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PREM 19/2727

PART 20

CONFIDENTIAL FILING

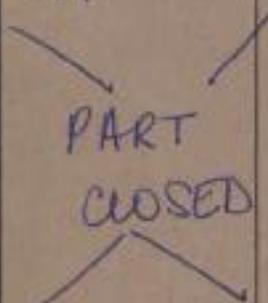
FUTURE OF HONG KONG

TERRITORIAL LEASES

HONG KONG

PART 1 JUNE 1979

PART 20 OCT 1987

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CDP to FCO 22.2.89.

PART

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CDP to Pm 17d

Foreign and Commonwealth Office documents

Reference: DD 1985/258 DESPATCH

Description: The Development of Representative Government in
Hong Kong: The 1988 White Paper

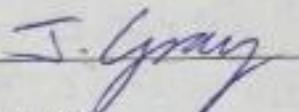
The Governor of Hong Kong to The Secretary of State
for Foreign and Commonwealth Affairs

Date: 1 March 1988

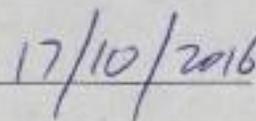
The above FCO document, which was enclosed on this file has been removed and destroyed.

Such documents are the responsibility of the Foreign and Commonwealth Office. When released they are available in the appropriate FCO CLASSES.

Signed



Date



PREM Records Team



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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

22 February 1989

SUBJECT CC MASTER.

PRIME MINISTER'S MEETING WITH THE GOVERNOR OF HONG KONG

The Prime Minister had a meeting lasting about an hour this evening with the Governor of Hong Kong.

Hong Kong Economy

The Governor gave the Prime Minister an account of developments in Hong Kong, drawing attention in particular to the performance of the economy. The Prime Minister expressed concern at the lack of new investment from Britain.

British Representation

The Prime Minister said that the Governor's task was to represent the interests of the people of Hong Kong. A case could be made for establishing a separate office to represent purely British interests. This would become the nucleus of our eventual Consulate-General after 1997. The Governor said that we already had a senior British Trade Commissioner. He was not convinced that further upgrading of the post would be justified. Hong Kong was a highly sophisticated market economy with only limited scope for official trade promotion activities. He attached great importance, however, to an early decision on a site for a British Consulate-General. The Prime Minister said that it was very important to future confidence in Hong Kong that Britain should be seen to acquire a substantial building on a prestigious site for its official representation. This would inevitably be expensive, but that would have to be borne. She wished to be involved in discussions and decisions on this.

Immigration

The Prime Minister said that she remained convinced that we should do more to attract enterprising Hong Kong people to the UK. As it was we ended up with Vietnamese boat people, while people with money and enterprise went to the US, Canada and Australia. Such people were more likely to stay and conduct their business in Hong Kong if they knew that they had the option of coming here. Although we were making it

slightly easier for these people to come to Britain, she felt that we were still not doing enough. The Governor said that he had no objection to the steps already being taken. But he would be concerned about the effect on confidence if this facility was greatly widened, as well as the effect on crown servants who would feel disadvantaged. As the metropolitan power, the United Kingdom had a particular obligation to encourage Hong Kong citizens to stay and prosper in their own territory. The Prime Minister indicated that she would wish to discuss the matter further with Ministerial colleagues.

The Prime Minister said that she also sympathised with the position of crown servants and thought that we should be more generous in offering them the possibility of acquiring British nationality. The contrast with the preferential treatment given by the Portuguese to the residents of Macao was very striking. The Governor said that he was concerned about being able to maintain efficient administration in Hong Kong up to 1997. He had some ideas for strengthening the assurances which had been given to crown servants. He would put these to the Foreign Secretary.

Democracy in Hong Kong

The Prime Minister wondered whether we should be moving more rapidly to establish representative government based on direct elections in Hong Kong. The impression was around that we were deferring too much to the Chinese Government's wishes on this. If there was fully representative government in Hong Kong in 1997, it would be much harder for the Chinese to dismantle or destroy it subsequently, without doing enormous damage to their standing and credibility and destroying any chance of regaining Taiwan.

The Governor explained the steps which were being taken to introduce direct elections. The fact was that Hong Kong opinion was deeply divided on this subject. The current pace of movement towards representative government was in tune with the wishes of the majority in Hong Kong. A confrontation with the Chinese Government on the issue would be very damaging indeed to confidence in Hong Kong.

Position of the Governor

The Governor said that his own authority would inevitably be eroded somewhat as 1997 drew closer and he would need a great deal of moral support from HMG, underlined by expressions of the Prime Minister's personal support. It was agreed that this should be reflected in what was said to the press after the meeting.

Vietnamese Boat People

The Governor said that he was grateful to the Prime Minister for confirming the UK offer to take 1,000 more Vietnamese boat people from Hong Kong over the next 2/3 years. But a major problem would remain, and it would be important for the UK to be seen to give a lead in working towards an

international conference on resettlement and return of Vietnamese refugees. The Prime Minister said that she would ask the Foreign Secretary to let her have a note about this.

Line for the Press

It was agreed that we should say to the press that the Governor had given the Prime Minister a full account of developments in Hong Kong and current issues. The Prime Minister had made clear that she took a close and supportive interest in all that was happening in Hong Kong. She had assured the Governor that the full weight of the British Government was behind ensuring that the Joint Declaration was carried out in full, and that Britain remained determined to ensure that Hong Kong's prosperity and way of life were maintained. He could also confirm the United Kingdom's intention to take a further 1,000 Vietnamese boat people from Hong Kong over the next 2/3 years.

I am copying this letter to Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry), Brian Hawtin (Ministry of Defence) and to Philip Mawer (Home Office).

Charles Powell

R.N. Peirce, Esq.,
Foreign and Commonwealth Office.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

Prime Minister

You found this folder at the
week. There are now three
additional papers:

- Henry Cadogan's views.
- a note on HKS B
- a note by Lord Young &
comment by W Home Secretary.

C.D.P.

21/2.

ccfe

RESTRICTED



HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

21 February 1989

Dear Charles,

HONG KONG : TRADE AND INVESTMENT

(file with COF)

Since we know that the Prime Minister is to see the Governor of Hong Kong tomorrow, this records the Home Secretary's first reactions to Lord Young's minute of 16 February. The Prime Minister has of course discussed this matter recently with the Home Secretary and the Foreign and Commonwealth Secretary.

As the Home Secretary's letter of 25 January to the Foreign and Commonwealth Secretary explained, he is willing to consider exercising his discretion under the Immigration Rules and the British Nationality Act 1981 generously. He would, accordingly, be, in principle, glad to see his existing proposals take their place in the context of the sort of investment initiative Lord Young has in mind. He does not believe, however, that we would be justified in proposing the changes to the nationality law which Lord Young envisages, which would run counter to the basis of the 1981 Act and expose us to a host of other applicants, not least from Hong Kong itself, whose arguments we have hitherto managed to resist.

I am copying this letter to Bob Peirce (FCO) and to Trevor Woolley (Cabinet Office).

Yours sincerely,

P J C MAWER

C D Powell, Esq
Private Secretary
10 Downing Street

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PRIME MINISTER

21 February 1989

MEETING WITH GOVERNOR OF HONG KONG, 22 FEBRUARY, 5PM

You are to see David Wilson on Wednesday for a general chat. You have not seen him since he took up his post in April 1987.

Flag A.

The Foreign Office have provided a background note, which is worth reading through. Since the conclusion of the Hong Kong Agreement in 1984 Hong Kong has generally been a success story. Thirty per cent growth in the economy in the past 3 years. Booming exports. Buoyant property market. UK merchandise exports to Hong Kong over £1bn in 1988 and UK invisible earnings probably of the same order. As against this, the outflow of professional talent from Hong Kong remains worryingly high.

