF THE DAMAGE WHICH THEIR INTRANSIGENCE WAS CAUSING THE HONG KONG ECONOMY: AND THAT WHILE A FRIENDLY PAUSE FOR REFLECTION MIGHT NOT BE POSSIBLE NOW IT SHOULD NOT BE RULED OUT FOR THE FUTURE. SINCE THE PEOPLE OF HONG KONG HAD NO FAITH IN THE CHINESE PLAN, THE GREATEST BLOW TO CONFIDENCE WOULD BE A BELIEF ON THEIR PART THAT HMG WAS CAPITULATING TO CHINESE DEMANDS. THERE SHOULD THEREFORE BE NO WEAKENING OR COMPROMISE. FOUR OR FIVE MEMBERS TOOK A SIMILAR VIEW.

4. MR O.V. CHEUNG TOOK THE VIEW THAT WE COULD NOT EXPECT TO MOVE THE CHINESE FROM THEIR POSITION BY A "FRONTAL ASSAULT". HE AND THREE OR FOUR OTHERS THOUGHT THAT WE SHOULD STILL LOOK FOR WAYS OF GETTING THEM TO ENLARGE ON THEIR PLAN, AND EXPLORE WHAT "LINKS" WITH THE U.K. THEY WOULD ACCEPT. WHILE ALL AGREED THAT A BREAKDOWN IN OCTOBER SHOULD BE AVOIDED IF AT ALL POSSIBLE PERHAPS HALF OF THE MEMBERS THOUGHT THAT THE CONSEQUENCES WOULD BE CONTAINABLE, THOUGH SERIOUS, AND THAT THERE WOULD BE PUBLIC SUPPORT FOR CONTINUED RESISTENCE TO THE CHINESE PLAN. OTHERS WERE CONCERNED THAT THE EFFECTS OF A BREAKDOWN WOULD BE IRREPARABLE WITH GRAVE CONSEQUENCES FOR CONFIDENCE, PARTICULARLY IN THE THE HONG KONG DOLLAR: HENCE THEIR VIEW THAT EFFORTS SHOULD BE MADE TO EXPLORE THE CHINESE POSITION FURTHER, IN AN ATTEMPT TO FIND OUT WHAT FLEXIBILITY THERE MIGHT BE IN THEIR CONCEPT OF "ADMINISTRATION" E.G. COULD IT MEAN THE RIGHT TO ADMINISTRATION AS DISTINCT FROM ITS FULL EXERCISE.

5. IN FURTHER DISCUSSION WE SOUGHT TO LEAD MEMBERS TO COMMENT ON:

- (A) WHETHER IT WAS RIGHT TO ASSUME THAT THE ONLY CHOICE LAY BETWEEN CONFRONTATION AND CAPITULATION TO CHINESE DEMANDS: AND  
(B) THE IMPLICATIONS OF A COMPLETE BREAKDOWN IN PARTICULAR WHAT IT WOULD MEAN FOR THE PEOPLE OF HONG KONG AND WHAT WE WOULD EXPECT TO ACHIEVE BY IT.

THE DISCUSSION DID NOT GET VERY FAR ON THESE POINTS, THOUGH THERE WERE SIGNS THAT MEMBERS WERE BEGINNING TO REFLECT ON THEM.

6. I TOLD THE COUNCIL THAT I DID NOT INTEND TO SUM UP THEIR DISCUSSION AT THIS STAGE. MR LUCE SAID THAT HE WOULD REPORT THE VIEWS EXPRESSED TO YOU AND THE PRIME MINISTER. AFTER STRESSING THAT HMG'S COMMITMENT TO HONG KONG AND OBJECTIVES IN THE NEGOTIATIONS REMAINED UNCHANGED HE INFORMED MEMBERS OF MINISTERS' WISH TO CARRY THEIR CONSULTATIONS WITH THE UNOFFICIALS A STAGE FURTHER BY INVITING THEM TO LONDON. HE MENTIONED 6 AND/OR 7 OCTOBER AS VERY TENTATIVE DATES. THE UNOFFICIALS WELCOMED THIS INVITATION AND INDICATED THAT THEY WOULD BE PREPARED TO GO TO LONDON AT ANY TIME WHICH WOULD SUIT MINISTERS.

CLOSED UNDER THE  
FREEDOM OF INFORMATION  
ACT 2000

CONFIDENTIAL

TOP COPY FILED ON: LEBANON

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FM FCO 201745Z SEP 73

TO FLASH OTTAWA

CONFIDENTIAL

TELEGRAM NUMBER 284 OF 26 SEPTEMBER

INFO UKMIS NEW YORK (FOR PRIVATE SECRETARY)

FOLLOWING FOR PS/PRIME MINISTER

OVERNIGHT DEVELOPMENTS 25/26 SEPTEMBER: FOREIGN AFFAIRS

1. FOLLOWING IS A REPORT ON OVERSEAS DEVELOPMENTS SINCE THE PRIME MINISTER'S DEPARTURE FROM THE UK.

UNDERLINE THE NEXT WORD.

LEBANON: THE SYRIANS AND THE SAUDIS ANNOUNCED ON 25 SEPTEMBER THAT A CEASEFIRE HAD BEEN AGREED. FIGHTING IN BEIRUT CONTINUED IN TO THE EVENING OF 25 SEPTEMBER, BUT REPORTS ON THE MORNING OF 26 SEPTEMBER ARE THAT THE CEASEFIRE IS HOLDING. WE ARE SAYING THAT WE WARMLY WELCOME THE CEASEFIRE: THAT WE SHALL BE CONSULTING OUR PARTNERS IN THE MNF ON THE NEXT STEPS: AND THAT WE HOPE THE OPPORTUNITY PROVIDED BY THE CEASEFIRE WILL BE USED TO GOOD EFFECT.

FOREIGN MINISTERS OF THE MNF COUNTRIES WILL BE CONSIDERING IN NEW YORK THE TEXT OF A JOINT STATEMENT. THE US CONTINUES TO LOOK TO THE UK TO CO-ORDINATE THIS EXERCISE. WE SHALL BE CIRCULATING A REVISED TEXT IN THE COURSE OF THE MORNING. WE HOPE FOREIGN MINISTERS WILL ALSO BE ABLE TO DISCUSS THE QUESTION OF OBSERVERS AND THE FUTURE ROLE OF THE MNF.

UNDERLINE THE NEXT WORD.

HONG KONG: FOLLOWING THE LATEST ROUND OF TALKS MARKETS IN HONG KONG HAVE CONTINUED TO REACT BADLY. THIS WAS FURTHER AFFECTED BY ADVANCE RUMOURS ABOUT THE ANNOUNCEMENT OF SIR P CRADOCK'S FORTHCOMING NEW APPOINTMENT. REUTERS IN PEKING PUT OUT A STORY SAYING THAT THE BRITISH EMBASSY WOULD BE MAKING AN IMPORTANT ANNOUNCEMENT LATER TODAY. IN HONG KONG LOCAL MARKETS REACTED BY SPECULATING THAT THERE WOULD BE AN ANNOUNCEMENT ON THE FUTURE. THE GOVERNOR, AFTER DISCUSSION WITH MR LUCE, RECOMMENDED THAT, IN ORDER TO COOL SPECULATION, AT LEAST THE SECTION OF THE ANNOUNCEMENT DEALING WITH SIR P CRADOCK'S APPOINTMENT AS DEPUTY UNDER-SECRETARY WITH RESPONSIBILITY FOR HONG KONG SHOULD BE BROUGHT FORWARD. AFTER DISCUSSION WITH THE NO 10 DUTY PRIVATE



SECRETARY, AUTHORITY FOR THIS WAS GIVEN AND HONG KONG RELEASED  
THE FOLLOWING STATEMENT AT 0737 GMT: QUOTE SIR P CRADOCK WILL  
BE RETIRING FROM THE DIPLOMATIC SERVICE AT THE END OF THE YEAR.  
THEREAFTER HE WILL BE TAKING UP A SPECIAL APPOINTMENT IN THE  
FCO AS DEPUTY UNDER SECRETARY OF STATE WITH RESPONSIBILITY FOR  
NEGOTIATIONS ON THE FUTURE OF HONG KONG UNQUOTE. BECAUSE OF  
THIS THE RELEASE OF THE FULL ANNOUNCEMENT IN LONDON, INCLUDING  
SIR P CRADOCK'S APPOINTMENT AS SPECIAL ADVISER TO THE PRIME  
MINISTER, WAS ALSO BROUGHT FORWARD TO 0900Z.

UNDERLINE THE NEXT WORD.

ZIMBABWE: MUGABE POLITELY DECLINED, ON GROUNDS OF TIREDNESS,  
AN OFFER BY THE SECRETARY OF STATE TO CALL ON HIM AT GATWICK  
DURING A STOPOVER ON 24 SEPTEMBER. IN A PRESS INTERVIEW ON RETURN  
TO HARARE HE DENOUNCED THE UK FOR MEDDLING IN ZIMBABWE'S INTERNAL  
AFFAIRS OVER THE SIX AIR FORCE OFFICERS AND ACCUSED US OF  
LOBBYING IRELAND, US AND CANADA TO RAISE THE CASE WITH HIM.

HOWE

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FM HONG KONG 260537Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1407 OF 26 SEPTEMBER

INFO IMMEDIATE PEKING UKMIS NEW YORK (PERSONAL FOR PRIVATE SECRETARY)

OTTAWA (PERSONAL FOR PRIVATE SECRETARY TO PRIME MINISTER)

438  
SECRET

Prime Minister  
he can. AR 26/9

PEKING TELNO 937: FUTURE OF HONG KONG

1. I AGREE GENERALLY WITH THE AMBASSADOR'S ASSESSMENT OF THE POSITION WE HAVE REACHED IN THE TALKS AND THE ALTERNATIVES NOW FACING US.

2. THE OTHER DIMENSION IS THE SITUATION IN HONG KONG. OVER THE PAST FEW WEEKS THE COMMUNIST PRESS HAVE CREATED AN ATMOSPHERE OF CONFRONTATION THROUGH A BARAGE OF PROPAGANDA DESIGNED TO CONVINCCE PEOPLE THAT CHINESE DEMANDS ARE NON-NEGOTIABLE AND THAT THE BRITISH ARE BEING UNREASONABLE IN REFUSING TO ACCEPT THEM. THEY HAVE ALSO SOUGHT TO SHIFT RESPONSIBILITY FOR THE RESULTING SLIDE IN CONFIDENCE ON TO THE HONG KONG GOVERNMENT. ALL THIS HAS HAD A SEVERE EFFECT ON THE MARKETS, AND PARTICULARLY ON THE EXCHANGE VALUE OF THE HONG KONG DOLLAR. IT IS THEREFORE A MATTER OF URGENCY TO DECIDE HOW WE SHOULD PROCEED.

3. ALTHOUGH SOME MEMBERS OF EXCO MAY NOW BE BEGINNING TO DOUBT PRIVATELY WHETHER THE OBJECTIVE OF CONTINUING BRITISH ADMINISTRATION IS IN FACT ATTAINABLE IT WILL BE VERY DIFFICULT FOR THE MAJORITY TO CONTEMPLATE THE IDEA, AND STILL MORE DIFFICULT FOR THEM TO COME TO TERMS WITH IT. IT IS THEREFORE VERY UNLIKELY THAT THEY WILL AT THIS STAGE BE PREPARED TO SUGGEST ANY OTHER COURSE THAN A CONTINUATION OF THE PRESENT STRATEGY, ACCEPTING THE NEAR CERTAINTY OF CONFRONTATION.

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4. I NEVERTHELESS BELIEVE THAT THE TIME HAS COME WHEN WE MUST PUT OUR ASSESSMENT FRANKLY TO EXCO. IT WILL NEED VERY CAREFUL PREPARATION AND I SEE ADVANTAGE IN WAITING UNTIL AFTER THE S OF S' MEETING WITH THE CHINESE FOREIGN MINISTER ON 27 SEPTEMBER AND IN ALLOWING A LITTLE MORE TIME FOR THE LESSONS OF THE LAST ROUND TO SINK IN. WE CAN ALSO TAKE INTO ACCOUNT MR LUCE'S IMPRESSIONS OF THE MOOD OF EXCO. I SHOULD HOWEVER LIKE AUTHORITY TO PUT TO THEM A PAPER WHICH WOULD CONFIRM OUR ASSESSMENT OF THE CHINESE POSITION AND SET OUT THE OPTIONS AS WE NOW SEE THEM. THE PAPER WOULD CONTAIN NO RECOMMENDATIONS, AND I WOULD ASK MEMBERS NOT TO REACH CONCLUSIONS OR GIVE ADVICE AT THIS STAGE. I WOULD SAY THAT MINISTERS WISHED TO HAVE A FULL DISCUSSION WITH THE UNOFFICIALS IN LONDON BEFORE THEY THEMSELVES REACHED ANY CONCLUSION, BUT THEY WANTED MEMBERS TO HAVE A FRANK ASSESSMENT OF THE POSITION BEFOREHAND.

5. AS THE AMBASSADOR SAYS, OPTION (C) IS NOT WITHOUT CONSIDERABLE RISKS. THERE CAN BE NO CERTAINTY THAT IT CAN BE MADE TO WORK, AND EVEN THE PURSUIT OF IT CARRIES RISKS FOR CONFIDENCE. THERE IS LITTLE FAITH HERE IN ANY GUARANTEE OTHER THAN BRITISH ADMINISTRATION AND EVEN THE BEST OBTAINABLE VERSION OF (C) MAY BE REJECTED IN HONG KONG. MUCH WOULD CERTAINLY DEPEND ON THE DEGREE OF SUPPORT HMG WERE PREPARED TO EXPRESS FOR IT. BUT AT LEAST WE SHOULD HAVE OFFERED THE PEOPLE OF HONG KONG AN HONEST CHOICE (AND TO THIS END IT WILL BE IMPORTANT TO MAINTAIN THE ULTIMATE RIGHT OF REJECTION: PARA 7 OF PEKING TELEGRAM UNDER REFERENCE) AND NOT HAVE DECIDED TO MAKE THEM RUN THE FULL RISKS OF (A) WITHOUT HAVING EXPLORED (C).

6. I WILL TELEGRAPH A POSSIBLE DRAFT OF THE PROPOSED PAPER WITHIN THE NEXT FEW DAYS. ASSUMING THAT MINISTERS AGREE THAT THE UNOFFICIALS SHOULD BE INVITED TO RETURN TO LONDON BEFORE THE NEXT ROUND OF THE TALKS WITH THE CHINESE (SEE MY TELNO 1408) I WOULD PUT THE PAPER TO THE COUNCIL A FEW DAYS BEFOREHAND.

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*Mr Coles*  
*No 10 Downing St*  
**43A**

ZZ UKMIS NEW YORK  
OO OTTAWA  
GRS 292  
SECRET  
DEDIP  
FM FCO 261130Z SEP 83  
TO FLASH UKMIS NEW YORK  
TELEGRAM NUMBER 500 OF 26 SEPTEMBER  
AND TO FLASH OTTAWA (FOR PUS)  
INFO IMMEDIATE HONG KONG, PEKING  
FOLLOWING FOR PRIVATE SECRETARY FROM PRIVATE OFFICE  
HONG KONG TELNOS 1407 - 1408:  
FUTURE OF HONG KONG

1. WE AGREE WITH THE ARGUMENTS SETOUT IN HONG KONG TURS. IN THE LIGHT OF THE STATE OF THE HONG KONG DOLLAR, IT IS CLEARLY DESIRABLE THAT VERY EARLY ACTION SHOULD BE TAKEN, DIRECTED AT CONFIDENCE AND PUBLIC OPINION IN HONG KONG. THE AMBASSADOR IN PEKING WILL MOREOVER NEED A CLEARLY DEFINED POSITION AT THE NEXT ROUND OF TALKS ON 19 OCTOBER. IT WOULD BE DISTINCTLY PREFERABLE FOR THESE TALKS TO GO AHEAD ON THE AGREED DATE RATHER THAN FOR A POSTPONEMENT TO BE REQUESTED BY THE BRITISH SIDE.
2. WE THEREFORE RECOMMEND THAT MR LUCE BE AUTHORISED TO INVITE THE UNOFFICIAL MEMBERS OF EXCO TO LONDON WHEN HE SEES THEM ON 27 SEPTEMBER, AND THAT THE GOVERNOR SHOULD PUT A PAPER TO THE COUNCIL, ALONG THE LINES PROPOSED, IN ADVANCE OF THE VISIT TO LONDON.
3. ON TIMING OF A VISIT (PARA 2 OF HONG KONG TELNO 1408), THE SECRETARY OF STATE COULD MANAGE THURSDAY AFTERNOON AND/OR FRIDAY MORNING (6/7 OCTOBER), SUBJECT ONLY TO THE PRIME MINISTER'S PROPOSED MEETING ON THE COMMUNITY AT 4PM ON 6 OCTOBER. INFORMAL SOUNDINGS WITH THE DIARY AT NO 10 SUGGEST THAT BOTH DAYS WOULD BE VERY DIFFICULT FOR THE PRIME MINISTER BUT THAT 7 OCTOBER MIGHT BE PREFERABLE.
4. (FOR PUS). GRATEFUL IF YOU WOULD SHOW THIS TELEGRAM TO COLES AND, SUBJECT TO THE SECRETARY OF STATE'S VIEWS, ASK WHETHER THE PRIME MINISTER WOULD AGREE TO RECEIVE THE EXCO

SECRET DEDIP

20465 - 1

DELEGATION ON EITHER OF THESE DAYS.

5. IT WOULD BE HELPFUL TO HAVE A DECISION IN TIME FOR MR LUCE TO ISSUE AN INVITATION TO EXCO IN HONG KONG AT 0130Z ON 27 SEPTEMBER.

HOWE

FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/PUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER  
MR BURROWS LEGAL ADVISER  
MR ROBERTS NEWS D  
MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE  
MR FLOWER PUSD  
MR COLES NO 10 DOWNING STREET  
SIR A PARSONS NO 10 DOWNING STREET  
MR WALKER RESEARCH D OAB 2/82

-2-  
SECRET

GR 350

UNCLASSIFIED  
FM HONG KONG 260800Z SEP 83  
TO PRIORITY PEKING  
TELEGRAM NUMBER 559 OF 26 SEPTEMBER  
AND TO PRIORITY FCO

*As Cops*

*h-a.  
M 3.*

THE FOLLOWING ARE PRESS STATEMENTS ISSUED BY HONG KONG GOVERNMENT ON 25 SEPTEMBER 1983:-

"THE GOVERNOR, SIR EDWARD YOUDE, THIS EVENING EXPRESSED GREAT CONCERN ABOUT THE EXCHANGE VALUE OF THE HONG KONG DOLLAR IN RECENT DAYS.

AFTER DAY-LONG DISCUSSIONS WITH THE CHIEF SECRETARY AND THE FINANCIAL SECRETARY, HE SAID HE SYMPATHISED WITH PEOPLE'S ANXIETIES BUT URGED THEM NOT TO BE CARRIED AWAY BY THE PRESENT MOOD OF PESSIMISM.

THE GOVERNOR SAID A STRONG EXPORT-LED RECOVERY WAS NOT UNDERWAY AND SO THE RATES QUOTED FOR THE HONG KONG DOLLAR WERE NOW QUITE UNREASONABLE. THEY CERTAINLY DID NOT PROPERLY REFLECT UNDERLYING ECONOMIC OR POLITICAL REALITIES. THE GOVERNOR STRESSED THAT HE WAS FULLY AWARE OF PEOPLE'S CONCERNS. HE BELIEVED THAT EVERYONE'S INTERESTS WOULD BE BEST SERVED BY CALMLY GETTING ON WITH THEIR JOBS. THEY SHOULD REFUSE TO BE DISTRACTED BY ALARMIST CHATTER AND MISLEADING COMMENTS WHICH HAVE THE EFFECT, INTENDED OR OTHERWISE, OF DAMAGING CONFIDENCE. THE TALKS ABOUT HONG KONG'S FUTURE ARE STILL IN PROGRESS AND IT WAS NOT TO BE EXPECTED, HE ADDED, THAT THEY WOULD REACH RAPID RESULTS BECAUSE THE ISSUES INVOLVED ARE COMPLEX.

IT HAS JUST BEEN LEARNED THAT A FURTHER ANNOUNCEMENT ABOUT THE OUTCOME OF CERTAIN CONSULTATIONS THAT THE ACTING FINANCIAL SECRETARY, MR DOUGLAS BLYE, HAS BEEN HAVING TODAY WITH REPRESENTATIVES OF THE NOTE-ISSUING BANKS COULD BE EXPECTED LATER THIS EVENING".

"AS A RESULT OF THE RECENT UNWARRANTED DEPRECIATION OF THE LOCAL CURRENCY THE ACTING FINANCIAL SECRETARY, MR DOUGLAS BLYE, HAS BEEN IN CONSULTATION THROUGHOUT THE WEEKEND WITH THE NOTE-ISSUING BANKS AND OTHER ADVISERS. VARIOUS PROPOSALS HAVE BEEN CONSIDERED. A BASIC PREREQUISITE OF ALL OF THESE PROPOSALS WAS FULL CONVERTIBILITY OF THE CURRENCY.

ONE PROPOSAL WHICH IS BEING ACTIVELY DEVELOPED INVOLVES A SUBSTANTIAL REVISION OF THE MECHANICS FOR ISSUING AND REDEEMING CERTIFICATES OF INDEBTEDNESS TO THE NOTE-ISSUING BANKS IN SUCH A WAY AS TO PRODUCE AN EXCHANGE RATE WHICH WOULD MORE ACCURATELY REFLECT THE FUNDAMENTAL STRENGTH OF THE ECONOMY. THE PROPOSAL

*/WILL*

WILL MEAN THE ASSUMPTION BY THE EXCHANGE FUND OF A MORE  
SIGNIFICANT ROLE IN THE EXCHANGE RATE DETERMINATION MECHANISM.  
IN THE MEANTIME, THE GOVERNMENT SPOKESMAN SAID THAT THE EXCHANGE  
FUND RETAINS ITS EXISTING CAPABILITY TO INTERVENE IN THE FOREIGN  
EXCHANGE AND MONEY MARKETS''.

YOUDE

THIS TELEGRAM  
WAS NOT  
ADVANCED

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/FUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/FUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

MR BURROWS LEGAL ADVISER

MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER FUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

SECRET

pa 43

SECRET

FN HONG KONG 260610Z SEP 83  
TO IMMEDIATE UKMIS NEW YORK  
TELEGRAM NUMBER 9 OF 26 SEPTEMBER  
INFO IMMEDIATE FCO OTTAWA (FOR PRIVATE SECRETARY TO PM) PEKING

FOLLOWING FOR PRIVATE SECRETARY FROM GOVERNOR

FCO TELNOS 448 TO YOU: FUTURE OF HONG KONG: BILATERAL MEETING  
WITH CHINESE FOREIGN MINISTER, 27 SEPTEMBER

1. UNOFFICIALS WILL ATTACH CONSIDERABLE IMPORTANCE TO THE  
SECRETARY OF STATE'S TALK WITH WU XUEQIAN. THIS WILL PROBABLY BE  
THE ONLY OPPORTUNITY WE WILL GET TO PUT POINTS TO THE CHINESE AT  
SENIOR LEVEL BEFORE THE NEXT ROUND OF TALKS IN PEKING, AND IT  
WOULD BE HELPFUL IF MR LUCE COULD ASSURE EXCO THAT THE SECRETARY  
OF STATE WILL BE TAKING A VERY ROBUST LINE.

2. I HAVE DISCUSSED THE SUGGESTED POINTS TO MAKE IN FCO  
TELEGRAM UNDER REFERENCE WITH THE AMBASSADOR. FOR REASONS WHICH  
WILL BE PLAIN FROM OTHER TELEGRAMS WE DO NOT THINK THIS IS THE  
RIGHT OCCASION TO GET INTO DETAILED NEGOTIATION. BUT IN THE LIGHT  
OF THE FALL IN CONFIDENCE AND THE SEVERE IMPACT ON THE HONG KONG  
DOLLAR OVER THE PAST FEW DAYS, WE RECOMMEND THAT THE S OF S SHOULD  
TAKE A SHARPER LINE THAN THE ONE PROPOSED. IN PARTICULAR HE  
MIGHT MAKE THE FOLLOWING POINTS:

(A) DEEPLY DISAPPOINTED WITH THE CHINESE ATTITUDE DURING LAST  
ROUND OF THE TALKS. WE HAD PROPOSED AN OBJECTIVE FACTUAL STUDY AND  
HAD PRESENTED DETAILED PAPERS AS AN INITIAL CONTRIBUTION TO THAT  
STUDY. THE CHINESE HAD DONE NOTHING EXCEPT INSIST THAT WE MUST  
ACCEPT THEIR POSITION BEFORE ANY DISCUSSION OF PRACTICAL POINTS  
COULD BEGIN.

(B) ASTONISHED THAT CHINESE SHOULD HAVE TURNED DOWN OUR PROPOSAL  
TO ISSUE A JOINT STATEMENT OF A KIND WHICH WOULD HAVE HELPED  
CONFIDENCE IN HONG KONG. UNDERSTAND THAT THEY REFUSED EVEN TO  
INCLUDE THE WORD QUOTE USEFUL UNQUOTE. THAT SUGGESTS CHINESE ARE NOT  
INTERESTED IN MAINTAINING CONFIDENCE.

(C) CHINESE SHOULD BE UNDER NO ILLUSIONS ABOUT CAUSE OF LACK OF  
CONFIDENCE AND DECLINE IN HONG KONG DOLLAR. THE REASON IS WORRY ABOUT  
FUTURE, BROUGHT ABOUT LARGELY BY THE INTENSE BARAGE OF CHINESE  
STATEMENTS AND BRIEFINGS IN RECENT WEEKS. CHINESE ALLEGED IN LAST  
ROUND OF TALKS THAT BRITISH WERE TRYING TO PUT PRESSURE ON THEM  
BY PLAYING QUOTE ECONOMIC CARD UNQUOTE. THIS TOTALLY UNTRUE.  
HONG KONG GOVERNMENT HAVE DONE AND ARE DOING EVERYTHING POSSIBLE  
TO SUSTAIN HONG KONG DOLLAR. CHINESE STATEMENTS ARE HAVING A  
DAMAGING EFFECT ON MARKET SENTIMENT.

SECRET



H-K: future

SECRET

3. WU IS LIKELY TO ACCUSE THE BRITISH OF HAVING CAUSED THE PRESENT SLIDE OF CONFIDENCE, EITHER DELIBERATELY IN AN ATTEMPT TO PUT PRESSURE ON THE CHINESE, OR THROUGH OUR ALLEGED QUOTE RIGIDITY UNQUOTE. THE SECRETARY OF STATE WILL WISH TO REFUTE THIS FIRMLY. HE MIGHT SAY THAT WE HAVE GIVEN OUR HONEST VIEW OF WHAT IS REQUIRED TO MAINTAIN STABILITY AND PROSPERITY IN HONG KONG AFTER 1997. THOUGH THERE REMAIN WIDE DIFFERENCES BETWEEN US WE REMAIN TOTALLY COMMITTED TO THE SEARCH FOR A SETTLEMENT WHICH WOULD ACCORD WITH THE INTERESTS OF BOTH CHINA AND BRITAIN. HOW COULD IT CONCEIVABLY BE IN ANYONE'S INTERESTS TO DESTROY THE PROSPERITY OF HONG KONG? FURTHER REASON BOTH SIDES SHOULD DO EVERYTHING POSSIBLE TO MAINTAIN CONFIDENCE IN HONG KONG AND SHOULD REFRAIN FROM ACTIONS WHICH DAMAGE ITS PROSPERITY.

YOUDE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/FUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

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SIR IAN SINCLAIR LEGAL ADVISER

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MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER FUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

<sup>-2-</sup>  
SECRET

SECRET

~~SECRET~~  
**OUT**  
ACTION COPY

42B

OTWON 06/26

OO HONG KONG

OO FCO

OO WASHINGTON (FOR PS TO CHANCELLOR OF THE EXCHEQUER)

OO UKMIS NEW YORK (FOR PS TO FORIEGN AND COMMONWEALTH SECRETARY)

OO PEKING

GRS 230

SECRET

FM OTTAWA 261245Z SEPT 83

TO IMMEDIATE HONG KONG (PERSONAL FOR GOVERNOR)

TELEGRAM NUMBER 06 OF 26 SEPTEMBER

AND TO IMMEDIATE FCO, WASHINGTON (FOR PS TO CHANCELLOR OF THE EXCHEQUER), UKMIS NEW YORK (FOR PS TO FORIEGN AND COMMONWEALTH SECRETARY), PEKING

FOR GOVERNOR FROM PRIVATE SECRETARY TO THE PRIME MINISTER

**SECRET**

1. THE PRIME MINISTER HAS SEEN YOUR LATEST REPORTS AND IS OF COURSE VERY CONCERNED ABOUT THE CONTINUING AND RAPID SLIDE IN CONFIDENCE. WE REALISE THAT YOU, MR LUCE AND SIR P CRADOCK WILL BE CONSIDERED EVERY POSSIBILITY FOR STEMMING IT.

2. IT WOULD BE VERY HELPFUL TO HAVE YOUR JOINT ASSESSMENT ON THE  
FOLLOWING POINTS:-

SECRET

- A) WHAT SORT OF STATEMENT FROM PEKING WOULD CONTRIBUTE TO A STEADYING OF OPINION IN HONG KONG?
- B) IS THERE ANY SUCH STATEMENT WHICH IN PRESENT CIRCUMSTANCES THE CHINESE GOVERNMENT COULD REALISTICALLY BE EXPECTED TO MAKE?
- C) WHAT MESSAGE SHOULD SIR P CRADOCK TAKE BACK TO PEKING TO PERSUADE THE CHINESE LEADERS THAT THERE IS A GENUINE CRISIS OF CONFIDENCE AND NOT JUST AN ARTIFICIAL CREATION OF THE BRITISH ADMINISTRATION WHICH COULD BE STOPPED IF WE SO WISHED?
- D) ARE THERE OTHER WAYS EG SPECIAL EMISSARIES OR MINISTERIAL MESSAGES WHICH COULD BE USED TO GET ACROSS THE GENUINENESS AND SERIOUSNESS OF THE SITUATION TO THE CHINESE LEADERSHIP?

MORAN

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*Political*

SECRET

00 OTTAWA

GR 820

RESTRICTED

FM HONG KONG 260115Z SEP 83

TO IMMEDIATE OTTAWA (FOR PRIME MINISTER'S PARTY)

TELEGRAM NUMBER 10 OF 26 SEPTEMBER

AND TO IMMEDIATE UKMIS NEW YORK (FOR SECRETARY OF STATE'S PARTY)

**IN ACTION COPY**

FOLLOWING TELEGRAM IS NOW REPEATED TO YOU AT REQUEST OF  
ORIGINATOR:-

RESTRICTED

DESKBY 241230Z

FM HONG KONG 241130Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1402 OF 24 SEPTEMBER

INFO IMMEDIATE HONG KONG GOVERNMENT OFFICE LONDON, PEKING

INFO PRIORITY HK GOVT REPS WASHINGTON, CG NEW YORK, UKMIS GENEVA,  
BRUSSELS

*A.S.C. 27/4*

**THE FUTURE: PRESS COVERAGE.**

THE COMMUNIST PRESS HAS CONTINUED ITS UNRELENTING BARRAGE OF  
PROPAGANDA. WITHIN AN HOUR OF THE RELEASE OF THE JOINT STATEMENT  
ANNOUNCING THE NEXT ROUND OF TALKS, THE NCNA ISSUED A STATEMENT  
ATTACKING THE NOTION THAT BRITISH ADMINISTRATION IS INDISPENSABLE  
TO THE FUTURE OF HONG KONG. THE PROSPERITY OF HONG KONG HAS BEEN  
ACHIEVED MAINLY AS THE RESULT OF THE DILIGENCE, WISDOM AND  
METICULOUS MANAGEMENT OF THE FIVE MILLION HONG KONG RESIDENTS  
OF WHOM OVER 98 PERCENT ARE CHINESE COMPATRIOTS. ANOTHER  
IMPORTANT FACTOR HAS BEEN THE VIGOROUS SUPPORT BY THE CHINESE  
MAINLAND.

2. THE LEFT WING WEN WEI PO AND TA KUNG PAO QUOTED A NUMBER OF INDEPENDENT OBSERVERS AS CALLING ON THE GOVERNMENT TO TAKE POSITIVE ACTION TO SALVAGE THE DOLLAR AND CURB ANY SUBSEQUENT PRICE RISES. TOGETHER WITH THE NEW EVENING POST THEY COMMENTED THAT THE SLIDE OF THE DOLLAR WAS ATTRIBUTABLE TO GOVERNMENT INACTION, ULTERIOR MOTIVES ON THE BRITISH SIDE AND MOVEMENT TO CONDONE SPECULATORS IN THE FOREIGN EXCHANGE MARKET. THERE WERE ALSO SUGGESTIONS THAT THE HK GOVERNMENT'S 'FRANTIC TAX AND CHARGE INCREASES', AND HIGH INFLATION AND LAND PRICE POLICIES WERE TO BLAME AND WARNINGS THAT THE GOVERNMENT SHOULD NOT PLAY WITH FIRE. THE INDEPENDENT HONG KONG ECONOMIC JOURNAL SUGGESTED THAT THE GOVERNMENT SHOULD SEEK FOREIGN LOANS TO PROP UP THE DOLLAR AND CALLED ON LEFT WING PAPERS IN PEKING AND HONG KONG TO CEASE THEIR ATTACK ON GOVERNMENT. THE FINANCIAL DAILY SUGGESTED THAT THE CONFIDENCE CRISIS WAS NOW CLOSE TO THE POINT OF NO RETURN. THE HONG KONG DAILY NEWS AND MING PAO SAID THAT THE DOLLAR CRISIS WAS DUE TO PEKING'S FAILURE TO UNDERSTAND THE IMPORTANCE OF THE STATUS QUO. MING PAO ADDED THAT THE HONG KONG ECONOMY WAS FUNDAMENTALLY VERY SOUND, GOVERNMENT ACCOUNTS WERE IN GOOD ORDER AND THE RESERVES WERE HEALTHY. UNLESS THE CONCERNED PARTIES WISHED TO DESTROY THE DOLLAR, THERE WERE NO REASONS WHY IT SHOULD COLLAPSE. A REPORT FILED BY SING PAO'S REPORTER IN PEKING QUOTED MR LU PING, A CHINESE DELEGATE TO THE TALKS, AS SAYING THAT HE WAS EXTREMELY SURPRISED BY THE HONG KONG DOLLAR'S NOSEDIVE AND THAT THIS WAS IMPOSSIBLE.

3. THE PRIME MINISTER'S REMARKS TO JOURNALISTS YESTERDAY WAS WIDELY REPORTED. TA KUNG PAO HEADLINED THE REPORT AND REMARKED THAT SHE WAS MERELY DEFENDING COLONIALISM.

4. IN COMMENTING ON THE STATEMENT ISSUED AT THE CONCLUSION OF THE TALKS, SOME PAPERS DETECTED CRUMBS OF COMFORT. THE ENGLISH LANGUAGE SCMP SAID THAT THERE HAD BEEN DEFINITE SIGNS OF PROGRESS AND QUOTED SOURCES WHO DISMISSED SUGGESTIONS OF INSOLUBLE OBSTACLES. SING TAO JIK PAO SUGGESTED THAT THE PESSIMISTIC ATMOSPHERE WAS QUITE NORMAL AT THIS STAGE OF INTERNATIONAL NEGOTIATIONS AND WAS COMFORTED THAT A DATE HAD BEEN SET FOR THE NEXT MEETING. HOWEVER THE PRO LEFT TIN TIN DAILY NEWS SUGGESTED THAT THERE HAD BEEN NO PROGRESS IN THE TALKS BECAUSE THE TWO SIDES WERE REFUSING TO BUDGE WHILE BLAMING EACH OTHER FOR THE DECLINE OF THE DOLLAR.

5. ALL PAPERS REPORTED A SPEECH BY SIR S.Y. CHUNG TO THE COMMONWEALTH LAW CONFERENCE IN WHICH HE CALLED FOR 'SOME KIND OF ASSURANCE OR GUARANTEE THAT A CAPITALIST SYSTEM CAN SURVIVE WITHIN A COMMUNIST SYSTEM'. SPEAKING TO REPORTERS AFTER HIS ADDRESS SIR S.Y. ATTACKED THE CHINESE FOR NOT KEEPING TO THEIR AGREEMENT TO MAINTAIN THE CONFIDENTIALITY OF THE TALKS. SOME PAPERS ALSO QUOTED A SPEECH BY THE FORMER ATTORNEY GENERAL, MR JOHN GRIFFITHS WHO STRESSED THE NEED FOR A BUFFER BETWEEN CAPITALIST HONG KONG AND COMMUNIST CHINA.

6. THE ERSTWHILE INDEPENDENT ENGLISH LANGUAGE STANDARD CARRIED AN EDITORIAL SUGGESTING THAT IN THE TRUE TRADITIONS OF LIONHEARTEDNESS, THE BRITISH WERE DETERMINED TO GO DOWN WITH THE FLAG FLYING NO MATTER THE PAIN TO HONG KONG. THE PAPER WARNED THAT CHINA MAY BE FORCED TO THE KIND OF ACTION WHICH MORAL PRUDENCE WOULD ADVISE AGAINST. THIS WOULD LEAD TO CHAOS IN HONG KONG AND IRREPERABLE DAMAGE TO SINO-BRITISH RELATIONS. COMMENT ELSEWHERE IN THE SAME EDITION REFLECTED THE INCREASINGLY PRO PEKING SENTIMENT OF THE PAPER.

YOUDE

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**SECRET**

Sü A. Aelund  
42A has seen

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OO OTTAWA

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D E D-I P

SECRET

DESKBY 261500Z

FM FCO 251300Z SEPT 83

TO IMMEDIATE UKMIS NEW YORK

TELEGRAM NUMBER 504 OF 26 SEPTEMBER

INFO IMMEDIATE OTTAWA STRICTLY PERSONAL FOR PUS (PRIME  
MINISTER'S PARTY)

STRICTLY PERSONAL FOR PRIVATE SECRETARY TO SECRETARY OF STATE  
FROM CLIFT

OUR TELECONS ON 24 SEPTEMBER: HAWK

1. GOVERNOR HAS TOLD US THAT HAWK HAS NOT REPEAT NOT CLOSED DOORS  
TODAY. HONG KONG GOVERNMENT ACTION IS THEREFORE POSTPONED BY  
AT LEAST 24 HOURS BUT NO MORE PRECISE FORECAST CAN BE MADE YET.
2. FOR PUS. YOU MAY WISH TO TELL COLES.

HOWE

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**SECRET**

PS/PM

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CONFIDENTIAL

OO OTTAWA

GRS57

CONFIDENTIAL

FM FCO 261330Z SEP 83

TO IMMEDIATE UKMIS NEW YORK

TELEGRAM NUMBER 506 OF 26 SEPTEMBER

INFO IMMEDIATE OTTAWA (FOR PRIVATE SECRETARY TO PM)

HONG KONG PEKING

FOR PRIVATE SECTETARY

HONG KONG TELNO 9: BILATERAL MEETING WITH CHINESE FOREIGN  
MINISTER, 27 SEPTEMBER

1. PARAS 2 AND 3 OF TUR. WE HAVE NO OBJECTION TO SUGGESTED  
POINTS TO MAKE.

HOWE

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IN  
ACTION COPY

CONFIDENTIAL



RESTRICTED

DESKBY 260900Z

FM HONG KONG 260640Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1409 OF 26 SEPTEMBER

INFO IMMEDIATE PEKING UKMIS NEW YORK (FOR S OF S'S PARTY)

OTTAWA (FOR PRIVATE SECRETARY TO THE PRIME MINISTER)

**RESTRICTED**

*Yves Dimal*

*has seen. AM 26/9*

FUTURE OF HONG KONG: PRESS COVERAGE

1. THE MAJOR COMMUNIST NEWSPAPERS (TA KUNG PAO, WEN WEI PO AND NEW EVENING POST) HAVE ALL REACTED SHARPLY TO THE PRIME MINISTER'S COMMENTS TO U.S. JOURNALISTS ON 23 SEPTEMBER (CPI RETRACT NUMBER 03923 SEPT). THEIR COMMENTS CAN BE TAKEN AS REFLECTIONS OF THE OFFICIAL CHINESE VIEW.

2. THE THREE PAPERS REFUTED THE ASSERTION THAT THERE WAS GREAT FINANCIAL AND POLITICAL UNCERTAINTY OVER THE FUTURE OF HONG KONG AND DENIED THAT THERE WAS ANY BASIS FOR A COMPARISON BETWEEN HONG KONG AND SINGAPORE. IN ITS EDITORIAL YESTERDAY WEN WEI PO DESCRIBED THE PM'S STATEMENT AS "'ASTONISHING AND OUTRAGEOUS"' AS WELL AS "'DAMAGING TO THE INTERESTS OF HONG KONG'S FIVE MILLION PEOPLE'". THE EDITORIAL ACCUSED THE PM OF DISTORTING THE TRUTH IN ORDER TO "'PUT THE BLAME ON CHINA"' BUT THAT SUCH ACTIONS CONTRADICTED BRITAIN'S PLEDGE TO MAINTAIN PROSPERITY AND STABILITY. TA KUNG PAO AND THE NEW EVENING POST ATTACKED THE PM'S ATTEMPT TO "'PLAY THE HONG KONG INDEPENDENCE CARD"' BY URGING LOCAL RESIDENTS TO CUT THEIR PROPER TIES WITH THE CHINESE MOTHERLAND AND SEEK INDEPENDENCE. THE PAPERS INSISTED THAT BRITAIN WAS TRYING TO MAINTAIN ITS COLONIAL PRESENCE IN HONG KONG FOR PURELY ECONOMIC GAIN. BRITISH ENTREPRENEURS ENJOYED AS SPECIAL STATUS IN HONG KONG, THEY INVESTED HEAVILY IN THE LOCAL STOCK MARKETS AND HONG KONG'S RESERVES WERE KEPT IN BRITAIN.

3. THE MOST VITRIOLIC RESPONSE TO THE PM'S COMMENTS APPEARED IN TODAY'S WEN WEI PO IN AN ARTICLE SIGNED BY THE PAPER'S DIRECTOR LI ZISONG (WHO IS ALSO A DELEGATE TO THE CPPCC). LI ACCUSED THE PM OF "WILFULLY TELLING LIES" BY CLAIMING THAT BRITAIN DERIVED NO ECONOMIC BENEFIT FROM HONG KONG. HONG KONG'S RESERVES WERE KEPT IN THE UK FOR BRITAIN'S BENEFIT, THE HONG KONG GOVERNMENT HAD ACUTIONED OFF THE TERRITORY'S LAND (WHICH WAS CHINA'S) AT HIGH PRICES, AND HAD ACCUMMULATED THE REVENUE IN GOVERNMENT COFFERS. THE HONG KONG GOVERNMENT'S POLICY OF AWARING FRANCHISES, ITS INVESTMENT POLICIES AND THE TAX LEVY ON BETTING WERE ALL DESIGNED TO REAP HUGE BENEFITS. IF NOT FOR THE PURPOSES OF "INVASION AND LOOTING" SAID LI, WHY DID BRITAIN COMME ALL THIS WAY TO OCCUPY A PART OF CHINESE TERRITORY. BEFORE LIBERATION (I.E. 1949) BRITAIN HAD TAKEN AWAY AN "INCALCULABLE AMOUNT OF MONEY AND MATERIALS" FROM CHINA.

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SECRET

FM HONG KONG 260550Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1408 OF 26 SEPTEMBER

INFO IMMEDIATE OTTAWA (FOR PS TO PRIME MINISTER) UKMIS NEW YORK  
(FOR PRIVATE SECRETARY) PEKING

MIPT AND PEKING TELNO 937: FUTURE OF HONG KONG

I HAVE DISCUSSED THE SITUATION WITH MR LUCE. ON TIMING. IN THE LIGHT OF THE TWO TELEGRAMS UNDER REFERENCE, WE WERE ALL TAKE THE VIEW THAT WE MUST ENDEAVOUR TO GET THE UNOFFICIALS BACK TO LONDON FOR DISCUSSIONS WITH THE PRIME MINISTER AND YOU BEFORE THE NEXT ROUND OF TALKS ON 19 OCTOBER. AS SUGGESTED IN YOUR TELNO 960 WE SHALL BE CONSIDERING POSSIBLE TIMING WITH EXCO TOMORROW. THEY CAN BE EXPECTED TO OFFER TO COME TO LONDON AT ANY TIME CONVENIENT FOR MINISTERS. BUT IF WE ARE TO HAVE A WORTHWHILE DISCUSSION IN EXCO ON THIS, WE SHALL NEED TO KNOW BEFOREHAND WHAT SEEM TO YOU TO BE THE PRACTICAL POSSIBILITIES FOR A MEETING IN LONDON IN THE PERIOD.

2. IN VIEW OF THE DATES OF THE CONSERVATIVE PARTY CONFERENCE (11 - 14 OCTOBER) AND MY OWN COMMITMENT TO GIVE MY ANNUAL SPEECH TO LEGCO ON 5 OCTOBER, IT WOULD SEEM TO US THAT THE ONLY POSSIBLE SLOT IS FROM 6 TO 10 OCTOBER. WE CANNOT DO ANYTHING EARLIER BECAUSE OF THE NEED TO PREPARE WITH YOUR APPROVAL A PAPER FOR EXCO SETTING OUT THE COURSES OPEN TO US. (SEE MIPT). WE THINK A MEETING WITH UNOFFICIALS SHOULD BE PRECEDED BY A MEETING AT WHICH YOU AND THE PM COULD GO OVER THE GROUND WITH THE AMBASSADOR AND MYSELF.

3. IF YOU TAKE THE VIEW THAT DATES BEFORE 19 OCTOBER ARE IMPOSSIBLE, THEN THE ONLY OPTION OPEN TO US IS FOR THE AMBASSADOR TO APPROACH YAO GUANG TO SEEK A DEFERMENT OF THE NEXT ROUND FOR, SAY, SEVEN TO TEN DAYS ON THE GROUNDS THAT WE NEED EXTRA TIME FOR REFLECTION. WE THINK YAO WOULD PROBABLY AGREE TO THIS. IT WOULD, OF COURSE, REQUIRE PUBLIC EXPLANATION AND WOULD CAUSE SPECUALTION, BUT WE THINK THIS WOULD BE MANAGEABLE.

4. THE ONE COURSE WHICH IN OUR VIEW IS TO BE AVOIDED IS TO DEFER MEETING THE UNOFFICIALS IN LONDON UNTIL AFTER THE NEXT ROUND: FOR THE REASONS GIVEN IN PEKING TELEGRAM UNDER REFERENCE THERE IS A HIGH RISK OF A PUBLIC BREAKDOWN AT THIS MEETING, AND WHATEVER COURSE OF ACTION WE WISH TO ADOPT WILL NEED TO BE DECIDED IN ADVANCE.

H-K: future

SECRET

5. GRATEFUL FOR YOUR IMMEDIATE VIEWS ON WHAT CAN BE MANAGED. MR LUCE FEELS IT ESSENTIAL TO BE ABLE TO INVITE EXCO TO LONDON WHEN HE SEES THEM TOMORROW MORNING, AND HE WOULD LIKE IF POSSIBLE TO BE ABLE TO GIVE THEM AN INDICATION OF DATES.

YOUDE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

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MR DONALD

MR WRIGHT

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MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

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SECRET

CONFIDENTIAL

FM UKMIS NEW YORK 261355Z SEP 83

TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 005 OF 26 SEPTEMBER

INFO FCO, PEKING, OTTAWA (FOR PRIVATE SECRETARY TO THE PRIME MINISTER)

**IN**  
**ACTION COPY**

FOLLOWING FROM PRIVATE SECRETARY.

*PS/PM*

YOUR TELNO 448 AND HONG KONG TELNO 9: BILATERAL MEETING WITH CHINESE FOREIGN MINISTER.

1. THE SECRETARY OF STATE WOULD LIKE AS FAR AS POSSIBLE TO BE ARMED WITH THE FACTS ABOUT THE HONG KONG DOLLAR ETC BEFORE HE MEETS THE CHINESE FOREIGN MINISTER TOMORROW. IN PARTICULAR HE WOULD LIKE TO BE ABLE TO REFUTE THE CLAIM MADE IN COMMUNIST NEWSPAPERS IN HONG KONG (HONG KONG TELNO 1409) THAT HONG KONG RESERVES ARE KEPT IN BRITAIN FOR BRITAIN'S BENEFIT.

ANY ADDITIONAL MATERIAL TO DEAL WITH OTHER CHARGES REFERRED TO IN THE SAME TELEGRAM WOULD ALSO BE HELPFUL.

2. THE SECRETARY OF STATE WOULD ALSO LIKE TO HAVE THE FIGURES FOR THE EXTENT OF DIRECT INTERVENTION IN THE FOREIGN EXCHANGE MARKETS TO SUPPORT THE HONG KONG DOLLAR (HONG KONG TELNO 11 TO OTTAWA), ALTHOUGH OF COURSE HE REALISES THAT THESE FIGURES COULD PRESUMABLY NOT BE REVEALED EITHER TO THE CHINESE FOREIGN MINISTER OR PUBLICLY. HE WOULD ALSO LIKE TO HAVE THE FIGURES ABOUT THE RAISING OF DEPOSIT INTEREST RATES ETC. IN RECENT MONTHS. PRESUMABLY THESE FIGURES ARE PUBLIC AND COULD BE USED IF NECESSARY.

THOMSON

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WONOT 033/26

ZZ OTTAWA

GRS 120

CONFIDENTIAL

FM UKMI S NEW YORK 261540Z SEP 83  
TO FLASH OTTAWA  
TELEGRAM NUMBER 003 OF 26 SEPTEMBER  
AND TO IMMEDIATE FCO, HONG KONG, PEKING.

FOLLOWING FOR PUS (WITH PRIME MINISTER'S PARTY)  
FROM PRIVATE SECRETARY.

FCO TELNO 500: FUTURE OF HONG KONG.

1. THE SECRETARY OF STATE AGREES WITH THE RECOMMENDATIONS IN TUR.  
IN PARTICULAR HE AGREES THAT WE SHOULD AVOID IF AT ALL POSSIBLE  
ANY POSTPONEMENT OF THE NEXT ROUND OF TALKS, AND THAT A  
MEETING WITH EXCO SHOULD THEREFORE BE ARRANGED FOR 6 OR 7  
OCTOBER, DESPITE THE DIFFICULTIES.