We have also been broadly successful in our twin objectives of negotiating and applying the fine print of the Agreement in close co-operation with the Chinese and at the same time showing our continuing commitment to the territory. But this will always be a delicate balancing act; we can expect pressures right up to 1997; and as the hand-over date approaches we shall have to put increased effort into ensuring stable and confident government in the territory. The UK press, which dislikes the success of the Agreement and would love things to go wrong, can be relied on to make the most of any controversial issue. It is on some of these issues that you will want to concentrate with the Governor.

- a) Immigration from Hong Kong. Our attention has been mainly focussed on how to make sure we do not lose all the business talent which is leaving

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Hong Kong to settle in Australia, Canada and the United States. Here we have to tread carefully. As a party to the Agreement and as the government responsible for Hong Kong we have a duty to do all we can to stem the outward flow and to ensure that Hong Kong citizens stay and prosper in their own territory. It would be fatal to confidence if we were seen to be openly touting for talent, in effect writing off the future of the Agreement. Moreover, most of the Hong Kong people leaving the territory prefer to settle among the established well-to-do Chinese communities in Canada and Australia. But we have satisfied ourselves that our immigration rules are not more restrictive than those of our competitors and provided we act with discretion we can to a limited extent have it both ways.

- b) A number of other immigration issues on which the press have fastened are variants of the above:
- i) alleged preferential treatment for residents of Macao. There are historical reasons for the difference and very much smaller numbers are of course involved in the case of Macao (100,000 against 3½ million for Hong Kong). The British Nationality Act of 1981 reflected deep concern in the UK about the prospect of large numbers of Hong Kong Chinese coming here and during negotiations on the Agreement in 1984 Ministers underlined our anxiety to avoid such immigration.
 - ii) possible issue of UK passports to certain Hong Kong categories, eg businessmen. Here again

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we run into the problem outlined in a) above: openly handing out passports would undermine the British Nationality Act and demonstrate lack of confidence in the Agreement. This effect would be compounded by charges of discrimination - why one group rather than others?

- c) Democracy in Hong Kong. A popular press theme, particularly in the UK, is that we should push representative government and direct elections ~~much faster~~ and that ~~we have failed to do so because of fear of the Chinese.~~ In fact we are introducing elements of direct election at the pace the Hong Kong people themselves prefer, as evidenced in the result of the review of 1987. The timing and manner of introducing a fully directly elected legislature is currently a matter of controversy and it may be that the present proposals in the Basic Law swing too much in the direction of conservative Hong Kong opinion. We shall take this up with the Chinese, who may well realise that some correction is needed.
- d) The Basic Law. Part of the Basic Law simply reproduces the provisions of the 1984 Agreement. Part of it is more detailed work, breaking new ground. Here the Chinese are in the lead but have been responsive to our persuasions. There are now only a limited number of points which cause us concern and we should be able to deal with these in the next round of consultations before the final version is promulgated in 1990.
- e) Vietnamese Boat People. Our policy here is seen in Hong Kong as an acid test of whether we remain committed to Hong Kong or whether we are now concerned only with

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narrower British interests. What rankles with Hong Kong people is the contrast between the policy of giving asylum to boat people while promptly repatriating all illegal immigrants from China. We need action at international level but we shall not get that unless we show that we are prepared to take the lead by doing more in the way of resettlement. I realise your reservations here, but having looked at the issue I do not see any respectable alternative course. Fortunately the conditions attached to our offer of December to take 1000 more boat people seem now to be met and we can confirm that offer after your talk with the Governor.

Conclusion

In all the above I think the line we have been following is about right. We cannot diverge much without serious consequences for Hong Kong. Some of the alternative courses proposed, eg on passports, might seem to offer greater immediate benefits to the UK. But I am sure that in the longer term, given our overriding interest in the success of the Agreement, the benefit to us would prove illusory. Our only safe touchstone, as in times of doubt while negotiating the Agreement, is - what is best for the people of Hong Kong. That does not mean that we should deliberately neglect or sacrifice our narrower interests. To a considerable extent we can have the best of both worlds, eg opportunities for British trade provided by a flourishing territory. What it does mean is that on proper analysis our interests are best served

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by consulting those of Hong Kong. None of this will save us from press and other public criticism from time to time, but we have no real alternative but to soldier on, doing our best for the territory as we see it and knowing that any alternative would be infinitely worse.



PERCY CRADOCK

CONFIDENTIAL

PRIME MINISTER

You are to have a talk with the Governor of Hong Kong on Wednesday. The FCO have prepared the attached paper which you may like to look at over this weekend.

The paper conveys a generally satisfactory, indeed rosy, picture of Hong Kong. The economy is booming, British trade is flourishing, the Joint Declaration is being implemented, the Basic Law is being drafted in accordance with the Joint Declaration and the arrangements envisaged for the introduction of direct elections meet the wishes of the majority of the inhabitants of Hong Kong.

With everything in the garden so lovely, it is a bit hard to see why papers like the Wall Street Journal ("Maggie's Honour") and the Financial Times have recently produced such savage editorials, claiming that the United Kingdom is failing to honour its obligations and is deferring too much to the Chinese. Perhaps the presentation of our policy is not as good as it might be. Or perhaps things are not really as rosy as we are told. The forthcoming visit by the Foreign Affairs Committee may throw more light on this.

The FCO suggest the following points for discussion with the Governor:

- invite the Governor to give an account of the general situation in Hong Kong and the state of opinion there;
- ask him about progress with the drafting of the Basic Law and the development of representative government;
- discuss the problem of the Vietnamese boat people;
- ask about the state of confidence in the territory.

If you restrict your bowling to this, the Governor will not have much difficulty in playing you. There are a number of more tricky points which you might raise:

- if everything in the garden is so lovely, why are 10,000 professionally qualified people a year now leaving Hong Kong? What implications does that have for Hong Kong's economy between now and 1997? What be done to slow down the exodus?
- Can we not do more to attract talented, qualified and entrepreneurial people to the United Kingdom? You have made some progress with the Home Secretary on this. But the arrangements now envisaged are only ever going to apply to a handful of people. It is sometimes argued that we cannot offer anything too attractive, since it will encourage people to leave Hong Kong. But if 10,000 a year are leaving anyway, does not it make sense for us to try to attract a higher proportion of them?
- Could we not make it possible for a rather wider category of Hong Kong people to enter the UK after 1997? With Portugal granting the right to 100,000 Portuguese passport holders in Macau to come in to the European Community, surely we can afford to be a bit more generous than we are?
- Are we doing enough to promote the interests of British firms in Hong Kong, particularly as regards major public procurement and infrastructure contracts?
- Is there nothing that can be done to persuade the Hong Kong Government to adopt a less absurdly restrictive air services policy? The present policy ('one route, one airline') runs entirely counter to the principles of free enterprise and free trade.

- You are glad that we are to begin to talk to the Hong Kong and Shanghai Bank about its future. But it is not helpful to set unrealistic conditions about what will and will not happen - e.g. that the headquarters of the HKSB must remain in Hong Kong - before even agreeing to talks to the Bank.

C.D.P.

CHARLES POWELL
18 February 1989

ccpe ✓

VISIT OF SIR DAVID WILSON, KCMG, TO LONDON 20-25 FEBRUARY 1989

PROGRAMME (Finalised 15 February)

Monday 20 February

0545 Arrive at LHR from Hong Kong by flight BA 28, accompanied by Lady Wilson and Mr Hoare. HKGO car will then take the party to the Stafford Hotel, St James' Street

Room WH245 (telno 270 2630) has been reserved for you and your two Private Secretaries from Monday 20 February to Friday 24 February. Three passes have also been arranged for the week and may be collected from Room W1.

1300 Lunch with Mr John Weston at the Oxford and Cambridge Club

Tuesday 21 February

0915 Call on Mr Paul, HKD
1000 Call on Mr McLaren
1100-1130 Call on Sir P Wright, Room WH297
1215 Call on Mr Gillmore (then onto lunch)
1300-1430 Lunch for Messrs Gillmore, McLaren and Paul at the Athenaeum
1500-1600 Call on Sir P Cradock, No 10 Downing Street
1630-1800 Private engagement
1930 Dinner with Lord Maclehose at the Stafford Hotel

Wednesday 22 February

0915-1045 Private meeting with the Secretary of State in Room WH201
0945-1045 General meeting with the Secretary of State's office



7 Call on Mr Charles Powell, No 10 Downing Street
1245 Lunch for Mr David Howell MP, at the Athenaeum
1700 Call on the Prime Minister
1800-1930 Drinks at 19 Cawley Street for members of the UK/Hong
Kong Parliamentary Group
2000 Private dinner

Thursday 23 February

0930 Call on Editor of the "Times" at Wapping
1100-1215 Seminar at the DTI (with Senior Officials only)
1245 Lunch with Journalists at HKGO
1600-1700 Meeting with the FAC at the House of Commons
1715 Round-up meeting with Messrs McLaren and Paul
Evening free

Friday 24 February

Private arrangements (reception at Oxford)

Saturday 25 February

1445 Depart for Hong Kong by flight BA 27 from LHR

TELEGRAPHIC ADDRESS:
MATHESON LONDON EC3
FACSIMILE: 01-523 5024
TELEX: 8953378 MANDCO
TELEPHONE: 01-528 4000

Matheson & Co. Ltd
3 Lombard Street
London EC3V 9AQ

PRIVATE & CONFIDENTIAL

17th February, 1989

Dear Geoffrey

HONG KONG

As you are no doubt aware the Hong Kong Association has been carrying out a vigorous debate with the FCO on the level of British Representation in Hong Kong and the possible appointment of a British Commissioner to fill our perceived gap.

We appear to have lost the debate and the views of the Governor have prevailed that he is a devolved negotiating partner with Britain, who has no prime responsibility for British Commercial/Political interests in the colony. His authority must not be undermined by the appointment of a British Commissioner and therefore Britain's long term strategic commercial and political interests must be looked after by a Senior Trade Commissioner whose mission is by nature limited in its scope.

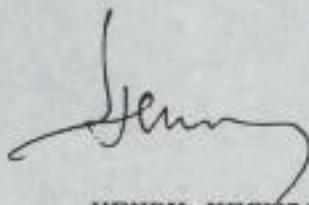
As they are of a delicate nature, may I personally raise the enclosed five points for your consideration?. They cannot entirely suitably be settled by the Senior Trade Commissioner.

Cont/.....

If you feel any of these points have merit having taken a broad view where British interests (and we would argue Hong Kong) lie, then in the final analysis perhaps they must be decided by the British not the Hong Kong Government as the Joint Declaration clearly enshrines British sovereignty over Hong Kong until 1997.

With best personal regards.

Yours ever



HENRY KESWICK

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
Secretary of State,
Foreign and Commonwealth Office,
Downing Street,
LONDON, S.W.1A 2AL.

BRITISH STRATEGIC LONG TERM INTERESTS
IN HONG KONG

FIVE AREAS WHERE BRITISH INTERESTS MAY BE IN
CONFLICT WITH THE HONG KONG GOVERNMENT
AND THEREFORE NEED HIGH LEVEL UNITED
KINGDOM GOVERNMENT SUPPORT

1. A suitable British Consul General building for 1997 at nil cost for the land.
2. An elegant solution (merger with Midland Bank?) for changing the domicile for the Hong Kong Bank (market value £2.5b) so that it can remain a British managed International Bank after 1997 and will not slip into Chinese Control.
3. The Hong Kong Government to treat British Airways equally with Cathay Pacific for future landing rights etc.
4. Ensuring that British Contracting, Finance, engineering etc. obtain the lions share in future Infrastructure contracts valued at £3 billion, in particular the new airport.
5. Level playing field up to 1997 in the rule of law for British Commercial interests to operate in. Hong Kong Government should be encouraged not to appease powerful Hong Kong Chinese and Mainland interests in condoning Insider Trading (K.S. Li "C.B.E.") taking no sanction against censure by take-over panel ("Sir" Y.K. Pao) soft sweetheart land transactions (Bank of China/China Resources) and release of contractual obligations (PRC interests in Tin Shui Wai.)

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ce P.C.
Blup.



Foreign and Commonwealth Office

London SW1A 2AH

17 February 1989

Dear Charles

mt

Hong Kong

The Governor of Hong Kong will be calling on the Prime Minister on Wednesday 22 February at 5.00 pm. As background for that meeting, we have prepared the enclosed paper on Hong Kong which describes our objectives for the territory and how we are achieving them. It sets out the key issues of concern in Hong Kong and how these are being tackled.

The meeting with the Governor, the first since Sir David Wilson took up the post in 1987, is a timely one. There is heightened Parliamentary and media interest in Hong Kong. There are also a number of current misconceptions about our commitment to the territory and the way we are carrying out our responsibilities towards it. The Foreign Affairs Committee enquiry into Hong Kong, which begins next month, will provide an important opportunity to set the record straight.

The Prime Minister might invite the Governor to give an account of the general situation in Hong Kong; the state of opinion there; and the priorities for his administration.

As the background paper makes clear, a very great deal of work is being done to make sure that the Joint Declaration sticks, so that Hong Kong can enjoy a stable and prosperous future. The Prime Minister might ask the Governor about the progress that is being made over the drafting of the Basic Law and the development of representative government in the territory.

The most difficult problem facing the Governor has undoubtedly been that of Vietnamese boat people in Hong Kong. Sir David Wilson will wish to describe what the Hong Kong authorities are doing to contain the problem.

The Prime Minister might ask about the state of confidence in the territory. As the briefing paper shows, the recent upward trend in emigration from the territory is a source of concern and the Hong Kong authorities are taking a number of steps to contain its effects. The paper also covers the subject of nationality, which remains a source of some resentment in the territory.

Yours ever
R N Peirce
(R N Peirce)
Private Secretary

C D Powell Esq
10 Downing Street

CONFIDENTIAL

HONG KONG

The starting point for any discussion of Hong Kong must be the Sino British Joint Declaration of 1984, under which the territory will become a Special Administrative Region of the People's Republic of China on 1 July 1997 with a high degree of autonomy. The Joint Declaration provides in great detail for the preservation of Hong Kong's present economic, legal and other systems, its freedoms, and its way of life. Given that 92% of the territory was due to revert to China by Treaty in 1997 without any safeguards, the conclusion of the Joint Declaration was a major achievement. It was and is recognised as such by the vast majority of the people of Hong Kong, even though they would have preferred the perpetuation of British administration had that been attainable.

Four years after the signing of the Joint Declaration, Hong Kong is as busy and dynamic as it has ever been. In the past 3 years the economy has grown by over 30%, and growth of 7-8% is expected this year. Exports are booming. The traditional entrepot trade has revived and Hong Kong is now China's foremost trading partner. The container port is the busiest in the world in terms of throughput. The property market is buoyant; there has been a rapid growth in hotel construction to cater for an increased tourist demand. A new Exhibition and Convention Centre, one of the most modern in the world, has been recently completed and should enhance Hong Kong's role as a regional business centre. The Hong Kong Government are embarking on a number of ambitious new infrastructure projects, including (subject to final decisions) a third harbour crossing and a new airport.

The construction of a third University has begun. If there are economic problems (inflation and an acute labour shortage) they are problems of success.

Britain's trade with Hong Kong is doing unprecedently well. In 1988, our merchandise exports to Hong Kong exceeded f1 billion. Our invisible earnings were probably of about the same order. Hong Kong is the UK's third largest market in Asia; its people consume more British goods per capita than anywhere else in Asia, and more than the United States or Canada. British investment in Hong Kong is growing. We have a very substantial economic stake in Hong Kong's future, in addition to our political commitment to make a success of the Joint Declaration.