THOMSON

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RS/PM

**SECRET**per  
41

SECRET

FM HONG KONG 260907Z SEP 83

TO FLASH OTTAWA (FOR PS TO PM)

TELEGRAM NUMBER 11 OF 26 SEPTEMBER

INFO IMMEDIATE\*FCO, UKMIS NEW YORK (FOR PS TO S OF S), WASHINGTON  
(FOR PS TO CHANCELLOR OF THE EXCHEQUER)

\*(PERSONAL FOR CLIFT HKD)

FOR PRIVATE SECRETARY TO PRIME MINISTER FROM GOVERNOR.

FUTURE OF HONG KONG: FINANCIAL SITUATION.

AT THE CLOSE ON 23 SEPTEMBER 1983 THE HONG KONG DOLLAR/U.S. DOLLAR EXCHANGE RATE WAS 8.73 COMPARED WITH 6.12 A YEAR AGO, A DEPRECIATION OF 42.5 PERCENT. THE TRADE WEIGHTED EXCHANGE RATE INDEX STOOD AT 62.6 COMPARED WITH 87.3 A YEAR AGO, A FALL OF 28.3 PERCENT. THE EXTENT OF THE DEPRECIATION WAS PARTICULARLY SHARP IN OCTOBER LAST YEAR AND IN JUNE THIS YEAR, BUT IT IS THIS PAST WEEK WHICH HAS HAD A TRULY DRAMATIC AIR ABOUT IT: BETWEEN THE CLOSE ON 16 SEPTEMBER AND THE CLOSE ON 23 SEPTEMBER THE RATE FELL FROM 7.78 TO 8.73, OR BY 10.8 PERCENT. THE TRADE WEIGHTED INDEX FELL FROM 68.3 TO 62.7, OR BY 8.2 PERCENT. BY THE CLOSE AT NOON ON SATURDAY 24 SEPTEMBER THE RATE HAD PLUNGED TO 9.50 AND THE TRADE WEIGHTED INDEX TO 57.2.

2. THE HANG SENG INDEX ALSO DECLINED SHARPLY THIS PAST WEEK FROM 916 AT THE CLOSE ON 16 SEPTEMBER TO 786 AT THE CLOSE ON 23 SEPTEMBER, ON WHICH DAY IT DECLINED BY 63 POINTS. IN 1982 (MONTHLY AVERAGE) THE INDEX WAS 1106 AND IN THE FIRST HALF OF THIS YEAR WAS 967. TOTAL TURNOVER IN 1982 WAS HONG KONG DOLLARS 46 BILLION, COMPARED WITH 106 BILLION IN 1981 AND 19 BILLION IN THE FIRST SIX MONTHS OF THIS YEAR.

3. TO SOME EXTENT, THE WEAKENING TREND OF THE EXCHANGE VALUE OF THE HONG KONG DOLLAR OVER THE PAST YEAR HAS BEEN A REFLECTION OF THE STRENGTH OF THE US DOLLAR WORLDWIDE AND THERE HAS BEEN SOME SPECULATIVE ACTIVITY FROM TIME TO TIME, BUT ANXIETY ABOUT THE FUTURE HAS UNDOUBTEDLY BEEN THE MAIN FACTOR. CERTAINLY, THE RECENT COLLAPSE REFLECTS THE CUMULATIVE EFFECT OF THE BARRAGE OF CHINESE PROPAGANDA OVER THE PAST COUPLE OF MONTHS. THE MARKET IS NOW INDIFFERENT TO POSITIVE ECONOMIC NEWS, SUCH AS AN UPWARD REVISION OF THE GDP FORECAST FOR 1983: IT IS SUSCEPTIBLE TO RUMOUR-MONGERING AND UNHELPFUL COMMENTARY BY THE CHINESE: AND IT IS READY TO PLACE THE WORST POSSIBLE INTERPRETATION ON THE ABSENCE OF ANY AUTHORITATIVE STATEMENTS DEMONSTRATING THE PROGRESS OF THE NEGOTIATIONS. AT THE END OF LAST WEEK AND OVER THE WEEKEND THERE WAS SOMETHING AKIN TO PANIC IN THE AIR. THERE WAS A SCRAMBLE TO DUMP HONG KONG DOLLARS AND GO LONG IN U.S. DOLLARS AND GOLD. THERE WAS EVEN SOME DOMESTIC STOCK PILING OF BASIC FOODSTUFFS.

4. THE CHINESE HAVE ARGUED THAT THE WEAKNESS OF THE HONG KONG DOLLAR IS AN ECONOMIC PHENOMENON AND NOT A POLITICAL ONE: MORE RECENTLY THEY HAVE PERSISTENTLY ACCUSED THE HONG KONG GOVERNMENT EITHER OF INERTIA OR OF ACTUALLY ENGINEERING THE SITUATION WITH A VIEW TO INFLUENCING THE NEGOTIATIONS.

**SECRET**

# SECRET

5. THROUGHOUT THE PAST YEAR THE GOVERNMENT, THROUGH THE EXCHANGE FUND, HAS SOUGHT TO SMOOTH ERRATIC AND WAYWARD SHIFTS IN THE EXCHANGE RATE. THERE HAS BEEN SUBSTANTIAL DIRECT INTERVENTION IN THE FOREIGN EXCHANGE MARKETS IN HONG KONG AND SOMETIMES IN LONDON AND NEW YORK. THE EXCHANGE FUND HAS ALSO BEEN ACTIVELY BORROWING IN THE INTERBANK MONEY MARKET IN ORDER TO DRIVE UP MONEY MARKET INTEREST RATES. DESPITE UNDESIRABLE SIDE EFFECTS (E.G. ON THE PROPERTY MARKET AND MANUFACTURING COSTS), THE HONG KONG ASSOCIATION OF BANKS HAS RAISED DEPOSIT INTEREST RATES ON A NUMBER OF OCCASIONS IN ORDER TO MAKE THE HOLDING OF HONG KONG DOLLARS MORE ATTRACTIVE AND TO PUSH UP LENDING RATES (MAKING IT MORE EXPENSIVE FOR EXPORTERS TO BORROW HONG KONG DOLLARS TO MEET THEIR LOCAL LIABILITIES

INSTEAD OF REPATRIATING THEIR FOREIGN CURRENCY EARNINGS). BUT THESE EFFORTS HAVE ONLY HAD A LIMITED EFFECT. AT BEST, THE RATE OF DEPRECIATION HAS BEEN SLOWED DOWN. THE DEMAND FOR FOREIGN CURRENCIES TO HOLD (MOSTLY U.S. DOLLARS) HAS REMAINED STRONG, AND THERE HAS BEEN AN ABSENCE OF TWO-WAY TRADING. IN OTHER WORDS, SENTIMENT IN THE MARKET HAS BEEN PERSISTENTLY AGAINST THE DOMESTIC CURRENCY: DRAMATICALLY SO OVER THE PAST WEEK.

6. IT COULD BE ARGUED THAT UP TO LAST WEEK WE HAD EXPERIENCED NOTHING WORSE THAN A SERIES OF SLIPS AND THE WIDE SPREADS QUOTED FROM TIME TO TIME HAVE BEEN INDICATIVE OF A VERY THIN, ARTIFICIAL MARKET. ALSO, ALTHOUGH WE HAVE BEEN PRESSURISED FROM TIME TO TIME TO 'ACT' TO 'SAVE THE DOLLAR' AND PROTECT THE PEOPLE'S LIVELIHOOD, ETC., THERE HAS BEEN A RELUCTANT PUBLIC ACCEPTANCE THAT MARKET FORCES ARE INEXORABLE. HOWEVER, THIS HAS BEEN COMBINED WITH SOME BEMILDERMENT AND RESTLESSNESS ABOUT OUR PASSIVE PUBLIC RELATIONS STANCE IN RELATION TO THE NEGOTIATIONS IN THE FACE OF THE COMMUNIST CAMPAIGN, BUT WAS UNTIL LAST WEEK, CONTAINABLE.

7. BUT BY YESTERDAY (SUNDAY) WE HAD TO CONCLUDE THAT THE PRESENT SITUATION WAS SO DIFFERENT IN DEGREE AS TO BE DIFFERENT IN KIND TO THAT WHICH WE HAD EXPERIENCED SO FAR. SO WE DECIDED ON THE FOLLOWING MOVES IN AN ATTEMPT TO STOP REAL PANIC SETTING IN AT THE BEGINNING OF THIS WEEK:

(i) WE ISSUED A STATEMENT EXPRESSING GREAT CONCERN ABOUT THE QUITE UNREASONABLE RATES BEING QUOTED FOR THE HONG KONG DOLLAR ARGUING THAT THEY WERE QUITE INCONSISTENT WITH THE UNDERLYING ECONOMIC AND POLITICAL SITUATION AND URGING PEOPLE TO IGNORE RUMOURS AND UNHELPFUL COMMENTARY (AN OBLIQUE REFERENCE TO COMMUNIST PROPAGANDA).

(ii) THE ACTING FINANCIAL SECRETARY SUBSEQUENTLY ISSUED A FURTHER STATEMENT HINTING AT A REVISION OF THE PRESENT ARRANGEMENTS FOR ISSUING AND REDEEMING CERTIFICATES OF INDEBTEDNESS TO THE NOTE-ISSUING BANKS, WHICH MIGHT HAVE A HELPFUL INFLUENCE ON THE EXCHANGE RATE, AND HE STRESSED THAT THE EXCHANGE FUND WOULD OPERATE IN THE FOREIGN EXCHANGE AND INTERBANK MONEY MARKETS AS AND WHEN APPROPRIATE. SECRET -2- (iii)



# SECRET

- (III) IF RUMOURS THAT SOME TRADERS ARE REFUSING TO ACCEPT HONG KONG DOLLARS FOR GOODS IN THE SHOPS PERSIST, ATTENTION WILL BE DRAWN TO THE FOREIGN NOTES (PROHIBITION OF CIRCULATION) ORDINANCE WHICH MAKES IT ILLEGAL TO ASK FOR, OR EVEN OFFER, FOREIGN NOTES FOR DOMESTIC TRANSACTIONS.
- (IV) IN AN ATTEMPT TO TURN THE MARKET ROUND AND GET TWO WAY TRADING ESTABLISHED, THE EXCHANGE FUND IS INTERVENING ON A SUBSTANTIAL SCALE AND, ALTHOUGH THE RATE AT MIDDAY HAD IMPROVED (HK DOLLAR 8.50 TO THE U.S. DOLLAR), VERY LARGE SPREADS WERE STILL BEING QUOTED, INDICATIVE OF AN ARTIFICIAL MARKET. THE SPREADS NARROWED SOMEWHAT AFTER THE LUNCH BREAK.
- (V) THE HONG KONG ASSOCIATION OF BANKS WAS PERSUADED TO RAISE DEPOSIT INTEREST RATES BY 3 PERCENTAGE POINTS AND LENDING RATES HAVE CONSEQUENTIALLY BEEN RAISED.

8. WE CANNOT, OF COURSE, GO ON COMMITTING LARGE TRANCHES OF U.S. DOLLARS TO THE MARKET INDEFINITELY. THE ONLY OTHER MEASURES WE COULD DEPLOY WOULD BE TO ABOLISH INTEREST TAX ON HONG KONG DOLLAR DEPOSITS (BUT THIS WOULD HAVE THE MOST MARGINAL EFFECT AND BE EXPENSIVE OF REVENUE): AND WE COULD TRY SOMEHOW TO PENALISE THOSE CUSTOMERS BORROWING HONG KONG DOLLARS AGAINST THE SECURITY OF FOREIGN CURRENCY ASSETS (BUT SUCH A DEVICE WOULD BE COMPLICATED TO POLICE AND COULD BE DAMAGING TO CONFIDENCE IN HONG KONG AS A FINANCIAL CENTRE).

9. IT REMAINS TO BE SEEN WHETHER WHAT WE HAVE DONE WILL HAVE ANY DURABLE EFFECT. BUT TO HAVE DONE NOTHING WOULD HAVE GRAVELY WEAKENED PUBLIC CONFIDENCE IN THE HONG KONG GOVERNMENT. I WILL REPORT FURTHER AS THE SITUATION DEVELOPS.

YOUDE

## FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
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PS/MR LUCE  
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- 3 -  
SECRET

H - K. Fulwider

OO OTTAWA (FOR PM'S PARTY)

SECRET

40c

QRS 500

SECRET

DEDIP

DESKBY 261000Z

FM UKDEL IMF/IBRD WASHINGTON 260001Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 327 OF 25 SEPTEMBER

INFO IMMEDIATE OTTAWA (FOR PRIME MINISTER'S PARTY)

MS

PERSONAL FOR MIDDLETON (TREASURY)

HONG KONG

THE CHANCELLOR OF THE EXCHEQUER TELEPHONED HADDON-CAVE TODAY FOR AN UP-TO-DATE BRIEFING ON THE HONG KONG DOLLAR.

2. HADDON-CAVE SAID HE WAS VERY PLEASED TO HAVE THE OPPORTUNITY TO TALK TO THE CHANCELLOR ON THE PRESENT STATE OF PLAY. THE CAUSE OF THE PRESSURE WAS ENTIRELY POLITICAL. THE ECONOMIC FUNDAMENTALS IN HONG KONG WERE EXCELLENT. 6 PERCENT GROWTH HAD BEEN ACHIEVED THIS YEAR. THE MARKET ON SATURDAY HAD BEEN VERY THIN. BUT IT HAD BEEN ALL ONE WAY, WITH SELLERS AND NO BUYERS.

3. HADDON-CAVE EXPLAINED THAT THE DIFFICULTY WAS LARGELY A FLIGHT INTO U S DOLLARS. RESIDENT ACCOUNT HOLDERS WERE CONVERTING INTO U S DOLLARS, BUT THERE WAS NO CAPITAL FLOW OUT OF HONG KONG. THERE WAS ALSO A LEADS AND LAGS EFFECT WITH EXPORTERS DELAYING REPATRIATION OF U S DOLLAR EARNINGS. THE FUNDAMENTAL REASON WAS NOT LACK OF CONFIDENCE IN THE HONG KONG ECONOMY NOR IN THE INTENTIONS OF THE BRITISH GOVERNMENT. IT REFLECTED CONCERN OVER THE PROSPECTS FOR AN AGREEMENT GIVEN THE PRESENT CHINESE ATTITUDE.

4. THE HONG KONG GOVERNMENT, HADDON-CAVE SAID, WERE PREPARING TO TAKE FIRM ACTION ON 26 SEPTEMBER TO DEAL WITH THE PROBLEM BY A PACKAGE OF MEASURES. THE AUTHORITIES WOULD INTERVENE STRONGLY ON THE MARKET USING THE RESERVES AS NECESSARY. THERE WOULD BE A SUBSTANTIAL INCREASE IN INTEREST RATES. MEASURES WOULD BE INTRODUCED TO IMPOSE TAXES AND PENALTIES ON COMPANIES DELAYING REPATRIATION OF EARNINGS. HADDON-CAVE CONFIRMED THAT THE IMPOSITION OF EXCHANGE CONTROL WAS NOT A FEASIBLE OPTION.

SECRET

5. HADDON-CAVE CONSIDERED THAT IN THE LONGER TERM THE CRISIS WOULD PROBABLY DIE DOWN, WITH THE PRESSURE BURNING ITSELF OUT. THERE WAS NO ALTERNATIVE BUT FOR THE HONG KONG AUTHORITIES TO SIT IT OUT. THERE WAS NO ACTION ON THE ECONOMIC FRONT WHICH THE BRITISH GOVERNMENT COULD USEFULLY TAKE AT THE PRESENT TIME. IT WAS TO BE HOPED THAT OVER TIME THE CHINESE GOVERNMENT WOULD COME TO APPRECIATE MORE CLEARLY THE ECONOMIC DAMAGE WHICH THEIR RECENT STATEMENTS HAD CAUSED.

6. THE CHANCELLOR HAS INSTRUCTED THE TREASURY TO MOBILISE STUDIES, FOR REPORT TO HIM NOT LATER THAN HIS RETURN TO LONDON, ON THE FOLLOWING:

- THE PRESENT CAPACITY OF THE HONG KONG AUTHORITIES TO CONTROL DOMESTIC MONEY SUPPLY, AND OPTIONS FOR SECURING SATISFACTORY CONTROL:

- THE IMPLICATIONS OF STERLING SUPPORT OF THE HONG KONG DOLLAR INCLUDING THE CHOICE OF INTERVENTION POINT AND ITS IMPLICATIONS, LOCALLY AND FOR STERLING:

- THE IMPLICATIONS OF THE RECENT AND PROSPECTIVE DECLINE IN THE HK DOLLAR FOR THE LOCAL ECONOMY, SENTIMENT AND SECURITY.

FCO PLEASE ADVANCE ONLY TO MIDDLETON (TREASURY), BALFOUR (BANK OF ENGLAND). NO FURTHER DISTRIBUTION.

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FM FCO 241030Z SEPT 83

TO IMMEDIATE OTTAWA

ACTION COPY

TELEGRAM NUMBER 283 OF 24 SEPTEMBER

AND TO IMMEDIATE WASHINGTON, UKMIS NEW YORK. (FOR PRIVATE SECRETARY ON ARRIVAL).

INFO IMMEDIATE CANBERRA (PERSONAL FOR HIGH COMMISSIONER), PEKING, HONG KONG.

FOLLOWING FOR PRIVATE SECRETARY TO PRIME MINISTER ON ARRIVAL

FUTURE OF HONG KONG

1. IN THE LIGHT OF THE LATEST ROUND OF TALKS ON HONG KONG'S FUTURE IN PEKING, THE PM MAY WISH TO DRAW ON THE FOLLOWING ADDITIONAL POINTS IN HER TALKS WITH MR TRUDEAU IN OTTAWA AND WITH PRESIDENT REAGAN OR VICE PRESIDENT BUSH IN WASHINGTON:

“(A) TALKS WERE HELD IN PEKING ON 22/23 SEPTEMBER. NEXT ROUND 19/20 OCTOBER.

(B) ANOTHER DIFFICULT SESSION. CHINESE LINE VERY TOUGH. CHINESE REITERATION THAT WE ACCEPT THEIR PREMISE OF CHINESE SOVEREIGNTY AND ADMINISTRATION IN 1997. WE CONTINUED TO EXPLAIN THE FACTORS WHICH WE BELIEVE ARE IN HONG KONG'S BEST INTERESTS, IE WHICH WOULD BEST PRESERVE PROSPERITY, STABILITY AND THE PEOPLES WELL-BEING.

(C) HOPE AT NEXT ROUND TO EXPLAIN FURTHER OUR POSITION AND TO DRAW OUT CHINESE ON THEIRS, WITHOUT PREJUDICE TO EITHER SIDES' PRINCIPLES.

(D) WE ARE INSISTING THAT IT IS THE TALKS THAT COUNT. CHINESE ARE CARRYING OUT ~~LARGESCALE~~ <sup>LARGE SCALE PROPAGANDA CAMPAIGN.</sup> ~~THIS IS HAVING~~ VERY HARMFUL EFFECT ON CONFIDENCE IN HONG KONG. POOR PERFORMANCE OF HONG KONG DOLLAR AND STOCK MARKETS DUE TO POLITICAL UNCERTAINTY, NOT ECONOMIC FACTORS.”

2. THE ABOVE LINE COULD ALSO BE USED BY THE SECRETARY OF STATE WITH MR SHULTZ AND WITH MR HAYDEN, THE AUSTRALIAN FOREIGN MINISTER, AT BILATERALS IN NEW YORK.

SECRET

SECRET

SECRET

DESKBY FCO 240800Z

DESKBY H.K. 240730Z

FROM PEKING 240600Z

TO IMMEDIATE FCO

TELEGRAM NUMBER 937 OF 24TH SEP

INFO IMMEDIATE HONG KONG

M

40A

MY TELNO 933 : FUTURE OF HONG KONG.

1. THE TALKS HAVE NOW REACHED A CRITICAL JUNCTURE. IT MAY BE HELPFUL IF I SET OUT MY VIEWS ON THE CHOICES OPEN TO US.

2. AS WILL BE CLEAR FROM THE RECORDS AND FROM OUR COMMENTS ON THEM, THIS ROUND WAS TOTALLY STERILE. THE CHINESE DID NOTHING BUT REPEAT IN A STEADILY DETERIORATING ATMOSPHERE THEIR BASIC THESIS THAT BRITAIN MUST ACCEPT THE RETURN OF BOTH SOVEREIGNTY AND ADMINISTRATION TO CHINA IN 1997. THEY SHOWED NO INTEREST IN DISCUSSION OF THE DETAILS OF THE HONG KONG SYSTEMS, AND THEY REJECTED OUR FOUR PAPERS AS A PUT-UP JOB DESIGNED TO SERVE WHAT THEY DESCRIBE AS OUR COLONIALIST PURPOSE OF CONTINUING TO RULE HONG KONG. THEY CHARACTERISED OUR INSISTENCE ON BRITISH ADMINISTRATION AS AN INSURMOUNTABLE OBJECT TO PROGRESS, AND MADE THINLY VEILED THREATS THAT THE TALKS WOULD BE BROKEN OFF IF WE DID NOT MOVE. THEY SHOWED NO PARTICULAR CONCERN AT THE CONSEQUENCES A BREAKDOWN WOULD HAVE FOR HONG KONG. FINALLY, THEY STATED UNEQUIVOCALLY THAT CHINA WOULD MAKE A UNILATERAL ANNOUNCEMENT ON THE FUTURE OF HONG KONG IF AGREEMENT WERE NOT REACHED BY SEPTEMBER 1984.

3. THERE IS NO RELIEF IN THIS SOMBRE PICTURE. THE CHINESE MADE IT CLEAR AT THE DINNER LAST NIGHT THAT THEY SAW NO POINT IN ELABORATING THEIR PROPOSALS UNLESS WE FIRST ACCEPTED THE PREMISE. THIS ANSWER WILL PROBABLY BE PUT FORMALLY TO US AT THE BEGINNING OF THE NEXT ROUND, IF NOT BEFORE. THEIR INTEREST IN THE EXPRESSION 'BRITISH LINK' MEANS ONLY THAT THEY ARE SEEKING TO DISCOVER WHETHER THE EXPLANATION WHICH I GAVE ON DAY ONE OF THIS ROUND BETOKENS A CHANGE IN POSITION. THEY ALREADY SUSPECT CORRECTLY THAT IT DOES NOT.

4. IN THE LIGHT OF WHAT HAS BEEN SAID IN THESE TWO DAYS, IT IS CLEAR THAT WE ARE AT THE END OF THIS ROAD. THERE ARE, IN ESSENCE,

TWO PATHS WHICH WE CAN FOLLOW, THAT OF CONFRONTATION, OR THAT OF SEEKING TO NEGOTIATE THE BEST POSSIBLE ARRANGEMENTS FOR HONG KONG AS A SPECIAL ADMINISTRATIVE REGION OF CHINA.

5. THERE IS, I UNDERSTAND, A DISPOSITION IN EXCO TO ARGUE THAT IF BRITISH ADMINISTRATION IS UNOBTAINABLE THEN CONFRONTATION IS BETTER THAN SURRENDER. THIS VIEW IS PARTLY, IF NOT WHOLLY, PREDICATED ON THE BELIEF THAT WHEN THE CHINESE SEE THE DAMAGE WHICH A CONFRONTATION CAUSES TO THE HONG KONG ECONOMY, THEY

SECRET

/WILL

WILL BACK DOWN. I REGARD THIS VIEW AS DANGEROUSLY WRONG: THE CHINESE HAVE ALL ALONG MADE IT CLEAR THAT IF THEY HAVE TO CHOOSE BETWEEN REUNIFICATION AND THE PROSPERITY OF HONG KONG THEY WILL CHOOSE REUNIFICATION. I BELIEVE THEY MEAN THIS. IF ANY PROOF WERE NEEDED, THE CHINESE GAVE IT WHEN THEY REFUSED TO GIVE US ANY ASSISTANCE FOR THE HONG KONG DOLLAR BY WAY OF A WORD IN THE COMMUNIQUE. CONFRONTATION WILL NOT, THEREFORE, ACHIEVE ITS OBJECT. NOR WILL IT REMOVE THE FACT THAT UNDER THE TREATIES—WHICH THE UK RECOGNISES — 92 PERCENT OF THE TERRITORY OF HONG KONG WILL REVERT TO CHINA IN 1997. CONVERSELY, IT IS CLEAR THAT CONFRONTATION WILL GRAVELY DAMAGE AND EVENTUALLY RUIN THE HONG KONG ECONOMY. IT COULD, IN MY VIEW, LEAD TO A CHINESE TAKE-OVER OF HONG KONG WELL BEFORE 1997. THERE IS, IN FACT, NO FUTURE AT ALL FOR HONG KONG EXCEPT IN COOPERATION WITH CHINA.

6. THE ALTERNATIVE TO CONFRONTATION IS TO SEE WHAT CAN BE NEGOTIATED ON THE CHINESE PREMISE. THIS IS OPTION 'C'. OPTION 'B' WILL NOT RUN: FROM WHAT THE CHINESE HAVE SAID IN THE TALKS, AND INDEED FROM WHAT THEY SAID AT THE DINNER ON 23 SEPTEMBER, IT IS PLAIN THAT THEY WILL NOT CONSIDER ANY SOLUTION INVOLVING A BRITISH-APPOINTED GOVERNOR, OR A GOVERNOR WITH A LINK OF AUTHORITY TO LONDON. MOREOVER, SINCE UNDER OPTION B WE WOULD BE PROPOSING CHANGES TO THINGS WHICH, UNDER OPTION C, WE WOULD WISH TO KEEP UNCHANGED, WE WOULD DAMAGE OUR PROSPECTS OF OBTAINING THE BEST TERMS POSSIBLE UNDER OPTION C: TO TRY OPTION B WOULD, THEREFORE, BE SELF-DEFEATING.

7. WE HAVE AT THIS MEETING SECURED A SINGLE FURTHER ROUND OF TALKS ON 19-20 OCTOBER. IN MY VIEW THERE IS A BETTER THAN EVEN CHANCE THAT, UNLESS I AM ARMED AT THE NEXT MEETING WITH A FALLBACK POSITION WHICH ENABLES US TO DISCUSS THE CHINESE PLAN POSITIVELY, THE BREAKDOWN WILL OCCUR DURING THAT ROUND. I BELIEVE THE CHINESE ARE NOW PREPARED IF NECESSARY TO ACCEPT SUCH A BREAKDOWN AND THE CONSEQUENCES. IT FOLLOWS THAT WE MUST CONSIDER BEFORE THAT ROUND WHETHER A BREAKDOWN IS ACCEPTABLE. IF MY VIEW THAT IT IS NOT IS ENDORSED, WE MUST THEN FIND A BASIS WHICH WILL AT LEAST ALLOW US TO EXPLORE THE POSSIBILITIES UNDER OPTION C. TO DO THIS WE SHALL HAVE TO MAKE A BOW IN THE DIRECTION OF THE CHINESE PREMISE. BUT IT IS POSSIBLE TO DEVISE A FORMULA WHICH WOULD ALLOW US TO DO THIS WHILE RESERVING THE ULTIMATE RIGHT, IF THE PACKAGE PROVES UNACCEPTABLE, TO REJECT IT.

8. I REALISE THAT THIS IS A SERIOUS STEP, AND THAT EXCO WILL FIND IT DIFFICULT TO CONTEMPLATE. THE GOVERNOR WILL, NO DOUBT, GIVE HIS VIEWS ON HOW THEY SHOULD BE CONSULTED.

9. IT MIGHT SEEM TEMPTING TO DEFER A DECISION OF THIS IMPORTANCE UNTIL THE CHINESE HAVE FORMALLY REJECTED THE PROPOSAL THAT THEY ELABORATE ON THEIR IDEAS. THIS WOULD BE EXTREMELY DANGEROUS, BECAUSE IT WOULD GIVE US NO FALLBACK WHEN, AS I EXPECT THE CHINESE REJECT OUR PROPOSAL AT THE FIRST MEETING OF THE NEXT ROUND. THERE WOULD THEN BE NO MEANS OF STAVING OFF A BREAKDOWN.

THIS WOULD IMMEDIATELY BECOME PUBLIC. WE SHOULD THEN FACE THE NEED TO DEVISE A RETREAT FORMULA IN A PUBLIC ATMOSPHERE OF CRISIS WITH ALL THE RESULTANT DAMAGE TO THE HONG KONG ECONOMY. A RETREAT IN SUCH CIRCUMSTANCES WOULD BE A PUBLIC HUMILIATION. MOREOVER, IN SUCH AN ATMOSPHERE THE PRICES IN THE MARKET WOULD CHANGE: WE SHOULD FIND IT MUCH MORE DIFFICULT TO GET THE BEST TERMS UNDER OPTION C.

10. THERE IS NO POSSIBILITY OF A GENTLEMANLY AGREEMENT TO SUSPEND TALK. IF THE TALKS BREAK DOWN THE CHINESE WILL TURN ON THE FULL PROPAGANDA MACHINE, WHICH AT PRESENT IS AT NO MORE THAN HALF THROTTLE. CHINESE LEADERS WOULD BE LIKELY TO TAKE UP PUBLIC POSITIONS FROM WHICH THEY COULD NOT LATER RETREAT, AT AN EARLY STAGE, THE CHINESE PLAN WOULD PROBABLY BE FORMALLY ANNOUNCED.

11. I DO NOT WISH TO SUGGEST THAT THE COURSE I PROPOSE IS A SAFE ONE. BUT WE FACE A CHOICE OF EVILS. BEFORE WE MAKE THE FINAL CHOICE BETWEEN THEM, WE ARE BOUND TO EXAMINE WHAT IS AVAILABLE TO US. IF WE WERE TO CHOOSE CONFRONTATION NOW, WE SHOULD DO SO WITHOUT HAVING ANY CLEAR IDEA OF WHAT WE MIGHT BE ABLE TO NEGOTIATE UNDER OPTION C. CONFRONTATION AT ANY TIME CANNOT BE IN THE INTERESTS OF THE PEOPLE OF HONG KONG: STILL LESS CAN IT BE IN THEIR INTERESTS TO ALLOW IT TO HAPPEN BEFORE WE KNOW WHAT ELSE MIGHT BE DEvised FOR THEM.

12. TO SUM UP, AS I SEE IT, WE NEED TO FIND A WAY OF EXPLORING WHAT WE CAN ACHIEVE UNDER OPTION C. WE NEED TO BRING EXCO WITH US. WE NEED TO DO THIS IN THE RELATIVELY SHORT TIME BEFORE 19 OCTOBER.

CRADOCK

FUTURE OF HONG KONG

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HD/HKD  
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HD/PLANNING STAFF  
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PS/LADY YOUNG  
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MR COLES NO 10 DOWNING STREET  
SIR A PARSONS NO 10 DOWNING STREET  
MR WALKER RESEARCH D OAB 2/82



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FM HONG KONG 241145Z SEP 83

TO IMMEDIATE BRUSSELS

TELEGRAM NUMBER 18 OF 24 SEPTEMBER

INFO IMMEDIATE GENEVA WASHINGTON NEW YORK FCO HONG KONG GOVERNMENT  
OFFICE LONDON

FOR HONG KONG GOVERNMENT REPRESENTATIVES GUIDANCE TELEGRAM 34/83

THE FUTURE

THE FOLLOWING JOINT STATEMENT WAS ISSUED AT 3 P.M. PEKING TIME ON  
23 SEPTEMBERQUOTE THE BRITISH AND CHINESE SIDES HELD FURTHER TALKS ON THE  
QUESTION OF HONG KONG ON 22 AND 23 SEPTEMBER AND THE FIFTH ROUND  
WILL BE HELD IN BEIJING ON 19 AND 20 OCTOBER UNQUOTE.

2. YOU WILL BE AWARE THAT MARKET AND PUBLIC SENTIMENT HAS REACTED  
NERVOUSLY TO RECENT UNITED FRONT PROPOGANDA BY CHINA, STATEMENTS  
BY CHINESE LEADERS AND THE ABSENCE OF ANY APPARENT SIGN OF PROGRESS  
IN THE RECENT ROUND OF TALKS. IN THE PAST WEEK THE HK DOLLARS/US  
DOLLAR EXCHANGE RATE HAS DEPRECIATED FROM 7.87 TO 9.4. IN  
YESTERDAY'S TRADING THE HANG SENG INDEX DROPPED 63 POINTS TO  
CLOSE AT 786.

LINE TO TAKE

3. YOU SHOULD SUGGEST THAT THE MARKETS HAVE OVER REACTED. THE  
IMPORTANT THING IS THAT THE TALKS ARE CONTINUING. THE COMMON AIM  
OF THE BRITISH AND CHINESE GOVERNMENTS IS TO MAINTAIN THE  
STABILITY AND PROSPERITY OF HONG KONG. THERE ARE NO RATIONAL  
GROUNDS FOR SENTIMENT TO FALL AWAY SO SHARPLY DAY BY DAY,  
GIVEN THE TIME SCALE FOR THE TALKS WHICH INEVITABLY, BECAUSE OF  
THE COMPLEX ISSUES INVOLVED, ARE BOUND TO STRETCH OVER A LENGTHY  
PERIOD.

4. YOU MAY ALSO CARE TO DRAW ON THE FOLLOWING REMARKS BY THE PRIME  
MINISTER IN RESPONSE TO JOURNALISTS IN LONDON YESTERDAY.

"WELL THE NEGOTIATIONS ARE CONFIDENTIAL BUT IT'S NOT  
DIFFICULT TO SEE WHAT THE PROBLEM IS. THE LEASE OF OVER 90 PER CENT  
OF THE TERRITORY COMES TO AN END IN 1997. OBVIOUSLY SOME LOANS ARE  
NOW BEING TAKEN OUT OR WOULD LIKE TO BE TAKEN OUT, FOR A PERIOD GOING  
BEYOND 1997, AND THERE IS THEREFORE A GREAT FINANCIAL UNCERTAINTY AND  
A GREAT POLITICAL UNCERTAINTY ABOUT THE FUTURE OF HONG KONG AND  
IT'S THAT I THINK WHICH IS CAUSING THE DROP IN THE HONG KONG  
DOLLAR AND ALSO OF COURSE THE DROP IN THE HONG KONG STOCK EXCHANGE, I  
CANNOT SAY MORE ABOUT THE NEGOTIATIONS, THEY ARE TAKING PLACE. THEY  
TAKE PLACE AGAINST A BACKGROUND WHERE BOTH CHINA AND WE WISH TO MAKE  
ARRANGEMENTS TO ENSURE AND SECURE THE STABILITY AND PROSPERITY OF  
HONG KONG. AFTER ALL UNDER THE PRESENT ARRANGEMENTS WHICH CONSISTS OF

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/MORE.

H-K Future

## CONFIDENTIAL

MORE THAN FOUR MILLION CHINESE PEOPLE LIVING IN HONG KONG UNDER THE PRESENT SYSTEM, THE BRITISH SYSTEM, YOU'VE GOT THIS CHINESE CHARACTER AND THE BRITISH SYSTEM, WHICH REALLY HAVE ACHIEVED REMARKABLE PROSPERITY AND STABILITY FOR ALL THOSE PEOPLE THERE. WE ENTERED THESE NEGOTIATIONS BELIEVING IT IS POSSIBLE TO FIND A WAY FOR THAT STABILITY AND PROSPERITY TO CONTINUE, TO THE BENEFIT MAINLY OF THE PEOPLE OF HONG KONG. BRITAIN DOESN'T TAKE A PENNY PIECE OUT OF HONG KONG, WE'RE ONLY TOO RELIEVED THAT WE DON'T HAVE TO PUT MONEY IN, AS YOU DO FREQUENTLY WITH TERRITORIES WHICH ARE NOT FULLY INDEPENDENT. BUT FOR THE PARTICULAR SITUATION OF HONG KONG AND THE LEASES, BUT FOR THAT, HAD IT BEEN AN ORDINARY BRITISH COLONY, SHE WOULD HAVE BEEN INDEPENDENT YEARS AGO. SHE WOULD HAVE BEEN ANOTHER SINGAPORE. WE SHOULDN'T HAVE HUNG ON IN ANY WAY BUT HONG KONG IS DIFFERENT IN THAT SHE IS ATTACHED TO CHINA AND THERE ARE THOSE LEASES AND THEREFORE THAT COURSE WAS NOT OPEN. BUT WE CAN'T BE ACCUSED OF COLONIALISM IN ANY WAY WHEN OTHER COUNTRIES IN A SIMILAR POSITION LIKE SINGAPORE HAVE BEEN INDEPENDENT FOR YEARS AND HAVE DONE MARVELLOUSLY WELL, BECAUSE THE CHINESE, UNDER THE SYSTEMS WHICH WERE STARTED BY BRITAIN, ARE VERY VERY TALENTED, VERY VERY ABLE AND HAVE BUILT UP VERY CONSIDERABLE PROSPERITY.''

YOUDE

### FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

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MR WALKER RESEARCH D OAB 2/82

HK90, LONDON

<sup>2</sup>  
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GRS 250  
SECRET  
DESKBY 240800Z FCO  
DESKBY 240600Z H.K.  
FROM PEKING 240530Z SEP 83  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 935 OF 24TH SEP  
INFO IMMEDIATE HONG KONG

SECRET

*per*

40

FUTURE OF HONG KONG

1. AT DINNER ON 23 SEPTEMBER I SOUGHT YAO GUANG'S REACTIONS TO OUR REQUEST FOR FURTHER AND BETTER PARTICULARS OF THE CHINESE PLAN (MY TELNO 932, PARA 3). HE SAID THAT DISCUSSION ON THIS SUBJECT COULD NOT BE FRUITFUL UNTIL WE HAD ACCEPTED THE CHINESE PREMISE. THE PREMISE AND PLAN WERE INDISSOLUBLE. KE ZAISHUO ADDED THAT THE PLAN WAS BUILT ON THE PREMISE.

2. AT THE SAME DINNER LU PING SAID THAT A GOVERNOR APPOINTED BY BRITAIN OR RESPONSIBLE TO BRITAIN WAS OUT OF THE QUESTION. THE SENTIMENT WAS ENDORSED BY ALL THE CHINESE AT THE TABLE, INCLUDING YAO GUANG.

3. OTHER TITBITS FROM AN UNUSUALLY VOLUBLE CHINESE DELEGATION AT THE DINNER WERE:

- A) THAT SOME LINKS WITH BRITAIN COULD BE RETAINED:
- B) WHEN I ASKED YAO WHAT HE MEANT BY LOOKING AFTER BRITISH INTERESTS HE SAID THAT THE CHINESE WOULD PAY RESPECT TO HISTORICAL REALITY. HE HAD EARLIER SAID THAT OF COURSE THE CHINESE RECOGNISED HONG KONG'S LINKS WITH BRITAIN AS A FACT RESULTING FROM HISTORY.

4. THE CHINESE WERE AT ONE IN ASSURING US THAT EVERYTHING ELSE WAS NEGOTIABLE IF THE PRINCIPLE THAT SOVEREIGNTY AND ADMINISTRATION SHOULD PASS TO CHINA WERE ACCEPTED.

CRADOCK

FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/PUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER  
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MR ROBERTS NEWS D  
MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE  
MR FLOWER PUSD  
MR COLES NO 10 DOWNING STREET  
SIR A PARSONS NO 10 DOWNING STREET  
MR WALKER RESEARCH D OAB 2/82

SECRET

~~ADZ~~



10 DOWNING STREET

Mr. Clift suggested  
that you would want  
to take the attached  
on the trip. X

Mal

P.S. He also wanted to  
talk to you urgently  
on an unrelated matter.  
Switch have numbers for  
him at home and work.

OUT TELEGRAM

*Future of HK*

Classification and Caveats  
CONFIDENTIAL

Precedence/Deskby  
IMMEDIATE 250100Z

1 ZCZC  
2 GRS  
3 CONFIDENTIAL  
4  
5 250100Z  
6 FM FCO 241100Z SEPT  
7 TO IMMEDIATE HONG KONG  
8 TELEGRAM NUMBER  
9 INFO IMMEDIATE PEKING DESKBY 250100Z (PERSONAL FOR AMBASSADOR/  
10 CHARGE)  
11 MY TELNOS 940 AND 941: MR LUCE'S PRESS CONFERENCE  
12 1. Following are suggested amendments to a number of points  
13 to take the present situation into account. References are to  
14 second TUR.  
15 (a) Paragraph 3 and 18 and 19. Combine in composite answer  
16 covering "Confidentiality, British silence and Chinese  
17 propaganda", as follows: "I quite understand why <sup>people would</sup> ~~the policy of~~  
18 ~~confidentiality causes concern and uncertainty.~~ <sub>like us to say more.</sub> I have given  
19 you a full description of the basis of the British position.  
20 People in Hong Kong need to know that. I still believe that it  
21 is right that the actual content of the talks should be  
22 confidential. The negotiations themselves are what matter. We  
23 must not prejudice them. We have of course seen a number of  
24 reports of remarks by Chinese public figures or media agencies.  
25 Some have been made to the press, others to Hong Kong people.

NNNN ends telegram	BLANK	Catchword I
File number	Dept HKD	Distribution FUTURE OF HONG KONG
Drafted by (Block capitals) R D CLIFT		
Telephone number 233 3184		
Authorised for despatch <i>[Signature]</i>		
Comcen reference	Time of despatch	

OUT TELEGRAM (CONT)

Classification and Caveats

CONFIDENTIAL

Page

2

1 <<<<

2 I believe that statements made outside the talks, but referring

3 directly to the negotiating position on either side, are not

4 helpful. They are too easily misunderstood and, as we have seen,

5 damage confidence severely. It is of course helpful if Hong

6 Kong people make their views known on any of these statements,

7 not only to us but to the Chinese. (If asked whether we have

8 made representations to the Chinese about propaganda). Yes,

9 we have told them why we think this is unhelpful. We have

10 explained why in our view the only place for an exchange of

11 views is the conference table."

12 (b) Paragraph 9. ~~This is being covered in a separate telegram~~ *"This is covered" The Governor described*  
*his visit to Peking on his return. The next round "on 19/20*  
*October is the earliest practical date for both sides.*

13 ~~on a statement by Mr. Luce.~~

14 (c) Paragraph 17. Reword: ~~"We are entering the discussions on~~  
~~the basis of firmness and flexibility: we are firm in our~~  
~~commitment to seek a solution which will maintain the well-being~~  
~~and way of life of Hong Kong. We have no inflexible preconceived~~  
~~view on the means of achieving this. The important point is~~  
~~that continuity should be effectively guaranteed."~~

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20 (c) Paragraph 20, reword: *how worried* "I well understand ~~that~~ Hong Kong

21 people are ~~worried~~ about the future. This arises partly from the

22 length of the negotiations. They are bound to take time. But

23 the Prime Minister has made clear that HMG is committed to

24 *a solution which will find acceptance among the people of*  
~~seeking the best possible arrangements for~~ Hong Kong, ~~since~~

25 ~~1997~~. We are determined to make a success of this. Meanwhile

26 I know it is not easy but I would ask you and investors to be

27 patient. I am impressed by the basic good shape of the Hong

28 Kong economy. The present damage to the exchange rate and the

29 stock markets stems from political uncertainty and unhelpful

30 stories circulating outside the talks. I know you understand

31 ~~very well~~ the limitations on intervention in a free economy by

32 governments to smooth out erratic shifts in the exchange rate.

33 But I know that the Hong Kong Government are doing all they

34 can."

NNNN ends  
telegram

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Catchword

(e)

OUT TELEGRAM (CONT)

Classification and Caveats  
CONFIDENTIAL

Page  
3

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1 <<<<

2 (d) Paragraph 23, for "testing" read "determin<sup>ing</sup>"

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4 HOWE

5 NNNN

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NNNN ends  
telegram

BLANK

Catchword

AJC

Future of MK

Mr. Clift phoned. A line was omitted from one of the telegrams which the FCO sent over last night,- the third telegram headed "Mr. Luce's discussion with EXCO: talking points".

Paragraph 6 should read:-

"I know you have discussed this. I am grateful for your views. I think we generally agree that there is a danger in formal public statements which describe our position too precisely ....."

Maul

24 September, 1983.



39<sup>A</sup>

SECRET

20394 - 1

OO PEKING

GRS 583

SECRET

FM FCO 231315Z SEP 83

TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 961 OF 24 SEPTEMBER

INFO IMMEDIATE PEKING

MIPT. PROPOSED STATEMENT FOR MR LUCE'S USE WITH THE MEDIA IN HONG KONG.

1. AS YOU KNOW THE TALKS WITH THE CHINESE GOVERNMENT ARE CONTINUING. THE NEXT ROUND WILL BE ON 19 AND 20 OCTOBER. IT IS OF COURSE VERY USEFUL FOR ME TO BE IN HONG KONG SO SOON AFTER THE LATEST ROUND AND TO HEAR THE VIEWS, NOT ONLY OF THE GOVERNOR AND AMBASSADOR BUT ALSO OF THE EXECUTIVE COUNCIL AND UMELCO ON THE PRESENT POSITION..

2. SINCE THE BEGINNING OF THE NEGOTIATIONS, WE HAVE SAID VERY LITTLE ABOUT OUR VIEWS ON THE FUTURE OF HONG KONG. WE THOUGHT IT BEST THAT OUR TALKS ON THIS SUBJECT WITH THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA SHOULD BE KEPT CONFIDENTIAL. WE HAVE DELIBERATELY AVOIDED NEGOTIATION IN PUBLIC AND WE STILL BELIEVE THAT IS RIGHT. ABOVE ALL WE MUST AVOID PREJUDGING THE FINAL SETTLEMENT. HOWEVER, OUR SILENCE HAS BEEN IN SOME QUESTIONS MISUNDERSTOOD AND MISINTERPRETED. I THEREFORE THINK IT MAY BE HELPFUL IF I GIVE YOU SOME BACKGROUND TO EXPLAIN OUR APPROACH TO THE QUESTION.

3. AS YOU KNOW, CONTRARY TO THE BELIEF OF SOME, THE BRITISH GOVERNMENT DRAW NO DIRECT ECONOMIC BENEFIT FROM THE PRESENT STATUS OF HONG KONG. WE RECEIVE NO TAX REVENUE FROM HONG KONG AND HAVE NO CONTROL OVER THE HONG KONG GOVERNMENT'S RESERVES. CLEARLY WE HAVE A VERY STRONG INTEREST IN THE CONTINUED PROSPERITY OF AN IMPORTANT TRADING PARTNER AND FINANCIAL CENTRE, IN WHICH COMPANIES FROM BRITAIN AND MANY OTHER COUNTRIES HAVE CONSIDERABLE INVESTMENTS. BUT OUR COMMITMENT TO HONG KONG DOES NOT STEM FROM THAT, OR FROM ANY CONSIDERATION WHICH COULD RIGHTLY BE LABELLED COLONIAL. IT IS BASED ON OUR SENSE OF RESPONSIBILITY FOR THE FUTURE OF THOSE PEOPLE WHO HAVE

CHOSEN TO MAKE HONG KONG THEIR HOME.

4. THE STORY OF HONG KONG HAS BEEN ONE OF ALMOST UNPARALLELED ECONOMIC SUCCESS. THIS IS THE RESULT OF THE ENTERPRISE AND SHEER HARD WORK OF THE PEOPLE OF HONG KONG, AS WELL AS COOPERATION WITH CHINA. BUT IT IS ALSO DUE TO THE WELL-TRIED FRAMEWORK OF STABILITY AND CONTINUITY WHICH THE PRESENT ARRANGEMENTS HAVE PROVIDED FOR SO MANY YEARS. IT IS OUR BELIEF, AND, WE ARE CONFIDENT, THE BELIEF OF THE MAJORITY OF PEOPLE OF HONG KONG, THAT THE BEST WAY TO ENSURE THE CONTINUED PROSPERITY AND STABILITY OF HONG KONG IS TO AVOID DISTURBING THE COMPLEX ARRANGEMENTS WHICH NOW PROVIDE THE FRAMEWORK OF HONG KONG'S SUCCESS. WE BELIEVE THAT THIS APPROACH REFLECTS THE INTERESTS OF THOSE PEOPLE WHO OVER THE YEARS HAVE CHOSEN TO LIVE HERE.

5. THROUGHOUT THE NEGOTIATIONS WE ARE OF COURSE CONCERNED TO GET A COMPLETE UNDERSTANDING OF THE VIEWS OF THE CHINESE GOVERNMENT, AS THE CHINESE HAVE BEEN PREPARED TO LISTEN TO OUR VIEWS. ON THE BASIS OF MUTUAL UNDERSTANDING WE BELIEVE THAT THE TALKS SHOULD FOCUS PARTICULARLY ON HOW FUTURE ARRANGEMENTS CAN GUARANTEE THE CONTINUATION OF HONG KONG'S FREE ECONOMY AND WAY OF LIFE, AND THUS SUSTAIN THE CONFIDENCE WHICH IS ABSOLUTELY ESSENTIAL TO HONG KONG'S SUCCESS.

6. AS I HAVE SAID, WHAT IS AT STAKE IS THE CONTINUATION OF A NOTABLY SUCCESSFUL SOCIETY. WE ARE THEREFORE COMMITTED TO SEEKING A SOLUTION ACCEPTABLE TO THE PEOPLE OF HONG KONG. WE ARE CONDUCTING OUR TALKS WITH THE CHINESE IN GOOD FAITH AND WITH A SENSE OF REALISM. FROM THE PRIME MINISTER DOWN WE ARE DEEPLY CONSCIOUS OF HONG KONG'S CONCERNS AND ARE DETERMINED TO MAKE A SUCCESS OF THE NEGOTIATIONS.

7. I AM CONFIDENT THAT WE CAN BUILD ON OUR GOOD RELATIONSHIP WITH CHINA AND OUR MUTUAL RESPECT TO WORK OUT TOGETHER A SOLUTION WHICH WILL ACHIEVE THIS.