Against this background, our main objectives for Hong Kong can be summarised as follows:

- (a) to continue to administer Hong Kong to the best of our ability until the transfer of sovereignty;
- (b) to ensure that the Chinese Government stick to the assurances in the Joint Declaration about Hong Kong's future and to work steadily for the full implementation of that Agreement;
- (c) to prepare Hong Kong for the change of sovereignty, in particular by measures to enhance before 1997 the high degree of autonomy that Hong Kong is to enjoy after 1997 and by the development of representative government in the territory in line with the wishes of the community as a whole;

(d) to increase trade and investment flows between the UK and Hong Kong and to ensure that Hong Kong remains a major market for Britain after 1997;

(e) to deal effectively with problems of particular concern to Hong Kong people.

Implementation of the Joint Declaration

While the Joint Declaration provides the basis for a successful future for Hong Kong, we need to make sure that the agreement sticks and works in practice. We are pursuing this through the work of the Joint Liaison Group and through the influence we have been able to exert on the drafting of the Basic Law (which will provide the constitutional framework for Hong Kong's autonomy after 1997). The Joint Liaison Group has made steady progress in a number of areas of importance to Hong Kong. Annex I to this paper contains a list of the more important agreements achieved so far. None of this has been won easily: each agreement has required meticulous and persistent negotiation in order to secure the best possible arrangements for Hong Kong on terms fully consistent with the Joint Declaration. Several key points have only been resolved by direct discussion between the Foreign Secretary and his Chinese opposite number. The workload is a heavy one and there is a major input from the Hong Kong Government. This Hong Kong involvement helps to ensure that local concerns are fully reflected in the process of implementing the Joint Declaration.

Much remains to be done. There is a great deal of work in the legal field, particularly over the continued

application of international treaties and agreements to Hong Kong, and the localisation of UK legislation now applied directly in the territory. Difficult discussions lie ahead on the disposal of lands and facilities now used by the British garrison; on Hong Kong's own system of Air Service Agreements and Extradition agreements; and on arrangements for the transition through 1997. We are on schedule so far; but in order to keep up the momentum we shall need to sustain steady pressure on the Chinese at all levels and to continue the process of educating them about the realities and sensitivities of Hong Kong - a process which of course began with the negotiations of the Joint Declaration. We shall continue to negotiate firmly and toughly while seeking to avoid public confrontation which serve only to undermine confidence in Hong Kong.

Basic Law

The drafting of the Basic Law is the responsibility of a Basic Law Drafting Committee (BLDC) on which Hong Kong people have minority representation. The first draft was published in April 1988 after 2 years work and submitted for several months public consultation in Hong Kong. A second, revised draft will be published shortly for further public consultation. The final version is due to be promulgated by the National People's Congress of the PRC in 1990.

The Basic Law falls naturally into two parts: those provisions which directly correspond to specific provisions in the Joint Declaration; and those which amplify the Joint Declaration; for example in areas such as the section on the political system where the Joint Declaration is couched in very general terms. By far the

greater part of the Basic Law falls into the first category, reproducing provisions of the Joint Declaration in satisfactory (and often verbatim) form.

Under the Joint Declaration, the Chinese Government has responsibility for the Basic Law. Our influence on the drafting process has nevertheless been extensive and important. While taking due account of sensitivities in public, we have worked hard in private discussions with them behind the scenes to ensure that the Basic Law complies with the Joint Declaration. This approach has paid off: the Chinese have made it clear that they value our contribution and have accepted many of our ideas. We have also secured the tacit acknowledgement by the Chinese of Parliament's right to debate the draft and to have their views passed to the authorities in Peking.

Annex II contains a summary of the changes which we know have already been made to the first draft, at least in part in response to our representations and those of the Governor of Hong Kong. Our assessment of the position now is that all the provisions of the Joint Declaration are reflected in the draft Basic Law. The only articles of the draft which might contravene the Joint Declaration are those containing policy provisions, included at the insistence of the Hong Kong businessmen on the Basic Law Drafting Committee. These prescribe the economic policies of the future Hong Kong SAR Government (balanced budgets and low taxes) and thus undermine the principle of the high degree of autonomy that Hong Kong is to enjoy after 1997. There are other areas (eg over the power of interpretation of the Basic Law) where the drafting can be further improved. We will want to pursue these points in the light of reactions in Hong Kong.

There are particular difficulties over the section on the future political system. The Joint Declaration says only that the legislature will be "composed of local inhabitants" and "constituted by elections"; and that the Chief Executive will be "selected by election or through consultations held locally". There have been differences of view amongst the Hong Kong members of the Basic Law Drafting Committee, reflecting a similar divergence of opinion in Hong Kong. Some members of the BLDC, led by Mr Martin Lee, are pressing for the fastest possible progress towards a directly elected Chief Executive and a fully directly elected legislature. Others, including such business figures as Sir Y K Pao, advocate a considerably more cautious approach, involving minimal evolution from the status quo. The draft as it now stands embodies a position which leans to the more conservative of the two views. It sets a timetable for change after 1997 and proposes that referenda should be held in 2011 and 2012 to determine whether at that point Hong Kong should have a directly elected Chief Executive and a fully directly elected legislature. It also proposes that the move to universal suffrage would require the consent of the Chief Executive, two thirds of the Legislature and the Standing Committee of the National People's Congress. We shall need to press for modifications which can command the confidence of the community as a whole, for example by bringing forward the timescale for change or removing some of the preconditions for such change to take place. There are indications that the Chinese recognise that the proposals as they stand may give too much weight to more conservative opinion in Hong Kong.

Representative Government

At the time of the signature of the Joint Declaration in 1984, there were no elected members of LegCo: all were appointed. In parallel with our discussions with the Chinese about Hong Kong's future, we have sought to ensure that the process of development of representative government is well established in Hong Kong before 1997. The pace of change has been steady and deliberate, in line with the wishes of the community as a whole. Indirect elections to LegCo were introduced in 1985; and a comprehensive review of public opinion on the subject of constitutional change was held in 1987. That review showed that while most people wanted a directly elected element in the legislature, opinion was sharply divided over when it should be introduced. Our decision to introduce a directly elected element in 1991 was mostly welcomed in the territory. There is moreover scope for further change. In the interest of continuity we have succeeded in persuading the Chinese to accept that those members of LegCo elected in 1995 should serve across the change of sovereignty in 1997, and this will mean holding the 1995 elections in accordance with the provisions of the Basic Law, which as it currently stands, envisages a legislature in 1997 composed of 27% directly elected seats and 73% indirectly elected ones. There is thus the prospect of a steady evolution towards fully representative government at a pace which is in line with what Hong Kong people want.

There is, however, a vocal and articulate minority in Hong Kong who claim that the Government had promised in 1984 to introduce direct elections in 1988; that we reneged on this "promise" in response to Chinese pressure; and that the review of Hong Kong opinion in

1987 was fixed in order to achieve the desired outcome. They argue that the establishment of a fully democratic system in Hong Kong is the most effective safeguard against interference by China after 1997 and that the Government's reluctance to force the pace over the development of representative government is undermining confidence, particularly amongst the young professional classes in Hong Kong. This allegation of 'broken promises' cannot be sustained. The record shows clearly that we gave no undertaking in respect of 1988: we undertook only to hold a Review on the way forward in 1987 - an undertaking which we carried out to the letter. The Review was fair and objective. Our decision to introduce an element of direct elections in 1991 was based on our best assessment of the wishes of the community as a whole and on a careful judgement of what was best for Hong Kong, given all the circumstances. There is little doubt that this judgement has been endorsed by the majority of people in Hong Kong.

Hong Kong's High Degree of Autonomy

In practice the Hong Kong Government has enjoyed extensive autonomy for many years. We are now seeking wherever possible to formalize those arrangements so as to allow the Hong Kong authorities to exercise now the high degree of autonomy that Hong Kong is to enjoy after 1997. The Hong Kong Government manages most of its internal affairs by itself, while keeping HMG generally informed. Hong Kong also exercises full autonomy in external trade matters and, as a separate contracting party to the GATT, has its own representation the GATT in Geneva. There are plans for similar representation to the EC. We are also encouraging the establishment of free standing Economic and Trade Offices in the capitals

of some of Hong Kong's major trading partners. Similarly, through the Air Services separation process, we are seeking to ensure that Hong Kong's existing autonomy in aviation matters is clearly established before 1997. This is important for the preservation of Hong Kong's role as an important international civil aviation centre, and for the protection of the legitimate interests of Hong Kong airlines. Such autonomy is not of course inconsistent with the progressive introduction of more liberal civil aviation policies, which we are urging the Hong Kong authorities to adopt, and which would be in the wider interests of Hong Kong and the travelling public.

Britain's Commitment to Hong Kong

Despite the solid achievements we have made so far in securing a stable and prosperous future for Hong Kong, the local community remain, as ever, understandably unsure and nervous about their future and about Britain's continuing commitment to Hong Kong. Reassuring the local community that Britain is not ducking its responsibilities, or seeking to disengage from Hong Kong as soon as is conveniently possible, will continue to be a major task in the run up to 1997. This will require tact and sensitivity in demonstrating that we understand the problems that matter most to the local community. It will also require a readiness by HMG to play our full part, and to be seen to be doing so, in helping the Hong Kong authorities to tackle these problems.

Vietnamese Boat People

Since 1979, Hong Kong has given temporary asylum to over 130,000 Indo Chinese refugees, of whom well over

100,000 have been resettled abroad. The number of boat people in Hong Kong had been steadily diminishing until 1987, when a new exodus began. In 1988, 18,000 boat people arrived in Hong Kong: the total population in the camps is now about 25,000. That has created a major political problem in Hong Kong: it is a source of deep and growing concern amongst Hong Kong people and there is much resentment over the marked contrast between the policy of giving asylum to all boat people and the prompt repatriation of all illegal immigrants from China: the boat people problem is widely seen in Hong Kong as an acid test of Britain's responsibility towards the territory. We are helping the Hong Kong authorities to tackle it by giving our full support of their policy of screening and repatriation introduced in June 1988; by our talks with the Vietnamese on repatriation of those who are screened out as non refugees; and by our initiative to stimulate a new international resettlement effort. We are publicly committed to doing all we can to solve the problem before 1997 and are coming under increasing pressure from Hong Kong people to demonstrate our determination and ability to do so. The forthcoming International Conference on Indo-Chinese refugees (likely to be held in June) should provide a useful opportunity to make progress on both repatriation and resettlement. It will enable us to emphasise the need for a solution at an international level, but Hong Kong and the international community will expect Britain to take a lead in shouldering its share of the responsibility including doing more on resettlement. Failure to do so will seriously damage our credibility in the territory.

Emigration

The other key problem of concern to Hong Kong is emigration. Hong Kong, with its highly mobile population, has always had a strong tradition of emigration (just as it has been subject to fluctuating flows of immigrants from China: some 28,000 legal immigrants and 21,000 illegal ones in 1988). What is new is the increasing number of qualified professional people (about 10,000 in 1988) who are leaving Hong Kong. This trend remains manageable but is being carefully monitored. The Hong Kong Government are taking various steps to contain the effects of emigration, such as stepping up higher education and training so that qualified people are available to fill the gaps left by those who go, and measures to make it easier for people settled abroad to return to Hong Kong with their families. We are also making clear that Hong Kong people are free to leave the territory if they wish. But we must at the same time be careful to ensure that, by our own words and actions, we are not seen to be actively encouraging the flow of talent and capital from the territory.

Nationality

There is still concern and resentment in Hong Kong about nationality matters, and in particular about the fact that holders of Hong Kong British passports do not have the right of abode in this country. Some people in the territory and in this country believe that Britain should open its doors more widely to Hong Kong British passport holders. This feeling is not new: it has existed since the early 1960s when restrictions were first introduced. But the controversy reawakens each

time new legislation enshrining this situation is passed. The relevant provisions of the British Nationality Act of 1981 (which were of course enacted partly in response to deep domestic concern about the prospect of very large numbers of people coming to the UK from Hong Kong) nevertheless created particularly strong resentment in the territory. Groups such as civil servants have strong feelings about what they perceive as the UK's obligations towards its nationals in Hong Kong. The fact that Portuguese Nationality Law as applied to Macao means that henceforth some Macao residents will be able to enter the UK more easily than Hong Kong British passport holders has provoked bitterness, although it is well understood that the numbers involved in Macao are small (a maximum of 100,000) compared with the 3.5 million in Hong Kong.

It is clear that we cannot afford the spectacular gestures towards Hong Kong British passport holders advocated by some press commentators. That would undermine the British Nationality Act. It would also be impossible to reconcile with our responsibilities towards Hong Kong and the need to sustain confidence in the territory. But while taking full account of these considerations, there is no reason why we need ignore the opportunities presented by entrepreneurs and other talented or deserving individuals who have decided to leave Hong Kong and who wish to invest and/or make their lives overseas. People in this category could make a significant contribution to Britain and Hong Kong after 1997. We need to ensure that such individuals understand that they would be welcome in Britain and that our rules on settlement and nationality can be operated flexibly. Provided we proceed discreetly and with our responsibility towards Hong Kong clearly in mind, it should be possible to ensure that Britain secures a

reasonable share of the entrepreneurial talent that is seeking to establish itself outside the territory.

Anglo-Hong Kong Links

One way in which we can underline our commitment to the territory is by making it clear that we intend to maintain a substantial official presence in Hong Kong after 1997 and to do all that we can to promote more extensive links between Britain and Hong Kong, both economic and cultural. We are now looking for a suitable site for our future Consulate General, which if it is to make the sort of impact we want will require substantial financial resources. We decided last year to upgrade the post of Senior British Trade Commissioner in Hong Kong, as a mark of the importance we attach to our growing commercial relationship with Hong Kong. And we have given our support to private initiatives to strengthen Anglo-Hong Kong links, such as the establishment in 1987 of the British Chamber of Commerce in Hong Kong and the recently formed Anglo-Hong Kong Trust, in ways consistent with our own objectives.

Conclusion

There will inevitably be difficulties on the road to 1997. Administering a territory with an advancing deadline will not be easy; and demonstrating that the UK is carrying out to the full its obligations to Hong Kong will require continuous and very substantial effort. There is also still a vast amount of detail to negotiate with the Chinese and the process will require firm but sensitive handling. And there are bound to be some people who will accuse us of failing to do enough for the territory. But Hong Kong still has a very great deal

going for it. The level of international confidence in Hong Kong is high and other governments (eg the United States) have expressed their strong support for our policies. We must now continue to press for what we believe to be in Hong Kong's best interests and demonstrate our own confidence in and commitment to the territory. Provided we can do so, there is no reason why Hong Kong should not enjoy a secure and prosperous future.