HOWE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

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MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

2  
SECRET

**IMMEDIATE**

*Mr. Coles, Now  
Downing St.*

FUTURE OF HONGKONG

ADVANCE COPIES 13

PS (7)

**ADVANCE COPY**

PS/PUS

PS/MR LUCE

MR DONALD

HD/HKD

HD/FED

ADVANCE COPY

**IMMEDIATE**

RESIDENT CLERK

DESKBY 240800Z

39

**SECRET**

DESKBY 240800Z FCO  
DESKBY 240600Z H.K.  
FROM PEKING 240530Z SEP 83  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 935 OF 24TH SEP  
INFO IMMEDIATE HONG KONG

*The Prime Minister  
has seen.*

*24.  
9*

FUTURE OF HONG KONG

1. AT DINNER ON 23 SEPTEMBER I SOUGHT YAO GUANG'S REACTIONS TO OUR REQUEST FOR FURTHER AND BETTER PARTICULARS OF THE CHINESE PLAN (MY TELNO 932, PARA 8). HE SAID THAT DISCUSSION ON THIS SUBJECT COULD NOT BE FRUITFUL UNTIL WE HAD ACCEPTED THE CHINESE PREMISE. THE PREMISE AND PLAN WERE INDISSOLUBLE. KE ZAISHUO ADDED THAT THE PLAN WAS BUILT ON THE PREMISE.
2. AT THE SAME DINNER LU PING SAID THAT A GOVERNOR APPOINTED BY BRITAIN OR RESPONSIBLE TO BRITAIN WAS OUT OF THE QUESTION. THE SENTIMENT WAS ENDORSED BY ALL THE CHINESE AT THE TABLE, INCLUDING YAO GUANG.
3. OTHER TITBITS FROM AN UNUSUALLY VOLUBLE CHINESE DELEGATION AT THE DINNER WERE:
  - A) THAT SOME LINKS WITH BRITAIN COULD BE RETAINED:
  - B) WHEN I ASKED YAO WHAT HE MEANT BY LOOKING AFTER BRITISH INTERESTS HE SAID THAT THE CHINESE WOULD PAY RESPECT TO HISTORICAL REALITY. HE HAD EARLIER SAID THAT OF COURSE THE CHINESE RECOGNISED HONG KONG'S LINKS WITH BRITAIN AS A FACT RESULTING FROM HISTORY.
4. THE CHINESE WERE AT ONE IN ASSURING US THAT EVERYTHING ELSE WAS NEGOTIABLE IF THE PRINCIPLE THAT SOVEREIGNTY AND ADMINISTRATION SHOULD PASS TO CHINA WERE ACCEPTED.

CRADOCK

NNNN

FUTURE OF HONGKONG

ADVANCE COPIES 7 13

*Mr. Coles,  
No 10  
Downing St*

PS (7)  
PS/PUS  
PS/MR LUCE  
MR DONALD  
HD/HKD  
HD/FED  
RESIDENT CLERK

ADVANCE COPY

IMMEDIATE

38

DESKBY 240800Z

OO F C O DL 000Z

OO HONG KONG DESKBY 240730Z

ADVANCE COPY

GRS 1750

SECRET

IMMEDIATE

DESKBY FCO 240800Z  
DESKBY H.K. 240730Z  
FROM PEKING 240600Z  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 937 OF 24TH SEP  
INFO IMMEDIATE HONG KONG

*MS*

MY TELNO 933 : FUTURE OF HONG KONG.

1. THE TALKS HAVE NOW REACHED A CRITICAL JUNCTURE. IT MAY BE HELPFUL IF I SET OUT MY VIEWS ON THE CHOICES OPEN TO US.
2. AS WILL BE CLEAR FROM THE RECORDS AND FROM OUR COMMENTS ON THEM, THIS ROUND WAS TOTALLY STERILE. THE CHINESE DID NOTHING BUT REPEAT IN A STEADILY DETERIORATING ATMOSPHERE THEIR BASIC THESIS THAT BRITAIN MUST ACCEPT THE RETURN OF BOTH SOVEREIGNTY AND ADMINISTRATION TO CHINA IN 1997. THEY SHOWED NO INTEREST IN DISCUSSION OF THE DETAILS OF THE HONG KONG SYSTEMS, AND THEY REJECTED OUR FOUR PAPERS AS A PUT-UP JOB DESIGNED TO SERVE WHAT THEY DESCRIBE AS OUR COLONIALIST PURPOSE OF CONTINUING TO RULE HONG KONG. THEY CHARACTERISED OUR INSISTENCE ON BRITISH ADMINISTRATION AS AN INSURMOUNTABLE OBJECT TO PROGRESS, AND MADE THINLY VEILED THREATS THAT THE TALKS WOULD BE BROKEN OFF IF WE DID NOT MOVE. THEY SHOWED NO PARTICULAR CONCERN AT THE CONSEQUENCES A BREAKDOWN WOULD HAVE FOR HONG KONG. FINALLY, THEY STATED UNEQUIVOCALLY THAT CHINA WOULD MAKE A UNILATERAL ANNOUNCEMENT ON THE FUTURE OF HONG KONG IF AGREEMENT WERE NOT REACHED BY SEPTEMBER 1984.
3. THERE IS NO RELIEF IN THIS SOMBRE PICTURE. THE CHINESE MADE IT CLEAR AT THE DINNER LAST NIGHT THAT THEY SAW NO POINT IN ELABORATING THEIR PROPOSALS UNLESS WE FIRST ACCEPTED THE PREMISE. THIS ANSWER WILL PROBABLY BE PUT FORMALLY TO US AT THE BEGINNING OF THE NEXT ROUND, IF NOT BEFORE. THEIR INTEREST IN THE EXPRESSION 'BRITISH LINK' MEANS ONLY THAT THEY ARE SEEKING TO DISCOVER WHETHER THE EXPLANATION WHICH I GAVE ON DAY ONE OF THIS ROUND BETOKENS A CHANGE IN POSITION. THEY ALREADY SUSPECT CORRECTLY THAT IT DOES NOT.

4. IN THE LIGHT OF WHAT HAS BEEN SAID IN THESE TWO DAYS, IT IS CLEAR THAT WE ARE AT THE END OF THIS ROAD. THERE ARE, IN ESSENCE,

TWO PATHS WHICH WE CAN FOLLOW, THAT OF CONFRONTATION, OR THAT OF SEEKING TO NEGOTIATE THE BEST POSSIBLE ARRANGEMENTS FOR HONG KONG AS A SPECIAL ADMINISTRATIVE REGION OF CHINA.

5. THERE IS, I UNDERSTAND, A DISPOSITION IN EXCO TO ARGUE THAT IF BRITISH ADMINISTRATION IS UNOBTAINABLE THEN CONFRONTATION IS BETTER THAN SURRENDER. THIS VIEW IS PARTLY, IF NOT WHOLLY, PREDICATED ON THE BELIEF THAT WHEN THE CHINESE SEE THE DAMAGE WHICH A CONFRONTATION CAUSES TO THE HONG KONG ECONOMY, THEY WILL BACK DOWN. I REGARD THIS VIEW AS DANGEROUSLY WRONG: THE CHINESE HAVE ALL ALONG MADE IT CLEAR THAT IF THEY HAVE TO CHOOSE BETWEEN REUNIFICATION AND THE PROSPERITY OF HONG KONG THEY WILL CHOOSE REUNIFICATION. I BELIEVE THEY MEAN THIS. IF ANY PROOF WERE NEEDED, THE CHINESE GAVE IT WHEN THEY REFUSED TO GIVE US ANY ASSISTANCE FOR THE HONG KONG DOLLAR BY WAY OF A WORD IN THE COMMUNIQUE. CONFRONTATION WILL NOT, THEREFORE, ACHIEVE ITS OBJECT. NOR WILL IT REMOVE THE FACT THAT UNDER THE TREATIES WHICH THE UK RECOGNISES - 92 PERCENT OF THE TERRITORY OF HONG KONG WILL REVERT TO CHINA IN 1997. CONVERSELY, IT IS CLEAR THAT CONFRONTATION WILL GRAVELY DAMAGE AND EVENTUALLY RUIN THE HONG KONG ECONOMY. IT COULD, IN MY VIEW, LEAD TO A CHINESE TAKE-OVER OF HONG KONG WELL BEFORE 1997. THERE IS, IN FACT, NO FUTURE AT ALL FOR HONG KONG EXCEPT IN COOPERATION WITH CHINA.

6. THE ALTERNATIVE TO CONFRONTATION IS TO SEE WHAT CAN BE NEGOTIATED ON THE CHINESE PREMISE. THIS IS OPTION 'C'. OPTION 'B' WILL NOT RUN: FROM WHAT THE CHINESE HAVE SAID IN THE TALKS, AND INDEED FROM WHAT THEY SAID AT THE DINNER ON 23 SEPTEMBER, IT IS PLAIN THAT THEY WILL NOT CONSIDER ANY SOLUTION INVOLVING A BRITISH-APPOINTED GOVERNOR, OR A GOVERNOR WITH A LINK OF AUTHORITY TO LONDON. MOREOVER, SINCE UNDER OPTION B WE WOULD BE PROPOSING CHANGES TO THINGS WHICH, UNDER OPTION C, WE WOULD WISH TO KEEP UNCHANGED, WE WOULD DAMAGE OUR PROSPECTS OF OBTAINING THE BEST TERMS POSSIBLE UNDER OPTION C: TO TRY OPTION B WOULD, THEREFORE, BE SELF-DEFEATING.

7. WE HAVE AT THIS MEETING SECURED A SINGLE FURTHER ROUND OF TALKS ON 19-20 OCTOBER. IN MY VIEW THERE IS A BETTER THAN EVEN CHANCE THAT, UNLESS I AM ARMED AT THE NEXT MEETING WITH A FALLBACK POSITION WHICH ENABLES US TO DISCUSS THE CHINESE PLAN POSITIVELY, THE BREAKDOWN WILL OCCUR DURING THAT ROUND. I BELIEVE THE CHINESE ARE NOW PREPARED IF NECESSARY TO ACCEPT SUCH A BREAKDOWN AND THE CONSEQUENCES. IT FOLLOWS THAT WE MUST CONSIDER BEFORE THAT ROUND WHETHER A BREAKDOWN IS ACCEPTABLE. IF MY VIEW THAT IT IS NOT IS ENDORSED, WE MUST THEN FIND A BASIS WHICH WILL AT LEAST ALLOW US TO EXPLORE THE POSSIBILITIES UNDER OPTION C. TO DO THIS WE SHALL HAVE TO MAKE A BOW IN THE DIRECTION OF THE CHINESE PREMISE. BUT IT IS POSSIBLE TO DEVISE A FORMULA WHICH WOULD ALLOW US TO DO THIS WHILE RESERVING THE ULTIMATE RIGHT, IF THE PACKAGE PROVES UNACCEPTABLE, TO REJECT IT.

8. I REALISE THAT THIS IS A SERIOUS STEP, AND THAT EXCO WILL FIND IT DIFFICULT TO CONTEMPLATE. THE GOVERNOR WILL, NO DOUBT, GIVE HIS VIEWS ON HOW THEY SHOULD BE CONSULTED.

9. IT MIGHT SEEM TEMPTING TO DEFER A DECISION OF THIS IMPORTANCE UNTIL THE CHINESE HAVE FORMALLY REJECTED THE PROPOSAL THAT THEY ELABORATE ON THEIR IDEAS. THIS WOULD BE EXTREMELY DANGEROUS, BECAUSE IT WOULD GIVE US NO FALLBACK WHEN, AS WE EXPECT THE CHINESE REJECT OUR PROPOSAL AT THE FIRST MEETING OF THE NEXT ROUND. THERE WOULD THEN BE NO MEANS OF STAVING OFF A BREAKDOWN. THIS WOULD IMMEDIATELY BECOME PUBLIC. WE SHOULD THEN FACE THE NEED TO DEVISE A RETREAT FORMULA IN A PUBLIC ATMOSPHERE OF CRISIS WITH ALL THE RESULTANT DAMAGE TO THE HONG KONG ECONOMY. A RETREAT IN SUCH CIRCUMSTANCES WOULD BE A PUBLIC HUMILIATION. MOREOVER, IN SUCH AN ATMOSPHERE THE PRICES IN THE MARKET WOULD CHANGE: WE SHOULD FIND IT MUCH MORE DIFFICULT TO GET THE BEST TERMS UNDER OPTION C.

10. THERE IS NO POSSIBILITY OF A GENTLEMANLY AGREEMENT TO SUSPEND TALKS. IF THE TALKS BREAK DOWN THE CHINESE WILL TURN ON THE FULL PROPAGANDA MACHINE, WHICH AT PRESENT IS AT NO MORE THAN HALF THROTTLE. CHINESE LEADERS WOULD BE LIKELY TO TAKE UP PUBLIC POSITIONS FROM WHICH THEY COULD NOT LATER RETREAT, AT AN EARLY STAGE, THE CHINESE PLAN WOULD PROBABLY BE FORMALLY ANNOUNCED.

11. WE DO NOT WISH TO SUGGEST THAT THE COURSE WE PROPOSE IS A SAFE ONE. BUT WE FACE A CHOICE OF EVILS. BEFORE WE MAKE THE FINAL CHOICE BETWEEN THEM, WE ARE BOUND TO EXAMINE WHAT IS AVAILABLE TO US. IF WE WERE TO CHOOSE CONFRONTATION NOW, WE SHOULD DO SO WITHOUT HAVING ANY CLEAR IDEA OF WHAT WE MIGHT BE ABLE TO NEGOTIATE UNDER OPTION C. CONFRONTATION AT ANY TIME CANNOT BE IN THE INTERESTS OF THE PEOPLE OF HONG KONG: STILL LESS CAN IT BE IN THEIR INTERESTS TO ALLOW IT TO HAPPEN BEFORE WE KNOW WHAT ELSE MIGHT BE DEvised FOR THEM.

12. TO SUM UP, AS WE SEE IT, WE NEED TO FIND A WAY OF EXPLORING WHAT WE CAN ACHIEVE UNDER OPTION C. WE NEED TO BRING EXCO WITH US. WE NEED TO DO THIS IN THE RELATIVELY SHORT TIME BEFORE 19 OCTOBER.

CRADOCK

NNNN

GR 300

SECRET

37A

SECRET

FM HONG KONG 231050Z SEP 83  
TO IMMEDIATE PEKING  
TELEGRAM NUMBER 552 OF 23 SEPTEMBER  
INFO IMMEDIATE FCO

FOR GOVERNOR FROM DEPUTY GOVERNOR  
FUTURE OF HONG KONG  
YOUR TELNO 142

OBVIOUSLY YOUR PROPOSED SPEAKING NOTE HAS BEEN DRAFTED AGAINST THE BACKGROUND OF TODAY'S SESSION, THE CONTENT AND OUTCOME OF WHICH I AM AS YET, OF COURSE, UNAWARE. BUT I FEEL BOUND TO EMPHASISE THAT MARKET (AND FOR THAT MATTER PUBLIC) SENTIMENT HERE IS CURRENTLY RUNNING SO STRONGLY AGAINST US THAT WHAT YOU SAY WILL BE LISTENED TO WITH RAPT ATTENTION AND PORED OVER WORD BY WORD. THAT IS AN ARGUMENT, OF COURSE, FOR CHOOSING YOUR WORDS EVEN MORE CAREFULLY THAN USUAL. BUT IT IS ALSO, ON THIS OCCASION, AN ARGUMENT FOR INSINUATING SOMETHING OF COMFORT INTO WHAT YOU SAY. THE ATMOSPHERE HERE TODAY HAS BEEN AS NEAR TO PANIC AS I CARE TO THINK. (NEXT TWO WORDS UNDERLINED) INTER ALIA THERE HAS BEEN A SPATE OF RUMOURS ABOUT THE CONDITION OF 4 - 5 BANKS. THE FACT THAT A DATE HAS BEEN SET FOR THE NEXT ROUND OF TALKS IN THIS PHASE IS ONLY GOOD NEWS IN THE SENSE THAT, IF A DATE HAD NOT BEEN FIXED, IT WOULD HAVE BEEN BAD NEWS.

2. IF YOU CANNOT SAY ANY MORE ABOUT THE TALKS, IT MIGHT POSSIBLY HELP IF YOU WERE TO ADD, ALMOST CASUALLY BEFORE YOU MOVE OFF THAT:

- (A) YOU HAD BEEN DISTRESSED TO HEAR THAT THE MARKETS, PARTICULARLY THE FOREIGN EXCHANGE MARKET, HAD BEEN SO VOLATILE THESE PAST FEW DAYS AND ON SUCH A WEAKENING TREND:
- (B) THAT YOU CANNOT UNDERSTAND WHY THIS SHOULD HAVE BEEN SO:
- (C) THAT IT ALL SEEMS VERY UNREASONABLE TO YOU, GIVEN THAT A STRONG EXPORT-LED UPSWING WAS UNDER WAY:
- (D) THAT, WHEREAS YOU SYMPATHISE WITH PEOPLE'S ANXIETIES, FOR UNCERTAINTY TENDED TO BREED SUCH ANXIETIES, THERE ARE REALLY NO GROUNDS FOR THE PESSIMISTIC MOOD THAT SEEMS CURRENTLY TO PREVAIL:

SECRET

(CE)

# SECRET

(E) THAT, IN THESE CIRCUMSTANCES, EVERYONE'S INTERESTS WOULD BE BEST SERVED BY CONCENTRATING ON DAILY TASKS AND TURNING A DEAF EAR TO THE CURRENT SPATE OF PESSIMISTIC CHATTER AND RUMOUR-MONGERING:

(F) THAT IT IS FAINTLY RIDICULOUS FOR SENTIMENT TO FALL AWAY SO VIOLENTLY DAY BY DAY, GIVEN THE TIME SCALE FOR THE TALKS. WHICH INEVITABLY, BECAUSE OF THE COMPLEX ISSUES INVOLVED, ARE BOUND TO STRETCH OVER MANY MONTHS.

HADDON-CAVE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

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MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

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MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

<sup>2</sup>  
SECRET



S E C R E T

I have conveyed  
amendment to the F/C.O.  
M 24/9



Foreign and Commonwealth Office

London SW1A 2AH

37

~~PRIME MINISTER~~

Do you agree these  
instructions?

Poly Clerk  
23/9

23 September 1983

Dear John,

MT

Hong Kong

You will have seen the Ambassador's reports on the latest round of talks in Peking (copies enclosed). These went pretty much as we expected. The Chinese took a very hard line, insisting that progress must depend on our acceptance of their conditions. Sir P Cradock deployed the tactic agreed with EXCO, inviting the Chinese to provide further details of their own ideas without making any concession of principle. The Chinese agreed that this could be considered. They also agreed to further talks on 19 and 20 October but they were very cold to the idea of a joint action to help confidence in Hong Kong and the resulting agreed communique was a bald statement that talks would continue.

The Foreign Secretary has been considering our possible next steps, taking into account particularly Mr Luce's visit to Hong Kong from 24-28 September. He believes that we should take advantage of this visit to concentrate on two areas: helping morale in Hong Kong and sounding EXCO out on our next moves.

As you know, there has been considerable criticism of HMG and the Hong Kong Government for remaining silent on the substance of the issue while the Chinese have been freely engaging in propaganda. Sir Geoffrey does not think that the time has come for any major public statement of our position. That could well prejudice the progress of the talks, which must still be central to our planning. It may well be that we can do more in the future by background briefing of the press but that needs further consideration in the light of the development of our strategy. Sir Geoffrey believes nevertheless that it would be right for Mr Luce to say more than we have done in the past about the British approach to the talks, our concern for Hong Kong and our basic ideas on the criteria which must be met in any final settlement.

Mr Luce will be discussing the position with EXCO on 27 September. As well as the Governor, Sir P Cradock will be present. This will provide a useful chance to continue the work of assessment which the Governor began before the latest round of talks. Sir Geoffrey believes that it would

be right

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be right to put the position frankly to EXCO and to make clear that the talks are at a critical stage.

For practical reasons (Chinese Ministerial absences) there will be a gap of over three weeks before the next talks. We shall need to use this pause to work out our strategy and to discuss it with EXCO. One possibility might be another visit by EXCO to London. The Foreign Secretary will wish to consider, in the light of Mr Luce's discussion, whether this should take place before the next round of talks with the Chinese.

I enclose draft telegrams to Hong Kong containing general instructions, a proposed statement for Mr Luce to use, probably at his press conference at the end of his visit, and points on which he could draw when he meets EXCO. These need to be despatched on 24 September if at all possible. The Resident Clerk here can despatch them if the Prime Minister is content. If you have problems, you may wish to discuss them with Dick Clift in the first place (he will be in the office tomorrow morning).

I am copying this letter to Richard Mottram (MOD).

(J E Holmes)  
Private Secretary

*Yours ever*  
*John Holmes*

A J Coles Esq  
10 Downing Street

S E C R E T

SECRET

DESKBY 221400Z

FROM PEKING 221100Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 927 OF 22ND SEP

INFO IMMEDIATE HONG KONG, IMMEDIATE BRUNEI (PERSONAL FOR PS/MR LUCE)

FUTURE OF HONG KONG SECOND PHASE TALKS  
ROUND FOUR: FIRST DAY

1. YAO SPOKE FIRST AT TODAY'S MEETING AND DELIVERED THE OPENING STATEMENT IN YOUR TELNO 895 INCORPORATING THE AMENDMENTS IN YOUR TELNO 619.
2. YAO GUANG THEN REPLIED, EXPRESSING GREAT DISAPPOINTMENT AT MY STATEMENT. THE CHINESE SIDE HAD HOPED FOR A CHANGE OF ATTITUDE ON OUR PART. IN THE FIRST THREE ROUNDS WE HAD CLUNG OBSTINATELY TO OUR UNREASONABLE DEMAND FOR CONTINUED BRITISH ADMINISTRATION, THUS CREATING A STALEMATE IN THE TALKS. NOW WE WERE STILL SINGING THE SAME TUNE. CHINA HAD MADE UP ITS MIND TO RECOVER BOTH SOVEREIGNTY AND ADMINISTRATION OVER HONG KONG IN 1997. THE TWO WERE INDIVISIBLE. THERE WAS ABSOLUTELY NO ROOM FOR BARGAINING. IT WAS FUTILE TO TRY TO RESIST THIS.
3. YAO SAID THAT OUR INSISTENCE ON ADMINISTRATION AMOUNTED TO OUT AND OUT INSISTENCE ON COLONIAL RULE. HE REFERRED TO THE OPPIUM WAR AND ACCUSED US OF TRYING TO REPLACE THE OLD UNEQUAL TREATIES WITH A NEW ONE, AND ADOPTING AN IMPERIALIST ATTITUDE. WE MUST BE DAY-DREAMING.
4. WE HAD USED CONFIDENCE AND POPULAR OPINION AS A PRETEXT FOR CONTINUED BRITISH ADMINISTRATION. BUT THE KEY QUESTION WAS WHETHER WE WOULD COOPERATE WITH CHINA IN SOLVING THE HONG KONG PROBLEM AND REMOVING THOSE FACTORS UNFAVOURABLE TO THE STABILITY AND PROSPERITY OF HONG KONG. THE FACT THAT WE WERE NOT ACTING IN THIS WAY SHOWED A LACK OF SINCERITY. HE QUESTIONED WHETHER WE WERE SEEKING TO SUSTAIN CONFIDENCE IN HONG KONG. WE WERE SEEKING TO EXERT PRESSURE ON THE CHINESE GOVERNMENT IN ORDER TO EXTRACT COMPROMISES. BUT THE CHINESE GOVERNMENT WOULD NOT BE SCARED. THEY WERE FULLY PREPARED FOR ANY EVENTUALITIES.
5. YAO SAID THAT BRITISH INSISTENCE ON ADMINISTRATION LED THE CHINESE TO WONDER ABOUT OUR SINCERITY IN SEEKING A NEGOTIATED SETTLEMENT. THE CHINESE SIDE HAD SAID THAT ONLY ON THE BASIS OF THE RECOGNITION OF CHINA'S SOVEREIGNTY OVER HONG KONG AFTER 1997 WOULD IT BE POSSIBLE TO DISCUSS OTHER MATTERS RELATING TO HONG KONG. BY PROPOSING CONTINUED BRITISH ADMINISTRATION AS SOON AS DISCUSSION OF THE FIRST AGENDA ITEM BEGAN THE BRITISH SIDE HAD IN EFFECT WRITTEN OFF THE SECOND AND THIRD ITEMS. WE HAD REFERRED TO THE BRITISH LINK AND CONTINUITY BUT WE HAD FAILED TO EXPLAIN CLEARLY WHAT WE MEANT BY THIS. NOT ONLY HAD WE VIOLATED THE AGREED AGENDA BUT WE HAD ALSO PLACED SERIOUS OBSTACLES IN THE WAY OF THE TALKS. IN THESE CIRCUMSTANCES HOW COULD TALKS PROCEED AND WHAT WAS THE POINT OF HAVING TALKS?

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/YAO SAID

6. YAO SAID THAT DENG XIAOPING HAD TOLD MR HEATH AT THEIR RECENT MEETING THAT HE HOPED THE BRITISH GOVERNMENT WOULD NO LONGER HAGGLE OVER ADMINISTRATION AND THAT THEY WOULD ADOPT A WISE APPROACH AND NOT ENTER A BLIND ALLEY. HE HAD ASKED THE BRITISH CHARGE TO REPORT THESE REMARKS AND HOPED THE BRITISH SIDE WOULD CONSIDER THEM IN EARNEST.

7. YAO SAID THAT THE CHINESE SIDE HAD EXPRESSED A FRIENDLY DESIRE FOR BRITISH COOPERATION ON THE BASIS OF CHINESE SOVEREIGNTY. THEY HAD TOLD US ABOUT THE POLICIES THEY INTENDED TO ADOPT TOWARDS HONG KONG, THEIR INTENTION TO PROTECT BRITISH INTERESTS AND THEIR WILLINGNESS TO HEAR OUR CONSTRUCTIVE SUGGESTIONS. REGRETTABLY WE HAD SHOWN NO INTEREST IN THE CHINESE PROPOSALS AND WE HAD FAILED TO MAKE CONSTRUCTIVE SUGGESTIONS. WE HAD SIMPLY ALLEGED THAT THE CHINESE PLAN WOULD NOT MAINTAIN CONFIDENCE. COULD THIS BE CALLED SINCERITY?

8. YAO SAID THAT CHINA AND BRITAIN HAD AGREED IN 1972 TO ESTABLISH FULL DIPLOMATIC RELATIONS ON THE BASIS OF MUTUAL RESPECT FOR EACH OTHER'S SOVEREIGNTY AND TERRITORIAL INTEGRITY, NON-AGGRESSION, NON-INTERFERENCE, EQUALITY AND MUTUAL BENEFIT. THE BRITISH POSITION DID NOT ACCORD WITH THESE PRINCIPLES.

9. YAO SAID HE WANTED TO REPEAT ONCE AGAIN THAT CHINA WOULD DEFINITELY RECOVER HONG KONG IN 1997 AND THAT THIS WAS NOT SUBJECT TO INFLUENCE OR INTERFERENCE FROM ANY QUARTER. AS DENG XIAOPING HAD TOLD MRS THATCHER, CHINA WOULD DEFINITELY ANNOUNCE THE POLICIES IT WOULD ADOPT TOWARDS HONG KONG WITHIN ONE OR TWO YEARS IN SEPTEMBER 1984. IF, HOWEVER, THERE WERE MAJOR DISTURBANCES IN HONG KONG THE CHINESE WOULD HAVE NO CHOICE BUT TO RECONSIDER HOW AND WHEN TO RECOVER HONG KONG. CHINA SINCERELY HOPED THAT IT WOULD NOT HAVE TO ISSUE A UNILATERAL STATEMENT. A JOINT STATEMENT WOULD BE IN THE INTERESTS OF BRITAIN AND BENEFICIAL TO BOTH SIDES.

10. YAO SAID THAT BRITAIN HAD RELINQUISHED MANY COLONIES SINCE WORLD WAR II. IF TODAY WE COULD ADOPT A FAR-SIGHTED POLICY, THE FRIENDLY RELATIONS BETWEEN CHINA AND BRITAIN COULD BE MAINTAINED AND DEVELOPED FOR A LONG TIME TO COME. CHINA HAD HAD EVERY RIGHT TO TAKE BACK HONG KONG AT ANY TIME SINCE THE FOUNDING OF THE NEW CHINA BUT, IN DEFERENCE TO THE FRIENDLY RELATIONS BETWEEN CHINA AND BRITAIN, CHINA WAS READY TO WAIT UNTIL 1997 AND TO HAVE A NEGOTIATED SETTLEMENT. WAS THIS NOT THE UTMOST FOREBEARANCE AND PATIENCE ON CHINA'S PART? BUT THERE WAS A LIMIT TO CHINA'S PATIENCE. HE ADVISED THE BRITISH GOVERNMENT NOT TO MISINTERPRET THIS PATIENCE: TO GIVE UP ITS UNREASONABLE DEMAND FOR ADMINISTRATION AND TO GET DOWN TO EARNEST NEGOTIATION OF ARRANGEMENTS AFTER 1997 AND IN THE TRANSITIONAL PERIOD.

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11. AFTER A BREAK HE REPLIED WITH SOME COMMENTS ON YAO GUANG'S STATEMENT. HE SAID THAT HE WAS DISAPPOINTED IN IT. WE HAD HOPED THAT THE FOUR PAPERS HANDED OVER AT THE LAST MEETING WOULD HAVE ENABLED US TO GET DOWN TO AN OBJECTIVE FACTUAL STUDY WHICH WE BELIEVED WAS THE PRE-REQUISITE OF SUCCESS IN OUR DISCUSSIONS. WE HAD EXPECTED AT THE LEAST SOME REFERENCE TO THEM OR QUESTIONS DERIVED FROM THEM. HOWEVER, LISTENING TO YAO'S STATEMENT, IT WAS AS IF THE PAPERS HAD NEVER BEEN WRITTEN. HE HAD SIMPLY REITERATED PRINCIPLES AND DEMANDS WHICH APPARENTLY HAD TO BE MET BEFORE WORTHWHILE NEGOTIATIONS COULD BEGIN. THIS WAS PUTTING THE CART BEFORE THE HORSE.

12. HE SAID THAT THERE WERE DEEP DIFFERENCES BETWEEN US BUT WE SHOULD NOT BE OVERWHELMED BY THIS FACT. IT WAS TO RESOLVE THOSE DIFFERENCES THAT WE WERE MEETING. HE EXPRESSED REGRET THAT YAO HAD CHARGED US WITH A LACK OF SINCERITY. WE WERE SINCERE. AN EXAMPLE OF THIS WAS THE MATERIAL WHICH WE HAD PREPARED SO CAREFULLY AND HANDED TO THE CHINESE SIDE AND WHICH HAD RECEIVED SUCH SCANT ATTENTION.

13. HE TOLD YAO THAT WE PROFOUNDLY WISHED FOR A NEGOTIATED SETTLEMENT. THERE WAS NO FUTURE FOR HONG KONG EXCEPT ON THE BASIS OF AN AGREEMENT BETWEEN BRITAIN AND CHINA. WE WISHED FOR A BILATERAL AGREEMENT. IT WAS NOT HELPFUL TO USE THE THREAT OF A UNILATERAL DECLARATION AS AN ULTIMATUM. HE REBUTTED YAO'S ACCUSATION THAT WE WERE VIOLATING THE AGENDA. WE WERE TRYING TO TACKLE THE FIRST ITEM AS AGREED, AND WE WOULD BE READY TO MOVE ON FROM THAT TO THE SECOND AND THIRD ITEMS.

14. HE SAID HE WAS SOORY IF IT SEEMED TO YAO THAT WE WERE SINGING THE SAME OLD TUNE BUT IT REPRESENTED OUR HONEST VIEW, WHICH WAS BASED ON AN OBJECTIVE EXAMINATION OF THE FACTS.

15. IN ANSWER TO THE CHARGE OF COLONIALISM HE TOLD YAO THAT IT WOULD HAVE BEEN ENTIRELY IN ACCORDANCE WITH BRITISH POLICY SINCE THE SECOND WORLD WAR IF HONG KONG HAD BECOME INDEPENDENT. FOR REASONS THAT HE AND HE DID NOT NEED TO DISCUSS HERE, INDEPENDENCE WAS NOT AN OPTION FOR HONG KONG; BUT THIS WAS NOT BECAUSE OF ANY BRITISH COLONIAL AMBITION, NOR WAS IT FOR SUCH A REASON THAT WE WERE ARGUING FOR THE RETENTION OF THE ADMINISTRATIVE LINK WITH BRITAIN. IT WAS BECAUSE WE SAW NO OTHER WAY OF ACHIEVING OUR COMMON AIM OF MAINTAINING PROSPERITY AND STABILITY.

16. HE ASSURED YAO THAT DENG'S WORDS TO MR HEATH HAD BEEN CAREFULLY REPORTED AND WERE BEING CAREFULLY STUDIED, AS WOULD YAO'S OWN WORDS.

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17 TAKING UP YAO'S QUESTION ABOUT OUR WILLINGNESS TO COOPERATE IN REMOVING THE FACTORS UNFAVOURABLE TO STABILITY AND PROSPERITY, AND SEEKING TO MAINTAIN CONFIDENCE, HE SAID THAT WE WISHED MOST EARNESTLY TO COOPERATE TOWARDS THIS END. THERE WERE MANY THINGS THAT WE MIGHT DO IN THE FUTURE BUT THERE WERE ALSO THINGS WHICH ALSO COULD BE DONE HERE AND NOW. HE THEN PROPOSED THAT AFTER TOMORROW'S MEETING WE SHOULD ISSUE A JOINT STATEMENT ON THE FOLLOWING LINES WHICH WOULD GREATLY ASSIST CONFIDENCE:

" THE TWO SIDES RESUMED THEIR TALKS ON 22 AND 23 SEPTEMBER IN A FRIENDLY ATMOSPHERE AND HAD USEFUL AND CONSTRUCTIVE EXCHANGES. THEY REAFFIRM THEIR COMMON AIM WHICH IS TO MAINTAIN HONG KONG'S STABILITY AND PROSPERITY AND THEIR DETERMINATION TO PURSUE THEIR DISCUSSIONS TO THIS END. THEY TAKE THE OPPORTUNITY TO CONFIRM THEIR CONFIDENCE IN HONG KONG NOW AND IN THE FUTURE. THEY WILL MEET AGAIN FOR FURTHER TALKS ON.....".

18. YAO THEN MADE SOME COMMENTS. HE CLAIMED THAT THE CHINESE SIDE HAD STUDIED THE FOUR PAPERS VERY CAREFULLY AND HAD CONCLUDED THAT THE REAL POINT OF THEM WAS TO ARGUE THE CASE FOR CONTINUED BRITISH ADMINISTRATION. THEY PROCEEDED FROM THE PRINCIPLE OF CONTINUED BRITISH ADMINISTRATION, AND FACTS HAD BEEN MANUFACTURED IN SUPPORT OF THIS PRINCIPLE. HE CLAIMED THAT HIS OPENING STATEMENT CONSTITUTED AN ANSWER TO THIS ARGUMENT.

19. YAO AGAIN TOOK UP OUR REFERENCE TO THE BRITISH LINK. WHAT WAS THIS LINK AND WHAT WAS THE SUBSTANCE OF THE CONTINUATION WE HAD IN MIND? THIS HAD NOT BEEN EXPLAINED TO THE CHINESE SIDE, YET WE WANTED THEM TO BELIEVE THAT WE WERE NOT INSISTING ON CONTINUED BRITISH COLONIAL RULE.

20. YAO GUANG REFERRED AGAIN TO THE CHINESE PREMISE AND SAID THAT, ONCE THIS HAD BEEN AGREED, IT WOULD BE EASY TO SETTLE OTHER RELEVANT ISSUES. HE SAID THAT IT WAS WE, NOT THE CHINESE, WHO WERE PUTTING THE CART BEFORE THE HORSE.

21. YAO DENIED THAT THE SEPTEMBER 1984 DEADLINE WAS AN ULTIMATUM. IT WAS INSTEAD / SOLEMN STAND OF THE CHINESE GOVERNMENT. HE SAID IT WAS OUT OF CONSIDERATION FOR THE BRITISH SIDE THAT CHINA HAD DECIDED TO WAIT UNTIL 1984 TO PUBLICISE ITS POLICIES FOR HONG KONG. HE REMARKED THAT THIS LINE OR ARGUMENT TOOK MY BREATH AWAY.

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22. YAO NOTED WHAT HE HAD SAID ABOUT OUR WISH FOR COOPERATION AND FOR A JOINT STATEMENT (HE HAD IN FACT SAID BILATERAL AGREEMENT) AND SAID THAT WE SHOULD THEREFORE MAKE UP OUR MIND TO HAND OVER SOVEREIGNTY AND ADMINISTRATION TO CHINA, AND THEN MAKE GOOD USE OF THE LIMITED TIME REMAINING. HE SAID THAT THE CHINESE SIDE WOULD BE VERY INTERESTED TO KNOW THE DIFFERENCE BETWEEN CONTINUED BRITISH ADMINISTRATION AND COLONIAL RULE. THE CHINESE SIDE HAD EXPLAINED ITS POLICIES FOR HONG KONG AFTER 1997 IN EXPLICIT TERMS ABOUT WHAT WAS THE CONTENT OF THE BRITISH LINK? FINALLY HE REPEATED THAT IF WE DID NOT ACCEPT THE PREMISE OF CHINESE SOVEREIGNTY AND ADMINISTRATION IT WOULD BE VERY DIFFICULT FOR THE TALKS TO PROCEED.

23. SEE MIFT FOR COMMENT.

CRADOCK

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

MR BURROWS LEGAL ADVISER

MR ROBERTS NEWS D

MR MARTIN ASSESSMENT'S STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D CAB 2/82

- 5 -  
SECRET

SECRET

SECRET

DESKBY 221400Z

FROM PEKING 221125Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 928 OF 22/9/83

REPEATED FOR INFO TO IMMEDIATE HONG KONG  
AND IMMEDIATE BRUNEI (PERSONAL FOR PS/MR LUCE)

MIPT: FUTURE OF HONG KONG: SECOND PHASE,

ROUND FOUR: FIRST DAY

COMMENT

1. THE ATMOSPHERE WAS DISTINCTLY CHILLIER THAN IN THE EARLIER ROUNDS. YAO GUANG'S OPENING STATEMENT WAS A FEW DEGREES STRONGER THAN ITS PREDECESSORS AND HIS DELIVERY WAS STERNER THAN BEFORE. HE USED MORE EMOTIONAL LANGUAGE, ACCUSING US FOR EXAMPLE OF ADOPTING AN "IMPERIALIST MANNER" TOWARDS CHINA.
2. THE SUBSTANCE OF HIS STATEMENT WAS TOUGH, AS WE HAD EXPECTED IT WOULD BE. YAO REPEATED DENG'S DEADLINE AND, FOR THE FIRST TIME IN THIS FORUM, SPECIFIED SEPTEMBER 1984. HE ALSO REPEATED THE THREAT THAT CHINA WOULD RECONSIDER THE TIMING OF ITS RECOVERY OF HONG KONG IF THERE WERE MAJOR DISTURBANCES. HE SAID THAT THERE HAD BEEN STALEMATE IN THE FIRST THREE MEETINGS AND THAT, UNLESS WE ACCEPTED THE PREMISE THAT SOVEREIGNTY AND ADMINISTRATION WOULD PASS TO CHINA IN 1997, IT WAS DIFFICULT TO SEE HOW OUR TALKS COULD PROCEED.
3. YAO, HOWEVER, STOPPED SHORT OF A DIRECT THREAT TO SUSPEND THE TALKS. INDEED SOME OF HIS REMARKS IMPLIED THAT TALKS SHOULD CONTINUE, EG HIS SUGGESTION THAT WE SHOULD GO AWAY AND STUDY DENG'S WORDS TO MR HEATH; AND THE INTEREST HE EXPRESSED, THREE TIMES, IN HEARING MORE ABOUT WHAT WE MEANT BY THE "BRITISH LINK".
4. THIS LAST POINT IS NOTEWORTHY. TO SOME EXTENT YAO MAY HAVE BEEN FISHING TO SEE IF THE USE OF THIS EXPRESSION REPRESENTED A SHIFT

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SECRET

AWAY FROM 'BRITISH ADMINISTRATION'. IN FACT, OF COURSE, IT WAS MADE CLEAR IN MY OPENING STATEMENT THAT THE ONLY CHANGE WAS ONE OF TERMINOLOGY. HOWEVER, IT IS MORE LIKELY THAT YAO'S MAIN MOTIVE IN THIS WAS TO DRAW US INTO SAYING THAT BY THE BRITISH LINK WE MEAN THE STATUS QUO, WHICH THE CHINESE HAVE ALREADY SAID IS UNACCEPTABLE, AND THEREBY GIVE THEM A CHANCE TO SHOW THAT WE ARE SIMPLY SEEKING TO MAINTAIN COLONIAL RULE.

5. IN CONCLUSION, OUR EARLIER ASSESSMENT OF THE BLEAK SITUATION WE ARE IN WAS CONFIRMED AT THIS MEETING. THERE HAS BEEN NO MOVEMENT IN THE CHINESE POSITION. OUR FOUR PAPERS HAVE BEEN BALDLY DISMISSED AS A PUT-UP JOB. THE DEMAND THAT WE ACCEPT THE CHINESE PREMISE HAS BEEN REPEATED MORE FIRMLY. AT THIS POINT, IT LOOKS AS THOUGH WE MAY GET A FIFTH ROUND, BUT IT IS PLAIN THAT OUR PRESENT COURSE HAS REACHED A DEAD END. I THEREFORE INTEND, WITH THE GOVERNOR'S AGREEMENT, TO DEPLOY TOMORROW THE TACTIC AUTHORISED IN YOUR TEL NO 624.

CRADOCK

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

MR BURROWS LEGAL ADVISER

MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D

OLD ADMIRALTY BUILDING

2

SECRET

**SECRET**

SECRET

FROM PEKING 230900Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 932 OF 23/9/83

REPEATED FOR INFO TO IMMEDIATE HONG KONG AND IMMEDIATE SINGAPORE (PERSONAL FOR PS/MR LUCE)

FUTURE OF HONG KONG: SECOND PHASE: FOURTH ROUND:

## SECOND DAY

1. I SPOKE BRIEFLY AT THE START OF TODAY'S MEETING, EXPRESSING MY HOPE THAT THE CHINESE SIDE COULD AGREE TO THE JOINT STATEMENT I HAD PROPOSED YESTERDAY. I ALSO TOLD YAO GUANG THAT I WOULD BE INTERESTED TO HEAR HIS PROMISED THOUGHTS ON THE STATE OF THE HONG KONG DOLLAR.
  
2. YAO SAID THAT HE HAD STUDIED MY STATEMENT AND COMMENTS AT YESTERDAY'S MEETING VERY CAREFULLY. HE HAD CONCLUDED THAT, DESPITE THE CLEVER PRESENTATION OF OUR VIEWS AND THE USE OF DIFFERENT EXPRESSIONS, OUR AIM WAS UNCHANGED I.E. THE CONTINUATION OF BRITISH ADMINISTRATION AFTER 1997. THIS WAS FRANKLY A BLIND ALLEY FOR BRITAIN AND AN INSURMOUNTABLE OBSTACLE IN OUR TALKS. HE MUST PLACE THIS ISSUE SQUARELY ON THE TABLE. IF BRITAIN CONTINUED TO CLING TO THIS UNREASONABLE AND COLONIALIST DEMAND WHAT POINT WAS THERE IN TALKING FURTHER? WHAT RESULT COULD ONE EXPECT? THE ONLY WAY OUT FOR BRITAIN ON THE QUESTION OF HONG KONG WAS TO MOVE WITH THE TIDE OF HISTORY, CAST OFF ITS COLONIALIST REPUTATION AND HAND HONG KONG BACK TO CHINA. I HAD SAID THAT BRITAIN DID NOT WANT TO SEE A UNILATERAL DECLARATION BY CHINA, SO YAO HOPED THAT BRITAIN WOULD CEASE HAGGLING AND GIVE UP THE IDEA OF AN EXCHANGE OF SOVEREIGNTY FOR ADMINISTRATION. THE CHINESE GOVERNMENT ATTACHED IMPORTANCE TO THE STABILITY AND PROSPERITY OF HONG KONG AND PLANNED TO SET UP A SPECIAL ADMINISTRATIVE REGION, IN ACCORDANCE WITH ARTICLE 31 OF THE CONSTITUTION. THEY WOULD ADOPT VERY SPECIAL POLICIES FOR HONG KONG AND WOULD GIVE FULL CONSIDERATION TO BRITISH INTERESTS THERE. I HAD REMARKED YESTERDAY THAT THE CHINESE HAD FORMULATED THEIR POLICIES IN A CONSTRUCTIVE SPIRIT. SO WHY COULD BRITAIN NOT AGREE TO HAVE DISCUSSIONS WITH CHINA ON THIS BASIS?
  
3. YAO REPEATED THE OBJECTION HE MADE YESTERDAY TO MY REMARKS THAT IN OTHER CIRCUMSTANCES BRITAIN WOULD BE READY TO GRANT INDEPENDENCE TO HONG KONG. HONG KONG WAS QUITE DIFFERENT FROM OTHER TERRITORIES TAKEN BY BRITAIN. IT WAS NOT A QUESTION OF NATIONAL LIBERATION, BUT OF THE RECOVERY OF CHINESE TERRITORY. THE FUTURE OF HONG KONG COULD ONLY BE AS PART OF THE MOTHERLAND.

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4. TURNING TO THE QUESTION OF CONFIDENCE, YAO ADMITTED THAT THERE WAS A WEAKENING OF CONFIDENCE IN HONG KONG BUT CLAIMED THAT IT WAS CREATED BY BRITAIN'S REFUSAL TO COOPERATE WITH CHINA. BRITAIN WAS USING CONFIDENCE AS A CARD. HONG KONG NEWSPAPERS HAD REFERRED TO BRITAIN HAVING A PROSPERITY CARD, A POPULAR OPINION CARD AND A CONFIDENCE CARD. IN FACT THESE WERE ALL ONE CARD - THE PRESSURE CARD - WHICH WE WERE SEEKING TO USE AS A MAGIC WEAPON TO EXERT PRESSURE ON CHINA. THIS CARD, FRANKLY, WAS USELESS. CHINA WOULD NOT BE INTIMIDATED. IT WAS FUTILE FOR BRITAIN TO PLAY CARDS IN HANDLING A SERIOUS POLITICAL QUESTION. THIS WAS LIFTING A ROCK ONLY TO DROP IT ON OUR OWN FEET. THE FALL OF THE HONG KONG DOLLAR WAS A CASE IN POINT. CHINA HAD FULL CONFIDENCE IN THE FUTURE OF HONG KONG SINCE THEY HAD FORMULATED CORRECT POLICIES TOWARDS HONG KONG. THE CHINESE PEOPLE WERE A MATURE NATION AND MEANT WHAT THEY SAID. HE ADVISED BRITAIN TO FACE REALITY AND STOP PLAYING CARDS.

5. YAO SAID THAT THE DRAFT JOINT PRESS STATEMENT I HAD PROPOSED YESTERDAY WAS UNACCEPTABLE. IT WOULD ONLY SERVE TO DECEIVE THE PUBLIC, SINCE THERE HAD BEEN NO CHANGE IN BRITAIN'S RIGID ATTITUDE. IN THE CHINESE VIEW, DISCUSSION OF MAINTAINING STABILITY AND PROSPERITY SHOULD NOT BE APPROACHED IN AN ISOLATED OR ACADEMIC WAY, AND COULD ONLY BE MEANINGFUL ON THE PREMISE OF CHINESE RECOVERY OF SOVEREIGNTY AND ADMINISTRATION. OUR DISCUSSIONS COULD NOT LAST INDEFINITELY. CHINA WOULD ANNOUNCE ITS POLICIES NOT LATER THAN SEPTEMBER 1984. HOW COULD WE SAY IN THE JOINT STATEMENT THAT WE HAD CONFIDENCE IN THE FUTURE, WHEN BRITAIN STILL DID NOT ACCEPT CHINA'S PROPOSALS FOR THE FUTURE? FOR THESE REASONS AND OTHERS THE JOINT STATEMENT WAS UNACCEPTABLE.

6. I SAID THAT I FOUND YAO'S STATEMENTS AT THIS ROUND VERY DISAPPOINTING AND WORRYING. I TOOK SERIOUS EXCEPTION TO HIS CHARGE THAT WE HAD MANUFACTURED FACTS TO SUPPORT CONCLUSIONS WE HAD ALREADY REACHED. IT WAS ONLY ON THE BASIS OF FACTS THAT WE HAD REACHED OUR SINCERE CONCLUSION THAT THE BRITISH LINK WAS THE ONLY WAY TO MAINTAIN STABILITY AND PROSPERITY. BECAUSE THE CHINESE TOOK A DIFFERENT VIEW, WE HAD PROPOSED THAT WE EXAMINE JOINTLY THE BASIS OF THIS CONCLUSION. BUT THE CHINESE SIDE HAD MADE NO ATTEMPT TO RESPOND ON A FACTUAL BASIS.

7. I DEPLORED THE CHARGE THAT WE WERE PLAYING CARDS - I DID NOT ACCUSE THE CHINESE OF PLAYING CARDS OR PIN-PONG OR ANY OTHER GAME. PEOPLE IN HONG KONG WERE FREE TO EXPRESS THEIR OPINIONS AND WE TOOK THEIR VIEWS SERIOUSLY. BOTH SIDES SHOULD. I FIRMLY REBUTTED ONE ACCUSATION THAT WE HAD SOMEHOW MANIPULATED CONFIDENCE. WE HAD SOUGHT TO MAINTAIN IT. IT WAS NOT THE BRITISH SIDE WHICH HAD INUNDED HONG KONG OPINION WITH PUBLICITY ABOUT ITS POSITION AND CREATED THE POLEMIC ATMOSPHERE WHICH WAS DAMAGING CONFIDENCE. IT WAS THE PURPOSE OF OUR PROPOSED JOINT PRESS STATEMENT TO BOLSTER CONFIDENCE. THE CHINESE SPOKE ABOUT COOPERATION BUT REFUSED TO JOIN US IN THE FIRST PRACTICAL PROPOSAL FOR COOPERATION.

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SECRET

3. I THEN DEPLOYED THE PROPOSAL THAT AT THE NEXT MEETING THE CHINESE SHOULD EXPOUND THEIR IDEAS MORE FULLY. I USED THE TEXT IN YOUR TEL NO 620, WITH MINOR ADDITIONS. IN ANSWER TO YAO'S QUESTIONS ABOUT THE MEANING OF BRITISH LINK, I REFERRED HIM TO THE GOVERNOR'S STATEMENT OF 25 JULY AND THE FOUR PAPERS.

9. YAO THEN MADE SOME BRIEF COMMENTS. HE SAID THAT THE CHINESE SIDE COULD CONSIDER OUR PROPOSAL. HE REPEATED THAT WE HAD FAILED TO EXPLAIN CLEARLY WHAT WE MEANT BY BRITISH LINK. HE CLAIMED THAT HE HAD NOT ACCUSED US OF MANUFACTURING FACTS, (AT WHICH POINT I QUOTED HIS WORDS BACK AT HIM) BUT SAID THAT WE PROCEEDED FROM OUR PRECONCEIVED PRINCIPLE THAT BRITISH COLONIAL ADMINISTRATION SHOULD BE MAINTAINED. I REJECTED THIS CHARGE.