ACHIEVEMENTS OF THE JLG

Since the Joint Declaration entered into force in May 1985, the British and Chinese Governments have been working together through the Sino-British Joint Liaison Group (JLG) to put flesh on the bones of the Joint Declaration and pave the way for a smooth transition in 1997. Much work remains to be done in the years ahead (and beyond: the JLG will remain in existence until 2000). In the meantime, the achievements of the JLG have included the following:

- i) Agreement that Hong Kong should remain a member of the Asian Development Bank after 1997.
- ii) Agreement that Hong Kong should be deemed a separate contracting party to the General Agreement on Tariffs and Trade and should continue in that status after 1997 in the name of "Hong Kong, China". Hong Kong duly became the GATT's 91st contracting party on 23 April 1986.
- iii) Agreement on transitional measures relating to the principal travel and identity documents issued to Hong Kong residents, to avoid any disruption in this important area on 1 July 1997.
- iv) Agreement on the establishment of a standing sub-group of experts to consider the question of the continued application of international rights and obligations affecting Hong Kong. The sub-group has its principal base in Hong Kong and it held its first meeting there from 15 to 17 October 1986. The group has subsequently agreed on Hong Kong's future participation in 14 international organisations.
- v) Agreement on the principles for the establishment of a separate Hong Kong Register of Shipping which can be maintained beyond 1997. Necessary work to put this into effect is now going on in Hong Kong.

vi) Agreement on the principles for the conclusion of separate Air Service Agreements between Hong Kong and its aviation partners, which are capable of remaining in force after 1997. The first such Air Service Agreement was signed between the Government of Hong Kong and the Government of the Kingdom of the Netherlands in The Hague on 17 September 1986. Subsequently, agreements have been signed with Switzerland, Canada and Brunei. Negotiations with other partners continue.

vii) Agreement on the introduction of a new pension scheme for civil servants in Hong Kong.

viii) Agreement that Hong Kong should become a separate member of the Customs Co-Operation Council (CCC) and should continue as such after 1997 in the name of "Hong Kong, China". Hong Kong was duly accepted as the 99th member of the CCC on 25 June 1987. As a result of the JLG's efforts Hong Kong has, and will retain after 1997, a separate standing in relation to the General Agreement on Tariffs and Trade, the Multi-Fibre Arrangements and the CCC. It is thus better placed to protect its own interests in world trade before and after 1997.

ix) Good progress in discussions on the important subject of the defence of Hong Kong and the maintenance of its public order. The two sides agreed in principle that the Hong Kong Police Force should undergo appropriate expansion to enable it to discharge its responsibility for maintenance of public order before and after 1997. The existing Auxiliary Air Force will be reorganised to form a civil Government Flying Services Department, with responsibility for providing the Hong Kong Government with necessary flying services. The Chinese side have also expressed understanding of the provisional plans for the withdrawal of the British Garrison from Hong Kong, which have been outlined by the British side. Her Majesty's Government's primary objective in this crucial and sensitive area is to ensure that Hong Kong's security and stability is maintained throughout the period up to 1997, and that suitable arrangements are made for defence and public order thereafter on the basis of the provisions in the Joint Declaration.

x) Agreement on the basic principles for future arrangements for the surrender of fugitive offenders between Hong Kong and foreign jurisdictions. Under this agreement, Hong Kong will be authorised to negotiate, conclude and maintain after 1997 its own agreements with foreign jurisdictions. Experts from the two sides will hold further discussions on the basis of this agreement.

xi) Agreement on future arrangements for improvement of terms of service and other matters relating to the Hong Kong Judiciary. The main elements include a separate set of Judicial Service Regulations, a separate pay scale for the Judiciary, a Standing Committee on Judicial Salaries and Conditions of Service, an enhanced pension scheme, a higher retirement age for district court judges employed after 1987 (from 60 to 65), and the embodiment in law of present administrative arrangements relating to the security of tenure of judicial officers other than judges.

xii) Discussions have continued in the JLG on the question of localising United Kingdom legislation applied to Hong Kong in a form which can continue after 1997. Following agreement reached on questions relating to the localisation of admiralty jurisdiction, the first piece of localised legislation will be introduced into the Legislative Council on 11 January 1989.

BASIC LAW

Improvements to Key Articles endorsed by the
Basic Law Drafting Committee
at its Eighth Plenum (9-15 January)

Criticism on ConsultationImprovements in latest draftDraftCentral/SAR Relationship

1. JD provision (JD 28) that the maintenance of public order in the SAR is the responsibility of the SAR is not reflected.

JD 28 is now reflected in Article 14(2)

2. legislative power of SAR legislature would be undermined by NPC Standing Committee's power to revoke or return any SAR law inconsistent with the BL (Art. 16)

NPC Standing Committee can only return (but not revoke) an SAR law inconsistent with those BL provisions falling within the CPG's responsibility (Art. 17)

3. the scope of nation-wide laws which could be applied to the SAR is too wide (Art.17)

nation-wide laws applicable to the SAR are confined to those outside the limits of the SAR's autonomy and are listed in an annex (Art.18 and Annex III)

4. restrictions on the jurisdiction of SAR courts (eg over executive acts) go beyond the present practice (Art.18)

SAR courts will have jurisdiction over all cases "except those constituted by acts of state". The wording seeks to follow the present practice (Art.19); but remains unclear. Text was not agreed by the necessary 2/3 majority of the BLDC and will need further consideration.

Criticism on Consultation
Draft

5. NPC Standing Committee's power of interpretation too wide. Before passing final judgements, SAR courts required to seek interpretation from the SC whenever a case involves an interpretation of a provision outside the SAR's autonomy (Art. 169)

6. the scope of "acts designed to undermine national unity or subvert the CPG" in Art. 22 is capable of being interpreted very widely

7. composition of Basic Law Committee unclear

Human Rights

8. inadequate protection of human rights, as the SAR legislature can enact laws to restrict human rights beyond the limits permissible under the two Covenants (Art. 38-39)

Improvements in latest draft

NPC Standing Committee delegates power to interpret the "autonomy" provisions to SAR courts on their own. Courts of SAR will only refer to the Standing Committee when in their view an interpretation from the Standing Committee on a provision outside SAR's autonomy is required for the judgement to be made (Art. 157)

a more precise and familiar formulation ("act of treason, splitting the state, sedition and the theft of state secrets") is adopted (Art. 23)

Basic Law Committee to consist of 6 HK members and 6 mainland members. HK members to be nominated jointly by Chief Executive, Chief Justice and President of Legco (BLDC recommendations)

restrictions on rights and freedoms must not contravene the Covenants (Art. 39)



Criticism on Consultation
Draft

9. drafting defects in some articles (eg prohibition against "unlawful" arrest or search of body/premises accords no real protection) (Art. 27-28)

Improvements in latest Draft

"arbitrary" arrest or search is also prohibited (Art. 28-29)

Political Structure

10. a break in Legco membership in 1997 is envisaged (Annex III)

members of the last HK Legco will become members of the first SAR legislature subject to certain conditions, is adopted (draft NPC Resolution)

11. unclear what role officials will play in the SAR legislature

there will be no officials in Legco, but they may attend meetings to transact government business without the right to vote (Art. 62); President of Legco will be elected from amongst its members (Art. 70); government business to be given priority (Art. 71)

Others

12. Chinese Nationality requirement extended to cover some officials who are not Principal Officials (Art. 100)

a reduced list covering Principal Officials only (Art. 100)



Criticism on Consultation
Draft

Improvements in latest draft

13. the status of English language is unclear (Art.9)

express provision that English will also be an official language in the SAR (Art. 9)

14. not clear whether there will be an authentic English text of the Basic Law

clear indication that the NPC Standing Committee will promulgate an authentic english text

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dti

the department for Enterprise

cc P.C. (2)
cc [unclear]

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PRIME MINISTER

ms

Prime Minister
I think you missed
this in the meeting
folder. CDD 22/2.

HONG KONG : TRADE AND INVESTMENT

I have been a frequent visitor to Hong Kong over the last twenty years and every time I go there I become more convinced that we must make a greater effort to promote our economic interests. We need to encourage UK industry and commerce to do more in Hong Kong and at the same time we must ensure that we get at least our fair share of mobile Hong Kong entrepreneurs.

WHA REQUEST IF REQUIRED

2. I was glad to see Douglas Hurd's letter of 25 January setting out more flexible arrangements for admitting Hong Kong businessmen here. But I doubt whether they yet go far enough to ensure that they see the UK as a welcoming haven for their entrepreneurial investments.

3. I have been told on a number of occasions by Hong Kong Chinese that they can easily get citizenship in Ireland or Portugal which would then give them the right to live here. I do think that we should adopt a much more flexible approach for up to 100 or so Hong Kong Chinese entrepreneurs who, provided that they made a suitable investment in the UK (of, say, half a million pounds or so), could be assured as a matter of certainty that they would in due course obtain a passport.

4. The second issue concerns our trading position in Hong Kong itself. Hong Kong is a increasingly competitive market but also an attractive one, particularly as a gateway to China. I am glad that the post of Senior British Trade Commissioner has been upgraded. But he ought to move to a more prestigious building

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as soon as possible, both to enhance his prestige and provide a better base for the time after 1997 when the Trade Commission will become a Consulate General in what will be by then the most important business centre in China.

5. The greatest scope for improvement is in our efforts in the UK. Exports begin at home. Many British companies have the wrong psychological approach to Hong Kong. They see 1997 as the end of an era of British influence and consequently adopt a negative attitude to the market. Our competitors do not have this historical hang-up and rightly see 1997 as releasing new opportunities.

6. We must get this message across to UK companies. At present, there is an active promotional programme directed by the businessmen of the Hong Kong Trade Advisory Group. But we need to put our effort on a different scale. I am considering appointing a businessman with direct experience of the Hong Kong market to act as a London-based Trade Commissioner. He would visit Hong Kong frequently but would spend most of his time in the UK promoting the Hong Kong market. He could also use his contacts in Hong Kong to promote further Hong Kong investment in this country, although he would do so discreetly.

7. My ideas on this proposal are not yet fully formed. We will need to work out a precise role and identify a candidate with the right business background and with the personal qualities to inform and motivate a wide range of exporters to Hong Kong - large and small, active and potential. He would be based in my Department and might either work full-time or part-time. I am convinced that Hong Kong provides a special opportunity over the next few years and that we need to approach it in an imaginative way.



the department for Enterprise

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8. I am copying this minute to Geoffrey Howe and Douglas Hurd,
and to Sir Robin Butler.

A handwritten signature in blue ink is located in the center of the page. The signature is stylized and appears to be 'D Y'.

D Y

16 February 1989

Department of Trade and Industry

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TO IMMEDIATE HONG KONG
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OF 131300Z FEBRUARY 89

FOLLOWING PERSONAL FOR GOVERNOR FROM CHARLES POWELL, 10 DOWNING
STREET

THANK YOU OF YOUR TELEGRAM SUGGESTING LUNCH ON 20 FEBRUARY.
I SHALL IN FACT BE IN GERMANY ALL DAY 20/21 FEBRUARY WITH THE PRIME
MINISTER FOR THE ANGLO/GERMAN SUMMIT. WE COULD MEET SOME TIME
ON THE MORNING OF 22 FEBRUARY IF THAT WAS POSSIBLE FOR YOU. WOULD
YOU LIKE TO SUGGEST A TIME?.

YYYY

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CONFIDENTIAL

TELEGRAM via CABINET OFFICE

TO IMMEDIATE HONG KONG

FOLLOWING PERSONAL FOR GOVERNOR FROM CHARLES POWELL,

10 DOWNING STREET

Thank you for your telegram suggesting lunch on 20 February. I shall in fact be in Germany all day 20/21 February with the Prime Minister for the Anglo/German Summit. We could meet some time on the morning of 22 February if that was possible for you. Would you like to suggest a time?

ED?

3 MR ~~POWELL~~
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TO IMMEDIATE CABINET OFFICE
TELNO MISC 105
OF 131050Z FEBRUARY 89

FOLLOWING PERSONAL FOR POWELL, NO 10 DOWNING STREET, FROM GOVERNOR
ANY CHANCE YOU WOULD BE FREE TO HAVE LUNCH ON MONDAY 20 FEBRUARY?
I ARRIVE EARLY THAT MORNING BUT, ALTHOUGH DOUBTLESS JETLAGGED,
WOULD STILL LIKE AN OPPORTUNITY OF POSSIBLE TO CHAT TO YOU BEFORE
SEEING THE PRIME MINISTER ON 22 FEBRUARY.

WILSON

YYYY

HMLNAN 8075

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PRIME MINISTER

HONG KONG

I am not sure how best to take forward the ideas which Lord Young put to you this morning on Hong Kong. I don't think you are going to get far on passports in yet another bilateral with the Foreign Secretary and Home Secretary. At the least, you are going to need a wider meeting, perhaps of OD(HK). You mentioned the possibility of stimulating some Parliamentary pressure. The Chairman of the Backbench Committee is now Peter Blaker, who stays fairly close to the FCO line. I am not sure, therefore, that he offers a very helpful way forward. There is the idea that I have put you separately, that you should agree to give a speech at a Hong Kong Trade Development Council dinner this autumn, then insist that FCO/Home Office must let you have new proposals e.g., on passports to make at it. That apart, I am a bit short of inspiration. How would you like to proceed?

CDP

C. D. POWELL
8 FEBRUARY 1989

*Let us first see
whether Henry Keswani's letter
invokes any response from others
me*

MRMAHC

TELEGRAPHIC ADDRESS:
MATHESON LONDONEC3
FACSIMILE: 01-623 5024
TELEX: 8953378 MANDCO
TELEPHONE: 01-528 4000

Matheson & Co., Ltd
3 Lombard Street
London EC3V 9AQ

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6th February, 1989

HONG KONG

Congratulations on your wide ranging speech at the Royal Asian Society dinner.

I have just returned from a fortnight in Hong Kong and never since I first went out as a boy to the territory in 1961, have I been more confident of the future prosperity and stability of the territory and felt more confident for the unique prospects for British commerce there. The implementation of the excellent 1984 Joint Declaration seems to be going very well.

Sadly I found the esteem for Britain and the perception of British commercial confidence in the territory never at a lower ebb.

I am sure you must have seen the manifestations of this situation by the extremely hostile reception you yourself get from the Hong Kong press, which is compounded by a continual bad press Britain gets for Hong Kong affairs both in London and world wide.

I believe this unsatisfactory British image, which is completely contradictory to the truth and reality is brought about by the gaping vacuum of British representation in Hong Kong.

Cont/.....

I believe the Governor of Hong Kong should come out of his closet with all the vice regal power available to him to be unashamedly pro British both in political and commercial matters. The Joint Declaration accepts Britain has sovereignty over Hong Kong until 1997. I believe this will lead to further confidence in Hong Kong and would be quite understood by both China and the Hong Kong public. Only in this way would the British point of view be put across.

I understand well the arguments in a devolved system of Government the Governor of Hong Kong is a negotiating partner with Britain with his own Hong Kong point of view. I personally believe the two interests are the same, but if the Foreign Office feels that it is essential that they are kept apart, then in my view, it is paramount that a British Commissioner is appointed in Hong Kong to strongly put forward the British point of view both in political as well as commercial matters.

I have written to David Young asking for his help in ensuring that there is proper British Government representation of commercial affairs in Hong Kong and I enclose a copy of my letter.

As Chairman of the Hong Kong Association I would welcome the opportunity, if it could be arranged, of having a half hour meeting with the Secretary of State for Foreign Affairs and yourself, to discuss my ideas for improving the perception of British Government policy as regards Hong Kong.

HENRY KESWICK

The Lord Glenarthur,
Minister of State for Foreign & Commonwealth Affairs,
Foreign & Commonwealth Office,
Downing Street,
LONDON, S.W.1A 2AH.

TELEGRAPHIC ADDRESS:
MATHESON LONDON EC3
FACSIMILE: 01-623 5024
TELEX: 8953378 MANDCO
TELEPHONE: 01-528 4000

Matheson & Co. Ltd
3 Lombard Street
London EC3V 9AQ

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6th February, 1989

HONG KONG

I have just returned from my quarterly two week stay in Hong Kong and never, since I went to live there in 1961, 27 years ago, have I been more confident about Britain's prospects in the territory and the opportunities they hold if we can co-ordinate and get our National act together.

Conventional wisdom that Britain has a declining interest in Hong Kong commerce is sadly too often put about by poorly lead Hong Kong Government officials, China and Britain's principal competitor nations, Japan and the U.S.A. There is no satisfactory British Government presence putting the British point across of British commercial confidence in the future of the territory.