10. YAO SAID THAT AT THE BEGINNING OF THE SECOND PHASE CHINA HAD WELCOMED MATERIAL FROM THE BRITISH SIDE WHICH WAS BENEFICIAL TO THE MAINTENANCE OF STABILITY AND PROSPERITY AFTER CHINA RECOVERED HONG KONG AFTER 1997. OBVIOUSLY IT WAS NOT RIGHT THAT WE SHOULD ASK CHINA TO DISCUSS SUCH MATERIAL AS LONG AS WE REJECTED THE IDEA OF CHINA'S RECOVERY OF HONG KONG. IT WAS A FACT THAT HONG KONG WAS CHINA'S TERRITORY FORCIBLY OCCUPIED BY BRITAIN. OUR INSISTENCE ON CONTINUING BRITISH RULE WAS A PRE-CONCEPTION. ON CONFIDENCE, WHETHER WE WERE PLAYING CARDS OR NOT, OR EXERTING PRESSURE OR NOT, WAS SOMETHING ON WHICH THE PUBLIC THEMSELVES WOULD MAKE UP THEIR OWN MIND. IF WE REALLY WANTED TO HAVE SERIOUS NEGOTIATIONS IN THE DAYS TO COME, WE SHOULD CEASE MANOEUVRES OF THIS KIND. WE HAD SAID THAT CONFIDENCE WAS THE CRUCIAL QUESTION BUT IN FACT THE CRUCIAL QUESTION WAS WHETHER WE WERE READY TO COOPERATE WITH THE CHINESE IN SETTLING THE QUESTION OF HONG KONG. WHETHER OR NOT IT WOULD BE POSSIBLE TO MAINTAIN STABILITY AND PROSPERITY IN HONG KONG AND FOR THE TALKS TO PROCEED SMOOTHLY DEPENDED ON THE BRITISH ATTITUDE.

11. DISCUSSION THEN TURNED TO THE DATE OF THE NEXT MEETING. WE HAD EARLIER PROPOSED 14 AND 15 OCTOBER. YAO SAID THAT THIS WAS DIFFICULT FOR THE CHINESE SIDE IN VIEW OF THE INTERVENING NATIONAL DAY HOLIDAY AND THE FOREIGN MINISTER'S TRIP TO AMERICA. WE EVENTUALLY AGREED ON 19 AND 20 OCTOBER. WE THEN AGREED THE PRESS STATEMENT WHICH I HAVE REPORTED SEPARATELY IN MY TEL N O-931. I PRESSED YAO VERY HARD TO AGREE TO INCLUDE AT LEAST THE WORD "USEFUL", STRESSING THAT WE HAD A COMMON RESPONSIBILITY TO PREVENT A WORSENING OF THE CONFIDENCE SITUATION. HE REFUSED. I ASKED HIM DIRECTLY WHETHER HE WISHED TO PREVENT THE VALUE OF THE HONG KONG DOLLAR FALLING FURTHER.

12. YAO ARGUED THAT, SINCE NO PROGRESS HAD BEEN MADE AT THIS ROUND, HE SAW NO NEED FOR A SUBSTANTIALLY DIFFERENT PRESS STATEMENT FROM THAT ISSUED AFTER THE LAST ROUND. HE SAID THAT, FRANKLY, BECAUSE OF THE BRITISH ATTITUDE, THE CHINESE SIDE HAD EVEN CONSIDERED WHETHER OR NOT TO ISSUE A PRESS STATEMENT AT ALL.

SECRET

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SECRET

13. I EXPRESSED DEEP REGRET AT OUR FAILURE TO AGREE TO TAKE THIS VERY MODEST STEP IN SUPPORT OF THE DOLLAR AND TOLD YAO THAT THE RESPONSIBILITY LAY WITH THE CHINESE. HE CLAIMED TO BE SHOCKED BY THIS REMARK. HE SAID OF COURSE THE CHINESE DID NOT WANT THE HK DOLLAR TO FALL BUT THAT EMPTY WORDS WOULD NOT SOLVE THE PROBLEM AND HE HOPED THAT THE BRITISH WOULD TAKE PRACTICAL STEPS TO SUPPORT THE DOLLAR. IF NOT WE WOULD BE HELD RESPONSIBLE.

14. SEE MIFT FOR COMMENT

CRADOCK

(REPEATED AS REQUESTED)

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

COPIES TO

SIR IAN SINCLAIR LEGAL ADVISER

MR BURROWS LEGAL ADVISER

MR ROBERTS NEWS D

MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

4  
SECRET

DWF F 010/23

LIM 145/23

OO F C O DESKBY 231030Z

OO HONG KONG DESKBY 231030Z

OO SINGAPORE DESKBY 240100Z

CRS 450

SECRET

DESKBY 231030Z FCO AND H.K.

DESKBY 240100Z SINGAPORE

FROM PEKING 230945Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 933 OF 23RD SEPT

INFO IMMEDIATE HONG KONG AND IMMEDIATE SINGAPORE (PERSONAL  
FOR PS/MR LUCE)

MIPT: FUTURE OF HONG KONG: SECOND PHASE, ROUND FOUR:  
SECOND DAY.

COMMENT

1. WE ACHIEVED OUR MINIMUM REQUIREMENT OF AGREEMENT TO A FURTHER  
ROUND BUT THIS WAS ANOTHER DIFFICULT SESSION AND THE TEMPERATURE  
FELL ANOTHER FEW DEGREES.

2. YAO MADE NO ATTEMPT TO ARGUE ON THE BASIS OF FACTS. HE REITERATED HIS DEMAND THAT WE SHOULD ACCEPT THE CHINESE PREMISE OF SOVEREIGNTY AND ADMINISTRATION. HIS COMMENTS WERE DOMINATED BY ONE ISSUE: BRITISH OBSTINACY IN INSISTING ON THE CONTINUATION OF BRITISH ADMINISTRATION WAS AN INSURMOUNTABLE OBSTACLE TO PROGRESS. WE HAD RAISED IT (SIC): WE MUST REMOVE IT. THE TALKS WERE DEADLOCKED AND NO PROGRESS WAS POSSIBLE UNLESS WE ACCEPTED THE CHINESE PREMISE. HE RE-EMPHASISED THAT WE WERE TRYING TO EXERT PRESSURE OVER CONFIDENCE AND THE HONG KONG DOLLAR BUT THAT CHINA WOULD NOT SUCCUMB. HE CAME CLOSER THAN ON 22 SEPTEMBER TO SAYING THAT UNLESS WE SHIFTED ON PRINCIPLES THE TALKS COULD NOT CONTINUE. HE REJECTED THE DRAFT PRESS RELEASE WHICH WE HAD PROPOSED AND ADDED THAT THE CHINESE HAD EVEN CONSIDERED NOT ISSUING AN AGREED STATEMENT. THE ONE WE ACHIEVED WAS THIN. YAO REITERATED THE CHINESE VIEW THAT THE TALKS WERE DEADLOCKED AND SAW NO SCOPE FOR PROGRESS EXCEPT ON THE BASIS OF OUR ACCEPTANCE OF THE CHINESE PRECONDITION ON SOVEREIGNTY AND ADMINISTRATION.

3. DISCUSSION OVER THE DRAFT COMMUNIQUE MADE IT PLAIN THAT THE CHINESE GOVERNMENT WOULD NOT GIVE ANY ASSISTANCE OVER BOLSTERING CONFIDENCE IN THE DOLLAR UNLESS THEIR TERMS WERE MET. IN THE MEANTIME IT WAS OUR PROBLEM.

4. YAO DID NOT REACT DIRECTLY TO MY PROPOSAL THAT THE CHINESE ENLARGE ON THE POLICIES THEY INTENDED FOR HONG KONG (YOUR TELNO 624), SAYING ONLY IT COULD BE CONSIDERED.

CRADOCK

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OUT TELEGRAM

	Classification and Caveats	Precedence/Deskby
	SECRET	IMMEDIATE 250100Z

ZCZC 1 ZCZC  
 GRS 2 GRS  
 CLASS 3 SECRET  
 CAVEATS 4  
 DESKBY 5 250100Z  
 FM FCO 6 FM FCO  
 PRE/ADD 7 TO IMMEDIATE HONG KONG  
 TEL NO 8 TELEGRAM NUMBER

9 REPEATED FOR INFO IMMEDIATE PEKING (PERSONAL FOR AMBASSADOR)  
 10 PEKING TELNOS 927,928, 932 AND 933: FUTURE OF HONG KONG:  
 11 MR LUCE'S VISIT  
 12 1. I agree with Sir P Cradock's comments on the latest  
 13 round of talks. It is satisfactory that we have got another  
 14 round agreed and announced but the Chinese performance clearly  
 15 confirms our earlier assessment. Mr Luce's visit takes place at  
 16 a critical time. It provides an opportunity to do more publicly  
 17 to sustain confidence and to review the position with EXCO.  
 18 (Begin Underlining) Public Position (Cease underlining)  
 19 2. While we agree with EXCO's view that the time has not  
 20 come for formal public statements on our position in the  
 21 negotiations, we think it would be helpful if Mr Luce were to take  
 22 a suitable opportunity to describe more fully the background to  
 23 our attitude to the talks and our general aims. Clearly we do  
 24 not want to do this in a way which would prejudice the talks <sup>or provoke a reaction from the Chinese</sup> but  
 25 we can make clear not only our commitment to seeking a solution

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File number	Dept HKD	Distribution FUTURE OF HONG KONG
Drafted by (Block capitals) R D CLIFT, HKD		
Telephone number 233 3184		
Authorised for despatch		
Comcen reference	Time of despatch	



OUT TELEGRAM (CONT)

Classification and Caveats

SECRET

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2 which will meet Hong Kong's interests but also our general views  
3 on the need for assurances which can genuinely maintain  
4 confidence. MIPT contains the text of a suggested statement.  
5 I think that unless you or Mr Luce see objections it should be  
6 discussed with EXCO. It might most usefully be deployed at his  
7 press conference (in combination with the other material in his  
8 brief and any suggestions which you wish to make).

9 Alternatively if Mr Luce and yourself judged that pressure in  
10 Hong Kong made an earlier statement desirable we would leave  
11 it to your discretion to arrange this.

12 3. I would envisage Sir P Cradock explaining the statement to  
13 the Chinese immediately on his return, emphasising that its  
14 purpose is to maintain confidence as they say they wish without  
15 revealing any detail about the discussions. We hope they will  
16 similarly exercise restraint.

17 (Begin underlining) Discussion with EXCO (cease underlining)

18 4. My second IFT contains notes on which Mr Luce could draw at  
19 this meeting. As you see these concentrate mainly on our  
20 assessment of the position. We do not think that it would be  
21 helpful to go into too much detail on discussion of possible  
22 options at this stage. Nevertheless we think that EXCO should be  
23 left in no doubt that the next round of talks is likely to be  
24 critical and that the negotiators' instructions will have to be  
25 very carefully devised in order to avoid a breakdown. They should  
26 be encouraged to comment and produce ideas themselves. The Prime  
27 Minister has only had time to consider the question briefly on the  
28 eve of her departure for New York. She would welcome EXCO's  
29 views on the present position and on the timing of a possible  
30 further discussion in London between Ministers and Unofficials.

/// 31 ~~The Prime Minister will wish to consider whether this should~~  
// 32 ~~take place before the next round or after.~~

33 HOWE

34 NNNN

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Catchword

OUT TELEGRAM

Classification and Caveats  
SECRET

Precedence/Deskby  
IMMEDIATE

ZCZC	1	ZCZC
GRS	2	GRS
CLASS	3	SECRET
CAVEATS	4	
DESKBY	5	
FM FCO	6	FM FCO 231315Z SEPT 83
PRE/ADD	7	TO IMMEDIATE HONG KONG
TEL NO	8	TELEGRAM NUMBER
	9	REPEATED FOR INFO IMMEDIATE PEKING
	10	MIPT. PROPOSED STATEMENT FOR MR LUCE'S USE WITH THE MEDIA IN HONG
	11	KONG.
	12	<del>DRAFT STATEMENT ON HONG KONG FOR USE BY MR LUCE WITH THE PRESS</del>
	13	<del>IN THE LIGHT OF THE TALKS ON 22/23 SEPTEMBER.</del>
	14	1. As you know the talks with the Chinese Government are
	15	continuing. The next round will be on 19 and 20 October. It is
	16	of course very useful for me to be in Hong Kong so soon after the
	17	latest round and to <sup>hear</sup> <del>back</del> the views, not only of the Governor and
	18	<del>the</del> Ambassador but also of the Executive Council and UMELCO on
	19	the present position..
	20	2. Since the beginning of the negotiations, we have said very
	21	little about our views on the future of Hong Kong. We thought it
///	22	best that our talks on this subject with the Government of the
//	23	People's Republic of China should be kept confidential.
/	24	We have deliberately avoided negotiation <del>f</del> in public and
	25	we still believe that is right. Above all we <sup>must</sup> <del>would</del> avoid

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File number	Dept HKD	Distribution  FUTURE OF HONG KONG
Drafted by (Block capitals) W MORRIS		
Telephone number		
Authorised for despatch		
Comcen reference	Time of despatch	

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 2 prejudging the final settlement. However, ~~by some~~ <sup>in some quarters</sup> our silence has  
 3 been <sup>misunderstood</sup> ~~misinterpreted and exploited~~. I therefore  
 4 think it may be helpful if I give you some background to explain  
 5 our approach to the question.

6 3. As you know, contrary to the belief of some, the British  
 7 Government draw no direct economic benefit from the present  
 8 status of Hong Kong. We receive no tax revenue from Hong Kong  
 9 and have no control over the Hong Kong Government's reserves.  
 10 Clearly we have a very strong interest in the continued  
 11 prosperity of an important trading partner and financial centre,  
 12 in which companies from Britain and many other countries have  
 13 considerable investments. But our commitment to Hong Kong does  
 14 not stem from that, or from any consideration which could rightly  
 15 be labelled colonial, ~~in the pejorative sense~~. It is based on our  
 16 sense of responsibility for the future of those people who have  
 17 chosen to make Hong Kong their home.

18 4. The story of Hong Kong has been one of almost unparalleled  
 19 economic success. This is the result of the enterprise and sheer  
 20 hard work of the people of Hong Kong, <sup>as well as cooperation with China.</sup> But it is also due to the  
 21 well-tried framework of stability and continuity which the  
 22 present arrangements have provided for so many years. It is our  
 23 belief, and, we are confident, the belief of the majority of the  
 24 people of Hong Kong, that the best way to ensure the continued  
 25 prosperity and stability of Hong Kong ~~in the future~~ is to avoid  
 26 <sup>disturbing</sup> undue disturbance of the complex arrangements which now provide  
 27 the framework of Hong Kong's success. We believe that this  
 28 approach reflects the interests of those people who over the  
 29 years have chosen to live here.

30 5. Throughout the negotiations we are of course concerned to  
 31 get a complete understanding, <sup>of the views</sup> ~~listen to the views~~ of the Chinese  
 32 Government, as the Chinese have been prepared to listen to our  
 33 views. On the basis of mutual understanding we believe that the  
 34 talks should focus particularly on <sup>how to</sup> ~~future~~ arrangements ~~which~~ can

*British  
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 is due  
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 Chinese  
 character  
 plus  
 2) British  
 system  
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 2 guarantee the continuation of Hong Kong's free economy and way of  
 3 life, and thus sustain the confidence which is absolutely  
 4 essential to Hong Kong's success.  
 5 6. As I have said, what is at stake is the continuation of a  
 6 notably successful society. We are therefore committed to  
 7 seeking a solution which will <sup>is what the people of Hong Kong want.</sup> ~~find acceptance among the people~~  
 8 of Hong Kong. We are conducting our talks with the Chinese in  
 9 good faith and with a sense of realism. From the Prime Minister  
 10 down we are deeply conscious of Hong Kong's concerns and are  
 11 determined to make a success of the negotiations.  
 12 7. I am confident that we can build on our good relationship  
 13 with China and our mutual respect to work out together a  
 14 solution which will achieve this.

*Int?*

16 HOWE


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2 GRS  
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5 250100Z  
6 FM FCO  
7 TO IMMEDIATE HONG KONG  
8 TELEGRAM NUMBER  
9 REPEATED FOR INFORMATION IMMEDIATE PEKING (PERSONAL FOR  
10 AMBASSADOR)  
11 MIPT: FUTURE OF HONG KONG: MR LUCE'S DISCUSSION WITH EXCO -  
12 TALKING POINTS  
13 1. I know that you had a useful discussion on 14/15 September  
14 with the Governor about the Chinese position before the last  
15 round of talks. The Chinese line at the 22/23 September session,  
16 as the Ambassador has described it, confirms our earlier  
17 assessment. It is satisfactory that dates have been fixed for  
18 the next round. But as expected the Chinese have not shifted in  
19 substance. They have said that they will consider our invitation  
20 ~~both~~ to provide further details of their plan. But there is a  
21 strong implication that at the next session they will continue to  
22 decline further substantive discussion unless we accept their  
23 premise.  
24 2. We now need to look ahead. But talks are at a critical  
25 stage. There is a clear risk of a breakdown at the next session.

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File number		Dept HKD		Distribution FUTURE OF HONG KONG	
Drafted by (Block capitals) R D CLIFT					
Telephone number 233 3184					
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Comcen reference		Time of despatch			

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Classification and Caveats

SECRET

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2 I am sure you will agree that this should be avoided. It is very  
 3 unlikely that it could be represented as a "friendly" pause or  
 4 that the Chinese would cooperate in this. There would therefore  
 5 be further severe damage to confidence in Hong Kong.

6 3. → I have no specific options to put to you but should be very  
interested to hear any views you may have. In particular, I  
 8 should like to have your view on how far and how we can provide  
 9 our negotiators with flexibility to follow up the invitation  
 10 which we have made to the Chinese in order to keep the talks  
 11 going.

12 5. We should also consider the timing of the next meeting  
 13 between British Ministers and Unofficials. You may have views on  
 14 this. As you know, Ministers in London are always very ready to  
 15 see you.

16 (Begin underlining) Public Relations Policy (Cease underlining)

17 6. I know you have discussed this. I am grateful for your views.  
 18 *3 that we generally agree that there is a danger in*  
 formal public statements which describe our position too  
 19 precisely. These could jeopardise the talks. However, more  
 20 background briefing of the responsible media could be helpful.

21 7. I should also like to use the opportunity to explain to  
 22 the Hong Kong press more about the British attitude to the talks,  
 23 without going into detail on the negotiations. I propose to  
 24 speak at my press conference on the lines of a note which is  
 25 being circulated to you. I should be grateful for your views.

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*I should like your views so that they can be thoroughly considered in London.*

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OUT TELEGRAM (CONT)

Classification and Caveats  
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2 8. Since we must assume that Chinese propaganda will  
3 continue and that confidence in Hong Kong ~~will~~<sup>may</sup> be further ~~ham~~  
4 damaged, we must examine together how to meet this on a  
5 day-to-day basis. I realise that you in Hong Kong bear the  
6 brunt of the problem. The Governor's message to LEGCO  
7 will be very important. But HMG will be prepared to help.  
8 Briefing of prestigious economic and other newspapers and  
9 journals could be helpful, in order to counter Chinese claims  
10 that the decline in the dollar and markets is in some way  
11 due to our negligence or manipulation. We have already  
12 had some success in this respect and are ready to do more.  
13 9. As you know the Chinese declined to cooperate with us in  
14 a joint statement designed to sustain confidence, after the  
15 most recent round of talks. Depending on their performance in  
16 propaganda and on the development of confidence itself, we may  
17 have to consider further action with them before the next  
18 round.

20 HOWE  
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FROM PEKING 230900Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 932 OF 23/9/83

REPEATED FOR INFO TO IMMEDIATE HONG KONG AND IMMEDIATE SINGAPORE (PERSONAL FOR PS/MR LUCE)

FUTURE OF HONG KONG: SECOND PHASE: FOURTH ROUND:

**SECOND DAY**

1. I SPOKE BRIEFLY AT THE START OF TODAY'S MEETING, EXPRESSING MY HOPE THAT THE CHINESE SIDE COULD AGREE TO THE JOINT STATEMENT I HAD PROPOSED YESTERDAY. I ALSO TOLD YAO GUANG THAT I WOULD BE INTERESTED TO HEAR HIS PROMISED THOUGHTS ON THE STATE OF THE HONG KONG DOLLAR.
  
2. YAO SAID THAT HE HAD STUDIED MY STATEMENT AND COMMENTS AT YESTERDAY'S MEETING VERY CAREFULLY. HE HAD CONCLUDED THAT, DESPITE THE CLEVER PRESENTATION OF OUR VIEWS AND THE USE OF DIFFERENT EXPRESSIONS, OUR AIM WAS UNCHANGED. THE CONTINUATION OF BRITISH ADMINISTRATION AFTER 1997, THIS WAS FRANKLY A BLIND ALLEY FOR BRITAIN AND AN INSURMOUNTABLE OBSTACLE IN OUR TALKS. HE MUST PLACE THIS ISSUE SQUARELY ON THE TABLE. IF BRITAIN CONTINUED TO CLING TO THIS UNREASONABLE AND COLONIALIST DEMAND WHAT POINT WAS THERE IN TALKING FURTHER? WHAT RESULT COULD ONE EXPECT? THE ONLY WAY OUT FOR BRITAIN ON THE QUESTION OF HONG KONG WAS TO MOVE WITH THE TIDE OF HISTORY, CAST OFF ITS COLONIALIST REPUTATION AND HAND HONG KONG BACK TO CHINA. I HAD SAID THAT BRITAIN DID NOT WANT TO SEE A UNILATERAL DECLARATION BY CHINA, SO YAO HOPED THAT BRITAIN WOULD CEASE HAGGLING AND GIVE UP THE IDEA OF AN EXCHANGE OF SOVEREIGNTY FOR ADMINISTRATION. THE CHINESE GOVERNMENT ATTACHED IMPORTANCE TO THE STABILITY AND PROSPERITY OF HONG KONG AND PLANNED TO SET UP A SPECIAL ADMINISTRATIVE REGION, IN ACCORDANCE WITH ARTICLE 31 OF THE CONSTITUTION. THEY WOULD ADOPT VERY SPECIAL POLICIES FOR HONG KONG AND WOULD GIVE FULL CONSIDERATION TO BRITISH INTERESTS THERE. I HAD REMARKED YESTERDAY THAT THE CHINESE HAD FORMULATED THEIR POLICIES IN A CONSTRUCTIVE SPIRIT. SO WHY COULD BRITAIN NOT AGREE TO HAVE DISCUSSIONS WITH CHINA ON THIS BASIS?
  
3. YAO REPEATED THE OBJECTION HE MADE YESTERDAY TO MY REMARKS THAT IN OTHER CIRCUMSTANCES BRITAIN WOULD BE READY TO GRANT INDEPENDENCE TO HONG KONG. HONG KONG WAS QUITE DIFFERENT FROM OTHER TERRITORIES TAKEN BY BRITAIN. IT WAS NOT A QUESTION OF NATIONAL LIBERATION, BUT OF THE RECOVERY OF CHINESE TERRITORY. THE FUTURE OF HONG KONG COULD ONLY BE AS PART OF THE MOTHERLAND.

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4. TURNING TO THE QUESTION OF CONFIDENCE, YAO ADMITTED THAT THERE WAS A WEAKENING OF CONFIDENCE IN HONG KONG BUT CLAIMED THAT IT WAS CREATED BY BRITAIN'S REFUSAL TO COOPERATE WITH CHINA. BRITAIN WAS USING CONFIDENCE AS A CARD. HONG KONG NEWSPAPERS HAD REFERRED TO BRITAIN HAVING A PROSPERITY CARD, A POPULAR OPINION CARD AND A CONFIDENCE CARD. IN FACT THESE WERE ALL ONE CARD - THE PRESSURE CARD - WHICH WE WERE SEEKING TO USE AS A MAGIC WEAPON TO EXERT PRESSURE ON CHINA. THIS CARD, FRANKLY, WAS USELESS. CHINA WOULD NOT BE INTIMIDATED. IT WAS FUTILE FOR BRITAIN TO PLAY CARDS IN HANDLING A SERIOUS POLITICAL QUESTION. THIS WAS LIFTING A ROCK ONLY TO DROP IT ON OUR OWN FEET. THE FALL OF THE HONG KONG DOLLAR WAS A CASE IN POINT. CHINA HAD FULL CONFIDENCE IN THE FUTURE OF HONG KONG SINCE THEY HAD FORMULATED CORRECT POLICIES TOWARDS HONG KONG. THE CHINESE PEOPLE WERE A MATURE NATION AND MEANT WHAT THEY SAID. HE ADVISED BRITAIN TO FACE REALITY AND STOP PLAYING CARDS.

5. YAO SAID THAT THE DRAFT JOINT PRESS STATEMENT I HAD PROPOSED YESTERDAY WAS UNACCEPTABLE. IT WOULD ONLY SERVE TO DECEIVE THE PUBLIC, SINCE THERE HAD BEEN NO CHANGE IN BRITAIN'S RIGID ATTITUDE. IN THE CHINESE VIEW, DISCUSSION OF MAINTAINING STABILITY AND PROSPERITY SHOULD NOT BE APPROACHED IN AN ISOLATED OR ACADEMIC WAY, AND COULD ONLY BE MEANINGFUL ON THE PREMISE OF CHINESE RECOVERY OF SOVEREIGNTY AND ADMINISTRATION. OUR DISCUSSIONS COULD NOT LAST INDEFINITELY. CHINA WOULD ANNOUNCE ITS POLICIES NOT LATER THAN SEPTEMBER 1984. HOW COULD WE SAY IN THE JOINT STATEMENT THAT WE HAD CONFIDENCE IN THE FUTURE, WHEN BRITAIN STILL DID NOT ACCEPT CHINA'S PROPOSALS FOR THE FUTURE? FOR THESE REASONS AND OTHERS THE JOINT STATEMENT WAS UNACCEPTABLE.

6. I SAID THAT I FOUND YAO'S STATEMENTS AT THIS ROUND VERY DISAPPOINTING AND WORRYING. I TOOK SERIOUS EXCEPTION TO HIS CHARGE THAT WE HAD MANUFACTURED FACTS TO SUPPORT CONCLUSIONS WE HAD ALREADY REACHED. IT WAS ONLY ON THE BASIS OF FACTS THAT WE HAD REACHED OUR SINCERE CONCLUSION THAT THE BRITISH LINK WAS THE ONLY WAY TO MAINTAIN STABILITY AND PROSPERITY. BECAUSE THE CHINESE TOOK A DIFFERENT VIEW, WE HAD PROPOSED THAT WE EXAMINE JOINTLY THE BASIS OF THIS CONCLUSION. BUT THE CHINESE SIDE HAD MADE NO ATTEMPT TO RESPOND ON A FACTUAL BASIS.

7. I DEPLORED THE CHARGE THAT WE WERE PLAYING CARDS. I DID NOT ACCUSE THE CHINESE OF PLAYING CARDS OR PIN-PONG OR ANY OTHER GAME. PEOPLE IN HONG KONG WERE FREE TO EXPRESS THEIR OPINIONS AND WE TOOK THEIR VIEWS SERIOUSLY. BOTH SIDES SHOULD. I FIRMLY REBUTTED ONE ACCUSATION THAT WE HAD SOMEHOW MANIPULATED CONFIDENCE. WE HAD SOUGHT TO MAINTAIN IT. IT WAS NOT THE BRITISH SIDE WHICH HAD INUNDED HONG KONG OPINION WITH PUBLICITY ABOUT ITS POSITION AND CREATED THE POLENICAL ATMOSPHERE WHICH WAS DAMAGING CONFIDENCE. IT WAS THE PURPOSE OF OUR PROPOSED JOINT PRESS STATEMENT TO BOLSTER CONFIDENCE. THE CHINESE SPOKE ABOUT COOPERATION BUT REFUSED TO JOIN US IN THE FIRST PRACTICAL PROPOSAL FOR COOPERATION.

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# SECRET

3. I THEN DEPLOYED THE PROPOSAL THAT AT THE NEXT MEETING THE CHINESE SHOULD EXPOUND THEIR IDEAS MORE FULLY. I USED THE TEXT IN YOUR TEL NO 620 , WITH MINOR ADDITIONS. IN ANSWER TO YAO'S QUESTIONS ABOUT THE MEANING OF BRITISH LINK, I REFERRED HIM TO THE GOVERNOR'S STATEMENT OF 25 JULY AND THE FOUR PAPERS.

9. YAO THEN MADE SOME BRIEF COMMENTS. HE SAID THAT THE CHINESE SIDE COULD CONSIDER OUR PROPOSAL. HE REPEATED THAT WE HAD FAILED TO EXPLAIN CLEARLY WHAT WE MEANT BY BRITISH LINK. HE CLAIMED THAT HE HAD NOT ACCUSED US OF MANUFACTURING FACTS. , (AT WHICH POINT I QUOTED HIS WORDS BACK AT HIM) BUT SAID THAT WE PROCEEDED FROM OUR PRECONCEIVED PRINCIPLE THAT BRITISH CONOLIAL ADMINISTRATION SHOULD BE MAINTAINED. I REJECTED THIS CHARGE.

10. YAO SAID THAT AT THE BEGINNING OF THE SECOND PHASE CHINA HAD WELCOMED MATERIAL FROM THE BRITISH SIDE WHICH WAS BENEFICIAL TO THE MAINTENANCE OF STABILITY AND PROSPERITY AFTER CHINA RECOVERED HONG KONG AFTER 1997. OBVIOUSLY IT WAS NOT RIGHT THAT WE SHOULD ASK CHINA TO DISCUSS SUCH MATERIAL AS LONG AS WE REJECTED THE IDEA OF CHINA'S RECOVERY OF HONG KONG. IT WAS A FACT THAT HONG KONG WAS CHINA'S TERRITORY FORCIBLY OCCUPIED BY BRITAIN. OUR INSISTENCE ON CONTINUING BRITISH RULE WAS A PRE-CONCEPTION. ON CONFIDENCE, WHETHER WE WERE PLAYING CARDS OR NOT, OR EXERTING PRESSURE OR NOT, WAS SOMETHING ON WHICH THE PUBLIC THEMSELVES WOULD MAKE UP THEIR OWN MIND. IF WE REALLY WANTED TO HAVE SERIOUS NEGOTIATIONS IN THE DAYS TO COME, WE SHOULD CEASE MANOEUVRES OF THIS KIND. WE HAD SAID THAT CONFIDENCE WAS THE CRUCIAL QUESTION BUT IN FACT THE CRUCIAL QUESTION WAS WHETHER WE WERE READY TO COOPERATE WITH THE CHINSE IN SETTLING THE QUESTION OF HONG KONG. WHETHER OR NOT IT WOULD BE POSSIBLE TO MAINTAIN STABILITY AND PROSPERITY IN HONG KONG AND FOR THE TALKS TO PROCEED SMOOTHLY DEPENDED ON THE BRITISH ATTITUDE.

11. DISCUSSION THEN TURNED TO THE DATE OF THE NEXT MEETING. WE HAD EARLIER PROPOSED 14 AND 15 OCTOBER. YAO SAID THAT THIS WAS DIFFICULT FOR THE CHINESE SIDE IN VIEW OF THE INTERVENING NATIONAL DAY HOLIDAY AND THE FOREIGN MINISTER'S TRIP TO AMERICA. WE EVENTUALLY AGREED ON 19 AND 20 OCTOBER. WE THEN AGREED THE PRESS STATEMENT WHICH I HAVE REPORTED SEPARATELY IN MY TEL N O 931 . I PRESSED YAO VERY HARD TO AGREE TO INCLUDE AT LEAST THE WORD 'USEFUL', STRESSING THAT WE HAD A COMMON RESPONSIBILITY TO PREVENT A WORSENING OF THE CONFIDENCE SITUATION. HE REFUSED. I ASKED HIM DIRECTLY WHETHER HE WISHED TO PREVENT THE VALUE OF THE HONG KONG DOLLAR FALLING FURTHER.

12. YAO ARGUED THAT, SINCE NO PROGRESS HAD BEEN MADE AT THIS ROUND, HE SAW NO NEED FOR A SUBSTANTIALLY DIFFERENT PRESS STATEMENT FROM THAT ISSUED AFTER THE LAST ROUND. HE SAID THAT, FRANKLY, BECAUSE OF THE BRITISH ATTITUDE, THE CHINESE SIDE HAD VEN CONSIDERED WHETHER OR NOT TO ISSUE A PRESS STATEMENT AT ALL.

3  
SECRET

/13.

SECRET

13. I EXPRESSED DEEP REGRET AT OUR FAILURE TO AGREE TO TAKE THIS VERY MODEST STEP IN SUPPORT OF THE DOLLAR AND TOLD YAO THAT THE RESPONSIBILITY LAY WITH THE CHINESE. HE CLAIMED TO BE SHOCKED BY THIS REMARK. HE SAID OF COURSE THE CHINESE DID NOT WANT THE HK DOLLAR TO FALL BUT THAT EMPTY WORDS WOULD NOT SOLVE THE PROBLEM AND HE HOPED THAT THE BRITISH WOULD TAKE PRACTICAL STEPS TO SUPPORT THE DOLLAR. IF NOT WE WOULD BE HELD RESPONSIBLE.

14. SEE MIFT FOR COMMENT

CRADOCK

(REPEATED AS REQUESTED)

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

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MR WALKER RESEARCH D OAB 2/82

<sup>4</sup>  
SECRET



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35

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DESKBY 231030Z FCO AND H.K.  
DESKBY 240100Z SINGAPORE  
FROM PEKING 230945Z SEP 83  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 933 OF 23RD SEPT  
INFO IMMEDIATE HONG KONG AND IMMEDIATE SINGAPORE (PERSONAL  
FOR PS/MR LUCE)

*mt*

MIPT: FUTURE OF HONG KONG: SECOND PHASE, ROUND FOUR:  
SECOND DAY.

COMMENT

1. WE ACHIEVED OUR MINIMUM REQUIREMENT OF AGREEMENT TO A FURTHER  
ROUND BUT THIS WAS ANOTHER DIFFICULT SESSION AND THE TEMPERATURE  
FELL ANOTHER FEW DEGREES.

2. YAO MADE NO ATTEMPT TO ARGUE ON THE BASIS OF FACTS. HE  
REITERATED HIS DEMAND THAT WE SHOULD ACCEPT THE CHINESE PREMISE  
OF SOVEREIGNTY AND ADMINISTRATION. HIS COMMENTS WERE DOMINATED  
BY ONE ISSUE: BRITISH OBSTINACY IN INSISTING ON THE CONTINUATION  
OF BRITISH ADMINISTRATION WAS AN INSURMOUNTABLE OBSTACLE TO  
PROGRESS. WE HAD RAISED IT (SIC): WE MUST REMOVE IT. THE TALKS  
WERE DEADLOCKED AND NO PROGRESS WAS POSSIBLE UNLESS WE ACCEPTED  
THE CHINESE PREMISE. HE RE-EMPHASISED THAT WE WERE TRYING TO  
EXERT PRESSURE OVER CONFIDENCE AND THE HONG KONG DOLLAR BUT  
THAT CHINA WOULD NOT SUCCEED. HE CAME CLOSER THAN ON 22 SEPTEMBER  
TO SAYING THAT UNLESS WE SHIFTED ON PRINCIPLES THE TALKS COULD  
NOT CONTINUE. HE REJECTED THE DRAFT PRESS RELEASE WHICH WE HAD  
PROPOSED AND ADDED THAT THE CHINESE HAD EVEN CONSIDERED NOT  
ISSUING AN AGREED STATEMENT. THE ONE WE ACHIEVED WAS THIN. YAO  
REITERATED THE CHINESE VIEW THAT THE TALKS WERE DEADLOCKED AND  
SAW NO SCOPE FOR PROGRESS EXCEPT ON THE BASIS OF OUR ACCEPTANCE  
OF THE CHINESE PRECONDITION ON SOVEREIGNTY AND ADMINISTRATION.

*h*

SECRET

13. DISCUSSION

10

SECRET

3. DISCUSSION OVER THE DRAFT COMMUNIQUE MADE IT PLAIN THAT THE CHINESE GOVERNMENT WOULD NOT GIVE ANY ASSISTANCE OVER BOLSTERING CONFIDENCE IN THE DOLLAR UNLESS THEIR TERMS WERE MET. IN THE MEANTIME IT WAS OUR PROBLEM.

4. YAO DID NOT REACT DIRECTLY TO MY PROPOSAL THAT THE CHINESE ENLARGE ON THE POLICIES THEY INTENDED FOR HONG KONG (YOUR TELNO 624), SAYING ONLY IT COULD BE CONSIDERED.

CRADOCK

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/FUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/FUS

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MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D OAB 2/82

2  
SECRET

34

SECRET

DESKBY 221400Z

FROM PEKING 221125Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 928 OF 22/9/83

REPEATED FOR INFO TO IMMEDIATE HONG KONG  
AND IMMEDIATE BRUNEI (PERSONAL FOR PS/MR LUCE)

MIPT: FUTURE OF HONG KONG: SECOND PHASE,

ROUND FOUR: FIRST DAY

COMMENT

1. THE ATMOSPHERE WAS DISTIQTCTLY CHILLIER THAN IN THE EARLIER ROUNDS. YAO GUANG'S OPENING STATEMENT WAS A FEW DEGREES STRONGER THAN ITS PREDECESSORS AND HIS DELIVERY WAS STERNER THAN BEFORE. HE USED MORE EMOTIONAL LANGUAGE, ACCUSING US FOR EXAMPLE OF ADOPTING AN "IMPERIALIST MANNER" TOWARDS CHINA.
2. THE SUBSTANCE OF HIS STATEMENT WAS TOUGH, AS WE HAD EXPECTED IT WOULD BE. YAO REPEATED DENG'S DEADLINE AND, FOR THE FIRST TIME IN THIS FORUM, SPECIFIED SEPTEMBER 1984. HE ALSO REPEATED THE THREAT THAT CHINA WOULD RECONSIDER THE TIMING OF ITS RECOVERY OF HONG KONG IF THERE WERE MAJOR DISTURBANCES. HE SAID THAT THERE HAD BEEN STALEMATE IN THE FIRST THREE MEETINGS AND THAT, UNLESS WE ACCEPTED THE PREMISE THAT SOVEREIGNTY AND ADMINISTRATION WOULD PASS TO CHINA IN 1997, IT WAS DIFFICULT TO SEE HOW OUR TALKS COULD PROCEED.
3. YAO, HOWEVER, STOPPED SHORT OF A DIRECT THREAT TO SUSPEND THE TALKS. INDEED SOME OF HIS REMARKS IMPLIED THAT TALKS SHOULD CONTINUE, EG HIS SUGGESTION THAT WE SHOULD GO AWAY AND STUDY DENG'S WORDS TO MR HEATH: AND THE INTEREST HE EXPRESSED, THREE TIMES, IN HEARING MORE ABOUT WHAT WE MEANT BY THE "BRITISH LINK".
4. THIS LAST POINT IS NOTEWORTHY. TO SOME EXTENT YAO MAY HAVE BEEN FISHING TO SEE IF THE USE OF THIS EXPRESSION REPRESENTED A SHIFT



SECRET

AWAY FROM "BRITISH ADMINISTRATION". IN FACT, OF COURSE, IT WAS MADE CLEAR IN MY OPENING STATEMENT THAT THE ONLY CHANGE WAS ONE OF TERMINOLOGY. HOWEVER, IT IS MORE LIKELY THAT YAO'S MAIN MOTIVE IN THIS WAS TO DRAW US INTO SAYING THAT BY THE BRITISH LINK WE MEAN THE STATUS QUO, WHICH THE CHINESE HAVE ALREADY SAID IS UNACCEPTABLE, AND THEREBY GIVE THEM A CHANCE TO SHOW THAT WE ARE SIMPLY SEEKING TO MAINTAIN COLONIAL RULE.

5. IN CONCLUSION, OUR EARLIER ASSESSMENT OF THE BLEAK SITUATION WE ARE IN WAS CONFIRMED AT THIS MEETING. THERE HAS BEEN NO MOVEMENT IN THE CHINESE POSITION. OUR FOUR PAPERS HAVE BEEN BALDLY DISMISSED AS A PUT-UP JOB. THE DEMAND THAT WE ACCEPT THE CHINESE PREMISE HAS BEEN REPEATED MORE FIRMLY. AT THIS POINT, IT LOOKS AS THOUGH WE MAY GET A FIFTH ROUND, BUT IT IS PLAIN THAT OUR PRESENT COURSE HAS REACHED A DEAD END. I THEREFORE INTEND, WITH THE GOVERNOR'S AGREEMENT, TO DEPLOY TOMORROW THE TACTIC AUTHORISED IN YOUR TEL NO 624.

CRADOCK

FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
HD/PUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
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MR WALKER RESEARCH D  
OLD ADMIRALITY BUILDING

2  
SECRET

SECRET

DESKBY 221400Z

FROM PEKING 221100Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 927 OF 22ND SEP

INFO IMMEDIATE HONG KONG, IMMEDIATE BRUNEI (PERSONAL FOR PS/MR LUCE)

## FUTURE OF HONG KONG SECOND PHASE TALKS

## ROUND FOUR: FIRST DAY

1. I SPOKE FIRST AT TODAY'S MEETING AND DELIVERED THE OPENING STATEMENT IN YOUR TELNO 895 INCORPORATING THE AMENDMENTS IN YOUR TELNO 619.
2. YAO GUANG THEN REPLIED, EXPRESSING GREAT DISAPPOINTMENT AT MY STATEMENT. THE CHINESE SIDE HAD HOPED FOR A CHANGE OF ATTITUDE ON OUR PART. IN THE FIRST THREE ROUNDS WE HAD CLUNG OBSTINATELY TO OUR UNREASONABLE DEMAND FOR CONTINUED BRITISH ADMINISTRATION, THUS CREATING A STALEMATE IN THE TALKS. NOW WE WERE STILL SINGING THE SAME TUNE. CHINA HAD MADE UP ITS MIND TO RECOVER BOTH SOVEREIGNTY AND ADMINISTRATION OVER HONG KONG IN 1997. THE TWO WERE INDIVISIBLE. THERE WAS ABSOLUTELY NO ROOM FOR BARGAINING. IT WAS FUTILE TO TRY TO RESIST THIS.
3. YAO SAID THAT OUR INSISTENCE ON ADMINISTRATION AMOUNTED TO OUT AND OUT INSISTENCE ON COLONIAL RULE. HE REFERRED TO THE OPIUM WAR AND ACCUSED US OF TRYING TO REPLACE THE OLD UNEQUAL TREATIES WITH A NEW ONE, AND ADOPTING AN IMPERIALIST ATTITUDE. WE MUST BE DAY-DREAMING.
4. WE HAD USED CONFIDENCE AND POPULAR OPINION AS A PRETEXT FOR CONTINUED BRITISH ADMINISTRATION. BUT THE KEY QUESTION WAS WHETHER WE WOULD COOPERATE WITH CHINA IN SOLVING THE HONG KONG PROBLEM AND REMOVING THOSE FACTORS UNFAVOURABLE TO THE STABILITY AND PROSPERITY OF HONG KONG. THE FACT THAT WE WERE NOT ACTING IN THIS WAY SHOWED A LACK OF SINCERITY. HE QUESTIONED WHETHER WE WERE SEEKING TO SUSTAIN CONFIDENCE IN HONG KONG. WE WERE SEEKING TO EXERT PRESSURE ON THE CHINESE GOVERNMENT IN ORDER TO EXTRACT COMPROMISES. BUT THE CHINESE GOVERNMENT WOULD NOT BE SCARED. THEY WERE FULLY PREPARED FOR ANY EVENTUALITIES.
5. YAO SAID THAT BRITISH INSISTENCE ON ADMINISTRATION LED THE CHINESE TO WONDER ABOUT OUR SINCERITY IN SEEKING A NEGOTIATED SETTLEMENT. THE CHINESE SIDE HAD SAID THAT ONLY ON THE BASIS OF THE RECOGNITION OF CHINA'S SOVEREIGNTY OVER HONG KONG AFTER 1997 WOULD IT BE POSSIBLE TO DISCUSS OTHER MATTERS RELATING TO HONG KONG. BY PROPOSING CONTINUED BRITISH ADMINISTRATION AS SOON AS DISCUSSION OF THE FIRST AGENDA ITEM BEGAN THE BRITISH SIDE HAD IN EFFECT WRITTEN OFF THE SECOND AND THIRD ITEMS. WE HAD REFERRED TO THE BRITISH LINK AND CONTINUITY BUT WE HAD FAILED TO EXPLAIN CLEARLY WHAT WE MEANT BY THIS. NOT ONLY HAD WE VIOLATED THE AGREED AGENDA BUT WE HAD ALSO PLACED SERIOUS OBSTACLES IN THE WAY OF THE TALKS. IN THESE CIRCUMSTANCES HOW COULD TALKS PROCEED AND WHAT WAS THE POINT OF HAVING TALKS?

SECRET

/YAO SAID

33

6. YAO SAID THAT DENG XIAOPING HAD TOLD MR HEATH AT THEIR RECENT MEETING THAT HE HOPED THE BRITISH GOVERNMENT WOULD NO LONGER HAGGLE OVER ADMINISTRATION AND THAT THEY WOULD ADOPT A WISE APPROACH AND NOT ENTER A BLIND ALLEY. HE HAD ASKED THE BRITISH CHARGE TO REPORT THESE REMARKS AND HOPED THE BRITISH SIDE WOULD CONSIDER THEM IN EARNEST.

7. YAO SAID THAT THE CHINESE SIDE HAD EXPRESSED A FRIENDLY DESIRE FOR BRITISH COOPERATION ON THE BASIS OF CHINESE SOVEREIGNTY. THEY HAD TOLD US ABOUT THE POLICIES THEY INTENDED TO ADOPT TOWARDS HONG KONG, THEIR INTENTION TO PROTECT BRITISH INTERESTS AND THEIR WILLINGNESS TO HEAR OUR CONSTRUCTIVE SUGGESTIONS. REGRETTABLY WE HAD SHOWN NO INTEREST IN THE CHINESE PROPOSALS AND WE HAD FAILED TO MAKE CONSTRUCTIVE SUGGESTIONS. WE HAD SIMPLY ALLEGED THAT THE CHINESE PLAN WOULD NOT MAINTAIN CONFIDENCE. COULD THIS BE CALLED SINCERITY?

8. YAO SAID THAT CHINA AND BRITAIN HAD AGREED IN 1972 TO ESTABLISH FULL DIPLOMATIC RELATIONS ON THE BASIS OF MUTUAL RESPECT FOR EACH OTHER'S SOVEREIGNTY AND TERRITORIAL INTEGRITY, NON-AGGRESSION, NON-INTERFERENCE, EQUALITY AND MUTUAL BENEFIT. THE BRITISH POSITION DID NOT ACCORD WITH THESE PRINCIPLES.

9. YAO SAID HE WANTED TO REPEAT ONCE AGAIN THAT CHINA WOULD DEFINITELY RECOVER HONG KONG IN 1997 AND THAT THIS WAS NOT SUBJECT TO INFLUENCE OR INTERFERENCE FROM ANY QUARTER. AS DENG XIAOPING HAD TOLD MRS THATCHER, CHINA WOULD DEFINITELY ANNOUNCE THE POLICIES IT WOULD ADOPT TOWARDS HONG KONG WITHIN ONE OR TWO YEARS IN SEPTEMBER 1984. IF, HOWEVER, THERE WERE MAJOR DISTURBANCES IN HONG KONG THE CHINESE WOULD HAVE NO CHOICE BUT TO RECONSIDER HOW AND WHEN TO RECOVER HONG KONG. CHINA SINCERELY HOPED THAT IT WOULD NOT HAVE TO ISSUE A UNILATERAL STATEMENT. A JOINT STATEMENT WOULD BE IN THE INTERESTS OF BRITAIN AND BENEFICIAL TO BOTH SIDES.

10. YAO SAID THAT BRITAIN HAD RELINQUISHED MANY COLONIES SINCE WORLD WAR II. IF TODAY WE COULD ADOPT A FAR-SIGHTED POLICY, THE FRIENDLY RELATIONS BETWEEN CHINA AND BRITAIN COULD BE MAINTAINED AND DEVELOPED FOR A LONG TIME TO COME. CHINA HAD HAD EVERY RIGHT TO TAKE BACK HONG KONG AT ANY TIME SINCE THE FOUNDING OF THE NEW CHINA BUT, IN DEFERENCE TO THE FRIENDLY RELATIONS BETWEEN CHINA AND BRITAIN, CHINA WAS READY TO WAIT UNTIL 1997 AND TO HAVE A NEGOTIATED SETTLEMENT. WAS THIS NOT THE UTMOST FOREBEARANCE AND PATIENCE ON CHINA'S PART? BUT THERE WAS A LIMIT TO CHINA'S PATIENCE. HE ADVISED THE BRITISH GOVERNMENT NOT TO MISINTERPRET THIS PATIENCE: TO GIVE UP ITS UNREASONABLE DEMAND FOR ADMINISTRATION AND TO GET DOWN TO EARNEST NEGOTIATION OF ARRANGEMENTS AFTER 1997 AND IN THE TRANSITIONAL PERIOD.

SECRET

11. AFTER A BREAK HE REPLIED WITH SOME COMMENTS ON YAO GUANG'S STATEMENT. HE SAID THAT HE WAS DISAPPOINTED IN IT. WE HAD HOPED THAT THE FOUR PAPERS HANDED OVER AT THE LAST MEETING WOULD HAVE ENABLED US TO GET DOWN TO AN OBJECTIVE FACTUAL STUDY WHICH WE BELIEVED WAS THE PRE-REQUISITE OF SUCCESS IN OUR DISCUSSIONS. WE HAD EXPECTED AT THE LEAST SOME REFERENCE TO THEM OR QUESTIONS DERIVED FROM THEM. HOWEVER, LISTENING TO YAO'S STATEMENT, IT WAS AS IF THE PAPERS HAD NEVER BEEN WRITTEN. HE HAD SIMPLY REITERATED PRINCIPLES AND DEMANDS WHICH APPARENTLY HAD TO BE MET BEFORE WORTHWHILE NEGOTIATIONS COULD BEGIN. THIS WAS PUTTING THE CART BEFORE THE HORSE.

12. HE SAID THAT THERE WERE DEEP DIFFERENCES BETWEEN US BUT WE SHOULD NOT BE OVERWHELMED BY THIS FACT. IT WAS TO RESOLVE THOSE DIFFERENCES THAT WE WERE MEETING. HE EXPRESSED REGRET THAT YAO HAD CHARGED US WITH A LACK OF SINCERITY. WE WERE SINCERE. AN EXAMPLE OF THIS WAS THE MATERIAL WHICH WE HAD PREPARED SO CAREFULLY AND HANDED TO THE CHINESE SIDE AND WHICH HAD RECEIVED SUCH SCANT ATTENTION.

13. HE TOLD YAO THAT WE PROFOUNDLY WISHED FOR A NEGOTIATED SETTLEMENT. THERE WAS NO FUTURE FOR HONG KONG EXCEPT ON THE BASIS OF AN AGREEMENT BETWEEN BRITAIN AND CHINA. WE WISHED FOR A BILATERAL AGREEMENT. IT WAS NOT HELPFUL TO USE THE THREAT OF A UNILATERAL DECLARATION AS AN ULTIMATUM. HE REBUTTED YAO'S ACCUSATION THAT WE WERE VIOLATING THE AGENDA. WE WERE TRYING TO TACKLE THE FIRST ITEM AS AGREED, AND WE WOULD BE READY TO MOVE ON FROM THAT TO THE SECOND AND THIRD ITEMS.

14. HE SAID HE WAS SOORY IF IT SEEMED TO YAO THAT WE WERE SINGING THE SAME OLD TUNE BUT IT REPRESENTED OUR HONEST VIEW, WHICH WAS BASED ON AN OBJECTIVE EXAMINATION OF THE FACTS.

15. IN ANSWER TO THE CHARGE OF COLONIALISM HE TOLD YAO THAT IT WOULD HAVE BEEN ENTIRELY IN ACCORDANCE WITH BRITISH POLICY SINCE THE SECOND WORLD WAR IF HONG KONG HAD BECOME INDEPENDENT. FOR REASONS THAT HE AND HE DID NOT NEED TO DISCUSS HERE, INDEPENDENCE WAS NOT AN OPTION FOR HONG KONG: BUT THIS WAS NOT BECAUSE OF ANY BRITISH COLONIAL AMBITION, NOR WAS IT FOR SUCH A REASON THAT WE WERE ARGUING FOR THE RETENTION OF THE ADMINISTRATIVE LINK WITH BRITAIN. IT WAS BECAUSE WE SAW NO OTHER WAY OF ACHIEVING OUR COMMON AIM OF MAINTAINING PROSPERITY AND STABILITY.

16. HE ASSURED YAO THAT DENG'S WORDS TO MR HEATH HAD BEEN CAREFULLY REPORTED AND WERE BEING CAREFULLY STUDIED, AS WOULD YAO'S OWN WORDS.

SECRET

17 TAKING UP YAO'S QUESTION ABOUT OUR WILLINGNESS TO COOPERATE IN REMOVING THE FACTORS UNFAVOURABLE TO STABILITY AND PROSPERITY, AND SEEKING TO MAINTAIN CONFIDENCE, I SAID THAT WE WISHED MOST EARNESTLY TO COOPERATE TOWARDS THIS END. THERE WERE MANY THINGS THAT WE MIGHT DO IN THE FUTURE BUT THERE WERE ALSO THINGS WHICH ALSO COULD BE DONE HERE AND NOW. I THEN PROPOSED THAT AFTER TOMORROW'S MEETING WE SHOULD ISSUE A JOINT STATEMENT ON THE FOLLOWING LINES WHICH WOULD GREATLY ASSIST CONFIDENCE:

' ' THE TWO SIDES RESUMED THEIR TALKS ON 22 AND 23 SEPTEMBER IN A FRIENDLY ATMOSPHERE AND HAD USEFUL AND CONSTRUCTIVE EXCHANGES. THEY REAFFIRM THEIR COMMON AIM WHICH IS TO MAINTAIN HONG KONG'S STABILITY AND PROSPERITY AND THEIR DETERMINATION TO PURSUE THEIR DISCUSSIONS TO THIS END. THEY TAKE THE OPPORTUNITY TO CONFIRM THEIR CONFIDENCE IN HONG KONG NOW AND IN THE FUTURE. THEY WILL MEET AGAIN FOR FURTHER TALKS ON.....' '.

18. YAO THEN MADE SOME COMMENTS. HE CLAIMED THAT THE CHINESE SIDE HAD STUDIED THE FOUR PAPERS VERY CAREFULLY AND HAD CONCLUDED THAT THE REAL POINT OF THEM WAS TO ARGUE THE CASE FOR CONTINUED BRITISH ADMINISTRATION. THEY PROCEEDED FROM THE PRINCIPLE OF CONTINUED BRITISH ADMINISTRATION, AND FACTS HAD BEEN MANUFACTURED IN SUPPORT OF THIS PRINCIPLE. HE CLAIMED THAT HIS OPENING STATEMENT CONSTITUTED AN ANSWER TO THIS ARGUMENT.

19. YAO AGAIN TOOK UP OUR REFERENCE TO THE BRITISH LINK. WHAT WAS THIS LINK AND WHAT WAS THE SUBSTANCE OF THE CONTINUATION WE HAD IN MIND? THIS HAD NOT BEEN EXPLAINED TO THE CHINESE SIDE, YET WE WANTED THEM TO BELIEVE THAT WE WERE NOT INSISTING ON CONTINUED BRITISH COLONIAL RULE.

20. YAO GUANG REFERRED AGAIN TO THE CHINESE PREMISE AND SAID THAT, ONCE THIS HAD BEEN AGREED, IT WOULD BE EASY TO SETTLE OTHER RELEVANT ISSUES. HE SAID THAT IT WAS WE, NOT THE CHINESE, WHO WERE PUTTING THE CART BEFORE THE HORSE.

21. YAO DENIED THAT THE SEPTEMBER 1984 DEADLINE WAS AN ULTIMATUM. IT WAS INSTEAD / SOLEMN STAND OF THE CHINESE GOVERNMENT. HE SAID IT WAS OUT OF CONSIDERATION FOR THE BRITISH SIDE THAT CHINA HAD DECIDED TO WAIT UNTIL 1984 TO PUBLICISE ITS POLICIES FOR HONG KONG. I REMARKED THAT THIS LINE OR ARGUMENT TOOK MY BREATH AWAY.

SECRET

22. YAO NOTED WHAT HE HAD SAID ABOUT OUR WISH FOR COOPERATION AND FOR A JOINT STATEMENT (HE HAD IN FACT SAID BILATERAL AGREEMENT) AND SAID THAT WE SHOULD THEREFORE MAKE UP OUR MIND TO HAND OVER SOVEREIGNTY AND ADMINISTRATION TO CHINA, AND THEN MAKE GOOD USE OF THE LIMITED TIME REMAINING. HE SAID THAT THE CHINESE SIDE WOULD BE VERY INTERESTED TO KNOW THE DIFFERENCE BETWEEN CONTINUED BRITISH ADMINISTRATION AND COLONIAL RULE. THE CHINESE SIDE HAD EXPLAINED ITS POLICIES FOR HONG KONG AFTER 1997 IN EXPLICIT TERMS ABOUT WHAT WAS THE CONTENT OF THE BRITISH LINK? FINALLY HE REPEATED THAT IF WE DID NOT ACCEPT THE PREMISE OF CHINESE SOVEREIGNTY AND ADMINISTRATION IT WOULD BE VERY DIFFICULT FOR THE TALKS TO PROCEED.

23. SEE MIFT FOR COMMENT.

CRADOCK

FUTURE OF HONG KONG

LIMITED  
HD/HKD  
HD/FED  
HD/PLANNING STAFF  
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- 5 -  
SECRET

SECRET

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SECRET

FM HONG KONG 210640Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1391 OF 21 SEPTEMBER

INFO IMMEDIATE PEKING (PERSONAL FOR AMBASSADOR), BRUNEI (FOR PS TO MR LUCE)

AR 23/9

h.a.

YOUR TELEGRAM NO 937: FUTURE OF HONG KONG: FURTHER DISCUSSION WITH EXCO.

I PUT YOUR POINTS TO EXCO ON 21 SEPTEMBER EMPHASISING THE RISK THAT THE CHINESE WOULD MISREPRESENT OUR REQUEST FOR DETAILS OF THEIR PLANS AS A SHIFT OF POSITION ON OUR PART.

2. THE MEMBERS CONFIRMED THEIR RECOGNITION OF THIS RISK AND THEIR VIEW THAT IT WAS ACCEPTABLE IF IT WERE THE ONLY ALTERNATIVE TO A BREAKDOWN OF THE TALKS.

3. WITHOUT WEAKENING THIS CONFIRMATION AND WITHOUT SEEKING TO TIE THE HANDS OF OUR NEGOTIATORS (IN WHOM THEY EXPRESSED EVERY CONFIDENCE) THEY MADE THE FOLLOWING COMMENTS ON NEGOTIATING TACTICS. I SAID I WOULD PASS THEM ON, ALTHOUGH PERSONALLY I BELIEVE THEM TO BE SUPEREROGATORY.

(A) IF THE CHINESE PROPOSED SUSPENSION OF THE TALKS, WE SHOULD EMPHASISE THE CRITICAL EFFECT THIS WOULD HAVE ON CONFIDENCE IN HONG KONG. ONLY IF THIS FAILED TO MOVE THEM SHOULD WE DEPLOY THE TACTIC OF ASKING FOR THEIR DETAILED PLANS (ALTHOUGH THE DANGERS OF EXCESSIVE BRINKMANSHIP WERE MENTIONED BY SEVERAL MEMBERS AND NO-ONE WAS DISPOSED TO AMEND IN ANY WAY THE ADVICE CONTAINED IN TELNO 1368).

(B) GREAT STRESS SHOULD BE LAID ON THE POINT THAT OUR REQUEST WAS ENTIRELY WITHOUT PREJUDICE TO OUR BASIC POSITION AS STATED EARLIER IN THE TALKS.

(C) THE CHINESE SHOULD BE TOLD THAT IF THEY MISREPRESENTED OUR REQUEST PUBLICLY WE WOULD BE OBLIGED TO MAKE OUR POSITION AS AT (B) ABOVE KNOWN PUBLICLY ALSO.

HADDON-CAVE

## FUTURE OF HONG KONG

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TO PRIORITY HONG KONG

TELEGRAM NUMBER 941 OF 21 SEPT.

AND TO INFO PEKING, BRUNEI (PERSONAL FOR PS/MR LUCE)

QUESTIONS LIKELY TO ARISE AT MR LUCE'S PRESS CONFERENCE IN HONG KONG ON 28 SEPTEMBER 1983

FUTURE OF HONG KONG

Talks:

1. Talks in Peking through diplomatic channels have been taking place at intervals since the Prime Minister's visit to China a year ago. A second more detailed phase began in July. The latest session was held on 22/23 September.

Timetable for talks: Chinese threat to make announcement by 1984:

2. I cannot make any useful forecast of how long the talks will take. The issues are complex and are not helped by suggestions of artificial deadlines. We believe it is more important to find the right solution in the best interests of Hong Kong than to rush matters. But at the same time we understand Hong Kong's interest in avoiding undue delay.

Progress

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Progress Reports on Talks:

3. For reasons that will be obvious to you the contents of the talks must necessarily remain confidential. That the the talks are taking place in a good atmosphere and covering much detailed ground is in itself very encouraging. Do not mistake lack of bulletins for inaction.

Ministers' participation in the Talks/Why are you not going to China?:

4. The British negotiating team is led by our Ambassador in Peking, Sir P Cradock. They are doing a first class job and we have every confidence in them. There are no plans for the Secretary of State or for me to join the talks. But I do not rule out Ministerial participation at an appropriate time if this was felt desirable.

The Governor's participation in the Talks:

5. The Governor has been participating on the British side and will continue to do so as necessary. Both he, and through him, the Executive Council are closely involved in matters relating to the talks.

Participation by other Hong Kong Residents:

6. The composition of the British team is flexible, but the present pattern, involving the Governor and the Political Adviser, is likely to continue.

Change of Ambassador in Peking:

7. I understand Sir Percy Cradock will be staying until about the end of the year. His successor will be announced in due course.

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Does the Governor represent Hong Kong in the talks? What of Chinese criticism that EXCO should not be consulted?:

8. Sir E Youde is the Governor of Hong Kong. His position requires him to consult EXCO, who are his advisers on all important matters. EXCO's views are reported by him to the British Government.

How did the talks go on 22/23 September?:

9. This was another useful session. The next round will take place on .....

Have you discussed this latest session with the Governor and EXCO?:

10. I have, as part of the continuing process of close consultation.

Areas of Disagreement with the Chinese:

11. Of course there are differences between us. The purpose of the talks is to try to resolve those differences. But given our common objective I believe that satisfactory arrangements can be worked out. We both have a clear interest in a prosperous and stable future for the territory.

Failure to Reach Agreement with the Chinese:

12. That is a very pessimistic view. The Chinese leader and the Prime Minister agreed on a common aim to maintain the stability and prosperity of Hong Kong and the aim of the talks is to build on this. We mean to achieve an agreement. Our current good relations with China will help us to do so.

UK Position on Sovereignty and the Treaties:

13. Our position has been clearly stated. We are now looking to the future. The right way to deal with the question is by

friendly

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friendly discussion and agreement. I would not rule out any solution that was acceptable to the people of Hong Kong and to HMG.

China's SAR plan?:

14. We are well aware of the main lines of the Chinese Government's thinking. In our talks in Peking both sides have outlined their positions. There is much exploration still to be done. The important point is that talks are taking place. The people of Hong Kong are well able to judge for themselves what future arrangement would or would not inspire confidence. I hope that people in Hong Kong will continue to voice their opinions.

1997 Deadline set by Chinese:

15. Of course 1997 is a key date because of the New Territories Lease. That is precisely why we and the Chinese are holding talks. But the outcome must not be prejudged.

What is HMG's aim and plan for the future?:

16. HMG's aim, through discussion with the Chinese Government, is to agree arrangements for the future which will maintain Hong Kong's stability and prosperity in a way acceptable to the British Parliament, the Government of China and the people of Hong Kong. Both we and the Chinese Government have the strongest possible motives for reaching such an agreement.

17. We are entering the discussions on the basis of firmness and flexibility: we are firm on our commitment to maintain the well-being and way of life of Hong Kong. We are flexible on the means of achieving this. The important point is that continuity should be effectively guaranteed.

But since the Chinese have revealed their plan publicly, should not HMG tell Hong Kong their ideas in more detail?:

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18. We have of course seen a number of reports of remarks by Chinese public figures. Since many of these have been made to Hong Kong people, it is most important that Hong Kong people should make their frank views, known, not just to us but also to the Chinese. One of the main purposes of my visit here is to listen to those views.

19. The Prime Minister agreed with the Chinese leader that the talks should aim at the maintenance of stability and prosperity in Hong Kong. We are sure the Chinese share our view that nothing should be done to damage confidence in the territory. So far as we are concerned future arrangements must be worked out closely and responsibly between the two Governments in the interests of Hong Kong. The conference table is the place for an exchange of views.

Action to Prevent Erosion of Confidence in Hong Kong:

20. The Prime Minister has made it clear that Her Majesty's Government is committed to the people of Hong Kong. I know that it is the intention of the Hong Kong Government to continue to invest vigorously in the future of Hong Kong and its people, and in the development of the territory.

Involvement of People of Hong Kong:

21. The process of consultation takes place at many levels, official and unofficial, formal and informal. An important stage in it was the visit to London in July by the Governor and the Unofficial Members of the Executive and Legislative Councils. The process is a continuous one and careful consideration is being given as to how it can best be pursued. Many channels already exist through which people can make their views known. The views I have heard during my own visit are immensely helpful.

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Wishes of People of Hong Kong:

22. The Prime Minister has made it clear that the views of the people of Hong Kong will be fully taken into account in the talks.

"Acceptability" of proposals to the people of Hong Kong:

23. We shall, on a continuing basis, keep in close touch with the views of the people of Hong Kong through the existing means. When the main line of the settlement has emerged, we shall consider what means would be appropriate for testing its acceptability in the special circumstances of Hong Kong.

Independence for Hong Kong:

24. With the New Territories lease due to expire in 1997, this is not a feasible option.

Visit by Secretary of State:

25. There are no plans at present for the Secretary of State to visit Hong Kong or China.

Visit by Sir Percy Cradock:

26. The Ambassador has taken the opportunity to visit Hong Kong at the time of my visit as he did when Lord Belstead was here in December. This is very useful for me.

Frequent change of Minister responsible for Hong Kong:

27. These things happen but life goes on. I can understand Hong Kong's concern but I feel firmly in the saddle.

Hong Kong Stock Market and Exchange Rate Fluctuations:

28. Sharp fluctuations in the Hang Seng Index are more common than in Western stock exchanges. In 1973 the Index fell from 1700 to little more than 200. Of course uncertainty over the

future

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future from time to time affects the market but there are other factors such as the world recession, reduced growth forecasts, declining property prices, high international interest rates and the strength of the US\$ dollar affect the market.

Declining confidence in Hong Kong:

29. I know there is genuine concern here reflected in the Stock Markets and the exchange rate, about what the future holds in store. That is understandable and we are very conscious of this in London. But there is an underlying strength in the Hong Kong economy which is reflected in indicators such as export performance and full order books.

British sell-out:

30. This sort of talk is harmful and untrue. I would like to say this to the Hong Kong people: We have been trying through the talks to obtain the best possible deal for Hong Kong which will preserve its prosperity and stability. We will continue to do so. We are unwavering and united in our aim to seek a settlement which will be acceptable not only to Britain and China but also to Hong Kong.

Mr Heath's visit to China:

31. This was an entirely private visit. He carried no official message to or from the Chinese.

Mr Heath's exchange with EXCO:

32. There was a meeting between Mr Heath and EXCO members. This was an entirely private affair.

Prime Minister's meeting with Governor and Ambassador on 5 September:

33. This was an opportunity to get an up-to-date briefing from

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the men on the ground. Mr Heseltine's presence reflected his interest as a member of the Cabinet. He has attended previous meetings. No special emphasis on defence or garrison.

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TO IMMEDIATE PEKING

TELEGRAM NUMBER 628 OF 21 SEPTEMBER

INFO IMMEDIATE HONG KONG (FOR ACTING GOVERNOR)

YOUR TELNOS 913 AND 914 AND HONG KONG TELNO 539: FUTURE OF  
HONG KONG: COMMENTARY IN PEOPLE'S DAILY

1. WE HAVE THE FOLLOWING TO ADD TO SIR IAN SINCLAIR'S HELPFUL  
COMMENTS:

(A) THE VIENNA CONVENTION ON THE LAW OF TREATIES, BY ITS OWN  
TERMS (ARTICLE 4) RELATES ONLY TO TREATIES CONCLUDED AFTER ITS  
ENTRY INTO FORCE.

(B) THE MAJORITY OF HONG KONG'S INHABITANTS ARE BRITISH  
NATIONALS. THE UK ACCORDINGLY HAS THE RIGHT TO SPEAK FOR THEM  
IN INTERNATIONAL AFFAIRS.

(C) THE UK IS ALSO ENTITLED TO NEGOTIATE ON THEIR BEHALF IN  
ORDER TO PROMOTE THEIR WELL BEING, IN ACCORDANCE WITH ARTICLE 73  
OF THE UN CHARTER. INDEED THE UK IS UNDER A DUTY IN ALL CONTEXTS  
TO PROMOTE THAT WELL BEING. THE GENERAL ASSEMBLY'S DECISION IN  
1972 THAT HONG KONG BE REMOVED FROM THE LIST OF NON-SELF-GOVERNING  
TERRITORIES TO WHICH ARTICLE 73(E) APPLIES DID NOT ALTER THE  
LEGAL STATUS OF HONG KONG. THE FACT REMAINS THAT IT IS A  
TERRITORY FOR WHOSE ADMINISTRATION THE UK HAS RESPONSIBILITY AND  
TO ALLEGE OTHERWISE IS NOT IN ACCORDANCE WITH REALITY.

(D) ARTICLE 64 OF THE VIENNA CONVENTION, LIKE THE REST OF  
THE TREATY, APPLIES ONLY TO TREATIES CONCLUDED AFTER THE ENTRY  
INTO FORCE OF THE CONVENTION. IN ANY EVENT A PEREMPTORY NORM OF  
INTERNATIONAL LAW CAN EXIST ONLY WHEN IT IS 'ACCEPTED AND  
RECOGNISED BY THE INTERNATIONAL COMMUNITY AS A WHOLE AS A NORM  
FROM WHICH NO DEROGATION IS PERMITTED.' (ARTICLE 53). THE  
ALLEGED RULE AGAINST COLONIALISM IS CLEARLY NOT SO ACCEPTED AND  
RECOGNISED.

(E) THERE IS NO RULE OF INTERNATIONAL LAW WHICH WOULD PREVENT TWO

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STATES FROM AGREEING THAT TERRITORY UNDER THE SOVEREIGNTY OF ONE SHOULD BE ADMINISTERED BY THE OTHER. SUCH AN AGREEMENT MADE IN THE FREE EXERCISE OF SOVEREIGN RIGHTS IS IN NO WAY INCONSISTENT WITH THE RETENTION OF TERRITORIAL SOVEREIGNTY.

2. EXAMPLES OF SOME PRECEDENTS WERE SENT UNDER COVER OF DAVIES' LETTER OF 4 JULY TO CLIFT, COPIED TO PEKING. A MORE EXHAUSTIVE STUDY IS ON ITS WAY BY BAG. WE DO NOT HOWEVER BELIEVE THAT ANY CASE OR PRECEDENT IS WORTH CITING TO THE CHINESE, ALTHOUGH SOME FEATURES OF CERTAIN PRECEDENTS MAY PROVE USEFUL TO US.

3. THESE POINTS, WITH SIR IAN SINCLAIR'S, COULD BE USED AT YOUR DISCRETION IF THE CHINESE DIRECTLY REPEAT THE ARGUMENTS IN THE PEOPLE'S DAILY ARTICLE. YOU MAY HOWEVER WISH ALSO TO REMIND THE CHINESE THAT OUR COMMON AIM CLEARLY REQUIRES THAT THE FOCUS OF THE TALKS SHOULD BE KEPT ON THE FUTURE AND NOT ON THE PAST. WE ARE NEGOTIATING IN THAT SPIRIT. TO TALK OF 'CONTINUED BRITISH OCCUPATION AND COLONIAL RULE' DISTORTS THE PRESENT POSITION AND DOES NOT HELP IN AGREEING ARRANGMENTS FOR THE FUTURE.

HOWE

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FM HONG KONG 210940Z SEP 83

TO IMMEDIATE PEKING

TELEGRAM NUMBER 539 OF 21 SEPTEMBER

INFO IMMEDIATE HONG KONG GOVERNMENT OFFICE LONDON, FCO

PEKING TELNO 914: FUTURE OF HONG KONG: COMMENTARY IN PEOPLE'S DAILY.

1. SIR HAN SINCLAIR HAS NOW READ THE ARTICLE BY JIN PU. FOLLOWING ARE HIS COMMENTS, PREPARED WITHOUT THE BENEFIT OF ACCESS TO SOURCE MATERIALS.

VALIDITY OF SO-CALLED "UNEQUAL" TREATIES

(i) IT CAN BE CONCEDED THAT UNDER CONTEMPORARY INTERNATIONAL LAW, A WAR OF AGGRESSION IS UNLAWFUL AND INDEED, IN TERMS OF THE NUREMBERG PRINCIPLE, A CRIME AGAINST THE PEACE. AT MOST, HOWEVER, THIS PRINCIPLE RELATES BACK ONLY TO THE KELLOGG-BRAND PACT OF 1928 WHICH OUTLAWED WAR AS AN INSTRUMENT OF NATIONAL POLICY. THE BASIC FLAW IN THE CHINESE ARGUMENT IS TO APPLY NEWLY EMERGENT PRINCIPLES TO TEST THE VALIDITY OF TREATIES CONCLUDED LONG BEFORE THE MODERN LAW OF TREATIES ACHIEVED GENERAL ACCEPTANCE.

(ii) THE QUOTATION FROM THE VIENNA CONVENTION ON THE LAW OF TREATIES IS A MISTRANSLATION OF ARTICLE 52 OF THAT CONVENTION WHICH, ACCORDING TO MY RECOLLECTION, PROVIDES THAT "A TREATY IS VOID IF ITS CONCLUSION HAS BEEN PROCURED BY THE THREAT OR USE OF FORCE IN VIOLATION OF THE PRINCIPLES OF INTERNATIONAL LAW EMBODIED IN THE CHARTER OF THE UNITED NATIONS". THE USE OF THE EXPRESSION "IN VIOLATION OF THE PRINCIPLES OF INTERNATIONAL LAW EMBODIED IN THE CHARTER OF THE UNITED NATIONS" WAS PRECISELY DESIGNED TO CONFIRM THAT THE PRINCIPLE WAS NOT (NOT) TO BE REGARDED AS OPERATING RETROSPECTIVELY SO AS TO INVALIDATE TREATIES CONCLUDED BEFORE THE MODERN LAW HAD CRYSTALISED. OTHERWISE, ALL PEACE TREATIES CONCLUDED IN THE PAST (FOR EXAMPLE, THE TREATY OF VERSAILLES OF 1919 AND THE TREATY OF UTRECHT OF 1713) WOULD HAVE BEEN PUT AT RISK.

(iii) THE DOCTRINE THAT A TREATY MAY BECOME NULL AND VOID AS A RESULT OF THE EMERGENCE OF A NEW PAREMPTORY NORM OF INTERNATIONAL LAW (I.E. A NORM OF (NEXT TWO WORDS UNDERLINED) JUS COGENS) IS HIGHLY CONTROVERSIAL, SINCE THERE IS NO AGREEMENT AMONG JURISTS AS TO WHAT IS THE CONTENT OF EXISTING, FAR LESS EMERGING, NORMS OF (NEXT TWO WORDS UNDERLINED) JUS COGENS. SOME EVEN ASSERT THAT SELF-DETERMINATION IS A NORM OF EXISTING (NEXT TWO WORDS UNDERLINED) JUS COGENS. WE HAVE NEVER ACCEPTED, AND NEVER WOULD ACCEPT, THAT CONTINUANCE OF COLONIAL STATUS CONTRAVENES ANY EXISTING OR EMERGING NORM OF (NEXT TWO WORDS UNDERLINED) JUS COGENS.

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/ SOVEREIGNTY

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SOVEREIGNTY AND ADMINISTRATION

2. CHINA CEDED HONG KONG ISLAND IN PERPETUITY BY THE TREATY OF NANKING OF 1842; AND SHE CEDED PART OF KOWLOON PENINSULA BY THE TREATY OF PEKING OF 1860. THESE TREATIES REMAIN IN FULL FORCE AND EFFECT UNLESS TERMINATED OR MODIFIED BY MUTUAL AGREEMENT. IT IS WRONG TO SAY THAT SOVEREIGNTY IS INDIVISIBLE. THERE HAVE BEEN MANY EXAMPLES IN THE PAST AND THERE ARE SOME TODAY WHERE SOVEREIGNTY AND ADMINISTRATION HAVE BEEN DIVIDED (FCO CAN NO DOUBT PROVIDE SUITABLE EXAMPLES). HOW COULD IT BE SAID THAT CHINA WOULD BE ACCEPTING A NEW "UNEQUAL" TREATY IF IT FREELY NEGOTIATED A NEW INTERNATIONAL AGREEMENT TO REPLACE WHAT THE CHINESE ASSERT (AND WE DENY) TO BE THE EXISTING "UNEQUAL" TREATIES?

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TO IMMEDIATE FCO  
TELEGRAM NUMBER 913 OF 20TH SEP  
AND TO IMMEDIATE HONG KONG

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FUTURE OF HONG KONG: COMMENTARY IN PEOPLE'S DAILY

1. PEOPLE'S DAILY OF 20 SEPTEMBER CARRIED A LENGTHY ARTICLE UNDER THE HEADLINE "CHINA RECOVERING SOVEREIGNTY OVER HONG KONG IS ENTIRELY CONSISTENT WITH INTERNATIONAL LAW". IT WAS TAKEN FROM A LONGER ARTICLE IN THE FOURTH VOLUME OF THE QUARTERLY "STUDY OF INTERNATIONAL AFFAIRS". WE HAVE NOT YET RECEIVED THIS.
2. THE ARTICLE ARGUES ITS CASE UNDER THREE SUBHEADINGS:
  - A. THE ILLEGALITY IN INTERNATIONAL LAW OF THE THREE TREATIES;
  - B. THE LACK OF A LEGAL BASIS FOR THE SO-CALLED "EXCHANGE OF SOVEREIGNTY FOR ADMINISTRATION";
  - C. WHO GENUINELY REPRESENTS THE PEOPLE OF HONG KONG?
3. THE ARGUMENTS UNDER A ARE: THE BRITISH INVADED CHINA AND USED COERCION IN THE SIGNING OF ALL THE TREATIES. THEY THEREFORE HAVE NO VALIDITY IN INTERNATIONAL LAW. IN SUPPORT OF THIS A NUMBER OF INTERNATIONAL LAWYERS ARE CITED AND ALSO THE STIPULATION OF THE 1969 "VIENNA CONVENTION ON TREATY LAW" THAT TREATIES WHICH VIOLATE THE PRINCIPLES OF INTERNATIONAL LAW CONTAINED IN THE UN CHARTER AND WHICH ARE SIGNED THROUGH THE THREAT OR USE OF FORCE ARE INVALID. ARTICLE 64 OF THIS CONVENTION ALSO STIPULATES THAT A TREATY ALREADY IN EXISTENCE BECOMES INVALID SHOULD IT CONTRADICT ANY NEW NORM EMERGING IN INTERNATIONAL LAW. THE ARTICLES STATES THAT FOLLOWING THE SECOND WORLD WAR THERE EMERGED A SERIES OF PRINCIPLES IN INTERNATIONAL LAW WHICH SUPPORTED THE SOVEREIGN EQUALITY AND TERRITORIAL INTEGRITY OF STATES AND OPPOSED COLONIALISM, ETC.
4. UNDER B IT IS ARGUED THAT AS SOVEREIGNTY IN LAW STILL BELONGS TO THE INVADERS AND NOT THE INVADER IT IS NOT LEGALLY POSSIBLE FOR THE INVADER TO TALK OF EXCHANGING SOVEREIGNTY FOR ADMINISTRATION. IN ANY CASE ADMINISTRATION IS THE CONCRETE EXPRESSION OF A STATE'S SOVEREIGNTY OVER ITS TERRITORY AND THE TWO CANNOT BE SEEN AS SEPARATE ENTITIES. THE THEORY THAT SOVEREIGNTY COULD BE DIVIDED UP WAS A REACTIONARY WESTERN ONE CREATED TO JUSTIFY THE OCCUPATION OF THE TERRITORY OF OTHERS. IT HAS BEEN SWEEPED INTO THE RUBBISH BIN OF HISTORY.
5. UNDER C IT IS ARGUED THAT A BRITON REPRESENTING THE PEOPLE OF HONG KONG IN THE TALKS IS A NOTION WITHOUT LEGAL OR LOGICAL FOUNDATION. THE RELATIONSHIP BETWEEN THE BRITISH AUTHORITIES AND THE PEOPLE IN HONG KONG IS STILL ONE OF COLONIAL RULE. THE OVERWHELMING MAJORITY OF THE PEOPLE IN HONG KONG ARE CHINESE

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AND SO ONLY THE CHINESE GOVERNMENT CAN TRULY REPRESENT THEM. THE SPECIAL POLICIES THE CHINESE GOVERNMENT WILL ADOPT TOWARDS HONG KONG TO PRESERVE ITS WAY OF LIFE ARE EVIDENCE OF THE CHINESE CONCERN AND SENSE OF RESPONSIBILITY FOR THE PEOPLE OF HONG KONG.

6. THE ARTICLE CONCLUDES THAT A PRELIMINARY ANALYSIS OF THESE THREE MATTERS SHOWS THAT CONTINUED BRITISH OCCUPATION AND COLONIAL RULE WOULD VIOLATE INTERNATIONAL LAW. BUT CHINA'S DECISION TO RECOVER HONG KONG IN 1997 IS ENTIRELY CONSISTENT WITH THE LAW. THIS IS RECOGNISED THROUGHOUT THE WORLD AND EVEN AMONG SOME PEOPLE IN BRITAIN.

7. THE ARTICLE IS SIGNED BY JIN PU, PROBABLY A PSEUDONYM. THOUGH A NEW ONE TO US.

COMMENT

8. THIS IS THE FIRST TIME THAT A DEFENCE OF THE CHINESE POSITION IN TERMS OF INTERNATIONAL LAW HAS APPEARED IN THE PRESS HERE.

IT IS CLEARLY DESIGNED TO PUT FURTHER PRESSURE ON US, AND TIMED FOR THIS ROUND OF TALKS. THE CHINESE USED SIMILAR TACTICS LAST YEAR WHEN NEGOTIATING WITH THE AMERICANS, PARTICULARLY IN RELATION TO THE LEGALITY OF THE TAIWAN RELATIONS ACT. THE ARTICLE MAKES NO SPECIFIC REFERENCE TO THE POSITION ADOPTED BY THE BRITISH SIDE IN THE TALKS, THOUGH IT CARRIES THROUGHOUT A STRONG IMPLICATION THAT THE POINTS BEING ATTACKED REPRESENT OUR POSITION. IT DOES HOWEVER AT ONE POINT STATE "THE BRITISH SIDE SAYS THAT THE TASK OF THE BRITISH AND CHINESE NEGOTIATORS WILL BE TO STUDY HOW TO AMEND THE TREATIES ON HONG KONG", WHICH IS PRESUMABLY A REFERENCE TO THE PRIME MINISTER'S REMARKS AT HER PRESS CONFERENCE IN HONG KONG LAST SEPTEMBER.

9. SEE MIFT.

CRADOCK

FUTURE OF HONG KONG

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- 2 -  
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HONG KONG & Kowloon  
TUE

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NO ACK

21 September 1983

I enclose a copy of a letter the Prime Minister has received from the Hong Kong & Kowloon Trades Union Council.

I should be grateful for your advice on how we should respond to this letter by Wednesday 5 October.

WILLIAM RICKETT

John Holmes, Esq.,  
Foreign and Commonwealth Office.

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TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 937 OF 20 SEPTEMBER

INFORMATION IMMEDIATE PEKING (PERSONAL FOR  
AMBASSADOR) AND BRUNEI (FOR PS/MR LUCE)

MY TELNO 618 TO PEKING: FUTURE OF HONG KONG: FURTHER DISCUSSION  
WITH EXCO

1. AS EXPLAINED IN TUR, WE ATTACH IMPORTANCE TO EXCO BEING  
UNDER NO ILLUSIONS ABOUT THE POSSIBLE IMPLICATIONS OF THE TACTIC  
WHICH THEY HAVE SUGGESTED. I SHOULD BE GRATEFUL IF YOU WOULD  
ARRANGE TO SPEAK TO THEM ON THE FOLLOWING LINES:

'MINISTERS HAVE CAREFULLY STUDIED THE GOVERNOR'S REPORT OF  
HIS DISCUSSIONS WITH EXCO LAST WEEK. THEY ARE GRATEFUL FOR  
EXCO'S ADVICE AND CONSTRUCTIVE PROPOSALS. THEY ARE GLAD  
THAT IT IS AGREED THAT ON 22 SEPTEMBER THE BRITISH  
NEGOTIATORS SHOULD CONTINUE TO PRESS THE ARGUMENTS FOR  
BRITISH ADMINISTRATION. MINISTERS FIND HELPFUL THE  
SUGGESTION BY EXCO MEMBERS FOR TACTICS IF THE CHINESE REMAIN  
ADAMANT. THEY AGREE THAT IT WOULD BE USEFUL TO INVITE THE  
CHINESE TO DEVELOP AND PROVIDE FURTHER DETAILS OF THEIR OWN  
PLAN AND TO SAY WHAT GUARANTEES FOR HONG KONG'S AUTONOMY  
THESE MIGHT GIVE WHILE FIRMLY MAINTAINING OUR POSITION. WE  
UNDERSTAND THAT EXCO HAVE HAD A FULL DISCUSSION OF THE  
POSSIBLE IMPLICATIONS OF SUCH A MOVE, IN PARTICULAR THE RISK  
THAT THE CHINESE GOVERNMENT MIGHT TRY TO REPRESENT IT AS  
A SHIFT OF POSITION AND AN ACCEPTANCE BY THE BRITISH  
GOVERNMENT TO WORK ON THE BASIS OF THE CHINESE PROPOSALS  
WE UNDERSTAND THAT EXCO BELIEVE THAT THIS RISK WOULD BE  
ACCEPTABLE PROVIDED THAT WE WERE READY TO REFUTE ANY SUCH  
CHINESE STATEMENTS PUBLICLY. MINISTERS BELIEVE THAT THIS IS  
THE RIGHT APPROACH, AND THE INSTRUCTIONS TO THE AMBASSADOR

1

SECRET

SECRET

19333 - 1

MAKE IT ABSOLUTELY CLEAR THAT OUR INVITATION TO THE CHINESE TO PROVIDE MORE INFORMATION WOULD BE WITHOUT PREJUDICE TO THE POSITION OF EITHER SIDE.'

2. GRATEFUL IF YOU WOULD CONFIRM THAT THEY CAN UNDERSTAND THE IMPLICATIONS, ENABLING THE AMBASSADOR TO GO AHEAD AS INSTRUCTED IN TUR.

HOWE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

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CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D (GOGGS)

2  
SECRET

SECRET

19337 - 1

DD 210100Z PEKING  
GRS 498  
SECRET  
DESKBY 210100Z

FM FCO 201900Z SEP 83  
TO IMMEDIATE PEKING  
TELEGRAM NUMBER 620 OF 30 SEPTEMBER  
INFO IMMEDIATE HONG KONG AND BRUNEI (PERSONAL FOR PS/MR LUCE)

FUTURE OF HONG KONG: MIPTS: PASSAGES FOR POSSIBLE USE ON SECOND  
DAY OF TALKS  
TACTICAL MOVE

1. TEXT IS AS IN HONG KONG TELNO 1377, WITH THE FOLLOWING  
AMENDMENTS:

A) PARA 2. LAST SENTENCE. DELETE 'NOT FOR EVER BUT FOR A LONG TIME'  
B) AMEND PARA 4 TO READ:

'IF NEVERTHELESS IT REMAINS YOUR VIEW THAT YOU ARE RIGHT, YOU  
WILL NO DOUBT BE READY TO TELL US SOME OF YOUR PLANS. WE ON OUR  
SIDE HAVE SET OUT OUR CASE IN DETAIL: AND HAVE PROVIDED A  
SUBSTANTIAL AMOUNT OF MATERIAL TO SUPPORT IT. YOU HAVE SO FAR  
ONLY GIVEN US THE BAREST OUTLINE OF THE ARRANGEMENT YOU ENVISAGE  
FOR 1997. IN EFFECT, YOU HAVE SIMPLY SAID THAT BOTH SOVEREIGNTY  
AND ADMINISTRATION SHOULD REVERT TO CHINA, THAT HONG KONG WOULD  
BECOME A SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF  
CHINA, BUT THAT NOTHING ELSE WOULD CHANGE. WE THEREFORE SUGGEST  
THAT AT OUR NEXT MEETING THE CHINESE SIDE SHOULD EXPLAIN IN MUCH  
GREATER DETAIL THEIR PLAN FOR HONG KONG.

THIS WOULD BE WITHOUT PREJUDICE

EITHER TO THE PRINCIPLES OF EITHER SIDE OR TO THE FINAL  
OUTCOME. IN PARTICULAR, WE LOOK FORWARD TO HEARING WHAT  
GUARANTEES YOU BELIEVE THE CHINESE PLAN WOULD PROVIDE FOR THE  
CONTINUITY OF THE PRESENT ECONOMIC, LEGAL AND FINANCIAL SYSTEMS  
IN HONG KONG, AND THE PRESERVATION OF PRESENT FREEDOMS AND  
LIFESTYLE OF HONG KONG PEOPLE. FOR WITHOUT CREDIBLE GUARANTEES  
THERE WILL BE NO CONFIDENCE, AND WITHOUT CONFIDENCE THERE WILL BE

1

SECRET

SECRET

19337 - 1

NEITHER STABILITY NOR PROSPERITY IN HONG KONG'.

2. CONTINUATION OF TALKS (FOR USE AT DISCRETION)

'FAILURE TO ANNOUNCE PUBLICLY AT THE END OF THIS SESSION THE DATE FOR THE NEXT ROUND OF TALKS WOULD BE INTERPRETED IN THE WORST POSSIBLE LIGHT IN HONG KONG AND WOULD HIT CONFIDENCE THERE VERY HARD. WE MUST MAINTAIN THAT CONFIDENCE BY KEEPING UP THE MOMENTUM. THERE IS STILL MUCH TO DISCUSS BETWEEN US. I KNOW THE BRITISH GOVERNMENT ATTACHES GREAT IMPORTANCE TO THIS AND I AM SURE IT IS RIGHT IN VIEW OF OUR COMMON AIM.'

3. COMMON ACTION TO HELP CONFIDENCE (FOR USE IN ANY CASE)

NOT SURPRISINGLY CONFIDENCE IN HONG KONG HAS RECENTLY BEEN HIT BADLY BY UNCERTAINTY AND APPREHENSION ABOUT THE PROGRESS OF THE TALKS. (EXAMPLES: DOLLAR, PRESS COMMENT). ((THIS IS NOT BY ANY MEANS PURELY DUE TO ECONOMIC CAUSES. WORRIES ABOUT THE FUTURE ARE THE MOST IMPORTANT FACTOR)). IT IS IN THE INTERESTS OF BOTH THE CHINESE AND BRITISH GOVERNMENTS TO MAINTAIN CONFIDENCE SO FAR MUCH HAS DEPENDED ON THE PUBLIC ATMOSPHERE FOLLOWING EACH SESSION OF TALKS. I STRONGLY URGE THAT WE SHOULD MAKE A PARTICULAR EFFORT ON THIS OCCASION. I SUGGEST THAT WE ISSUE A JOINT STATEMENT ON THE FOLLOWING LINE:

'THE TWO SIDES HAVE HAD FURTHER USEFUL AND CONSTRUCTIVE TALKS IN A FRIENDLY ATMOSPHERE. THEY REAFFIRM THEIR COMMON AIM WHICH IS TO MAINTAIN HONG KONG'S STABILITY AND PROSPERITY AND THEIR DETERMINATION TO PURSUE THEIR DISCUSSIONS TO THIS END. THEY TAKE THE OPPORTUNITY TO CONFIRM THEIR CONFIDENCE IN HONG KONG NOW AND IN THE FUTURE. ((THEY WILL MEET AGAIN FOR FURTHER TALKS ON.... ..)).'

HOWE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

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MR WALKER RESEARCH D GOGGS

<sup>2</sup>  
SECRET

SECRET

19336 - 1

27

DD 210100Z PEKING  
GRS 170  
SECRET  
DESKBY PEKING 210100Z  
FM FCO 201900Z SEP 83  
TO IMMEDIATE PEKING  
TELEGRAM NUMBER 619 OF 20 SEPTEMBER  
INFO IMMEDIATE HONG KONG AND BRUNEI (PERSONAL FOR PS/MR LUCE)

FUTURE OF HONG KONG: MIPT: OPENING STATEMENT FOR 22/23 SEPTEMBER  
TALKS

1. TEXT IS AS IN OUR TELNO 895, WITH THE FOLLOWING  
AMENDMENTS:

(A) PARA 9, SECOND AND THIRD SENTENCES. AMEND TO READ:

'THE ADMINISTRATION, IT IS TRUE, IS HEADED BY A GOVERNOR  
APPOINTED FROM LONDON BUT IN PRACTICE A HIGH DEGREE OF AUTONOMY  
EXISTS IN HONG KONG, AND THE TERRITORY IN A VERY REAL SENSE  
ADMINISTERS ITSELF.'

PENULTIMATE SENTENCE: DELETE 'ADMINISTRATIVE' (PEKING TELNO 915  
REFERS).

(B) PARA 11 AMEND SECOND SENTENCE TO READ:

'WE HOPE THAT THESE PAPERS HAVE BEEN USEFUL TO THE CHINESE AND  
HAVE HELPED THE CHINESE TO DEEPEN THEIR UNDERSTANDING OF THE WAY  
HONG KONG OPERATES TODAY.'

(C) PARA 11 INSERT BEFORE LAST SENTENCE:

'WE SHOULD ALSO BE HAPPY TO PROVIDE ANY FURTHER MATERIAL THAT  
MIGHT BE HELPFUL, AND TO CONSIDER ANY MATERIAL WHICH THE  
CHINESE SIDE WOULD LIKE TO PROVIDE.' (PEKING TEL 892 REFERS)

HOWE

**FUTURE OF HONG KONG**

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

MR GIFFARD

MR DONALD

MR WRIGHT

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CABINET OFFICE

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MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D GOGGS

SECRET

File on Hong Kong

26

SECRET

19334 - 1

DD 210100Z PEKING

GRS 600

SECRET

DESKBY 210100Z PEKING

FM FCO 201900Z SEP 83

TO IMMEDIATE PEKING

TELEGRAM NUMBER 618 OF 20 SEPTEMBER

INFO IMMEDIATE HONG KONG (PERSONAL FOR

GOVERNOR) AND BRUNEI (FOR PS/MR LUCE)

HONG KONG TELNOS 1356, 1367 AND 1368: FUTURE OF HONG KONG: NEXT  
ROUND OF TALKS

1. FOLLOWING THE GOVERNOR'S DISCUSSIONS WITH EXCO, REPORTED IN  
TURS, THE PRIME MINISTER HAS AGREED THE LINE FOR YOU TO TAKE AT  
THE NEXT ROUND ON 22/23 SEPTEMBER. AS BEFORE YOU HAVE DISCRETION  
TO DEPLOY THE BRITISH POSITION DEPENDING ON THE CIRCUMSTANCES AT  
THE TIME BUT YOU SHOULD COVER THE FOLLOWING POINTS:

(BEGIN UNDERLINING) OPENING STATEMENT ON 22 SEPTEMBER (CEASE  
UNDERLINING)

2. YOU SHOULD SPEAK ON THE GENERAL LINES OF THE TEXT IN MY  
TELNO 895 TO HONG KONG, AS AMENDED BY MIFT.

(BEGIN UNDERLINING) TACTICS ON THE SECOND DAY (CEASE UNDERLINING)

3. IF THE CHINESE, AS EXPECTED, REJECT OUR ARGUMENTS FOR  
CONTINUING BRITISH ADMINISTRATION, IT IS AGREED IN PRINCIPLE THAT  
YOU SHOULD USE THE TACTIC OF INVITING THE CHINESE TO PROVIDE  
FURTHER DETAILS OF THEIR PROPOSALS WHILE FIRMLY MAINTAINING OUR  
POSITION ON THE NEED FOR BRITISH ADMINISTRATION. (PARAGRAPH 6 OF  
HONG KONG TELNO 1368).

YOU WILL OF COURSE AVOID GIVING ANY IMPRESSION THAT WE HAVE  
ACCEPTED THE CHINESE PROMISE. HOWEVER, IT IS IMPORTANT THAT EXCO  
SHOULD BE ABSOLUTELY CLEAR ABOUT THE POSSIBLE IMPLICATIONS OF OUR  
CHANGE OF TACTIC, IN PARTICULAR THAT THE CHINESE MIGHT TRY TO  
PRESENT IT AS A FURTHER CONCESSION ON OUR PART, SO THAT IT MIGHT  
LEAD TO OUR NEGOTIATING IN PRACTICE ON THE BASIS OF THE CHINESE  
CONDITIONS. I REALISE THAT THE GOVERNOR HAS ALREADY POINTED OUT THIS  
DANGER TO EXCO. NEVERTHELESS WE MUST AVOID ANY POSSIBLE  
MISUNDERSTANDING ON THIS. INSTRUCTIONS ARE THEREFORE BEING

1

SECRET

TELEGRAPHED SEPARATELY TO ASK THE ACTING GOVERNOR TO TOUCH BASE WITH EXCO ONCE MORE. YOUR USE OF THIS TACTIC IN THE TALKS SHOULD BE CONTINGENT ON CONFIRMATION FROM HONG KONG THAT EXCO ACCEPT THE POSITION.

(BEGIN UNDERLINING) CONTINUATION OF THE TALKS (CEASE UNDERLINING)

4. WHATEVER THE CHINESE REACTION ON SUBSTANCE, A KEY OBJECTIVE OF THIS ROUND MUST BE THEIR AGREEMENT TO THE CONTINUATION OF THE TALKS AND TO THE ANNOUNCEMENT OF A DATE FOR A FURTHER MEETING.

(BEGIN UNDERLINING) CONFIDENCE IN HONG KONG (CEASE UNDERLINING)

5. CONCERN IN HONG KONG HAS RECENTLY INCREASED, PARTLY BECAUSE OF UNCERTAINTY ABOUT THE POSITION IN THE TALKS BUT MORE BECAUSE OF THE INTENSIFICATION OF CHINESE PROPAGANDA. I REALISE THAT THE LATTER IS PART OF THE CHINESE NEGOTIATING TACTICS AND THAT THEY ARE UNLIKELY TO BE RECEPTIVE TO ANY PROTESTS ON OUR PART. NEVERTHELESS, YOU SHOULD POINT OUT TO THEM STRONGLY THE DAMAGE WHICH IS BEING DONE, EMPHASISE OUR COMMON INTEREST IN MAINTAINING CONFIDENCE AND URGE THEIR COOPERATION IN SUSTAINING IT. YOU SHOULD REFUTE EMPHATICALLY ANY SUGGESTION BY THE CHINESE THAT THE DECLINE IN CONFIDENCE IS DUE TO MANIPULATION BY THE BRITISH OR HONG KONG GOVERNMENTS. YOU SHOULD SUGGEST THAT A JOINT STATEMENT REITERATING THE BRITISH AND CHINESE INTEREST IN PURSUING THE COMMON AIM WOULD BE HELPFUL. DEPENDING ON THE FORM OF AGREEMENT ON CONTINUATION OF THE TALKS, THIS COULD BE PART OF A CONCLUDING COMMUNIQUE ON 23 SEPTEMBER.

6. MY SECOND IFT CONTAINS AMENDMENTS AND ADDITIONS TO THE TEXT IN HONG KONG TELNO 1377. YOU MAY VARY THE DETAILED TEXT BUT SHOULD DRAW ON THIS LINE WHICH NOW COVERS OUR TACTICAL MOVE, THE QUESTION OF THE NEXT MEETING AND THE PROBLEM OF CONFIDENCE.

7. WE NEED TO ENSURE THAT MR LUCE IS FULLY UP TO DATE ON DEVELOPMENTS WHILE ON TOUR. HIS TIMETABLE IS:

20-21 SEPTEMBER IN SINGAPORE (DEPART 0915 ON 21 SEPTEMBER):

21- EVENING OF 23 SEPTEMBER IN BRUNEI:

23-24 SEPTEMBER IN SINGAPORE (DEPART 1550 FOR HONG KONG).

PLEASE REPEAT TELEGRAMS ACCORDINGLY, PERSONAL FOR PS/MR LUCE.

HOWE

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

PS/PUS

SIR J BULLARD

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MR DONALD

MR WRIGHT

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MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D (GOGGS)

2  
SECRET

GRS 200

SECRET

DE DIP

FM THE HAGUE 200840Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 262 OF 20 SEPTEMBER

SECRET *M.*

25  
PS/NO 10  
DO NOTIFY IT

YOUR TEL NO 112: FUTURE OF HONG KONG: NEXT ROUND OF TALKS.

FOLLOWING PERSONAL FOR PS, FOREIGN AND COMMONWEALTH SECRETARY  
FROM PS, PRIME MINISTER.

1. THE PRIME MINISTER AGREES WITH THE RECOMMENDATIONS IN PARAGRAPH 11 OF TUR SUBJECT TO THE FOLLOWING POINTS.
2. WE SHOULD AVOID GIVING ANY IMPRESSION THAT THE UK HAS SHIFTED ITS POSITION AND IS NOW WORKING ON THE BASIS OF THE CHINESE PROPOSALS.
3. WITH REGARD TO YOUR PARAGRAPH 11B, THE PRIME MINISTER CONSIDERS THAT RATHER THAN 'MAINTAINING OUR POSITION IN PRINCIPLE' WE SHOULD 'FIRMLY MAINTAIN OUR POSITION'. SHE HAS COMMENTED THAT IT MUST BE CLEAR THAT OUR OWN VIEWS ON BRITISH ADMINISTRATION HAVE NOT CHANGED AND THAT IT WILL BE OPEN TO US, HAVING HEARD AN EXPOSITION OF THE CHINESE PROPOSALS, TO STATE WHY WE BELIEVE THAT THEIR PLANS WILL NOT MAINTAIN CONFIDENCE.
4. YOU SHOULD KNOW THAT IN REACHING THESE CONCLUSIONS THE PRIME MINISTER WAS MUCH INFLUENCED BY THE CONSIDERATION THAT THE ALTERNATIVE TO DEPLOYING THE TACTICS PROPOSED MIGHT BE A BREAK-DOWN IN THE TALKS OR A VERY CONSIDERABLE WORSENING OF THE ATMOSPHERE.

MANSFIELD

LIMITED

HD/ HKD

HD/ FED

PS

PS/ MR LUCE

PS/ PUS

MR GIFFARD

MR DONALD

COPIES TO

PS/NO 10 DST.

SECRET



DD 191400Z THE HAGUE  
GRS 1293  
SECRET  
DEDIP  
DESKBY 191400Z  
FM FCO 191318Z SEP 83  
TO IMMEDIATE THE HAGUE  
TELEGRAM NUMBER 112 OF 19 SEPTEMBER  
FOLLOWING PERSONAL FOR PS/PRIME MINISTER FROM PS/FOREIGN AND  
COMMONWEALTH SECRETARY

FUTURE OF HONG KONG: NEXT ROUND OF TALKS

1. YOU HAVE SEEN THE GOVERNOR'S REPORT ON HIS MEETINGS ON 14/15 SEPTEMBER WITH EXCO (HONG KONG TELEGRAM NUMBERS 1356, 1367 AND 1368). BRIEFLY, THERE WAS A RANGE OF VIEWS IN EXCO ON THE PROBLEMS LIKELY TO RESULT FROM A STALEMATE OR BREAKDOWN, FROM THOSE WHO THOUGHT THAT THE CRISIS WOULD BE NO WORSE THAN LAST AUTUMN TO OTHERS WHO TOOK A LESS SANGUINE VIEW. THERE WAS GENERAL AGREEMENT THAT A GOOD DEAL WOULD DEPEND ON HOW A STALEMATE OR BREAKDOWN OCCURRED AND HOW IT WAS PRESENTED. IT WOULD OBVIOUSLY BE MUCH WORSE IF THE CHINESE CHOSE TO PRESENT IT AS A CONFRONTATION.
2. ON THE WAY AHEAD, EXCO MEMBERS AGREED THAT OUR NEGOTIATORS SHOULD ARGUE FOR CONTINUED BRITISH ADMINISTRATION AT THE MEETING ON 22 SEPTEMBER. THEREAFTER, THEY DID NOT THINK THAT WE SHOULD AT THIS STAGE PURSUE THE OPTION OF STICKING TO THE BRITISH ADMINISTRATIVE LINK WHILE DISCUSSING POSSIBLE DETAILED CHANGES WITH THE CHINESE. THEIR VIEW WAS THAT TO OFFER SUCH CHANGES WOULD WEAKEN THE BRITISH NEGOTIATING POSITION WITHOUT GAINING ANYTHING IN RETURN.
3. ALL MEMBERS HOWEVER THOUGHT THAT WE SHOULD ADOPT THE TACTIC OF TELLING THE CHINESE THAT OUR OWN VIEW REMAINED THAT CONTINUED BRITISH ADMINISTRATION WAS ESSENTIAL TO CONFIDENCE: BUT THAT AT THE SAME TIME WE SHOULD INVITE THEM TO DEVELOP AND PROVIDE FURTHER DETAILS OF THEIR OWN PLAN AND IN PARTICULAR TO SAY WHAT GUARANTEES FOR HONG KONG'S AUTONOMY THEIR PLANS WOULD GIVE. THEY CONSIDERED THAT IF THE CHINESE PROVED ADAMANT ON 22 SEPTEMBER THERE WAS NO REASON WHY THIS TACTIC SHOULD NOT BE DEPLOYED AT THE END OF THE SESSION, IE ON 23 SEPTEMBER IF THE NEGOTIATORS THOUGHT IT NECESSARY. IT WAS THE GENERAL VIEW THAT OUR TEAM SHOULD SEEK TO AVOID A BREAKDOWN AT THE NEXT SESSION AND SHOULD IF NECESSARY LEAVE THE CHINESE IN NO DOUBT OF THE CONSEQUENCES OF A BREAKDOWN OF A CONFRONTATIONAL KIND.

Telegram sent.

WR 27.

Prime Minister

24

We discussed. Agree para. 11, plus an instruction to Sir Jerry Conrad that he should avoid any impression that the U.K. has shied at its position and was now working on the basis of the Chinese proposal?

A.S.C. 15/9

4. THE OTHER MAIN POINT WHICH EXCO CONSIDERED WAS THE BRITISH PUBLIC RELATIONS STANCE. THEY SHOWED CONCERN ABOUT THE EFFECTS OF CURRENT CHINESE PROPAGANDA COUPLED WITH OUR OWN SILENCE ON THE TALKS AND ON THE BRITISH POSITION. THEY DID NOT CONSIDER THAT THE TIME HAD YET COME FOR A FORMAL PUBLIC STATEMENT OF HMG'S POSITION BUT THEY BELIEVED THAT COMPLETE SILENCE WAS NO LONGER TOLERABLE. THEY WANTED TO DISCUSS THIS WITH MR LUCE DURING HIS VISIT FROM 24 - 28 SEPTEMBER.

5. EXCO'S VIEWS ON THE WAY AHEAD ARE INTERESTING AND GENERALLY HELPFUL. WHILE REJECTING OUR 'OPTION B' FOR A MODIFIED FORM OF THE BRITISH ADMINISTRATIVE LINK, THEY HAVE COME UP, WITHOUT PROMPTING, WITH THE PROPOSAL THAT THE CHINESE SHOULD BE DRAWN OUT FURTHER ON THEIR OWN PLAN. THIS IS VERY CLOSE TO THE SUGGESTION MADE BY THE PRIME MINISTER AT HER MEETING ON 5 SEPTEMBER. YOU WILL RECALL THAT SHE PROPOSED THAT WE SHOULD TELL THE CHINESE THAT WE HAD DESCRIBED THE FACTORS WHICH WE BELIEVED TO BE NECESSARY FOR STABILITY AND PROSPERITY: THE CHINESE FOR THEIR PART CLAIMED TO HAVE AN ALTERNATIVE SYSTEM WHICH WOULD MAINTAIN CONFIDENCE: WE SHOULD PROPOSE THAT THEY SHOULD DESCRIBE THIS SYSTEM IN DETAIL IN THE NEXT PHASE OF THE TALKS. IN DISCUSSING THE IDEA, THE GOVERNOR PUT SPECIFICALLY TO EXCO THE POSSIBLE DIFFICULTIES TO WHICH SIR P CRADOCK HAD REFERRED AT THE 5 SEPTEMBER MEETING: THAT THE CHINESE MIGHT TAKE OUR WILLINGNESS TO LISTEN TO DETAILS OF THEIR FORMULA AS A PRELUDE TO ACCEPTANCE OF THEIR CONDITION ON BOTH SOVEREIGNTY AND ADMINISTRATION: OR ALTERNATIVELY THAT THEY WOULD TAKE THE LINE THAT THEY HAD ALREADY GIVEN US SUFFICIENT DETAIL AND THAT THEY WOULD NOT GO FURTHER WITHOUT ANY SPECIFIC ACCEPTANCE OF THEIR POSITION. EXCO THOUGHT THAT THESE RISKS WERE WORTH RUNNING. THEY CLEARLY REGARD THIS TACTIC AS A MEANS OF PURSUING OUR PRESENT OBJECTIVE AND NOT AS A DEPARTURE FROM IT. THEY CONSIDERED THAT IF THE CHINESE TRY TO MISREPRESENT OUR POSITION WE SHOULD HAVE A CREDIBLE PUBLIC DEFENCE.

8. IN THESE CIRCUMSTANCES THE FOREIGN AND COMMONWEALTH SECRETARY BELIEVES THAT IT WOULD BE RIGHT TO AUTHORISE OUR NEGOTIATORS TO USE THIS TACTIC AT THEIR DISCRETION. BUT WE MUST FULLY RECOGNISE THE DANGER OF THE CHINESE REGARDING IT, AS THEY HAVE DONE OUR CONDITIONAL MOVE ON SOVEREIGNTY, AS A CONCESSION ALREADY MADE, AND PRESENTING IT AS SUCH PUBLICLY. IT MAY BE VERY

DIFFICULT TO GO BACK AGAIN, ONCE WE HAVE INVITED THE CHINESE TO  
OUTLINE THEIR IDEAS, TO DISCUSSIONS BASED ON OUR PRESENT POSITION  
INDEED, AN ATTEMPT TO DO SO COULD PROVOKE A BREAKDOWN IN EVEN-  
WORSE CIRCUMSTANCES THAN A BREAKDOWN NOW. IN OTHER  
WORDS THE EXCO IDEA MAY LEAD US WILLY NILLY TO THE POSITION OF  
NEGOTIATING WITH THE CHINESE ON AN OPTION C BASIS. THE FOREIGN  
SECRETARY THINKS THAT BEFORE THE MEETING ON 22 SEPTEMBER  
WE SHOULD MAKE THIS CLEAR AGAIN TO EXCO  
(WITHOUT OF COURSE MENTIONING OPTION C) TO HELP PREVENT ANY  
RECRIMINATIONS AFTERWARDS. THERE CAN OF COURSE BE NO GUARANTEE  
IN ANY CASE THAT OUR TACTIC WILL WORK. WE SHOULD HAVE TO MAKE  
CLEAR THAT OUR BASIC POSITION HAD NOT ALTERED: AND THE  
PROPOSITION MIGHT FOUNDER ON THAT POINT. BUT WE SHOULD STRESS  
OUR READINESS TO CONSIDER ANY PROPOSALS TO SUSTAIN CONFIDENCE  
AND TO MAINTAIN STABILITY IN HONG KONG WITHOUT PREJUDICE TO  
OUR POSITION ON A FINAL SETTLEMENT. AT THE LEAST THIS TACTIC  
SHOULD HELP TO GET THE CHINESE TO AGREE TO ANOTHER MEETING AFTER  
THE 22/23 SEPTEMBER ROUND.

*Too much  
of a hint?  
A.J.C. 18/9*

9. WE WILL NEED TO BE READY TO COUNTER CHINESE LEAKS OR PUBLIC  
INSINUATIONS THAT WE HAD CONCEDED THEIR CONDITIONS. THIS TOUCHES  
ON EXCO'S SECOND POINT ON PUBLIC RELATIONS. OUR VIEW SO FAR  
HAS BEEN THAT, WHILE THE SITUATION IN THE TALKS IS DEVELOPING  
RAPIDLY, THERE IS NO SCOPE FOR PUBLIC ANNOUNCEMENTS: BUT THIS  
IS CLEARLY SOMETHING WE NEED TO THINK ABOUT FURTHER AND TO  
DISCUSS AGAIN WITH EXCO. JUDICIOUS USE OF BACKGROUND BRIEFING ✓  
OF THE RESPONSIBLE MEDIA MAY WELL BE PART OF THE ANSWER, BUT WE  
ALSO HAVE TO LOOK AHEAD TO MR LUCE'S PRESS CONFERENCE AT THE  
END OF HIS VISIT, TO THE GOVERNOR'S OPENING SPEECH TO THE  
LEGISLATIVE COUNCIL ON 5 OCTOBER AND LATER TO THE RESUMPTION OF  
PARLIMENT.

*We may  
have to  
if the talks  
go badly.*

10. FINALLY, HOWEVER THE NEXT ROUND GOES, BUT PARTICULARLY  
IF THE CHINESE APPEAR RELUCTANT TO AGREE TO A FURTHER MEETING,  
WE SHALL NEED TO INSTRUCT OUR NEGOTIATORS TO PUT VERY FIRMLY  
TO THE CHINESE SIDE THE PROBLEMS CAUSED BY DAMAGED CONFIDENCE  
IN HONG KONG AND PARTICULARLY THE EFFECT OF THEIR OWN PROPAGANDA.  
WE SHOULD URGE ON THE CHINESE THE NEED TO LOOK AT THIS TOGETHER  
AND IF POSSIBLE TO ISSUE A JOINT STATEMENT DESIGNED TO BOOST

CONFIDENCE. WE SHOULD BE UNDER NO ILLUSIONS THAT IT WILL BE EASY TO PERSUADE THEM. CHINESE PROPAGANDA INCREASINGLY APPEARS TO BE PART AND PARCEL OF THEIR NEGOTIATING METHOD, DESIGNED TO PUT PRESSURE ON US. THEY MAY WELL CHOOSE TO SEE SUCH AN APPROACH BY US AS A DIVERSIONARY MOVE. NEVERTHELESS THE FOREIGN AND COMMONWEALTH SECRETARY THINKS THAT WE SHOULD TRY IT.

11. IN SUMMARY I SHOULD BE GRATEFUL TO KNOW WHETHER THE PRIME MINISTER AGREES THAT THE INSTRUCTIONS TO SIR P CRADOCK FOR 22/23 SEPTEMBER SHOULD COVER THE FOLLOWING:

- (A) ON 22 SEPTEMBER, A FIRM BUT NON-COMBATIVE STATEMENT THAT AFTER CAREFUL STUDY OF CHINESE PROPOSALS WE STILL CONSIDERED THAT BRITISH ADMINISTRATION PROVIDED THE ONLY EFFECTIVE GUARANTEE FOR CONFIDENCE IN HONG KONG:
- (B) AFTER TOUCHING BASE WITH EXCO AGAIN, AUTHORITY TO USE ON THE SECOND DAY THE TACTIC OF DRAWING THE CHINESE OUT ON THE DETAIL OF THEIR PROPOSALS WHILE <sup>firmly</sup> MAINTAINING OUR POSITION [~~IN PRINCIPLE~~]
- (C) STRONG ARGUMENTS FOR THE CONTINUATION OF THE TALKS AND THE SETTING OF A DATE FOR THE NEXT ROUND TO BE PUBLICLY ANNOUNCED:
- (D) A PROPOSAL THAT WITHOUT PREJUDICE TO OUR RESPECTIVE POSITIONS BOTH SIDES SHOULD COLLABORATE ON PRESERVING CONFIDENCE IN HONG KONG.

HOWE

P.S. - When how do we introduce Hong Kong opinion?

NNNN

I think we can use B provided it is clear that our own views on Brit. Admin have SS NOT changed and that we can say why we believe the Chinese plans won't maintain confidence. The alternative to deploying that tactic may otherwise be a breakdown in great hostility. Mr

GRS 550  
SECRET  
DESKBY FCO 160830Z  
FM HONG KONG 160720Z SEP  
TO IMMEDIATE F C O  
TELEGRAM NUMBER 1368 OF 16 SEPTEMBER  
INFO IMMEDIATE **PEKING**

MV

MIPT: FUTURE OF HONG KONG: DISCUSSION WITH EXCO

FOLLOWING IS TEXT OF MY SUMMING UP IN WHICH THE COUNCIL CONCURRED:-

THERE WAS A GENERAL RECOGNITION THAT A STALEMATE OR BREAKDOWN WOULD CARRY SERIOUS RISKS FOR CONFIDENCE BOTH INTERNAL AND EXTERNAL AND HENCE FOR THE HONG KONG DOLLAR. MEMBERS DID NOT WISH TO PREDICT BY HOW MUCH THE HONG KONG DOLLAR WOULD FALL BUT THE FALL WAS LIKELY TO BE SUBSTANTIAL. APART FROM THE DOMESTIC IMPACT THIS WOULD DAMAGE THE INTERNATIONAL PERCEPTION OF HONG KONG. SOME MEMBERS THOUGHT THAT THE CRISIS WOULD BE NO WORSE THAN LAST AUTUMN, OTHERS WERE LESS SANGUINE. THERE WOULD ALMOST CERTAINLY BE ANOTHER COLLAPSE OF THE STOCKMARKET WHICH COULD FEED INTO THE BANKING SECTOR. SOME MEMBERS WERE CONCERNED ABOUT THE EFFECT ON EMPLOYMENT BUT OTHERS THOUGHT THAT THE MANUFACTURING SECTOR OF THE ECONOMY WOULD STILL BE SUPPORTED BY THE NEW GROWTH IN DEMAND BY THE UNITED STATES.

2. A FEW MEMBERS WERE CONCERNED ABOUT THE POSSIBILITY OF SOCIAL UNREST BUT IN GENERAL THIS WAS NOT THOUGHT TO PRESENT A SERIOUS RISK.

3. AS REGARDS MOVEMENT OF PEOPLE, MANY HAD ALREAD MADE THEIR PREPARATIONS TO DEPART. THESE PREPARATIONS WOULD BE ACCELERATED BUT ENTRY INTO OTHER COUNTRIES WAS NOT NECESSARILY EASY FOR THEM TO OBTAIN.

4. MEMBERS TOOK THE VIEW THAT THE EXTENT TO WHICH CONFIDENCE WOULD BE AFFECTED WOULD BE MUCH INFLUENCED BY HOW A STALEMATE OR BREAKDOWN OCCURRED, AND HOW IT WAS PRESENTED. IF THE CHINESE CHOSE TO PRESENT IT AS A CONFRONTATION THE DAMAGE WOULD BE SERIOUS. IF THEY COULD BE PERSUADED TO PRESENT IT AS A "PAUSE FOR REFLECTION" SOME MEMBERS THOUGHT THAT THE IMPACT WOULD BE LIMITED.

5. THE MAJORITY FELT THAT, IF NECESSARY, IN ORDER TO SAFEGUARD ESSENTIAL PRINCIPLES, THE RISK OF A STALEMATE OR BREAKDOWN WOULD HAVE TO BE TOLERATED. BUT ALL AGREED THAT A BREAKDOWN SHOULD BE AVOIDED IF THIS COULD BE DONE WITHOUT SACRIFICING SUCH PRINCIPLES.

TO THIS END, IF THE CHINESE THREATENED A BREAKDOWN, THEY SHOULD BE MADE BLUNTLY AWARE OF THE RISK TO CONFIDENCE WHICH THIS INVOLVD.

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6. IN THE LIGHT OF THIS THEY THOUGHT THAT IF THE CHINESE PROVED ADAMANT ON SEPTEMBER 22 THE BEST TACTIC WOULD BE TO TELL THEM THAT OUR OWN VIEW REMAINED THAT CONTINUING BRITISH ADMINISTRATION WAS ESSENTIAL TO CONFIDENCE: BUT AT THE SAME TIME TO INVITE THEM TO DEVELOP AND PROVIDE FURTHER DETAILS OF THEIR OWN PLAN AND IN PARTICULAR TO SAY WHAT GUARANTEES THEIR PLANS WOULD GIVE.

7. MEMBERS DID NOT THINK THAT THE COURSE DESCRIBED IN PARAGRAPH 10 OF THE 'PRESENT POSITION' PAPER SHOULD BE PURSUED AT THIS STAGE.

8. MEMBERS TOOK THE VIEW THAT IT WOULD NOW BE RIGHT TO REVIEW OUR PUBLIC RELATIONS STANCE. THEY DID NOT CONSIDER THAT THE TIME HAD YET COME FOR A FORMAL PUBLIC STATEMENT OF HMG'S POSITION, BUT THEY BELIEVED THAT COMPLETE SILENCE WAS NO LONGER TOLERABLE. A NEW DRAFT POLICY, RECOMMENDING THE USE OF AUTHORITATIVE BACKGROUND BRIEFINGS, WOULD BE PREPARED FOR DISCUSSION WITH MR LUCE DURING HIS VISIT.

YOUDE

## FUTURE OF HONG KONG

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HD/PLANNING STAFF  
HD/PUSD  
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PS/MR LUCE  
PS/PUS  
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MR GIFFARD  
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MR WALKER RESEARCH D GOGGS

-2-  
SECRET

Prime Minute

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We shall soon receive  
advice on how, in the light  
of these meetings, we should  
handle the next round with  
the Chinese.

A.J.C. 16.  
9

GR 450

SECRET

DESKBY 160930Z

FM HONG KONG 160715Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1367 OF 16 SEPTEMBER

INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

MY TELNO 1356: FUTURE OF HONG KONG: DISCUSSION WITH EXCO

1. EXCO CONTINUED THE DISCUSSION REPORTED IN MY TEL UNDER REF ON 15 SEPTEMBER. AT THE CONCLUSION OF THE MEETING THE COUNCIL CONCURRED IN MY SUMMARY OF THE DISCUSSION ON BOTH DAYS. THE TEXT OF THIS SUMMARY, IS IN MIFT.

2. THIS WAS A GOOD MEETING. THE COUNCIL HAD NO DOUBT THAT IT WOULD BE RIGHT TO MAINTAIN OUR PRESENT LINE AT THE 22/23 MEETING WITH THE CHINESE AND AGREED THAT THE AMBASSADOR'S OPENING STATEMENT SHOULD BE ALONG THE LINES OF THE SUMMARY IN YOUR TELNO 896.

THEY CONTINUED TO SHOW LITTLE INTEREST IN THE OPTION DESCRIBED IN PARA 10 OF THE POSITION PAPER AND DID NOT THINK IT SHOULD BE CONSIDERED AT THIS STAGE. THEY ALL THOUGHT THAT THE TACTIC OF ASKING THE CHINESE TO ELABORATE ON THEIR PLAN WHILE MAINTAINING OUR VIEW THAT CONTINUING BRITISH ADMINISTRATION IS ESSENTIAL MIGHT PROVIDE A USEFUL WAY FORWARD AND SAW NO REASON WHY IT SHOULD NOT BE DEPLOYED AT THE END OF THE SESSION ON 22/23 SEPTEMBER IF THE NEGOTIATORS THOUGHT IT NECESSARY. THEY CLEARLY REGARDED THIS TACTIC AS A MEANS OF CONTINUING THE PURSUIT OF OUR PRESENT OBJECTIVES AND NOT IN ANY SENSE AS A DEPARTURE FROM THEM. THEY RECOGNISED THAT THERE WAS A RISK THAT THE CHINESE MIGHT LEAK SUCH A MOVE AND SEEK TO MISREPRESENT IT, BUT THEY TOOK THE VIEW THAT THE RISK WAS ACCEPTABLE SINCE WE WOULD HAVE A CREDIBLE PUBLIC DEFENCE IF THE CHINESE DID LEAK.

3. SUBJECT TO MINISTERS' VIEWS I SEE ADVANTAGE IN GIVING THE NEGOTIATING TEAM DISCRETION TO ADOPT THE TACTIC SUGGESTED BY THE COUNCIL AT NEXT WEEK'S MEETINGS. I SHALL BE TELEGRAPHING SEPARATELY A POSSIBLE SPEAKING NOTE WHICH MIGHT BE USED ON THE SECOND DAY IF THE CHINESE SHOW NO INTEREST IN PURSUING DISCUSSION OF OUR FOUR PAPERS. THE AMBASSADOR WILL NO DOUBT HAVE COMMENTS.

MS

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4. THE BULK OF THE DISCUSSION ON 15 SEPTEMBER WAS DEVOTED TO THE QUESTION OF OUR PUBLIC RELATIONS STANCE. THE COUNCIL DID NOT THINK THAT THE TIME HAD COME FOR A FORMAL PUBLIC STATEMENT OF HMG'S POSITION IN THE NEGOTIATIONS BUT THEY TOOK THE VIEW THAT SOME AUTHORITATIVE BACKGROUND BRIEFING WILL BE REQUIRED IN ORDER TO RESTORE PUBLIC MORALE AND COUNTER THE INTENSIFIED PROPAGANDA CAMPAIGN WHICH THE CHINESE HAVE BEEN CONDUCTING. THEY LOOK FORWARD TO DISCUSSING THIS FULLY WITH MR LUCE WHEN HE IS HERE. I WILL TELEGRAPH SUGGESTIONS SHORTLY.
5. SEE MIFT.

YOUDE

FUTURE OF HONG KONG

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-2-  
SECRET





21

10 DOWNING STREET

*From the Private Secretary*

SIR ROBERT ARMSTRONG

The Prime Minister has seen your minute of 13 September to which you attached a letter from 'C' about the forthcoming article in the next issue of the Far Eastern Economic Review on the future of Hong Kong.

I return 'C's' letter with this minute.

A. J. COLES

15 September 1983



The National Archives

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# 港九工團聯合總會

## Hong Kong & Kowloon Trades Union Council

President: Y. K. WONG

General Secretary: W. F. TONG

14th September 1983

The Rt. Hon. Margaret Thatcher,  
The Prime Minister of England,  
No. 10, Downing Street,  
London SW1, England.

Your Excellency,

We, the undersigned officers of the Hong Kong and Kowloon Trades Union Council, take pleasure in submitting to Your Excellency the views and thoughts of the multitude of free workers from eighty-two trades and craft unions presently working in the manufacturing and services industries in the private as well as the public sectors in Hong Kong, and whom this Council represents.

On the 9th September 1983 this Council held its 36th Annual Congress of all workers' representatives at the Council's premises. Before the end of that Congress all those present were unanimous to resolve on adopting a Proclamation on the issue of the "Future of Hong Kong after 1997", as the Council's formal representation to Your Excellency.

We hereby humbly submit a copy of our Proclamation to the office of Your Excellency, and pray that it will receive Your Excellency's kind attention.

Yours very humbly,  
HONG KONG AND KOWLOON TRADES UNION COUNCIL.

*Wong Yiu Kam*  
WONG Yiu Kam  
President

*Wong Bor*  
WONG Bor, BEM  
Vice-President

*Tong Woon Fai*  
TONG Woon Fai  
General Secretary

The 36th Congress of the  
Hong Kong & Kowloon Trades Union Council.

\* \* \* \* \*

A Proclamation on "The Future of Hong Kong"

The warning on the question of "The Future of Hong Kong" after the year 1997 is already with us. This put the Hong Kong people, who used to enjoy living in this free land, into frustration, anxiety and discomfort.

The Hong Kong people used to enjoy life without political interference, harrassment and victimization. Under the law all are equal, contended and feel very proud of their standards of living and work. The majority of them confide that the communist Chinese systems will not suit the Hong Kong society and the public trends. They also hold that the philosophies of "Hongkong people to rule Hong Kong" and "Rule Hong Kong in its own way" are most in-effective.

The Hon. Mrs. Salina CHOW LIANG Shuk-yee, an un-official member of the Legislative Council, pointed out that "if Hong Kong on one day flies the communist Chinese regime flag it will be the end of stability and prosperity here-at". We wonder who and what kind of a person will be that 'Hong Kong people', and with what and how will they rule Hong Kong? This will be very ambiguous and very worrying to most of us. The former Secretary For Chinese Affairs Mr. Waltheim once urged all the societies now operating in Hong Kong to unite together to form a grand confederation in order to reflect collectively the genuine wishes of the different social strata.

We accept and support these views as correct and applicable, and are sure that the general public in Hong Kong do unanimously agree.

We confide that the true reason behind our successes of today, after having already earned our renowned praise of the "Pearl Of The Orient", is that on this tiny territory of Hong Kong we have complete freedom and democracy within our social systems as well as law and order. Of course we still have our enormous work-force who, during the process of prosperity, played an important role with their labour, sweat and industriousness, have helped to build up our economically and socially strong, viable and affluent society. The Hong Kong industrial growth and development are obtained through innumerable human sacrifices and hard-working of the general public and the working people.

We of this Council are among the Hong Kong general public. When we notice that our lives, our fate, our wealth and properties, our future well-being and the livelihood of our youngsters are at stake we feel that we shall be free to speak out for ourselves. We are united here-for to reflect our views and thoughts to the authorities, and further-on to the world at large, and to struggle for what we are sure to belong to us.

On this 9th day of September 1983, when we hold our 36th Congress for all the free workers in Hong Kong, at the Labour Building at No. 11 Chang Sha Street, Kowloon, we unanimously pass a resolution to carry the following text of our Proclamation, and to submit it to Your Excellency :

1. That communist doctrines and communism anywhere in the world are very inconsistent with the normal living of human people at large. Not merely their people under their rule do not trust them but the followers of the communist regime also have no faith on them. The Chinese communists mentioned their promise to maintain the "stability and prosperity in Hongkong after 1997 and to protect investments benefits" are nothing but deadly poison under sugar-coating, and will in no way care for the well-being of the Hong Kong general public people.
2. Under the Chinese communist rule, matters like "Hongkong people to rule Hong Kong" and "Rule Hong Kong in its own way" are quite impracticable and impossible. The example of "Tibetians rule Tibet" is a good illustrative answer to the negative.
3. To maintain status-quo in Hong Kong is nothing less than protecting individual freedom, personal wealth, human rights; freedom of speech, living, abode and migration; freedom to organize; freedom on publication, and free choice on employment; in addition to all other aspects of freedom in the society.
4. The existing legal system, law and order in Hong Kong, are presently protecting the individuals and their personal freedom, and are the basis of excellent living conditions. There must be the full support on the complete independence in the administration of the law in order to maintain order and the continuence of prosperity.
5. Communism and Capitalism are two extremely contrasting and conflicting political systems. Both are unable to co-exist. If the Hong Kong system suddenly changes, the existing on-going social system will definitely collapse. Freedom for all will perish while livelihood will become extinct.
6. The Hong Kong people are aware of the vital importance of freedom and high standards of living in the Territory. Silence on this crucial issue will only invite exploitation and victimization. This is not the moment for silence, we must face facts, we must not expect anything beneficial from the communist Chinese regime to come upon us. We want to speak up, we will gather together public opinion and express ourselves. Let the world's right-thinking people be the judges over this crucial issue. Jointly, we want to protect Hong Kong's freedom, law and order, prosperity and stability.
7. We vouch that we are deadly against the Chinese communists attempting to rule Hong Kong with their system and their high-handed extremist faction ways. Collectively and unanimously we want to see Hong Kong continues with its free and democratic ways of living, to maintain its in-dependence in the administration of law and order, and freedom on enterprising. We pray that during the negotiations with the Chinese communist regime the British authorities must respect and abide by the wishes of the Hong Kong people to uphold freedom of living. We all vouch to support fully the British government in all her administrations.

The above Proclamation is humbly submitted to Your Excellencies.



Foreign and Commonwealth Office

London SW1A 2AH

14 September 1983

A.J.C. 16/9  
h.a.

Dear David,

7th Commonwealth Law Conference: Future of Hong Kong

As agreed, I attach a short note for the Lord Chancellor's personal background information on the subject of Hong Kong's future.

The next session of the talks on the future will take place on 22 and 23 September. Mr Luce will be discussing their outcome with the Governor during his visit to Hong Kong from 24 to 28 September.

Particular points of sensitivity in Hong Kong are:

- a) the three 19th century treaties;
- b) the "acceptability" of proposals to the people of Hong Kong;
- c) the role of the Governor as the symbolic link with Britain;
- d) the confidential nature of the talks;
- e) the fact that the Governor is a member of the British negotiating team and does not form part of a separate team;
- f) any change in the strength of the British garrison.

I am copying this letter to John Coles (No 10).

Yours ever

(J E Holmes)  
Private Secretary

David Staff Esq  
PS/Lord Chancellor

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(NOT FOR USE)

BACKGROUND NOTE ON THE FUTURE OF HONG KONG FOR THE LORD CHANCELLOR  
AND THE ATTORNEY-GENERAL

1. Prime Minister visited China and Hong Kong in September 1982. Following statement was issued after a meeting between Mrs Thatcher and Chairman Deng Xiaoping on 24 September:

"Today the leaders of both countries held far-reaching talks in a friendly atmosphere on the future of Hong Kong. Both leaders made clear their respective positions on this subject.

They agreed to enter talks through diplomatic channels following the visit with the common aim of maintaining the stability and prosperity of Hong Kong."

2. Talks through diplomatic channels between Britain and China began soon after. Meetings held in Peking with common aim of maintaining Hong Kong's stability and prosperity.

3. Progress initially slow because of Chinese demand that we first recognise their sovereignty over whole of Hong Kong. Matters greatly improved by exchange of letters between Prime Minister and Premier Zhao in March/April.

4. Prime Minister gave nothing away. Made clear that sovereignty not in her gift. Parliament alone could decide. Stressed need for finding workable arrangements after 1997 acceptable to Britain, China and people of Hong Kong.

5. Second, more detailed, phase of talks began in July. Next session 22/23 September. Chinese delegation led by Vice Foreign Minister Yao Guang, British delegation by HMA Peking. Governor of Hong Kong participating as appropriate on British side.

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6. Content of talks confidential. Atmosphere generally friendly though Chinese line on substance tough throughout. They demand sovereignty and maintain that administration cannot be separated from it.

7. Our aim is to seek a settlement acceptable to Britain, China and people of Hong Kong. Their views being taken fully into account. Made known to us and Governor through many channels. We are in close consultation, through the Governor, with Hong Kong's Executive Council (EXCO). Mr Luce visiting Hong Kong 24-28 September.

8. Chinese propaganda has floated idea of Hong Kong coming within the Chinese State but with considerable autonomy and functioning essentially as it does now. In the talks with us they have taken a similar line. Their main points are:

(a) Hong Kong would become a Special Administrative Region of China under Article 31 of the Constitution.

(b) The Government would be drawn from the local people of Hong Kong.

(c) The economy and basic freedoms would be "protected" and the laws would be "basically unchanged". There would be an independent convertible currency and "existing external relations in the economic and cultural fields" would be maintained.

9. Most people in Hong Kong sceptical of this SAR idea. It is superficially attractive but lacks key ingredient for confidence, an insulator against Chinese interference in Hong Kong. At present this is provided by British administration. Evidence suggests Chinese have not thought through most detailed issues involved. They appear to assert that by saying Hong Kong will continue to be internationally tradeable, this will just happen.

10. HMG have sought to educate Chinese about basis for confidence and importance of continuity of current systems. We have concentrated on Hong Kong's position as a financial/commercial

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centre, on the Hong Kong dollar and on the importance of a stable legal system.

Hong Kong Department  
Foreign & Commonwealth Office

14 September 1983

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GRS 750  
S E C R E T  
FM HONG KONG 141045Z SEP 83  
TO IMMEDIATE F C O  
TELEGRAM NUMBER 1356 OF 14 SEPTEMBER  
INFO IMMEDIATE PEKING

YOUR TELSNOs 870 AND 880 : FUTURE OF HONG KONG:

DISCUSSION WITH EXCO

1. H DISCUSSED THE CURRENT POSITION IN THE TALKS WITH EXCO ON 14 SEPTEMBER. H HAD WARNED THEM ON 13 SEPTEMBER THAT H WOULD BE SEEKING THEIR VIEWS AND HAD CIRCULATED COPIES OF THE PAPER IN YOUR SECOND TUR, THE OUTLINE OF THE DRAFT OPENING STATEMENT FOR 22 SEPTEMBER IN YOUR TELNO 896, AND A SUMMARY OF THE MAIN POINTS MADE BY THE CHINESE IN THE CONVERSATIONS BETWEEN ZHOU NAN AND MR CLARK (PEKING TELNO 812), US SENATORS HATCH AND ZORINSKY AND FOREIGN MINISTER WU XUEQIAN (PIERCE'S TELELETTER OF 7 SEPTEMBER) AND MR HEATH AND DENG XIAOPING (PEKING TELNO 879). THE COUNCIL CLEARLY WELCOMED THIS OPPORTUNITY TO DISCUSS THE POSITION REACHED AND ALTHOUGH THE MEETING WAS LONG (THREE AND A HALF HOURS) MEMBERS WISHED TO PURSUE THE DISCUSSION FURTHER BEFORE THE TALKS IN PEKING RESUME NEXT WEEK. H HAVE ARRANGED A FURTHER MEETING FOR TOMORROW EVENING (LOCAL TIME). YOU MAY NEVERTHELESS FIND IT USEFUL TO HAVE AN ACCOUNT OF THE MAIN POINTS TODAY.
2. H INTRODUCING THE SUBJECT H SPOKE AS INSTRUCTED IN YOUR FIRST TUR, ADDING THAT WHILE DENG'S REMARKS TO MR HEATH DID NOT CHANGE OUR VIEW OF THE LINE WHICH THE BRITISH TEAM SHOULD TAKE ON 22/23 SEPTEMBER, THEY DID REINFORCE THE ASSESSMENT OF THE CHINESE POSITION.
3. AS REGARDS THE POINT IN PARA 2(A) OF YOUR FIRST TUR, THERE WAS A REASONABLE CONSENSUS THAT A STALEMATE OR BREAKDOWN IN THE TALKS WOULD CARRY SERIOUS RISKS FOR THE HONG KONG DOLLAR, AND THAT IT WOULD ACCELERATE PREPARATIONS FOR DEPARTURE AMONG THOSE IN A POSITION TO LEAVE HONG KONG. THERE WAS ALSO AGREEMENT THAT THE EXTENT OF THE DAMAGE TO CONFIDENCE WOULD DEPEND IN PART ON THE CIRCUMSTANCES IN WHICH THE STALEMATE OR BREAKDOWN OCCURRED AND THE WAY IN WHICH IT WAS PRESENTED BY THE TWO SIDES. SOME MEMBERS BELIEVED THAT THE CHINESE WOULD COOPERATE IN PRESENTING AN AGREEMENT TO DIFFER IN A NEUTRAL WAY ('A FRIENDLY PARTING OF THE WAYS' OR 'A PAUSE FOR REFLECTION') AND TOOK THE VIEW THAT, IN THAT EVENT, THE CONSEQUENCES FOR CONFIDENCE WOULD BE LESS SERIOUS. SOME ALSO FELT THAT THE CONSEQUENCES FOR CONFIDENCE OF A STALEMATE OR BREAKDOWN, WOULD HAVE TO BE ACCEPTED NO MATTER HOW SERIOUS THEY MIGHT BE. OTHERS WERE MORE CONSCIOUS OF THE RISK THAT THE CHINESE MIGHT PLAY ROUGH, AND DECIDE FORMALLY TO ANNOUNCE THEIR PLAN.

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4. IT WAS THE GENERAL VIEW THAT THE BRITISH TEAM SHOULD SEEK TO AVOID A BREAKDOWN ON 22/23 SEPTEMBER, PROVIDE THIS COULD BE DONE WITHOUT CONCEDEDING ESSENTIAL PRINCIPLES, AND SHOULD IF NECESSARY LEAVE THE CHINESE IN NO DOUBT OF THE CONSEQUENCES OF A BREAKDOWN OF A CONFRONTATIONAL KIND. THERE WAS AGREEMENT ON THE NEED TO GIVE CAREFUL THOUGHT TO THE WAY IN WHICH ANY INTERRUPTION OF THE TALKS MIGHT BE PRESENTED PUBLICLY BY HMG AND THE HKG WHENEVER IT OCCURED.

5. IN DISCUSSION OF POSSIBLE COURSES OF ACTION SHOULD THE CHINESE MAINTAIN THEIR PRESENT HARD LINE, THERE WAS NO SUPPORT FOR THE OPTION SET OUT IN PARA 10 OF YOUR TELNO 880 AT LEAST AT THIS STAGE. THE VIEW WAS EXPRESSED THAT TO OFFER ADMINISTRATIVE CHANGES WOULD WEAKEN THE BRITISH NEGOTIATING POSITION WITHOUT GAINING ANYTHING IN RETURN.

6. A NUMBER OF MEMBERS SUGGESTED, ON THEIR OWN INITIATIVE AND WITHOUT PROMPTING, THAT THE BEST TACTICS MIGHT BE TO TELL THE CHINESE THAT OUR OWN VIEW WAS STILL THAT THAT CONTINUING BRITISH ADMINISTRATION WAS NECESSARY TO CONFIDENCE, BUT AT THE SAME TIME INVITE THEM TO DEVELOP AND PROVIDE FURTHER DETAILS OF THEIR OWN PLAN AND PARTICULARLY ON WHAT GUARANTEES THEY WOULD BE PREPARED TO OFFER.

7. SIR S Y CHUNG THOUGHT THAT THERE WERE OTHER OPTIONS THAT COULD BE CONSIDERED, E.G. SEEKING AN EXTENSION OF BRITISH ADMINISTRATION FOR A SPECIFIED PERIOD OF TIME, BUT HE HAD NOT DEVELOPED THESE FULLY. THE COUNCIL SHOWED LITTLE INTEREST IN THEM.

8. WHEN THE COUNCIL RESUMES ITS DISCUSSION TOMORROW IT IS LIKELY THAT MEMBERS WILL PURSUE FURTHER THE IDEA IN PARA 6 ABOVE AND ALSO FOCUS ON THE QUESTION OF OUR PUBLIC RELATIONS STANCE. THEY ARE MUCH CONCERNED ABOUT THE EFFECT WHICH OUR PRESENT SILENCE IS HAVING ON THE MORALE OF THE COMMUNITY IN HONG KONG.

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FUTURE OF HONG KONG

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FM HONG KONG 140950Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 1351 OF 14 SEPTEMBER

INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

M

YOUR TELNO 902: FUTURE OF HONG KONG: MR HEATH'S MEETING WITH UMELCO.

1. NO OFFICIAL WAS PRESENT AT MR HEATH'S MEETING WITH UMELCO WHICH LASTED WELL OVER AN HOUR. MR HEATH'S PARTY LEFT NO RECORD AND THE UMELCO RECORD IS NOT YET AVAILABLE.

2. FROM SUCH ACCOUNT AS WE HAVE SO FAR IT SEEMS THAT MR HEATH MADE THE FOLLOWING POINTS, IN ADDITION TO THOSE WHICH HE MADE TO THE PRESS IN PEKING ABOUT HIS INTERVIEW WITH DENG:

(A) IT WAS NOT THE CHINESE INTENTION TO TAKE ANY ACTION BEFORE 1997:

(B) THE CHINESE WERE FIRM THAT SOVEREIGNTY WAS NOT NEGOTIABLE: AND THERE WAS NO HOPE OF PERSUADING THE CHINESE TO SEPARATE SOVEREIGNTY AND ADMINISTRATION:

(C) THE CHINESE WOULD IF NECESSARY GIVE POLITICS PRIORITY OVER ECONOMICS AND WOULD REGAIN SOVEREIGNTY EVEN IF THIS MEANT SOME LOSS OF PEOPLE FROM HONG KONG AND A DIMINUTION OF ITS USEFULNESS TO THEM. THEY HAD SAID THAT EXPERTISE COULD IN ANY CASE BE BOUGHT:

(D) THE ISSUE SHOULD NOT HAVE BEEN RAISED SO EARLY: THE CHINESE WOULD HAVE BEEN CONTENT TO LET THINGS GO ON FOR A WHILE YET:

(E) THE PEOPLE OF HONG KONG WOULD HAVE TO ACCEPT THAT THE CHINESE MEANT WHAT THEY SAID OVER THE RECOVERY OF SOVEREIGNTY:

(F) HE UNDERSTOOD THE ANXIETIES OF PEOPLE ABOUT THE PAST BUT THINGS IN CHINA WERE CHANGING:

(G) THE CHINESE POSITION IN RESISTING GIVING THE HONG KONG PEOPLE A DIRECT VOICE IN THE NEGOTIATIONS WAS EXPLICABLE BECAUSE THE TREATIES WERE BILATERAL BETWEEN CHINA AND THE U.K.

3. THE ABOVE IS BASED ON ONLY ACCOUNTS OF SOME UNOFFICIALS WHO WERE PRESENT AND PARTICULARLY SIR S.Y. CHUNG. THE MEETING WAS A DIFFICULT ONE (SEE MY TELNO 1344) AND A NUMBER OF UMELCO MEMBERS ADOPTED A CRITICAL AND INTERROGATIVE ATTITUDE ON A NUMBER OF POINTS.

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FUTURE OF HONG KONG

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MR COLES NO 10 DOWNING STREET

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MR WALKER RESEARCH D GOGGS

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FM HONG KONG 140950Z SEP 83

TO PRIORITY FCO

TELEGRAM NUMBER 1353 OF 14 SEPTEMBER

INFO PRIORITY PEKING

FUTURE OF HONG KONG: VISIT OF MR HEATH.

FOLLOWING IS TEXT OF AFP REPORT OF MR HEATH'S TALK WITH THE FOREIGN CORRESPONDENTS CLUB ON SEPT 13.

BEGINS.

HONG KONG, SEPT, 13 (AFP) - FORMER BRITISH PRIME MINISTER EDWARD HEATH TODAY SAID HE WAS SATISFIED FOLLOWING HIS VISIT TO PEKING THIS WEEK THAT CHINA AND BRITAIN WOULD ARRIVE AT A "SATISFACTORY" SOLUTION TO HONG KONG'S POLITICAL FUTURE AND SAID THAT THE TERRITORY WOULD CONTINUE TO PROSPER DURING THE NEGOTIATIONS.

"BRITAIN AND CHINA CAN KEEP HONG KONG STABLE" WHILE THE TWO WRANGLE OVER THE FUTURE OF THE BRITISH COLONY, MOST OF WHICH IS DUE TO REVERT TO CHINA'S SOVEREIGNTY AFTER THE EXPIRY OF A 99-YEAR LEASE IN 1997, MR HEATH TOLD REPORTERS AFTER A SPEECH TONIGHT AT THE FOREIGN CORRESPONDENTS' CLUB.

HOWEVER, HE REFUSED TO COMMENT ON HOW BRITAIN COULD HELP MAINTAIN THE STABILITY OF THE HONG KONG DOLLAR, WHICH FELL TO A RECORD LOW TODAY OF 7.825 - 7.835 TO THE U.S. UNIT AND HAS SLUMPED STEADILY SINCE PRIME MINISTER MARGARET THATCHER VISITED PEKING LAST SEPTEMBER, JUST BEFORE OFFICIAL NEGOTIATIONS OPENED.

MR HEATH SAID CHINA'S TOP LEADER DENG XIAOPING HAD TOLD HIM DURING THEIR MEETING SUNDAY THAT CHINA INTENDS TO RECOVER SOVEREIGNTY IN 1997, THAT "NOTHING WILL HAPPEN UNTIL THEN" AND THAT CHINA "HOPES HONG KONG'S PROSPERITY WILL CONTINUE AFTER 1997".

ASKED WHETHER A SOLUTION WOULD BE ACCEPTABLE TO THE PEOPLE OF HONG KONG, WHOSE 5.5 MILLION POPULATION IS 98 PERCENT CHINESE, MR HEATH SAID HE CONSIDERED THE QUESTION "HYPOTHETICAL" AND REFUSED FURTHER COMMENT.

SOME CIRCLES IN HONG KONG HAVE EXPRESSED CONCERN THAT THE COLONY ITSELF IS NOT REPRESENTED IN THE TALKS, WHICH HAVE FEATURED OFFICIALS FROM CHINA AND BRITAIN.

"I DON'T THINK THERE'S ANY THING EVIL OR UNDERHAND" IN THE REPRESENTATION BY THE BRITISH, MR HEATH SAID. "I'M SURE THAT THE BRITISH GOVERNMENT WILL LISTEN TO EVERYTHING THAT IS SAID IN HONG KONG... THIS IS A TREATY THAT WAS MADE BETWEEN TWO POWERS AND IT IS UP TO THOSE TWO POWERS TO SETTLE IT".

MR HEATH ALSO COMMENTED THAT IT WAS NOT UNUSUAL FOR BRITISH DEFENSE MINISTER MICHAEL HESELTINE TO HAVE ATTENDED A RECENT BRITISH FOREIGN AFFAIRS MEETING IN LONDON ON THE SITUATION.

"IT IS NORMAL FOR THE DEFENSE MINISTER TO ATTEND FOREIGN AFFAIRS MEETINGS," HE SAID.

/AS.

AS FOR THE POSSIBILITY THAT HE COULD HAVE INFLUENCED THE SITUATION DURING HIS CHINA VISIT, HIS SIXTH SINCE 1974, THE FORMER PRIME MINISTER SAID: 'I HAD NO MESSAGE FROM THE BRITISH GOVERNMENT. I'M NOT IN THE CONFIDENCE OF THE BRITISH GOVERNMENT, AND THEY (THE CHINESE) KNOW THAT'.

HE REFUSED FURTHER COMMENT ON THE SINO-BRITISH TALKS.

MR HEATH ARRIVED HERE SUNDAY FOR AN INFORMAL VISIT AND IS TO LEAVE TOMORROW FOR NEW YORK. THE NEXT ROUND OF TALKS IS TO BEGIN LATER THIS MONTH.

EGH/AMC

AFT 131614 GMT SEP 83.

ENDS

YOUDE

THIS TELEGRAM  
WAS NOT  
ADVANCED

(REPEATED AS REQUESTED)

FUTURE OF HONG KONG

LIMITED

HD/HKD

HD/FED

HD/PLANNING STAFF

HD/PUSD

PS

PS/LADY YOUNG

PS/MR LUCE

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MR WRIGHT

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MR MARTIN ASSESSMENTS STAFF  
CABINET OFFICE

MR FLOWER PUSD

MR COLES NO 10 DOWNING STREET

SIR A PARSONS NO 10 DOWNING STREET

MR WALKER RESEARCH D GOGGS





Foreign and Commonwealth Office

London SW1A 2AH

14 September 1983

A.J.C. 15/9

Dear Sir,

7th Commonwealth Law Conference: Future of Hong Kong

As agreed I attach a note for the Attorney General's personal background information on the subject of Hong Kong's future.

The Attorney General will of course be aware of the need to avoid saying anything in Hong Kong that might damage confidence there or in any way jeopardise the confidential talks taking place between us and the Chinese in Peking. This is all the more important given that the next session of talks will take place on 22 and 23 September. Mr Luce will be discussing their outcome with the Governor during his visit to Hong Kong from 24 to 28 September.

The same considerations apply to the Attorney-General's visit to Australia (24 to 30 September). The Australians have a particular interest in Hong Kong and may raise the subject, but since they already receive briefing from us at a high level it would not be appropriate for the Attorney General to be drawn into discussion on this topic either with officials or publicly. Mr Whitney, who is to visit Australia in early October, will be briefed to provide the Australians with up to date material.

I am copying this letter to John Coles (No 10).

*Yours ever*  
*J E Holmes*

(J E Holmes)  
Private Secretary

J Nursaw Esq  
PS/Attorney General

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(NOT FOR USE)

BACKGROUND NOTE ON THE FUTURE OF HONG KONG FOR THE LORD CHANCELLOR  
AND THE ATTORNEY-GENERAL

1. Prime Minister visited China and Hong Kong in September 1982. Following statement was issued after a meeting between Mrs Thatcher and Chairman Deng Xiaoping on 24 September:

"Today the leaders of both countries held far-reaching talks in a friendly atmosphere on the future of Hong Kong. Both leaders made clear their respective positions on this subject.

They agreed to enter talks through diplomatic channels following the visit with the common aim of maintaining the stability and prosperity of Hong Kong."

2. Talks through diplomatic channels between Britain and China began soon after. Meetings held in Peking with common aim of maintaining Hong Kong's stability and prosperity.

3. Progress initially slow because of Chinese demand that we first recognise their sovereignty over whole of Hong Kong. Matters greatly improved by exchange of letters between Prime Minister and Premier Zhao in March/April.

4. Prime Minister gave nothing away. Made clear that sovereignty not in her gift. Parliament alone could decide. Stressed need for finding workable arrangements after 1997 acceptable to Britain, China and people of Hong Kong.

5. Second, more detailed, phase of talks began in July. Next session 22/23 September. Chinese delegation led by Vice Foreign Minister Yao Guang, British delegation by HMA Peking. Governor of Hong Kong participating as appropriate on British side.

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6. Content of talks confidential. Atmosphere generally friendly though Chinese line on substance tough throughout. They demand sovereignty and maintain that administration cannot be separated from it.
7. Our aim is to seek a settlement acceptable to Britain, China and people of Hong Kong. Their views being taken fully into account. Made known to us and Governor through many channels. We are in close consultation, through the Governor, with Hong Kong's Executive Council (EXCO). Mr Luce visiting Hong Kong 24-28 September.
8. Chinese propaganda has floated idea of Hong Kong coming within the Chinese State but with considerable autonomy and functioning essentially as it does now. In the talks with us they have taken a similar line. Their main points are:
  - (a) Hong Kong would become a Special Administrative Region of China under Article 31 of the Constitution.
  - (b) The Government would be drawn from the local people of Hong Kong.
  - (c) The economy and basic freedoms would be "protected" and the laws would be "basically unchanged". There would be an independent convertible currency and "existing external relations in the economic and cultural fields" would be maintained.
9. Most people in Hong Kong sceptical of this SAR idea. It is superficially attractive but lacks key ingredient for confidence, an insulator against Chinese interference in Hong Kong. At present this is provided by British administration. Evidence suggests Chinese have not thought through most detailed issues involved. They appear to assert that by saying Hong Kong will continue to be internationally tradeable, this will just happen.
10. HMG have sought to educate Chinese about basis for confidence and importance of continuity of current systems. We have concentrated on Hong Kong's position as a financial/commercial

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centre, on the Hong Kong dollar and on the importance of a stable legal system.

Hong Kong Department  
Foreign & Commonwealth Office

14 September 1983

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1 - SEP 1983



Prime Minister

This looks like pre  
invention.

Ref.A083/2592

MR COLES ✓

A.S.C.  $\frac{13}{7}$

MB

The Prime Minister may like to see  
the attached letter which I have received  
from 'C', warning us of a forthcoming  
article in the next issue of the  
Far Eastern Economic Review on the future  
of Hong Kong.

RIA

ROBERT ARMSTRONG

13 September 1983

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*[Faint, illegible handwritten text]*

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13 SEP 1983

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S E C R E T



10 DOWNING STREET

*From the Private Secretary*

13 September 1983

FUTURE OF HONG KONG: BRIEFING OF ALLIES

The Prime Minister has seen your letter of 9 September, has noted its contents and agrees with the conclusions in your final paragraph, namely that we should bring the New Zealanders and the Canadians into the picture at a high level and keep them and the Australians generally up to date; that we should also continue to provide the Americans with material in a little more detail; and that the Governor in Hong Kong and the Ambassador in Peking should keep their New Zealand and Canadian opposite numbers in the picture, as they do already in respect of the Australians and Americans.

John Holmes Esq  
Foreign and Commonwealth Office.

S E C R E T

*Let's*  
*44*

J. COLES

A handwritten signature in dark ink, appearing to be a stylized 'A' or similar character.





The National Archives

LETTERCODE/SERIES ..... <i>PREM 19</i> .....	Date and sign
PIECE/ITEM ..... <i>1057</i> ..... (one piece/item number)	
Extract/Item details:  <i>Folio 13 - 'C' to Codes dated 13 Sept 1983 x 2 attachments</i>	
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DESKBY 101000Z  
FROM PEKING 100915Z SEP 83  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 879 OF 10TH SEP  
INFO IMMEDIATE HONG KONG

MIPT: FUTURE OF HONG KONG: MR HEATH'S VISIT

1. FOLLOWING HIS EXTRACT RELATING TO HONG KONG OF RECORD OF MEETING WITH DENG XIAOPING ON 10 SEPTEMBER. BEGINS:

2. MR HEATH SAID THAT HE HOPED THAT BILATERAL RELATIONS WITH WESTER EUROPE AND THE UK WOULD REMAIN GOOD. MR DENG REPLIED THAT THERE WERE NO CONTRADICTIONS BETWEEN BRITAIN AND CHINA EXCEPT FOR HONG KONG, WHICH WAS NOT DIFFICULT TO RESOLVE. THE BRITISH AIM OF EXCHANGING SOVEREIGNTY FOR ADMINISTRATION WAS NOT POSSIBLE. HE WISHED TO SAY THIS FRANKLY. ON 22 SEPTEMBER THE SECOND PHASE OF THE NEGOTIATIONS WOULD RESUME. HE HAD NOT ASKED ABOUT THE DETAILS OF THE NEGOTIATIONS, BUT HE HOPED THAT THEY WOULD NOT GET STUCK ON THE ISSUE OF ADMINISTRATION. HE HOPED THAT CHINA WOULD NOT BE OBLIGED TO ISSUE A UNILATERAL DECLARATION ABOUT THE FUTURE OF HONG KONG: CHINA HOPED ON THE CONTRARY TO SEE A JOINT DECLARATION BY CHINA AND THE UK. THIS WOULD BE MORE BENEFICIAL FOR THE UK. HE HAD TOLD MRS THATCHER WHEN HE SAW HER IN 1982 THAT THE PROBLEM SHOULD BE SOLVED IN TWO YEARS TIME, HE BY SEPTEMBER 1984. (AT THIS POINT AN MFA REPRESENTATIVE TRIED TO CORRECT HIM THAT HE HAD SAID 1-2 YEARS RATHER THAN TWO YEARS: DENG BRUSHED THIS ASIDE AND SAID THAT IT WAS THE SAME AS SAYING TWO).

3. MR HEATH SAID THAT A JOINT STATEMENT WOULD BE BENEFICIAL NOT ONLY TO THE UK BUT TO CHINA AS WELL. IT WOULD HAVE A BIG INFLUENCE ON INTERNATIONAL OPINION ON TAIWAN, AND PARTICULARLY IN THE UNITED STATES. MR DENG AGREED THAT A JOINT STATEMENT WOULD BE IN THE INTERESTS OF BOTH SIDES, PARTICULARLY WITH A VIEW TO THE LONG TERM RELATIONS BETWEEN THE TWO COUNTRIES. AFTER THE SECOND WORLD WAR THE UK HAD GIVEN UP MANY COLONIES: HAVING HAD MORE COLONIES THAN OTHER COUNTRIES SHE HAD GIVEN UP MORE, STARTING WITH INDIA. WHEN CHINA RECOVERED HONG KONG SHE WOULD IMPLEMENT REALISTIC AND PRACTICAL POLICIES, WHICH WOULD NOT BE TO THE DISADVANTAGE OF THE UK, NOR DAMAGE THE UK. IF HONG KONG WERE TO GO ON ITS PRESENT POSITION, THE UK WOULD STILL REMAIN A COLONIAL POWER. HE ASKED WHETHER HONG KONG WAS THE LAST BRITISH COLONY. HE RECALLED THAT NOT LONG AGO A COLONY IN THE CARIBBEAN HAD BECOME INDEPENDENT. HE DID NOT KNOW IF WE HAD ANY OTHERS. MR HEATH REPLIED THAT THERE WERE A SMALL NUMBER OF COLONIES WHICH DID NOT WISH TO BE INDEPENDENT, FOR INSTANCE GIBRALTAR. MR DENG OBSERVED THAT BRITAIN'S QUARREL WITH SPAIN WAS NOT YET OVER. HE HOPED

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/ THAT

THAT MRS THATCHER AND HER GOVERNMENT WOULD ADOPT A WISE POLICY OVER HONG KONG, AND WOULD NOT GO INTO A DEAD END. HE HOPED THAT THE REPRESENTATIVES FROM THE EMBASSY WOULD TELL THE BRITISH GOVERNMENT THAT TO EXCHANGE SOVEREIGNTY FOR ADMINISTRATION WAS NOT POSSIBLE: BY 1997 CHINA WOULD RECOVER HONG KONG, AND THERE COULD BE NO CHANGE IN THIS POLICY. IF HE DID NOT DO THIS MR DENG WOULD GO DOWN AS A LI HONGZHANG IN HISTORY. ANYBODY WHO FAILED TO ADOPT THIS POLICY IN CHINA WOULD MEET THE SAME END.

4. MR HEATH SAID THAT HE WAS NOT OF COURSE IN THE CONFIDENCE OF THE BRITISH GOVERNMENT. MR DENG SAID THAT HE UNDERSTOOD THIS, AND HAD THEREFORE ASKED THE EMBASSY TO CONVEY HIS WORDS.

5. MR HEATH SAID THAT MR DENG HAD PREVIOUSLY TOLD HIM THAT WE SHOULD STUDY TAIWAN AND THE 9 POINTS. MR DENG SAID THAT HE HAD GONE BEYOND THE 9 POINT PROPOSAL RECENTLY WHEN TALKING TO AN AMERICAN PROFESSOR, PROFESSOR YANG. MR HEATH SAID THAT UNDER THE 9 POINTS TAIWAN WOULD KEEP HER PRIVATE ENTERPRISE SYSTEM AND MAKE HER OWN TRADING ARRANGEMENTS, AND HER CITIZENS WOULD TRAVEL FREELY. IT WOULD GVERN ITSELF AND KEEP ITS OWN ARMED FORCES. MR DENG SAID THAT TAIWAN WOULD ALSO BUY WEAPONS FOR ITS FORCES, THOUGH THE SITUATION WOULD BE DIFFERENT TO THE PRESENT, SINCE THEN THEY WOULD NOT NEED MANY WEAPONS.

6. MR HEATH ASKED HOW SUCH CONSIDERATIONS WOULD AFFECT HONG KONG. MR DENG REPLIED CHINA WOULD RECOVER SOVEREIGNTY, BUT EVERYTHING ELSE WOULD REMAIN THE SAME, AND THIS WAS SIMILAR TO TAIWAN. THE CHINESE GOVERNMENT WOULD NOT SEND PEOPLE TO HONG KONG. EVEN THE LEGAL SYSTEM MIGHT REMAIN THE SAME THOUGH THE HIGHEST APPEAL WOULD NOT BE TO LONDON, BUT WOULD REST IN HONG KONG.

7. MR HEATH SAID THAT MR DENG WAS A VERY PRACTICAL MAN. HE HAD READ A RECENT STATEMENT BY A PROMINENT CHINESE FIGURE TO THE EFFECT THAT NOTHING WOULD HAPPEN IN HONG KONG BEFORE 1997. MR DENG REPEATED THAT CHINA WOULD RECOVER SOVEREIGNTY IN 1997, AND THAT THERE WERE NOW 14 YEARS TO GO. THE PROCESS OF TRANSFERRING SOVEREIGNTY MUST BE CARRIED OUT WELL. THE CORE OF THE MATTER WAS THE SITUATION IN 1997, WHEN THE RECOVERY OF SOVEREIGNTY SHOULD BE EASILY ACCEPTED BY THE HONG KONG PEOPLE: THERE SHOULD BE NO DISTURBANCES OR DAMAGE IN HONG KONG. THIS WOULD BE BENEFICIAL TO ALL, AS WELL AS TO OTHER COUNTRIES WITH INTERESTS IN HONG KONG. DURING THE TRANSITIONAL PERIOD HONG KONG PEOPLE SHOULD PLAY AN INCREASING ROLE, THOUGH NOT AS YET THE MAIN ROLE, IN RUNNING HONG KONG, SO THAT THEY WULD KNOW HOW TO GOVERN HONG KONG IN 1997. THEY NEEDED FULLY TO UNDERSTAND THE POLITICAL, ECONOMIC, COMMERCIAL AND FINANCIAL SET UP OF HONG KONG: THEY SHOULD ENTER THE ADMINISTRATION GRADUALLY SO THAT THEY COULD GAIN THIS KNOWLEDGE.

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/ 8. ON 22

8. ON 22 SEPTEMBER WHEN NEGOTIATIONS RESTARTED THERE SHOULD BE NO FURTHER FUSS OVER SOVEREIGNTY OR THE RIGHT OF ADMINISTRATION. WE SHOULD DISCUSS WHAT WE SHOULD DO IN HONG KONG AFTER 1997, THE ARRANGEMENTS FOR THE TRANSITIONAL PERIOD AND THE GRADUAL INCLUSION IN THE ADMINISTRATION OF HONG KONG PEOPLE.

9. MR HEATH SAID THAT THESE WERE PRACTICAL POINTS. HE THOUGHT THAT THE HONG KONG PEOPLE DID UNDERSTAND THEIR SET UP VERY WELL, WHICH WAS WHY THEY WERE SO SUCCESSFUL. IF HE UNDERSTOOD MR DENG'S POLICIES CORRECTLY HE WOULD LIKE TO INTRODUCE THE SAME DYNAMISM IN CHINA. WE HAD TO RECOGNISE THAT THERE WERE TWO DIFFERENT POLITICAL SYSTEMS IN CHINA AND HONG KONG: IN THE LAST 15 YEARS THEY HAD WORKED WELL TOGETHER, BECAUSE BOTH COUNTRIES HAD BEEN PRACTICAL RATHER THAN LOGICAL. IN RELATION TO TAIWAN DID THE CHINESE HAVE IT IN MIND THAT THE 9 POINTS SHOULD BE SET OUT IN SOME KIND OF DECLARATION, PERHAPS PASSED BY THE CENTRAL COMMITTEE? MR DENG REPLIED THAT THE 9 POINTS WERE INTENDED TO SERVE AS A BASIS FOR NEGOTIATIONS WITH THE KMT ON A THIRD PERIOD OF COOPERATION BETWEEN THEM AND THE COMMUNIST PARTY. MR HEATH ASKED WHETHER THERE WOULD BE A BINDING AGREEMENT AT THE END OF SUCH NEGOTIATIONS. MR DENG REPLIED THAT THERE WOULD. MR HEATH SAID THAT PRACTICAL PROBLEMS WERE VERY IMPORTANT: HE NO LONGER HAD POWER AND RESPONSIBILITY, BUT HE DID NOT WANT CHINA TO SAY IN 1997 THAT HONG KONG HAD DETERIORATED AND WAS NO LONGER ANY GOOD. HE WANTED IT TO REMAIN AN IMPORTANT AND INFLUENTIAL CENTRE IN EAST ASIA, WHICH HE BELIEVED WAS LIKELY TO BE THE MOST DYNAMIC AND IMPORTANT REGION OF THE WORLD IN THE NEXT PERIOD OF HISTORY.

10. MR DENG SAID THAT BOTH SIDES SHOULD SETTLE THE HONG KONG PROBLEM SMOOTHLY. FRANKLY, CHINA KNEW THAT THE QUESTION COULD NOT BE SETTLED JUST TO ONE SIDE'S SATISFACTION: FOR THE REASON CHINESE POLICIES HAD BEEN WORKED OUT (AS FOR TAIWAN) THROUGH CAREFUL CONSIDERATION. THESE WERE NOT JUST EMPTY WORDS. CHINA HAD LAID ALL HER CARDS ON THE TABLE.

CLARK

FUTURE OF HONG KONG

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SIR A PARSONS " "  
MR WALKER, RESEARCH DEPT  
MR ROBERTS NEWS D GOGGS

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 TO IMMEDIATE FCO  
 TELEGRAM NUMBER 878 OF 10TH SEPT  
 INFO IMMEDIATE HONG KONG

## FUTURE OF HONG KONG: MR HEATH'S VISIT

1. MR HEATH HAD NEARLY TWO HOURS WITH DENG XHAOPING THIS MORNING 10 SEPTEMBER. DENG LOOKED EXTREMELY FIT AND BRONZED, AND SPOKE WITH VIGOUR. HIS TONE, THOUGH VERY FIRM ON HONG KONG, WAS FRIENDLY THROUGHOUT. MIFT CONTAINS A FULL RECORD OF THE PART OF THE CONVERSATION RELATING TO HONG KONG, WHICH WAS RAISED BY DENG AND NOT MR HEATH.
2. THE CONVERSATION CONTAINS NO REAL SURPRISES, AND IS A FURTHER AFFIRMATION FROM THE HIGHEST LEVEL THAT THERE WILL BE NO COMPROMISE ON BRITISH ADMINISTRATION. HOWEVER THE POINTS ABOUT INTRODUCING HONG KONG PEOPLE INTO THE ADMINISTRATION ARE INTERESTING, ALTHOUGH HE SHARED NO KNOWLEDGE OF HOW MUCH HAS ALREADY BEEN ACHIEVED IN THIS RESPECT.
3. MIFT IS NOT ENCOURAGING THAT DENG CLAIMED NOT TO HAVE EXAMINED THE DETAILS OF THE NEGOTIATIONS.

CLARK

### FUTURE OF HONG KONG

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Foreign and Commonwealth Office



London SW1A 2AH

9 September 1983

*Prime Minister*

*Agree last paper?*

*A.J.C. 12/2*

*Dear John,*

Future of Hong Kong: Briefing of Allies

We have so far kept the circle of knowledge about the negotiations on Hong Kong's future very close. This clearly remains important. However we are under increasing pressure from those who feel they ought to know. There is a difficult balance to strike here. Sir Geoffrey Howe is not particularly concerned about hurt feelings in this context.

But the chances of them doing or saying things which are damaging to confidence in Hong Kong are, in Sir Geoffrey's view, increased if they are completely unbriefed. He has therefore come to the conclusion that we should be a little more forthcoming in selected cases.

For some time now, with the Prime Minister's agreement, we have been keeping the Americans and, to a lesser extent, the Australians up-to-date in a general way at a high level. The Australians have been disappointed by what they see as our failure to take them fully into our confidence, given their particular interest in the region and their close relationship with us. It is true that, despite our briefings, the Australian Foreign Minister made one or two unhelpful remarks to the press about the Chinese plan for Hong Kong (which he described as encouraging) when he visited Hong Kong and Peking in August. But Sir Geoffrey Howe continues to think that we should give general briefings to the Australians. Anything else could be counter-productive. There is likely to be an opportunity for the Foreign and Commonwealth Secretary to speak to Mr Hayden in New York at the end of this month. A further opportunity could be provided by Mr Whitney's visit to Australia in early October, when the Australians have already said they would like to discuss Hong Kong.

/The Australians

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The Australians have asked separately if we could make available to them the contents of the four factual papers on how Hong Kong works which we handed to the Chinese. It would be damaging if the Chinese learnt that we had handed to a third party something laid on the negotiating table. We suggest that instead the Australians might be given a general account of what was in the papers (the contents of which were uncontentious).

The New Zealanders are also showing interest in Hong Kong both here and in Wellington. Like the Australians they have a regional interest as well as a close relationship with us. Again, Sir Geoffrey Howe will have an opportunity to say something to his New Zealand opposite number in mid-October; and Mr Whitney's visit in late September would also be a chance for a general exchange.

Finally, the Canadians take a close interest in China, and on occasions have passed us useful material in the Hong Kong context. But their perceptions of how things are going on Hong Kong are not always accurate. Briefings from us would help to set things straight. Here the Prime Minister's visit might be helpful. The Premier of Alberta, Mr Lougheed, whom Mrs Thatcher will meet, will just have returned from visiting China and Hong Kong. Mr Trudeau will be briefed on Hong Kong for the visit. (It is relevant that the Chinese Foreign Minister is visiting Canada in early October.)

We see no need to go wider than these old Commonwealth countries for the moment. But we have in mind also the possibility of taking the Japanese a little more into our confidence at some stage. They have of course a role to play in keeping up investors' confidence.

In short, if the Prime Minister agrees, we propose to bring the New Zealanders and the Canadians into the picture at a high level, and to keep them and the Australians generally up-to-date. We shall continue to provide the Americans with material in a little more detail. It would

/be desirable

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be desirable too if the Governor in Hong Kong and the Ambassador in Peking could keep their New Zealand and Canadian opposite numbers in the picture, as they do already in respect of the Australians and Americans.

*Yours ever*

*John Holmes*

(J E Holmes)  
Private Secretary

A J Coles Esq  
10 Downing Street

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-9 SEP 1983



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FM FCO 091445Z SEPT 83

TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 880 OF 9 SEPTEMBER

TO INFO IMMEDIATE PEKING

MIPT: FUTURE OF HONG KONG

FOLLOWING IS TEXT OF PAPER FOR EXCO:

1. 'INTRODUCTION. MINISTERS DISCUSSED THE POSITION IN SEPTEMBER WITH THE AMBASSADOR AND ME.

2. CHINESE POSITION. DURING THE FIRST THREE SESSIONS OF THE TALKS IN JULY AND AUGUST, THE CHINESE TOOK A VERY HARD LINE AGAINST THE CONTINUATION OF BRITISH ADMINISTRATION IN HONG KONG AFTER 1997 IE:

(A) SOVEREIGNTY AND ADMINISTRATION ARE INDIVISIBLE AND BOTH ARE NON-NEGOTIABLE:

(B) CHINA WOULD NEVER ACCEPT AN ARRANGEMENT WHEREBY CHINA HAD SYMBOLIC SOVEREIGNTY AND BRITAIN RETAINED ADMINISTRATION:

(C) HONG KONG PEOPLE SHOULD RUN HONG KONG:

(D) SOVEREIGNTY AND ADMINISTRATION SHOULD REVERT TO CHINA IN 1997:

(E) THEY INTENDED TO ANNOUNCE THEIR PLANS FOR THE FUTURE OF HONG KONG IN ONE OR TWO YEARS' TIME WHETHER OR NOT A BILATERAL AGREEMENT HAS BEEN REACHED.

3. THE LATEST AND MOST AUTHORITATIVE SUMMARY OF THE CHINESE PROPOSALS FOR THE ADMINISTRATION OF HONG KONG AFTER 1997 WAS GIVEN BY VICE FOREIGN MINISTER YAO GUANG IN THE TALKS ON 25 JULY. THIS INCLUDED THE FOLLOWING POINTS:

(A) HONG KONG WOULD BECOME A SPECIAL ADMINISTRATIVE REGION OF CHINA:

(B) THE GOVERNMENT WOULD BE DRAWN FROM THE LOCAL PEOPLE OF HONG KONG:

(C) THE ECONOMY, WAY OF LIFE AND BASIC FREEDOMS WOULD BE

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'PROTECTED' AND THE LAWS WOULD BE 'BASICALLY UNCHANGED'. THERE WOULD CONTINUE TO BE AN INDEPENDENT CONVERTIBLE CURRENCY AND 'EXTERNAL RELATIONS IN THE ECONOMY AND CULTURAL FIELDS' WOULD BE MAINTAINED.

4. THE CHINESE HAVE NOT GONE INTO DETAIL ABOUT THEIR PROPOSALS, WHICH THEY CLAIM WILL NOT DAMAGE CONFIDENCE. HOWEVER, IT IS MORE THAN PROBABLE THAT THEY WILL CONTINUE STRONGLY TO OPPOSE CONTINUATION OF BRITISH ADMINISTRATION, NOT MERELY IN ITS PRESENT FORM, BUT WITH ANY AUTHORITATIVE LINK THROUGH A GOVERNOR BY WHATEVER NAME RESPONSIBLE TO LONDON.

5. THERE ARE STRONG GROUNDS FOR BELIEVING THAT THIS IS MORE THAN A NEGOTIATING POSITION. THE CHINESE HAVE MADE CLEAR THAT THEIR NATIONAL PRIDE IS ENGAGED AND THAT WHILE THEY ARE PREPARED TO TOLERATE THE CONTINUATION OF THE PRESENT ARRANGEMENTS UP TO 1997, ANY CONTINUATION OF THE BRITISH COLONIAL LINK THEREAFTER WOULD BE UNACCEPTABLE. THEY VALUE THE ECONOMIC BENEFITS WHICH THEY OBTAIN FROM HONG KONG BUT HAVE CONSISTENTLY STATED THAT IF PUSHED TO CHOOSE, THEY WOULD SACRIFICE THOSE BENEFITS FOR POLITICAL REASONS. MOST IMPORTANT, THE CHINESE HAVE MADE PUBLIC THEIR POSITION ON BOTH SOVEREIGNTY AND ADMINISTRATION. TO RETREAT FROM THIS WOULD INVOLVE SERIOUS LOSS OF FACE.

6. BRITISH AIM AND CURRENT OBJECTIVES. HMG'S PUBLICLY STATED AIM IS TO SEEK A SOLUTION ON THE FUTURE OF HONG KONG WHICH WILL PRESERVE HONG KONG'S PROSPERITY AND STABILITY AND BE ACCEPTABLE TO THE BRITISH PARLIAMENT, TO THE CHINESE GOVERNMENT AND TO THE PEOPLE OF HONG KONG. THE BRITISH NEGOTIATING OBJECTIVE AGREED WITH EXCO AND UMELCO, BUT NOT PUBLICLY STATED, IS THE CONTINUATION OF BRITISH ADMINISTRATION FOR AS LONG AS POSSIBLE AFTER 1997.

7. FUTURE STRATEGY. MINISTERS HAVE AGREED THAT WHEN THE TALKS WITH THE CHINESE RESUME ON 22/23 SEPTEMBER, THE BRITISH TEAM SHOULD SEEK CHINESE REACTIONS TO THE PAPERS PRESENTED AT THE END OF THE LAST ROUND, AND CONTINUE TO ARGUE THAT THE AGREED COMMON OBJECTIVE OF MAINTAINING THE STABILITY AND PROSPERITY OF HONG KONG CAN ONLY BE ACHIEVED IF ARRANGEMENTS ARE MADE FOR THE CONTINUATION OF BRITISH ADMINISTRATION AFTER 1997.

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8. IF THE CHINESE ARE WILLING TO CONTINUE TO LISTEN TO BRITISH VIEWS WHILE ELABORATING THEIR OWN, THERE WILL BE NO DIFFICULTY ABOUT MAINTAINING THE PRESENT COURSE, AT ANY RATE FOR A FEW MORE MEETINGS. BUT THEY MAY WELL NOT DO SO. IN THAT CASE WE SHALL SOON BE FACED WITH TWO POSSIBILITIES.
9. THE FIRST WOULD BE TO MAINTAIN OUR PRESENT COURSE AIMED AT TH CONTINUATION OF BRITISH ADMINISTRATION. TO DO SO WOULD RUN THE RISK THAT THE TALKS WOULD SOON REACH STALEMATE OR BE BROKEN OFF BY THE CHINESE. THIS WOULD IN TURN ENTAIL A RISK OF PUBLIC CONFRONTATION WITH SERIOUS CONSEQUENCES FOR CONFIDENCE.
10. SECONDLY, WE COULD SEEK TO MAINTAIN THE BRITISH LINK THROUGH A GOVERNOR APPOINTED BY AND RESPONSIBLE TO HMG, BUT OFFER ADMINISTRATIVE CHANGES DESIGNED TO MAKE THE RETENTION OF THE BRITISH LINK MORE PALATABLE TO THE CHINESE. SUCH CHANGES MIGHT INCLUDE:
- (I) THE GOVERNOR TO BE A HONG KONG CHINESE.
  - (II) BRITISH TROOPS TO BE WITHDRAWN FROM HONG KONG (THERE WOULD HAVE TO BE A COMPENSATING INCREASE IN THE STRENGTH OF THE LOCAL SECURITY FORCES).
  - (III) APPEALS TO THE PRIVY COUNCIL TO BE ENDED, LEAVING THE REST OF THE LEGAL SYSTEM UNCHANGED.
  - (IV) A NUMBER OF CHANGES IN NOMENCLATURE AND STYLE.
11. CHINESE LONGER TERM ATTITUDE. THE CHINESE ARE LIKELY TO CONTINUE TO INSIST THAT DISCUSSION SHOULD BE ON THE BASIS OF THEIR PROPOSALS. THEY HAVE INDICATED THAT IF HMG WERE TO AGREE TO THIS THEY WOULD BE READY TO BE FLEXIBLE. THEY HAVE SAID THAT PROVIDED THAT HMG CONCEDED THEIR CONDITIONS ON SOVEREIGNTY AND 'THE POWER OF ADMINISTRATION', 'DISCUSSION ON THE MANY OTHER SUBJECTS WOULD BE RELATIVELY EASY'.
12. LONGER TERM RISKS. THERE ARE CONSIDERABLE RISKS IN STICKING TO OUR PRESENT POSITION, WHICH NEED CAREFUL CONSIDERATION. AS AN ALTERNATIVE WE HAVE THE OPTION OF OFFERING MODIFICATIONS TO THE PRESENT SYSTEM OF BRITISH ADMINISTRATION AS IN PARA 10. HOWEVER, GIVEN THE CHINESE POSITION ON THE INDIVISIBILITY OF SOVEREIGNTY AND ADMINISTRATION, THIS MAY ALSO BE REJECTED SOON. THERE WOULD AGAIN BE A HIGH RISK THAT THE TALKS WOULD REACH

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STALEMATE OR BREAK DOWN. THIS WOULD BECOME PUBLIC, WITH A SEVERE  
IMPACT ON CONFIDENCE IN HONG KONG.'

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FUTURE OF HONG KONG

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ED/PLANNING STAFF  
ED/FUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/FUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
MR WRIGHT

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MR COLES NO 10 DOWNING ST  
SIR A PARSONS " "  
MR WALKER, RESEARCH DEPT  
MR ROBERTS NEWS D GOGGS

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FM FCO 091548Z SEP 83

TO IMMEDIATE HONG KONG

TELEGRAM NUMBER 879 OF 9 SEPTEMBER

INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)

FUTURE OF HONG KONG: DISCUSSION WITH EXCO

1. MINISTERS HAVE AGREED THAT YOU SHOULD INITIATE A FULL DISCUSSION WITH EXCO ON THE CURRENT POSITION IN OUR TALKS WITH THE CHINESE. MIFT CONTAINS THE TEXT OF A PAPER WHICH MAY BE CIRCULATED TO EXCO MEMBERS UNDER THE USUAL SECURE CONDITIONS SHORTLY BEFORE THE MEETING.

2. IN INTRODUCING THE SUBJECT, YOU SHOULD SAY THAT YOU AND THE AMBASSADOR HAD A FULL DISCUSSION OF THE PROBLEM WITH THE PRIME MINISTER AND MYSELF. THE PAPER IS BASED ON THAT DISCUSSION. IT PROVIDES AN ASSESSMENT ON THE BASIS OF WHICH MINISTERS HOPE THAT EXCO CAN DISCUSS THE PRESENT POSITION, GIVE THEIR VIEWS ON IT AND IN PARTICULAR OFFER ADVICE ON THE FOLLOWING POINTS:

(A) THE EXTENT TO WHICH CONFIDENCE WOULD BE DAMAGED BY A STALEMATE OR BREAKDOWN IN THE TALKS WITH THE CHINESE. HOW FAR WOULD THIS LEAD TO AN INCREASED OUTFLOW OF MONEY OR SKILLED PERSONNEL FROM HONG KONG? WHAT WOULD BE THE DAMAGE TO THE ECONOMY AND TO PUBLIC MORALE? HOW QUICKLY WOULD ANY DAMAGE OCCUR TO WHAT EXTENT COULD IT BE REVERSED?

(B) EXCO'S VIEWS ON THE ACTION WE SHOULD TAKE IF THE CHINESE WERE TO STICK TO THE INDIVISIBILITY OF SOVEREIGNTY AND ADMINISTRATION IN THE TALKS ON 22/23 SEPTEMBER.

(C) IF EXCO CONSIDER THAT IT WOULD BE RIGHT TO MOVE TO THE COURSE SET OUT IN PARAGRAPH 10 OF THE PAPER, WHAT CHANGES IN THE PRESENT ADMINISTRATIVE ARRANGEMENTS IN HONG KONG COULD WE CONTEMPLATE SHORT OF THE SEVERANCE OF THE ADMINISTRATIVE LINK BETWEEN LONDON AND HONG KONG?

3. YOU SHOULD SAY THAT, AT THE 22/23 SEPTEMBER MEETING, OUR

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NEGOTIATORS WILL ADHERE TO OUR PRESENT LINE. THEY WILL MAINTAIN THE NEED FOR CONTINUING BRITISH ADMINISTRATION, RECALL THE ARGUMENTS ALREADY PUT FORWARD FOR THAT AND URGE THE CHINESE TO STUDY FURTHER THE MATERIAL WHICH WE HAVE PROVIDED. AT THE SAME TIME EXCO WILL UNDERSTAND THAT IT WILL BE VERY DESIRABLE TO GET AGREEMENT AT THE END OF THE 22/23 SEPTEMBER SESSION ON A DATE FOR THE NEXT MEETING. FAILURE TO ANNOUNCE THAT THE TALKS WILL CONTINUE AT A STATED TIME COULD HIT CONFIDENCE IN HONG KONG VERY BADLY. THE AMBASSADOR'S INSTRUCTIONS WILL NEED TO CONTAIN SUFFICIENT LATITUDE TO ACHIEVE THIS WITHOUT DEPARTING FROM OUR ESSENTIAL POSITION.

4. YOU SHOULD EXPLAIN TO EXCO THAT THEIR ADVICE WILL OF COURSE BE CAREFULLY CONSIDERED BEFORE MINISTERS REACH ANY DECISION. EXCO WILL MOREOVER HAVE THE OPPORTUNITY OF A FURTHER DISCUSSION AFTER THE 22/23 SEPTEMBER MEETING. THAT EXCO DISCUSSION WILL BE ATTENDED BY MR LUCE AND THE AMBASSADOR, WHO WILL BE VISITING HONG KONG.

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FUTURE OF HONG KONG

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ED/PLANNING STAFF  
ED/FUSD  
PS  
PS/LADY YOUNG  
PS/MR LUCE  
PS/FUS  
SIR J BULLARD  
MR GIFFARD  
MR DONALD  
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MR COLES NO 10 DOWNING ST  
SIR A PARSONS " "  
MR WALKER, RESEARCH DEPT  
MR ROBERTS NEWS D GOGGS

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10 DOWNING STREET

*From the Private Secretary*

9 September 1983

Future of Hong Kong

Thank you for your letter of 8 September enclosing draft telegrams of instructions for the Governor's discussion with ExCo next week. As I told you on the telephone earlier today the Prime Minister agrees that the telegrams may be despatched.

I am copying this letter to Richard Mottram (Ministry of Defence).

A. J. COLES

John Holmes, Esq.,  
Foreign and Commonwealth Office.

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Prime Minister

Foreign and Commonwealth Office

Sir A. Parris agrees with this. London SW1A 2AH

Agree that the instructions  
should be issued?

Yes not.

8 September 1983

A.S.C. 8/9

Dear John,

Future of Hong Kong

As requested in your letter of 5 September; I enclose draft telegrams of instructions for the Governor's discussion with ExCo next week. The first covers the general line which Sir E Youde should take with ExCo. The second contains the text of a paper to form the basis of the discussion, which he would circulate to members shortly before the meeting. The Governor has emphasised the importance of ExCo having an actual document to consider. Without this, experience has shown that their discussion would be likely to be diffuse and would not provide useful advice. As the Prime Minister knows, their record in maintaining the security of information of this sort is extremely good. They would of course only be shown the paper under secure conditions and would not be permitted to take it away.

I am copying this letter to Richard Mottram (MOD).

Yours ever  
John Holmes

(J E Holmes)  
Private Secretary

A J Coles Esq  
10 Downing Street



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Classification and Caveats

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1 ZCZC  
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6 FM FCO  
7 TO IMMEDIATE HONG KONG  
8 TELEGRAM NUMBER

9 INFO IMMEDIATE PEKING (PERSONAL FOR CHARGE)  
10 FUTURE OF HONG KONG: DISCUSSION WITH EXCO

11 1. Ministers have agreed that you should initiate a full  
12 discussion with ExCo on the current position in our talks with  
13 the Chinese. MIFT contains the text of a paper which may be  
14 circulated to ExCo members under the usual secure conditions  
15 shortly before the meeting.

16 2. In introducing the subject, you should say that you and the  
17 Ambassador had a full discussion of the problem with the Prime  
18 Minister and myself. The paper is based on that discussion. It  
19 provides an assessment on the basis of which Ministers hope that  
20 ExCo can discuss the present position, give their views on it  
21 and in particular offer advice on the following points:

/// 22 (a) the extent to which confidence would be damaged by a  
// 23 stalemate or breakdown in the talks with the Chinese. How far  
/ 24 would this lead to an increased outflow of money or skilled  
25 personnel from Hong Kong? What would be the damage to the

NNNN ends telegram	BLANK	Catchword economy
File number	Dept Private Office	Distribution  FUTURE OF HONG KONG
Drafted by (Block capitals) J E Holmes		
Telephone number		
Authorised for despatch		
Comcen reference	Time of despatch	

OUT TELEGRAM (CONT)

	Classification and Caveats  SECRET	Page  2
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 2 economy and to public morale? How quickly would any damage occur?  
 3 To what extent could it be reversed?  
 4 (b) ExCo's views on the action we should take if the Chinese  
 5 were to stick to the indivisibility of sovereignty and  
 6 administration in the talks on 22/23 September.  
 7 (c) If ExCo consider that it would be right to move to the  
 8 course set out in paragraph 10 of the paper, what changes in the  
 9 present administrative arrangements in Hong Kong could we  
 10 contemplate short of the severance of the administrative link  
 11 between London and Hong Kong?  
 12 3. You should say that, at the 22/23 September meeting, our  
 13 negotiators will adhere to our present line. They will maintain  
 14 the need for continuing British administration, recall the  
 15 arguments already put forward for that and urge the Chinese to  
 16 study further the material which we have provided. At the same  
 17 time ExCo will understand that it will be very desirable to  
 18 get agreement at the end of the 22/23 September session on a date  
 19 for the next meeting. Failure to announce that the talks will  
 20 continue at a stated time could hit confidence in Hong Kong very  
 21 badly. The Ambassador's instructions will need to contain  
 22 sufficient latitude to achieve this without departing from our  
 23 essential position.  
 24 4. You should explain to ExCo that their advice will of course  
 25 be carefully considered before Ministers reach any decision.  
 26 ExCo will moreover have the opportunity of a further discussion  
 27 after the 22/23 September meeting. That ExCo discussion will be  
 28 attended by Mr Luce and the Ambassador, who will be visiting  
 29 Hong Kong.

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Classification and Caveats  
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7 TO IMMEDIATE HONG KONG  
8 TELEGRAM NUMBER

9 AND TO INFO IMMEDIATE PEKING  
10 MIPT: FUTURE OF HONG KONG  
11 Following is text of paper for EXCO:  
12 1. "Introduction. Ministers discussed the position in September  
13 with the Ambassador and me.  
14 2. Chinese Position. During the first three sessions of the  
15 talks in July and August, the Chinese took a very hard line  
16 against the continuation of British administration in Hong Kong  
17 after 1997 ie:  
18 (a) sovereignty and administration are indivisible and both are  
19 non-negotiable:  
20 (b) China would never accept an arrangement whereby China had  
21 symbolic sovereignty and Britain retained administration:  
22 (c) Hong Kong people should run Hong Kong:  
23 (d) sovereignty and administration should revert to China in  
24 1997:  
25 (e) they intended to announce their plans for the future of

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File number	Dept HKD	Distribution Future of Hong Kong
Drafted by (Block capitals) R D CLIFT		
Telephone number 233 8732		
Authorised for despatch		
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OUT TELEGRAM (CONT)

Classification and Caveats

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2 Hong Kong in one or two years' time whether or not a bilateral  
3 agreement has been reached.

4 3. The latest and most authoritative summary of the Chinese  
5 proposals for the administration of Hong Kong after 1997 was  
6 given by Vice Foreign Minister Yao Guang in the talks on 25 July.  
7 This included the following points:

8 (a) Hong Kong would become a Special Administrative Region of  
9 China;

10 (b) the Government would be drawn from the local people of Hong  
11 Kong;

12 (c) the economy, way of life and basic freedoms would be  
13 "protected" and the laws would be "basically unchanged". There  
14 would continue to be an independent convertible currency and  
15 "external relations in the economy and cultural fields" would be  
16 maintained.

17 4. The Chinese have not gone into detail about their proposals,  
18 which they claim will not damage confidence. However, it is  
19 more than probable that they will continue strongly to oppose  
20 continuation of British administration, not merely in its present  
21 form, but with any authoritative link through a Governor by  
22 whatever name responsible to London.

23 5. There are strong grounds for believing that this is more than  
24 a negotiating position. The Chinese have made clear that their  
25 national pride is engaged and that while they are prepared to  
26 tolerate the continuation of the present arrangements up to 1997,  
27 any continuation of the British colonial link thereafter would be  
28 unacceptable. They value the economic benefits which they obtain  
29 from Hong Kong but have consistently stated that if pushed to  
30 choose, they would sacrifice those benefits for political reasons.  
31 Most important, the Chinese have made public their position on  
32 both sovereignty and administration. To retreat from this would  
33 involve serious loss of face.

34 6. British aim and current objectives. HMG's publicly stated

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OUT TELEGRAM (CONT)

Classification and Caveats

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1 aim is to seek a solution on the future of hong Kong which will  
 2 prese<sup>nt</sup> Hong Kong's prosperity and stability and be acceptable to  
 3 the British Parliament, to the Chinese Government and to the  
 4 people of Hong Kong. The British negotiating objective agreed  
 5 with ExCo and UMELCO, but not publicly stated, is the  
 6 continuation of British administration for as long as possible  
 7 after 1997.

8 7. Future strategy. Ministers have agreed that when the talks  
 9 with the Chinese resume on 22/23 September, the British team  
 10 should seek Chinese reactions to the papers presented at the end  
 11 of the last round, and continue to argue that the agreed common  
 12 objective of maintaining the stability and prosperity of Hong  
 13 Kong can only be achieved if arrangements are made for the  
 14 continuation of British administration after 1997.

15 8. If the Chinese are willing to continue to listen to British  
 16 views while elaborating their own, there will be no difficulty  
 17 about maintaining the present course, at any rate for a few more  
 18 meetings. But they may well not do so. In that case we shall  
 19 soon be faced with two possibilities.

20 9. The first would be to maintain our present course aimed at the  
 21 continuation of British administration. To do so would run the  
 22 risk that the talks would soon reach stalemate or be broken off  
 23 by the Chinese. This would in turn entail a risk of public  
 24 confrontation with serious consequences for confidence.

25 10. Secondly, we could seek to maintain the British link through  
 26 a Governor appointed by and responsible to HMG, but offer  
 27 administrative changes designed to make the retention of the  
 28 British link more palatable to the Chinese. Such changes might  
 29 include:

30 (I) the Governor to be a Hong Kong Chinese.

/// 31 (II) British troops to be withdrawn from Hong Kong (there would  
 // 32 have to be a compensating increase in the strength of the local  
 / 33 security forces).

34 (III) Appeals to the Privy Council to be ended, leaving the rest

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OUT TELEGRAM (CONT)

Classification and Caveats

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 2 of the legal system unchanged.  
 3 (IV) A number of changes in nomenclature and style.  
 4 11. Chinese longer term attitude. The Chinese are likely to  
 5 continue to insist that discussion should be on the basis of their  
 6 proposals. They have indicated that if HMG were to agree to this  
 7 they would be ready to be flexible. They have said that  
 8 provided that HMG conceded their conditions on sovereignty and  
 9 "the power of administration", "discussion on the many other  
 10 subjects would be relatively easy".  
 11 12. Longer term risks. There are considerable risks in sticking  
 12 to our present position, which need careful consideration. As  
 13 an alternative we have the option of offering modifications  
 14 to the present system of British administration as in para 10.  
 15 However, given the Chinese position on the indivisibility of  
 16 sovereignty and administration, this may also be rejected soon.  
 17 There would again be a high risk that the talks would reach  
 18 stalemate or break down. This would become public, with a severe  
 19 impact on confidence in Hong Kong.\*  
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The National Archives

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10 DOWNING STREET

*From the Private Secretary*

5 September 1983

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FUTURE OF HONG KONG

The Prime Minister held a meeting this afternoon to discuss the above subject. I enclose a note of the main points made during the discussion.

It was agreed that a draft telegram of instructions covering the line which the Governor should take with EXCO on his return to Hong Kong should be prepared and submitted to the Prime Minister for her approval.

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I am copying this letter and enclosure to Richard Mottram (Ministry of Defence).

A.J. COLES

John Holmes, Esq.,  
Foreign and Commonwealth Office.

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NOTE OF A MEETING HELD AT 1600 HOURS ON MONDAY 5 SEPTEMBER 1983  
AT No. 10 DOWNING STREET

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PRESENT

- Prime Minister
- Foreign and Commonwealth Secretary
- Secretary of State for Defence
- Mr. Luce
- Chief of Defence Staff
- Sir Antony Acland
- Sir Percy Cradock
- Sir Edward Youde
- Sir Ian Sinclair
- Mr. Donald
- Sir A. Parsons
- Mr. John Coles

\* \* \* \* \*

The Prime Minister asked Sir Percy Cradock to give his assessment of the latest Chinese position.

Sir Percy Cradock said that the three rounds of talks held so far had gone much as had been expected. We had achieved at least part of our aim in that we had begun a process of educating the Chinese in the complexities of Hong Kong. The Chinese had been affable, had listened carefully to our statements and had seemed glad to have the papers which we had provided. They might now more readily appreciate the complexities of Hong Kong but there was no sign that their basic attitude had changed. They insisted that administration should pass to China, together with sovereignty, in 1997. Unless we made some move towards accepting their position on this point there was a danger of deadlock in the talks. He did not believe that the Chinese would themselves make a move. It was therefore necessary to decide whether we should hold to our present position or consider various types of concession. One particular problem was that the timing of each session of talks was now publicly known and it had become the practice at the end of one session to announce

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the date of the next. Thus, if the Chinese decided to hold up progress this would become known publicly and have a bad effect on confidence in Hong Kong.

The options before us were set out in the FCO paper on "The Future of Hong Kong: Talks with the Chinese: A Re-appraisal One Year On". He himself believed that there was a stark choice between options A and C. It might be necessary to approach option C via option B but he doubted whether it would be possible to keep B in play for long.

Sir Edward Youde said that confidence in Hong Kong remained volatile. It had been holding up fairly well recently but the Hong Kong dollar was slowly drifting down and over the past year had done so quite substantially despite the Colony's good export performance. The bulk of the Hong Kong population had adopted a "wait and see" attitude towards the talks but the investors and the professionals were becoming nervous. The latter groups were facing a new Chinese propaganda campaign which argued that the Chinese plan for Hong Kong would work and that British administration was not necessary. There was still a widespread wish that British administration should continue after 1997 but many people in Hong Kong were doubtful whether this could be achieved.

It should be recognised that for EXCO to abandon the aim of continued British administration would be a traumatic matter for them. They believed that HMG had undertaken to pursue the objective of British administration. They were now waiting to see what would happen in September. As to the future, some members of ECXO would advocate brinkmanship. Others would be more disposed to look for ways forward. But he could not predict how EXCO would divide when the options were put to them.

The Prime Minister asked whether we could not adopt the following approach: we would tell the Chinese that we had described the factors which we believed to be necessary for stability and prosperity to continue; the Chinese for their part claimed to have an alternative system that would maintain confidence and be acceptable to the people of Hong Kong; we proposed that they should describe this system in detail in the

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next phase of the talks.

It was important to keep the talks going. For if they were broken off there was a risk that the Chinese would foment disturbances in Hong Kong and create a situation where the Armed Forces and the Police were actively involved in maintaining order.

The Foreign and Commonwealth Secretary said that he believed that the effort to produce a solution to this problem was one of the most difficult diplomatic tasks ever attempted. Ninety-two per cent of the land and 50 per cent of the population of Hong Kong would pass to the Chinese in 1997 without them doing anything. Given the cards we held, agreement on satisfactory arrangements for the future would be an outstanding achievement. It might be that the prize was unattainable. He saw some attractions in the Prime Minister's suggestion that we should persuade the Chinese to present their own proposal in detail, leaving aside the verbal arguments about sovereignty and administration. But there was a risk that the Chinese would refuse to proceed until we had accepted their position on these matters. We had to ask ourselves whether a rupture of the talks would, as the FCO paper stated, do irreversible damage.

Sir Percy Cradock said that it would be possible to adopt the approach suggested by the Prime Minister but it should be recognised that the Chinese would take this as a sign that we were changing our fundamental position. Thus, a statement of our willingness to listen to an exposition of their formula for the future would be a prelude towards the adoption of option C. The Foreign and Commonwealth Secretary added that we should also take into account the risk that it would become known in Hong Kong that we were changing our position and that this would have an adverse effect on confidence in the Colony.

Sir Percy Cradock said that the Chinese would be likely to say, in response to our request that they should expound their own plan, that they had already done so. Before he had left Peking for leave, the Chinese had impressed upon him that they were hoping he would return to the talks in September with good news about a change in the British position.

The Foreign and Commonwealth Secretary said that if we remained absolutely firm in our approach and this led to a rupture of the talks and the collapse of confidence, there was the political risk that critics would say that British rigidity had brought this situation about. The Prime Minister commented that it could be argued in return that her letter to the Chinese Premier had shown considerable flexibility. She was concerned that if, following that concession, we made a further concession it would simply be pocketed by the Chinese and we should appear to be weak.

Sir Percy Cradock said that he was in no doubt that we should maintain our present position at the next round of talks on 22/23 September. But the Chinese believed that the acquisition by them in 1997 of sovereignty and administration was a basic pre-requisite for agreement. It remained to be seen how in practice they would define the two terms. If we moved towards acceptance of their position, we could not be sure what attitude they would then adopt. They might simply say that it only remained to discuss the transitional period. The Prime Minister said that we could not get ourselves into a position where we had, in effect, handed Hong Kong to the Chinese subject merely to a discussion of transitional arrangements.

Sir Edward Youde said that he would find it valuable to have the judgement of EXCO on the various options. Its members were all intimately involved in the Hong Kong economy and their views would be important to eventual decisions.

Mr. Luce asked whether it was really the case that the Chinese were likely to provoke a breakdown in the talks at this stage. There could be no doubt that we had to carry EXCO with us. It might be worth running the risk of playing tough at the next stage of the talks and thereby demonstrate to EXCO the limits to Chinese willingness to move.

The Foreign and Commonwealth

The Foreign and Commonwealth Secretary said that he would like to see the talks take a more practical turn. We needed to get away from verbal arguments about sovereignty and administration. In the end, it was the British Governorship which was crucial. It was very difficult to see the Chinese accepting a regime where Britain continued to appoint the Governor. But if that were so, then the alternative was to adopt the outlines of the Chinese plan and try to inject a content that was more acceptable. The Prime Minister commented that if we went along this route we should have to aim for something close to total autonomy for Hong Kong. The Foreign and Commonwealth Secretary pointed out that this might be reconcilable with the Chinese concept of a Special Administrative Zone.

Sir Percy Cradock said that words mattered greatly in these negotiations. If we could concede words which helped the Chinese on their concepts of sovereignty and administration we might be able to devise a practical system for the future which met our essential points. Sir Edward Youde commented that at present it was the symbolic link provided by the Governor which was all important. If we abandoned that, what would we put in its place?

The Prime Minister asked what the Chinese would do if the talks broke down. Sir Percy Cradock replied that if the breakdown led to disturbances in Hong Kong the Chinese might carry out their threat to intervene. Sir Edward Youde said that his worry was that Hong Kong might be faced with the novel situation of a steadily declining economy. In response to a question from Sir Anthony Parsons, he said that he believed such a downward trend could begin if it became known in Hong Kong that we were trying to negotiate a system of autonomy for the Colony. He believed that EXCO, faced with options B and C, would select the former because it maintained the lifeline of the Governorship. But option C was an entirely different proposition.

The Prime Minister said that the question arose of whether it was better that confidence should collapse because we had made concessions or because we had maintained a position of principle. Sir Percy Cradock said that we needed to ask what Hong Kong's choice would be. Sir Edward Youde commented that that was why a /discussion with

discussion with EXCO was necessary. Sir Percy Cradock said that he doubted whether option B would keep the talks going for more than two or three meetings. There was a danger that we might prejudice option C by making concessions under option B to which the Chinese would later attempt to hold us. In effect, either now or in October, we should have to face the choice between options A and C.

The Foreign and Commonwealth Secretary said that it would be important to keep influential MPs closely informed. Mr. Luce said that in his view Parliamentary opinion was chiefly concerned with the prospects for obtaining a settlement which guaranteed stability - there was much less interest in the precise nature of the settlement or how we obtained it. The Prime Minister commented that there was also interest in the extent to which a settlement was genuinely acceptable to the people of Hong Kong. The Government might face criticism in the future for failing to do enough to mobilise Hong Kong opinion behind our policy. Sir Percy Cradock observed that the mobilisation of opinion, e.g. through a referendum might provoke a Chinese response which would not be in the interests of Hong Kong.

Sir Antony Acland asked whether, if EXCO reluctantly decided to endorse option C, they would be able to persuade the people of Hong Kong of its merits. The Prime Minister said that for EXCO the adoption of option C would be to disappoint their main ambition of continued British administration and would risk a total collapse of confidence. The Foreign and Commonwealth Secretary said that a breakdown in the talks might have the same effect.

Sir Percy Cradock reiterated his view that we should aim to give the Chinese the outer form of what they wanted but to fill that form with the substance of our own requirements. This was a very risky course but was the best approach.

Following further discussion of future tactics, the Prime Minister stated that at the next round of talks on 22/23 September the Ambassador should maintain our present position. It would be necessary to consult EXCO shortly about the latest situation. We should give EXCO an honest account of /our fears

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our fears but should in no sense imply that a policy decision had been taken in favour of any of the options in the FCO paper or even that option C was being seriously considered. A draft telegram of instructions should be prepared, covering the line that the Governor would take with EXCO on his return to Hong Kong, and should be submitted to her for approval.

The discussion ended at 1810.

5 September 1983

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PM/83/64

PRIME MINISTERFuture of Hong Kong: Reappraisal of Strategy

1. We are meeting on the afternoon of 5 September with Sir Edward Youde and Sir Percy Cradock to discuss the next steps in our negotiations with the Chinese. I propose to bring Richard Luce with me. Sir Antony Acland, Sir Ian Sinclair and Mr Alan Donald will also attend.
- / 2. I enclose a paper prepared in the FCO which reviews the present position and makes suggestions for our next moves. I also enclose telegrams reporting our talks with the Chinese during July and August together with a checklist of the main points which I think it would be useful for us to discuss.
3. The paper provides a frank survey of the present position and the problems which face us. It brings out particularly the dilemma we face, given our assessment of the Chinese position, if this is right, and the need to keep Hong Kong opinion, and particularly EXCO, closely in step with us.
4. We have now tested the Chinese out for a year on the concept of a sovereignty/administration deal. Sir P Cradock's assessment is that they do not accept this; indeed that they will reject any arrangement which involves a controlling link with Britain in the form of a Governor answerable to London beyond 1997. We need to look at this very carefully against our relationship with and the views of EXCO and the need to show convincingly here and in Hong Kong that we have fought for the best possible deal for Hong Kong, in the context of what is necessary to maintain confidence.



5. What we need to have in mind is the best ultimate position we are likely to be able to reach in negotiation with Peking and the best way of reaching this. The paper discusses this in the form of three options. There are some key questions here: how far should we be prepared to take a test of nerves with the Chinese, given the possible effect on Hong Kong confidence of a breakdown in the talks? If the Chinese definitively reject our present approach is there likely to be any mileage in trying a refined version of the British link to make it more palatable to the Chinese? Is moving relatively quickly on to Chinese ground, accepting the break of the British link, likely to increase the chances of negotiating in the end a reasonable package, or will the Chinese simply pocket the concession and demand more? Is it possible to devise an arrangement which would involve autonomy for Hong Kong free from mainland Chinese interference after 1997?

6. The timing of any change of position on our part is likely to be crucial. I am sure that at the next meeting with the Chinese on 22 September we should hold to our present position and test their reaction. But we must be ready to look beyond that. In any case I am sure that the Governor on his return to Hong Kong should give EXCO a very full and candid assessment of the position and of the options as we see them. He should not only seek their views but make clear that there may be a need for rapid decisions in the autumn. They will need very careful handling over this. Richard Luce's visit in late September will provide an opportunity for a further exchange of views. But it might well be necessary for EXCO to visit London again for further discussion here.

7. The essential minimum we need to decide on Monday is the line the Governor should take with EXCO and the Ambassador should take in the next round of talks..

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8. I am copying this minute, with its enclosures, to Michael Heseltine.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

2 September, 1983

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PRIME MINISTER'S MEETING ON THE FUTURE OF HONG KONG

1600 MONDAY 5 SEPTEMBER 1983

AGENDA

1. Assessment of Chinese position (Ambassador).
2. Assessment of mood in Hong Kong, EXCO (Governor).
3. Discussion of the options set out in paragraph 7 of Reappraisal Paper.
4. Timing of any shifts of strategy; problems we are likely to face.
5. Line for Governor to take with EXCO on his return to Hong Kong.
6. Line for Ambassador to take at next session of talks on 22/23 September.

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THE FUTURE OF HONG KONG  
TALKS WITH THE CHINESE  
A REAPPRAISAL ONE YEAR ON  
BY THE FOREIGN & COMMONWEALTH OFFICE

AUGUST 1983

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FUTURE OF HONG KONG

TALKS WITH THE CHINESE: A REAPPRAISAL OF OUR STRATEGY ONE YEAR ON

INTRODUCTION

1. Talks with the Chinese have gone into recess until late September. This paper considers the current position and reviews the options now open to us.

THE CHINESE POSITION

2. Although our talks with the Chinese have developed more rapidly since the exchange of letters between the Prime Minister and Premier Zhao in the spring, the Chinese have taken a very hard line against the continuation of British administration\* in Hong Kong after 1997. They have said:

- (a) Sovereignty and administration are indivisible and both are non-negotiable;
- (b) China will never accept an arrangement whereby China had symbolic sovereignty and Britain retained administration;
- (c) arrangements should be made for Hong Kong people to run Hong Kong;
- (d) 1997 is the date for transfer of sovereignty; (this was confirmed on 15 August in a remark by the CCP General Secretary);
- (e) they intend to announce their plans for the future of Hong Kong in one or two years' time whether or not a bilateral agreement has been reached.

3. The Chinese proposals for the administration in Hong Kong after 1997 were outlined by Vice Minister Yao Guang in the talks on 25 July. This is the latest and most authoritative statement. It included the following points:

\*British administration in its present form means ultimate control from London through a Governor responsible to HMG but with a large measure of de facto autonomy.

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- (a) Hong Kong would become a Special Administrative Region of China.
- (b) The Government would be drawn from the local people of Hong Kong.
- (c) The economy and way of life and basic freedoms would be "protected" and the laws would be "basically unchanged". There would be an independent convertible currency and "existing external relations in the economic and cultural fields" would be maintained.

The Chinese have not gone into detail on their proposals, which they claim will not damage confidence. However, if they stick to their position it is clear that they will not agree to the continuation of British administration, not merely in its present form but with any authoritative link through a Governor responsible to London. Our judgement is that they will stick on this essential point. They have published their position on the recovery of sovereignty and administration widely, and could only shift with unacceptable loss of face. They have made clear that where matters of national pride are concerned, they will not compromise. This means that we are unlikely to succeed in getting the Chinese to agree to preserve what we believe to be the most important requirement for sustaining confidence in Hong Kong. In any case the only prudent assumption on which to base our plans is that this will prove to be the case.

4. Thus, although the Chinese will study the case for continuing British administration, which we have made during the July and August sessions, this is unlikely to affect their position fundamentally. The best we can expect is that they will have learnt something about the complexity of Hong Kong administration. This may make them more ready to consider arrangements to preserve confidence in specific areas of administration, but on their own terms, and without the controlling British link through the Governor.

5. When or soon after talks resume in September, we may well face a Chinese demand for acceptance of their position on both sovereignty and administration in 1997: in effect a rejection of our

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position. They might even threaten to break off the talks. This could be accompanied or preceded by further Chinese leaks and wedge-driving propaganda, accusing HMG of footdragging or claiming that we had in fact conceded sovereignty.

BRITISH AIM AND CURRENT OBJECTIVES

6. HMG's publicly stated aim is to seek a solution on the future of Hong Kong acceptable to the British Parliament, the Government of China and the people of Hong Kong. At present our negotiating objective, agreed with EXCO but not publicly stated, is the continuation of British administration for as long as possible after 1997. We have opened substantive talks with the Chinese on the basis of an agreed agenda which, in our view, is consistent with the position in the Prime Minister's letter to the Chinese Premier. She could only recommend a transfer of sovereignty if an arrangement on administration acceptable to the three parties concerned could be agreed.

FUTURE STRATEGY OPTIONS

7. If, as expected, there is no shift in the Chinese position, when talks resume in September, HMG will face the following choices:

- (a) To maintain our present course aimed at the continuation of British administration on present lines, including the position and authority of the Governor, although continuing and possibly increasing internal autonomy. (In doing this we should have to be prepared to face the consequences of confrontation).
- (b) To seek to maintain the British link through a Governor, not necessarily an expatriate, appointed by and responsible to, HMG but with major administrative changes designed to make this more palatable to the Chinese.
- (c) To accept ending of an authoritative British link but to negotiate improvements to the Chinese proposals for autonomy in order to keep future Chinese interference to a minimum.

FACTORS AFFECTING HMG'S CHOICE

8. We must take into account:
- (a) Our assessment of the Chinese position;
  - (b) attitudes in Parliament and the UK generally;
  - (c) opinion in EXCO and Hong Kong generally.

Given the assessment of the Chinese position and the realisation in Hong Kong that HMG is obliged in any case to recognise the juridical implications of 1997, the arguments for accepting the Chinese conditions but trying to build in safeguards are strong. We believe that the chances of negotiating a better deal than this are slim and, if we waited too long the Chinese might be less willing to negotiate additional safeguards for Hong Kong which might provide some substitute for the withdrawal of the British link. They might moreover lose patience and announce their own proposals unilaterally.

9. However, HMG are obliged to show, both in the UK and Hong Kong, that they have done everything possible to achieve a deal for Hong Kong which is acceptable to the people of Hong Kong and will maintain confidence. Close consultation with EXCO is the key element in demonstrating that HMG are serious about acceptability. This means that HMG's strategy has to be tempered not only by our assessment of what Peking will accept, but also by an assessment of what Hong Kong, as represented by EXCO, regards as the minimum required to maintain stability and prosperity. EXCO's own credibility in Hong Kong is also at stake and their worries on these counts will affect their readiness to consider major shifts in our strategy as and when proposals are put to them. Our present negotiating objective, the continuation of British administration after 1997, is based to a great extent on Unofficials' advice and is not a stance from which they would easily be prepared to retreat. There will certainly be a body of opinion in EXCO which will favour digging in on our present position, taking the risk of a decline in confidence in Hong Kong and hoping that this will bring about a change of heart on the part of the Chinese. They will set particular store by the maintenance of an authoritative link through a British appointed Governor. They will be suspicious of

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suggestions by HMG that we should move in any other way than by cautious steps, allowing a long time to test the Chinese position on every essential point.

10. The possible options are considered in more detail against this background.

OPTION A- To maintain our present course.

11. In practical terms, we could stick to our present position either while continuing negotiation or during a suspension of the talks. Either course could give an initial impression of firmness and would probably be favoured at least initially by EXCO. But neither would be a realistic long-term option. There is no chance of the Chinese accepting confirmation of the administrative status quo. If we tried to continue talks on these lines we should before long run into stalemate. This would quickly become apparent in Hong Kong. Suspension of the talks would be even more public. Public knowledge of fundamental disagreement between Britain and China would lead to collapse of confidence in Hong Kong. The Chinese would be very likely to react by announcing their own proposals and possibly by threatening to take over earlier than 1997. Even if they did not go that far, we should be in a rapidly weakening position. People in Hong Kong would not believe that by holding firm, we could hope to obtain a better deal for Hong Kong in the long run. Our actions would be seen against the background of the approach of 1997 and the Chinese stranglehold on Hong Kong. There is no prospect at all that the Chinese would react to a rapid slide in confidence by reversing their position of principle and agreeing to the continuation of British administration. They might carry out Deng's threat to the Prime Minister in September 1982 to reconsider the timing 'of recovery of sovereignty'; if they did not go as far as this they could still cause considerable disruption by letting HMG take the responsibility and stepping up propaganda and subversion.

OPTION B - To propose modifications to make the British link more acceptable to Peking

12. Here the idea would be to work for the preservation of the British link through a Governor responsible to HMG but with administrative changes designed to remove elements of 'colonialism'

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and to make the system, particularly the position of the Governor, more palatable to the Chinese. The possible changes are discussed in Annex I.

13. The main problem is that there are clear indications that the Chinese would object the retention of a Governor responsible to HMG, however much this was dressed up. A new-look British administration on these lines would be acceptable to EXCO provided that measures designed to make it acceptable to the Chinese did not, in their cumulative effect, so obscure the British link as to destroy confidence in Hong Kong. The Governor's judgement is that they might agree to a negotiating position on these lines provided that our blueprint included a Governor appointed by and responsible to HMG.

14. There is thus already a large gap between what the Chinese are likely to concede and what EXCO would regard as adequate to preserve confidence. But the latter would moreover be likely to demand a long battle with the Chinese before they would accept that the position of the Governor should be given up. While that was in progress the danger would remain that the Chinese would unilaterally announce their plan for 'autonomy' with no additional guarantees. There could be an irreparable collapse of confidence for which HMG would be held responsible because it occurred under British administration. There could only one ultimate outcome, namely, a handover of the territory in circumstances which would add to the humiliation already caused by the collapse.

15. An additional factor is that, whatever the progress in the talks, it will be necessary to develop further the steps already taken towards internal autonomy, especially towards greater participation by Hong Kong Chinese in government. Not all of these will be welcome to Peking. Some may be regarded as a device intended to promote Hong Kong's independence. They therefore need to be introduced with caution and not allowed to cut across our discussion of changes with the Chinese.

OPTION C: Negotiation for Effective Safeguards for Autonomy for Hong Kong without an Authoritative Political Link with the UK

16. This would mean accepting that both sovereignty and at least



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ultimate control over administration would revert to China and that the British link would be cut. But we should not simply accept the Chinese 'plan' as it stands. It should be possible to improve on it considerably.

17. To move to this Option now would win Chinese goodwill. It would create an atmosphere in which Peking might be more inclined to agree to arrangements which would provide alternative insulators and incentives to the Chinese not to interfere. However the arguments against this course are:

- (a) We have not yet fully tested Chinese flexibility. The Chinese might on the contrary be more ready to agree to effective alternative insulators if we only conceded on the British link after a hardnegotiation. In other words, we should not give too much too early.
- (b) EXCO would not agree to the idea if taken as a single step. Nor would the people of Hong Kong be prepared for it. All the available evidence shows that the majority still want British administration to continue.
- (c) Therefore, even though agreement might be reached with Peking, HMG would risk a collapse of confidence in Hong Kong.

18. These objections would not apply so strongly if we reached Option C via Option B. There would of course still be serious damage to confidence in Hong Kong if the controlling British link were cut.

But, provided that we kept closely in touch with EXCO at each stage, they might accept the idea, although they would still argue that the process of testing the Chinese position should last for a long time.

19. Annex II considers a number of possible devices which might either bind or encourage China to respect Hong Kong's autonomy or provide alternative insulators to the present British link. We should be prepared to put these forward at the right time. We might start the process by probing the Chinese on the details of their own plans, in order to point up the need for additional insulation.

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SQUARING THE TRIANGLE

20. We face a gap which will require either a fundamental change of heart by the Chinese or substantial shift in the attitude of the people of Hong Kong, in particular the investors and professional classes. Neither is likely. British political interests demand a settlement acceptable to the people of Hong Kong. If British interests involved only the bilateral relationship with China and the advantages to us of maintaining a dependent territory in the Far East of which 92% would in any case revert to China in 1997, the right course would almost certainly be to negotiate on Chinese terms. But HMG's responsibilities to Hong Kong mean that we must only move ahead by carrying EXCO with us.

21. Ministers will wish to discuss with the Governor how far ahead we can look in our consultation with EXCO. By far the most satisfactory procedure would be to put to them frankly our assessment of the Chinese position and the options as we see them. We should make clear the dangers involved either in sticking to our present course (Option A) or even going for a modified form of British administration which may well not be successful (Option B). It would be wrong, for the sake of displaying resolution in defending Hong Kong's interests, to give EXCO the impression that we were more likely to succeed in retaining the British link than in fact appears to be the case. The object would be to give them a frank assessment of the situation as we see it and the likely consequences of pursuing the options open to us. On that basis EXCO would probably come to favour Option B. They would probably not be ready to focus on Option C until all other avenues had been exhausted.

22. There would be no advantage in seeking other tests of Hong Kong opinion at this stage. EXCO are the Governor's statutory advisers. HMG have quite clearly shown their confidence in them and any attempt at wider consultation would be seen as a prelude to a sell-out. Moreover, although EXCO as a body have been relatively cautious on the question of the future, there is no reason to suppose that a wider canvass of opinions would produce a different answer.

SUGGESTED STRATEGIC MOVES

23. Decisions are needed now in the light of:

- (a) The assessment that neither Option A nor B will be accepted by the Chinese and the Ambassador's view that the choice is therefore between Options A and C;
- (b) The need to retain the confidence of EXCO and to avoid prejudicing an ultimate settlement by giving away too much too soon;
- (c) The risk of confrontation with the Chinese if we hang on to A or B for too long.

Resumption of Talks in September

24. On 22 September our negotiating team should continue to insist on the requirement of British administration in order to see whether there has been any move on the Chinese side. This is most unlikely.

Choices of Options

25. Unless we are prepared to face the consequences for Hong Kong and for HMG of confrontation through sticking to Option A, we shall then have to shift. Given the assessment we need to plan now for a strategy which will enable us to achieve the best possible guarantees for Hong Kong's autonomy short of a continuing authoritative link with the UK. But given EXCO's views on what is needed to preserve confidence and the need to demonstrate that we are fighting hard at every stage, we should adopt Option B as a tactical move.

Timing of Further Shifts of Strategy

26. We must expect the Chinese to continue to reject any link with the UK through the Governor. The timing of a move from Option B to C need to be carefully considered, weighing the adverse effect of giving way too soon on confidence in Hong Kong and public opinion in the UK against the risks of confrontation.

Consultation with EXCO

27. No decisions should be taken by HMG without prior discussion with EXCO. HMG does not have to be bound by EXCO's advice but it

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would not meet HMG's declared policy or interests to appear to be imposing a solution on Hong Kong. Tactical handling is best left to the Governor. He will in any case be discussing the situation with EXCO when he returns to Hong Kong and before the resumption of talks on 22 September. He should then make clear the dangers in hanging on too long to our present position and warn EXCO that we may soon face the choice between confrontation (following a breakdown in the talks) or negotiations for a solution which excludes an authoritative political link with the UK. He should undertake to report their views to Ministers to enable HMG to react quickly to developments in the negotiations and in particular to the outcome of the 22 September session. There would be an opportunity for further discussion with EXCO when Mr Luce visits Hong Kong on 24 - 28 September.

TACTICAL FLEXIBILITY

28. EXCO's position is likely to make it necessary for us to move step by step, particularly as regards the position of the Governor. But we need also to preserve as much continuity in the negotiations as possible. It would be valuable to get detailed talks going on specific aspects such as law or the currency, perhaps by attempting to draw out the Chinese on their own plans. Initially we could aim to discuss changes which might take place under a system in which ultimate British control was maintained. Later we might use the same method to consider new safeguards which might offset the disadvantages of the severing of the British link.

CONTACTS WITH THE CHINESE

29. We may also need to consider possible channels and methods of approach to the Chinese. The Ambassadors contact with Assistant Foreign Minister Zhou Nan has proved effective so far and appears still to be open. If we wished to float new ideas (such as Option B) without finally committing HMG that would be the best channel. Other possibilities include:

- (a) a senior non-official intermediary who would carry weight with the Chinese and have the confidence of EXCO.
- (b) A meeting by the Governor of Hong Kong with a senior Chinese possibly passing through the territory.

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30. A stage beyond this would be to put new proposals to Peking with added weight. This could be done by:

- (i) another letter from the Prime Minister (But we do not want to devalue that currency and must choose the moment with care);
- (ii) a letter from the Secretary of State to the Chinese Minister of Foreign Affairs (But Wu Xueqian is not very influential on Hong Kong);
- (iii) a Ministerial visit (eg the Secretary of State to Peking). (An extreme situation such as a stalemate or a breakthrough might call for this).

31. Throughout the negotiations we should sustain efforts to educate the Chinese about the facts of Hong Kong life. This would most effectively be done through Hong Kong people themselves if they were prepared to do it. In default of that the negotiations are the best channel. Although this would not in itself fundamentally affect the Chinese position it might nevertheless help to produce a marginally better solution.

Hong Kong Department  
24 August 1983

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FUTURE OF HONG KONG: CHANGES IN PRESENT ADMINISTRATIVE ARRANGEMENTS

1. The Chinese have already declared categorically that the exchange of titular sovereignty for continuing British administration is not acceptable to them. It is very unlikely that the Chinese can be brought to accept any continuing British administrative role in Hong Kong after 1997. However, if we were to try to negotiate on this basis we should have to be ready to discuss changes, both substantive and symbolic, which might make the arrangements more palatable to the Chinese. Their demand that their sovereignty must be "exercised" after 1997 has been a strong element in their position from the outset. In considering what changes might be possible the first British objective would have to be to preserve intact the link between the Governor and HMG which is the expression of British authority in Hong Kong. Changes in practical arrangements, or symbolic changes in the style and form of administration, would be tolerable unless cumulatively they had the effect of casting doubt on the effectiveness of the guarantee against Chinese interference implicit in the authority of the Governor.

2. The Appendices to the Note consider areas where, from statements made by the Chinese, they will press strongly for changes. These are grouped in broadly descending order of importance. A-D are central issues, E-J cover practical arrangements, and K is concerned with essentially symbolic changes.

3. There will of course also be changes which the Hong Kong Government and HMG will wish to introduce before 1997, both to meet the natural aspirations of the people of Hong Kong for greater participation in Government, and to keep the systems suited to the needs of the territory as it develops. It would be our objective to introduce such changes as we think necessary. We would seek to avoid consulting the Chinese, who are likely to be ambivalent towards such changes, at least until any agreement on the future is reached or in prospect.

APPOINTMENT AND ACCOUNTABILITY OF GOVERNOREssential requirements for HMG

Appointment by HMG, if necessary in consultation with PRC; final procedural accountability to HMG; no interference from Peking in Governor's decisions.

Nature of Possible Changes

Governor to be local person nominated by EXCO/LEGCO; appointed by and accountable to HMG; HMG's authority limited to right to require review/resignation if decisions were unacceptable to LEGCO.

Likely Chinese reaction

Probably will consider HMG's essential requirements to be unacceptable.

Likely Chinese proposals

A locally generated governor ultimately accountable to Peking.

Likely effect on confidence in Hong Kong

The appointment of a Governor from London is seen as the strongest expression of HMG's guarantee against Chinese interference. A local Governor, who continued to be accountable to HMG would probably be acceptable but would be one degree less reassuring than an expatriate Governor.

APPENDIX B

FLAGS

Essential requirements for HMG

Limits on official display of Chinese flag alone.

Nature of possible changes

1. Reduction of use of Union flag.
2. Redesign and wider use (including at Government House) of Hong Kong flag.
3. Appropriate use of Chinese flag.
4. Ban on KMT flag.

Likely Chinese reaction

Key point for Chinese. May insist on Chinese flag on public buildings.

Likely Chinese proposals

The PRC flag to fly on Government House.

Likely effect on confidence in Hong Kong

Adverse. Manageable if Hong Kong flag flying over Government House, but there would be serious problems if the Chinese flag were to fly there.



APPENDIX C

OFFICIAL CHINESE REPRESENTATIVE

Essential requirements for HMG

Chinese representative's role to be clearly defined to avoid undermining "Governor's authority" or movement to shared rule.

Nature of Possible Change

Senior Chinese representative (currently First Director, NCNA) to enjoy official status; to be known as eg "Commissioner of Chinese Central Government"; to be entitled to consultation within defined limits on matters affecting Chinese interests.

Likely Chinese reaction

Might accept but would work for greater power for Representative. Might press for him to be an ex-officio member of EXCO.

Likely Chinese proposals

Uncertain. They have not in fact raised the idea of a representative in recent years.

Likely effect on confidence in Hong Kong

Tolerable if limits of role were clear-cut.

Other Difficulties

Definition of limits on matters affecting Chinese interests.

BRITISH PARTICIPATION IN ADMINISTRATIONEssential requirements for HMG

A proportion of senior officials to be British. (Without the support of such British official it would be difficult if not impossible for the Governor to discharge his responsibilities vis a vis HMG).

Nature of Possible Change

1. Reduction in number of British officials in senior posts. (If possible, Chief Secretary and Attorney General and Financial Secretary, or two of these three, should still be British).
2. Termination of administrative powers of Secretary of State except those relating to Governor's appointment.

Likely Chinese reaction

Would welcome reduction but try to limit British participation to long-term expatriates. Have already indicated opposition to British Chief Secretary.

Likely Chinese proposals

Chief Secretary and a proportion of senior officials to be Hong Kong Chinese. Remaining British officers to be long-term expatriates on contract to the Hong Kong Government.

Likely effect on confidence in Hong Kong

The gradual increase in the number of senior Hong Kong Chinese would be welcomed, but confidence in the Civil Service and in the Police would be weakened unless there was an essential minimum of expatriates in senior positions.

Other Difficulties

Determination of administrative powers needed by HMG to discharge residual authority.

## APPENDIX E

EXTERNAL RELATIONS AND TRADEEssential requirements for HMG

1. Hong Kong to continue to conduct its own bilateral trade and financial relations.
2. HKGOs to be separate from Chinese Embassies and to continue to be staffed by HKG, not PRC, personnel.
3. Retention of existing beneficial trade arrangements stemming from UK link (eg GATT, MFA).
4. No interference in Hong Kong's free trade system.
5. British consular protection for BDTCs.

Nature of possible changes

1. Hong Kong to sit separately (probably as an observer) rather than as part of UK delegation, in international organisations.
2. HKGOs, where they exist, to operate separately from British missions.
3. Removal of any remaining preferential trading arrangements eg Commonwealth Bus Agreement.
4. Divided responsibility for consular protection, according to citizenship (see Annex F)
5. Foreign consular representatives to be accredited to the Hong Kong Government.

Likely Chinese reaction

China may wish to oversee HKGOs and to assume sole responsibility for consular protection; and would oppose HMG's retention of any responsibility for external relations.

Likely Chinese proposals

Hong Kong to conduct its own commercial relations. China to conduct political relations and to represent Hong Kong in non-trade international fora.

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Likely effect on confidence in Hong Kong

Slight if acceptable to China.

Other difficulties

Difficulties of getting international acceptance for Hong Kong to operate independently in the international arena without statehood, both as regards political and commercial relations.

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NATIONALITY/CITIZENSHIP; MIGRATION/VISASEssential requirements for HMG

1. No restriction on Hong Kong residents' right to travel freely from and return to Hong Kong or to emigrate.
2. Hong Kong Government to retain control over immigration.
3. Preservation of BDTC status.

Nature of possible changes

1. Amendment of Chinese Nationality legislation to create a new form of Chinese citizenship eg Citizen of Hong Kong (China).
2. All persons born in Hong Kong after the date of the settlement would become such citizens. A distinctive form of PRC passports to be designed for such citizens - CPRC (HK)s.
3. Existing Hong Kong BDTCs to have position reserved. After the date of the settlement BDTC status to be acquired only by descent and only so long as UK retained responsibility for Hong Kong, (ie so long as Governor appointed by and accountable to HMG).

Likely Chinese reaction

1. May insist on more explicitly Chinese citizenship for non BDTCs and object to any future acquisition of BDTC status.

Likely Chinese proposals

Hong Kong residents to be PRC citizens.

Likely effect on confidence in Hong Kong

1. Possibly damaging at first, but containable if BDTC status can be preserved.

DEFENCE AND INTERNAL SECURITYEssential requirements for HMG

1. No stationing of Chinese military units or public security personnel in Hong Kong.
2. Internal security to be maintained by the local police, responsible to the Hong Kong Government.
3. Expanded police force, probably with substantial expatriate (particularly British) element.
4. Chinese authorities to exercise firm restraint on immigration from China.

Nature of possible changes

1. Removal of the British garrison from Hong Kong.
2. An increase in the size of the police force.

Likely Chinese reaction

Favourable, but may object to appointment of British Police Commissioner.

Likely Chinese proposals

Progressive localisation of police.

Likely effect on confidence in Hong Kong

Containable given reasonable continuity of personnel in the expanded police force and given visible sole control of the force by the Hong Kong Government.

Other difficulties

1. Arrangements for visits by representatives of the Chinese armed forces.
2. The probable Chinese wish for arrangements in special circumstances under which Chinese military forces could be deployed in Hong Kong eg for defence against an external threat.

LEGAL SYSTEM

Essential requirements for HMG

1. Existing Hong Kong legal system to remain in force.
2. Hong Kong Government to retain independent power of legislation.
3. Retention of independent judiciary.
4. No interference by PRC.

Nature of possible changes

1. Judicial appeals to be transferred from Privy Council to Supreme Court of Hong Kong.
2. UK laws only to be extended to Hong Kong through resolution of Legislative Council, rather than by UK Order in Council.
3. Appointments of judges to be made locally.
4. More use of Chinese language in courts.
5. Appointment of more local Chinese judges.

Likely Chinese reaction

Favourable.

Likely Chinese proposals

Termination of link with Privy Council.

Likely effect on confidence in Hong Kong

Some adverse arising from possible change 1, (and see Other difficulties 3 below), otherwise slight.

Other difficulties

1. Need to determine what legislative powers, if any, HMG would need to retain in order to discharge residual authority.
2. Difficulty of persuading local Chinese lawyers to join judiciary.
3. Possible strong wish in Hong Kong and among foreign investors for external Court of Appeal.

APPENDIX I

CURRENCY AND FINANCE

Essential requirements for HMG

1. Retention of independent convertible currency under control (through HKSB and Chartered Bank) of Hong Kong Government.
2. No Bank of China interference in financial and monetary system.
3. Exchange Fund to remain under direct control of Hong Kong Government.

Nature of possible changes

1. Change of emblems on banknotes and coins, which could be minted and issued in Hong Kong. (Similar change for stamps.)
2. Bank of China, as a continuing member of the committee of Hong Kong Association of Banks to share with HKS B and Chartered Bank note-issuing privileges and therefore become a member of the Exchange Fund Advisory Board.

Likely Chinese reaction

Favourable.

Likely Chinese proposals

Consultative role for Bank of China.

Likely effect on confidence in Hong Kong

Some, but probably tolerable.

Other difficulties

1. HMG's responsibility for Hong Kong's obligations to the Asian Development Bank (c. £110 million).



CIVIL AVIATION AND SHIPPINGEssential requirements for HMG

1. China not to assume civil aviation rights for Hong Kong under Chicago Convention.
2. Hong Kong Government to retain responsibility for operation of port and airport.

Nature of possible changes

1. HMG to relinquish civil aviation rights for Hong Kong, to be vested on Hong Kong Government.
2. CPA to become a joint venture with CAAC, or CAAC to take a substantial share-holding in CPA. CPA's rights to operate from Hong Kong as a regional and world-wide airline to be preserved.
3. Hong Kong to cease to be a UK port of registry.

Likely Chinese reaction

Favourable to changes, but may oppose arrangement to meet HMG's essential requirements 1 and 2.

Likely Chinese proposals

China to assume civil aviation rights for Hong Kong.

Likely effect on confidence in Hong Kong

Limited, provided CPA retained current traffic rights (CPA a important technical leader and employer in Hong Kong).

Other difficulties

(For Hong Kong) it might be difficult to gain international acceptance of right to negotiate own civil aviation rights; (for HMG) it would be difficult to secure permanently British airlines' present important route rights (see Essential requirement (2)) once we had relinquished civil aviation rights for the territory (change (1)); (for the Chinese) Essential requirements would mean that Hong Kong would need separate representation in certain international organisations such as IMO.

SECONDARY CONSTITUTIONAL MATTERSEssential requirements for HMG

1. Name: none, provided legally compatible with main agreement.
2. Title of Governor: none.
3. Royal prefix: none.
4. Royal visits: none.
5. Anthems: Chinese (and British) anthems to be used only on appropriate national occasions.
6. Language: official parity for English.

Nature of possible changes

1. Name: territory to be described formally as 'Hong Kong, China' or 'the Hong Kong Special Administrative Region of the People's Republic of China'. (Chinese might also seek some parallel use of the new Romanisation 'Xianggang'.)
2. Title of Governor: to be changed to eg 'Commissioner'; no further use of colonial uniform etc, and simplification of style on official documents.
3. Royal prefix: to be removed from official, and as far as possible, private institutions eg police, Jockey Club, Yacht Club.
4. Royal visits: to be subject to the agreement of the Peking Government.
5. Anthems: adoption of new Hong Kong anthem. No further use of British national anthem as the Hong Kong anthem.
6. Language: Mandarin as an official language on par with English and Cantonese.

Likely Chinese reaction

Changes 1-3 important. Others less so.

Likely Chinese proposals

Hong Kong to become an SAR with colonial titles etc removed.

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Likely effect on confidence in Hong Kong  
SAR status could cause concern, otherwise slight.

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## FUTURE OF HONG KONG: AIDS TO CONFIDENCE AFTER 1997

Aim

1. This paper examines ways in which reassurance might be provided against Chinese interference in Hong Kong after a change of status, probably in 1997. It assumes not only the transfer of sovereignty to China but also the ending of the existing administrative link with Britain. It is not envisaged that the Governor of Hong Kong, under whatever title, would be appointed by the British Government or could be answerable to London. It assumes that the new regime would include the main elements of the Chinese plan, so far as we know them. The degree of confidence which any other 'insulators' could instil in Hong Kong in such circumstances would be very uncertain. The most effective safeguards would be those which built on the existing economic incentives for China not to interfere.

Chinese Intentions

2. The most authoritative and up to date outline was given by Vice Foreign Minister Yao Guang in the talks with the Ambassador on 25 July. These are listed at Appendix 1. They include the following points:

- (a) Hong Kong would become a Special Administrative Region of China.
- (b) The Government would be drawn from the local people of Hong Kong.
- (c) The economy and way of life and basic freedom would be "protected" and the laws would be "basically unchanged". There would be an independent convertible currency and "existing external relations in the economic and cultural fields" would be maintained.

3. In addition we have the personal views of Assistant Foreign

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Minister Zhou Nan to the Ambassador on 11 July. These included Yao Guang's point, emphasised that "British administrative control" was not acceptable and gave the personal view that there could be no British Governor or Chief Secretary and no British troops after 1997, although British administrators could stay on in an advisory capacity. Full account would be taken of British interests. He said that a change of flag was important, but not enough.

Problem: To Bind China to Respect Autonomy

4. Taken at face value, the Chinese description of a future Hong Kong contains many elements of the present form of administration, although there would be important differences in the fields of political external relations, defence and probably nationality. Provided these terms were guaranteed they would probably be tolerable to the majority of Hong Kong people although some of those most necessary to Hong Kong's continuing prosperity would undoubtedly leave. Can guarantees be devised which would be regarded as sufficiently binding on China to limit the damage to Hong Kong which acceptance of the Chinese presence would inevitably cause?

Impracticable Solutions

5. These include:

- (a) Independence for Hong Kong. The Chinese have made clear that they would not accept this.
- (b) Trusteeship under the United Nations. This would not be acceptable to China which regards its sovereignty over Hong Kong as incontestable. Trusteeship arrangements have traditionally been used as a prelude to independence. The same objections would apply to trusteeship by other countries or regional groups.

Possible Arrangements

6. While the Chinese Government are very unlikely to agree to restrict their freedom of action with regard to Hong Kong, possible safeguards fall into the following categories:

- (i) Binding Undertakings by China to respect a 'Charter' for Hong Kong.
- (ii) Legislative/Constitutional arrangements
- (iii) British participation in administration, short of control.
- (iv) Changes in Hong Kong's administrative structure.
- (v) Involvement of other countries.

#### Undertakings By China

7. The Chinese will oppose inclusion of the administrative arrangements in Hong Kong (their "internal affairs") in any internationally binding framework. Nevertheless we should press for this. We do not believe that the Chinese will accept anything bearing the title "treaty" but some other form of international agreement may however be negotiable. Moreover although the present Chinese Government has repudiated all the basic treaties relating to Hong Kong, it would be unlikely to do so in respect of an international agreement which it had itself concluded. Indeed in general it has a good record of observance of its treaties.

8. A unilateral declaration by China that Hong Kong's autonomy would be respected after 1997 would not be legally binding, but it might be negotiable. The effect of such undertakings should not be underestimated. The technique of unilateral statements has become an accepted diplomatic device with Peking and is generally regarded by the Chinese Government as politically (if not legally) binding.

9. Any undertaking (whatever its form) could include a specific minimum time scale for the duration of the SAR. Recently reports have suggested Chinese readiness to leave Hong Kong untouched for fifty years. There would be obvious advantages in HMG tying down the present Chinese Government as specifically as possible and for as long as possible. Nevertheless many people in Hong Kong would still be very suspicious and would not consider the undertakings sufficient without more specific guarantees. They would see the danger of China either gradually interfering with specific areas of administration, for ideological or economic reasons; or of an internal upheaval leading to a more radical government which might feel impelled to take over the territory.

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Legislative/Constitutional Arrangements

10. Undertakings by China might be strengthened by the negotiation of an agreed constitution for Hong Kong. This could include a guaranteed minimum time scale for the arrangements, entrenched clauses covering essential freedoms (or a Bill of Rights see 12(d) below) and possibly a legislative structure, confirming the EXCO/LEGCO systems. These provisions might be incorporated in turn in Chinese legislation by the NPC under the provisions of the Chinese Constitution. This would be vulnerable to the argument that what the NPC could establish, it could overturn. But that applies to any undertaking by China (unless incorporated in an international agreement) and the enactment of Chinese legislation might marginally encourage Peking to respect the deal.

British Participation in Administration

11. The Chinese have expressed readiness to see that British trading interests are protected. We should try to build on this towards securing guarantees of Chinese non-interference. The possibilities are:

- (a) British participation in the appointment of Governor. There have been indications that the Chinese would favour a Hong Kong Chinese as Governor. There is also some evidence that they might acquiesce in the Governor's ultimate authority not being Peking and may show flexibility over arrangements for Gubernatorial appointments. In our view, the best insulator we are likely to achieve would be a Governor elected in some form by the Hong Kong people (see 9(a)) and accountable to them. Otherwise agreement that HMG and Hong Kong should be consulted might be negotiable though we might have to concede the power of veto to the Chinese.
- (b) Consultative position for "British Commissioner". It should be possible to get Chinese agreement to a local British representative being accorded a higher status than an ordinary Consul General. It would be worth negotiating for such a person to be consulted on major decisions or changes in Hong Kong. These could cover for instance economic relations and the

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currency. It would at the same time be important to avoid putting a representative into a position where he had constant arguments with the local government or with a Chinese representative and in effect became part of a condominium without power.

- (c) British Civil Servants in administration. The Chinese have specifically said that they would allow this. Assistant Foreign Minister Zhou Nan indicated that, besides the Governor, the Chief Secretary's position would be barred. It might however be possible to get agreement to British Civil Servants remaining in other key positions, such as the Financial Secretaryship or the Attorney General's office. This might provide some assurance to Hong Kong people and the retention of a substantial cadre of British Civil Servants could provide a degree of insulation. But prospects for the system's survival much beyond 1997 would be limited without agreement over continued mechanisms for recruitment. It would be difficult to get good people to take on jobs with little apparent security and the prospect of very serious disagreement over policy, though it could be possible to negotiate arrangements for seconding British Civil Servants to Hong Kong with the right of return (comparable to arrangements with the European Commission). However, such arrangements could in practice breed resentment among local people as blocking their own advancement and the effects of the system as an insulator would be limited.
- (d) British advisers on boards and commissions. There would be advantage in British expatriate experts participating in any form of advisory or regulatory boards which were set up to preserve basic systems and freedoms (see below).

Changes to Administrative Structure

12. In order to preserve confidence, there would be advantage in maintaining the basic administrative structure (Executive and Legislative Councils and departmentally organised Civil Service). This appears moreover to coincide with Chinese intentions. But, if no "insulator" can be provided by an external link, it might be possible to build certain internal checks and balances into the administrative structure. Possibilities are:

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(a) Elections

Direct elections to the Legislative Council (possibly with selection of the "Governor" and Executive Council from that body) should be considered. So far the Peking Government have made clear their opposition to elections in Hong Kong, fearing that it might lead to demands for independence. But there have been some reports of possible readiness in the future to have an elected Governor, although the extent to which this would be, in practice, an effective insulator is doubtful. However a good deal of comment from Hong Kong has suggested that internal democracy would strengthen public confidence in any form of post-1997 regime. Indirect elections, eg from the District Boards upwards, might be an alternative. In either case, members of EXCO could be given departmental responsibilities (Education etc) as local ministers.

(b) Independent Commissions

These would have the job of safeguarding current systems. The following are examples of areas which might be covered:

(i) Law and judicial system. The Chinese have said that they would maintain the current legal system. However, this would presumably mean the retention of the main body of law as it existed when a transfer of power took place, and the system for its administration (although with Hong Kong Chinese judges largely replacing British judges). It would be important to provide some guarantee that the law would not be eroded by an accretion of Chinese law and also that it would be allowed to develop, as under any other common law system, in order to meet future needs. Some kind of independent Legal Commission could be asked to watch over this and to vet recommendations for new legislation. Such a body would be particularly suitable for British participation. It could perhaps be chaired by a British judge or senior advocate. It might also lend itself to participation by legal experts from other countries.

(ii) Currency and finance. The Chinese have said that an

independent convertible currency would be maintained. There would still be suspicions that they would try to assert their influence in financial matters. This would destroy confidence in the currency. An independent Financial Commission could be set up to oversee the management of the currency. (Membership might include the leading banks - British, Hong Kong, Chinese and third country.)

(c) Central Commission

A variation or extension of the independent commission system would be to devise a supervisory body which would act as an overall watchdog for the autonomy and freedoms of the Special Administrative Region of Hong Kong. Such a body might be elected from the Executive Council and in effect put the powers of the Governor into commission, although it would probably need to be chaired by a Governor or "Administrator" enjoying Peking's approval. It might be possible for the British Commissioner and the Chinese representative from Peking to be members of this group. But there would be snags. The British representative could find himself in an impossible position if he disagreed with his Chinese or other colleagues and had no effective influence.

(d) Bill of Rights

This would be essentially a codification of the undertakings which we would expect the Chinese Government to make to respect local freedoms. It might be possible to get selected freedoms written into a new "constitution" for Hong Kong.

13. The degree of guarantee offered by Independent or Central Commissions if not appointed by a Governor answerable to London would clearly be limited. Joint choice or approval by London and Peking would give the latter an opportunity to interfere. The best arrangement would probably be some form of indirect election within Hong Kong, eg by an 'electoral college' formed of the elected members of the district boards, the Urban Council and other elected bodies. But once the UK link is broken no insulator can provide a complete guarantee. Such commissions would, however, offer a means of public opposition to attempts by Peking to meddle in Hong Kong affairs or pursue unwelcome policies towards the SAR. International

attention could be focussed on such activities and pressure thus increased on Peking to toe the line. Furthermore, the more the Chinese can be bound into a network of "internal" and quasi-external undertakings the more difficult it will be for the PRC to renege on such agreements and erode current systems. This should be reflected in confidence within Hong Kong.

#### Participation by Other Governments and Organisations

14. International control of Hong Kong would not be acceptable to Peking (see para 5) nor would any arrangement which fundamentally cut across its sovereignty. Moreover from the point of view of confidence in Hong Kong, there would be no point in new arrangements which in themselves appeared to dilute Hong Kong's autonomy. But, besides the introduction of foreign advisers for specific areas (see above) it might be possible to devise machinery to offer a degree of protection for Hong Kong's agreed future status and administrative arrangements:

- (a) there might be value in something on the lines of an "International Advisory Board for the Free Port of Hong Kong." This could include representatives of major banks and business houses, both local and foreign, and possibly also commercial or diplomatic representatives of governments.
- (b) HMG might seek Third countries' agreement that Hong Kong's position in international organisations (eg GATT) should continue after 1997 only for as long as HMG's bilateral "agreement" with the Chinese over Hong Kong's future or Hong Kong's "Charter" remained inviolate.
- (c) An alternative to (or extension of) (b) could be for Hong Kong to be empowered before and after 1997 to negotiate with its major trading partners access agreements for Hong Kong exports similar to those now in force but which would remain valid only as long as Peking honoured its commitment not to interfere with Hong Kong's full autonomy (Yao Guang has indicated that Hong Kong would be able to conclude its own external trade agreements).

Hong Kong Department

[Date]

APPENDIX 1Special Policies which the PRC had decided to adopt towards Hong Kong (as elaborated by Yao Guang to HMA Peking in the talks on 25 July)

- (i) Hong Kong would become a Special Administrative Region;
- (ii) The Government would comprise the local people of Hong Kong;
- (iii) Socio-Economic systems and way of life would remain unchanged;
- (iv) Private ownership of property and foreign investments would be protected;
- (v) Freedoms of speech, press, assembly, travel, change of domicile, correspondence and religion would be protected;
- (vi) Hong Kong Special Administrative Region(SAR) would enjoy a high degree of autonomy including legislative power and independent judiciary, including the "power of final judgement";
- (vii) Laws would be basically unchanged;
- (viii) Hong Kong would continue as a free port and international financial centre: Foreign exchange, gold, securities and futures markets and the free flow of capital to continue;
- (ix) The Hong Kong dollar would continue to circulate freely and remain fully convertible;
- (x) Financial independence;
- (xi) Hong Kong would maintain its existing external relations in economic and cultural fields and could establish mutually beneficial economic relations with Britain.

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F/K  
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pt. 7

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R.A. STALLABRASS

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C/F PPS?

1 September 1983

I am writing on behalf of the Prime Minister to thank you for your letter of 31 August with which you enclosed your policy paper on the future of Hong Kong. I am sure she will read this with interest.

W. F. S. RICKETT

R.A. Stallabross, Esq.

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PART 7 ends:-

Monday Club to pm 31.8.83

PART 8 begins:-

WR to R Stallabram 1.9.83

~~FCS to pm Fott 2.9.83~~