I believe the enclosed illustrative figures on the British managed or controlled position in public companies in Hong Kong tell an often overlooked tale of British vigour and dominant success in the Hong Kong economy. Those British institutions with a market value of about £20 billion (40% of the market) are continuously reinvesting their profits in Hong Kong and the region. After 1997 they will be a marvellous British beachhead for further British influence in commerce and trade (and politics) in the Asia Pacific region. How we must wish now that our forebears had a vision in the old Dominion territories before their independence.

Cont/.....

If you couple these publicly quoted British institutions of £20 billion together with British direct investment plus a growing export market of £1 billion per year, plus our invisible earnings, plus future infrastructure opportunities of £3 billion, then Britain has a jewel really worth cherishing and developing in a growth part of the world. Private enterprise must be the initiator but the British Government has a supportive role to be informed and to encourage our vision and to use the advantage of Hong Kong's colonial status while it still lasts.

The Foreign Office takes an opposite view that British representation of these interests in Hong Kong should be low key and unobtrusive. They cannot be seen to be helpful and pro British. I do not believe they understand what a valuable seed corn asset Britain has now and for the future after 1997. The British Governor (a devolved negotiating partner) privately and publicly states that over his dead body will he support British commerce. The same dead body has to be crossed before he will allow a high profile British Commissioner to do his job for him. Britain's case goes by default.

Any assistance the Department of Enterprise can give in focussing the FCO's vision of the future potential will be much appreciated and I hope the enclosed statistics will help illustrate the point.

I have sent a copy of this letter to Lord Glenarthur as I would not wish him to feel that I was going behind his back. I do feel strongly however, that the advice he is getting from his officials is wrong headed and against Britain's short and long term interests and ironically my suggested change in FCO policy will lead to greater confidence in the excellent 1984 Joint Declaration.

With best personal regards.

HENRY KESWICK

The Rt. Hon. The Lord Young of Graffham P.C.,
Secretary of State for Trade and Industry,
1 Victoria Street,
LONDON, S.W.1H 0ET.

c.c. The Lord Glenarthur

TELEGRAPHIC ADDRESS:
MATHESON LONDON EC3
FACSIMILE: 01-623 5024
TELEX: 6953378 MANDCO
TELEPHONE: 01-528 4000

Matheson & Co., Ltd
3 Lombard Street
London EC3V 9AQ

PRIVATE & CONFIDENTIAL

3rd February, 1989

Dear David

Just a short note to thank the Hong Kong Government very much indeed for laying on such an excellent programme during my recent visit to Hong Kong.

I met many senior Government officials and by becoming a little better informed it certainly makes my small contribution in the Hong Kong Association easier.

One misconception that struck me was a continual grouse from senior Government officials that British commerce was not playing its part in investing in Hong Kong. I was often told that American, Japanese, Italians, Germans etc. were all investing in Hong Kong but the British were overlooking the opportunities.

I feel strongly that this conventional wisdom is profoundly wrong and can only be put right by strong leadership by the British Colonial Government and British Ministers and Senior Businessmen, so perhaps I can explain why.

British managed and significantly controlled companies in the Hong Kong stock market have a market value of almost £20 billion which represents 40% of the total value of all Hong Kong quoted companies. It is a vigorous and dominating influence on the Hong Kong economy and is a marvellous British base that can be built on after 1997, both in China and the whole Asia/Pacific region. Britain is continually reinvesting its profits in these institutions.

It is plainly absurd to suggest that British investment is turning its back on Hong Kong.

Cont/.....

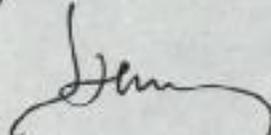
To illustrate this point, I suspect if Jardine's were offered to swop Exchange Square, which is currently valued at HK\$15 billion for all the Japanese, American or all the other countries put together over the last ten years, then we would decide to keep Exchange Square! I suspect another great British company, Swire's might also have the same view on Pacific Place.

Simon and myself had a friendly lunch with Mr. Xu Jiatun of the Xin Hua News Agency, and he also gave us the conventional wisdom that Britain should invest more in Hong Kong. We asked him how much China had invested, and rather surprisingly he gave us a figure of HK\$8 billion. We were able to tell him that the British managed investment was \$264 billion in Stock Exchange terms and that we would probably not swop our investment in Exchange Square for the combined value of all other foreign investment. He seemed to take the point, but on consideration it seemed to us that he had the same misconception of the real situation as many senior officials in the Hong Kong Government.

Obviously British commercial interests in Hong Kong have been selling themselves short and it is up to them to vigorously put the record straight.

Any help that you can give the mother country will be much appreciated. For the Hong Kong Government to openly praise and stress the British Commercial Commitment I am sure would lead to greater confidence. I am also writing to Lord Young of the D.T.I. and Lord Glenarthur of the Foreign Office to ask for their help in correcting present misconceptions.

Sorry for going on about all this, but my blood runs strong with pride that the great initial and ongoing contribution that British commerce has made for the prosperity and stability of Hong Kong.

Yours as


HENRY KESWICK

Sir David Wilson K.C.M.G.,
Governor,
Government House,
HONG KONG.

GROSS STOCK MARKET VALUE OF
BRITISH MANAGED COMPANIES IN HONG KONG
JANUARY 1989

	<u>Market Value</u> <u>£m</u>	<u>Group</u> <u>£m</u>	<u>Principal British</u> <u>Shareholder</u>
HK Telecom		4,350	Cable & Wireless plc
HK Bank	2,800	4,430	Public (British management)
Hang Seng Bank	1,630		
Swire Pacific	2,250	4,390	Swire
Cathay Pacific	1,930		
HAEC	210		
Jardine Matheson	800	4,150	Keswick
HK Land	1,970		
Mandarin	260		
Dairy Farm	560		
Jardine Strategic	560		
China Light & Power	1,480	1,930	Kadoorie
HK & S. Hotels	450		
TOTAL		19,250	
		<u>£19.3 billion</u>	
		<u>HK\$264 billion</u>	

Notes

1. These figures are illustrative of British influence in public companies in Hong Kong. They do not reflect British net investment because cross holdings and outside public ownership are not taken into account.
2. They reflect current low market prices not necessarily what the investments are worth if the underlying assets were sold or taken over by non British interests in hostile bids. Property shares are selling at over 30% discount to underlying values.
3. British managed companies represent 40% of the Hong Kong stock market's total value (£48b).

2/2/89

BRITISH COMPANIES WITH MEANINGFUL BUSINESS
SUBSIDIARIES OR ASSOCIATES OPERATING
IN HONG KONG

Standard Chartered Bank
Inchcape
Shell
Robert Fleming
I.C.I.
P. & O.
British Airways
Guardian Royal Exchange Insurance
Barclays Bank
Trafalgar House
Schroders
National Westminster Bank
Lloyds Bank
British Oxygen

Note

1. This list is not exhaustive
2. It does not include two way trade with Hong Kong or invisible/service earnings in Hong Kong.

From: Sir David Wilson KCMG



香港總督府

GOVERNMENT HOUSE
HONG KONG

PRIVATE AND CONFIDENTIAL

13 February 1989

See Henry.

Many thanks for your letter of 3 February about investment. I am all for British business shouting from the rooftops about its continuing involvement in Hong Kong through old investments and the successful management of some of Hong Kong's leading companies. Go to it! I should also like to see the UK move up the list of new investment in the manufacturing industry. That, too, would do a great deal of good for confidence.

Not relevant

Have you sent your figures to Reg Holloway? I know that he is very keen to publicise the extent of long term British investment in the territory and has been doing good work to that end. Indeed he has just sent me the latest version of the speaking notes he used on the subject, which I attach.

Some caution is however needed in using your figures. I have just had Adrian Swire here emphasising that Cathay Pacific is, and must be seen as, a Hong Kong company and Inchcapes, on your reserve list, think highly of the size of their own activities - larger they say than Jardine Pacific.

*Correct but
checked
by Britain*

*Not true
but unclear*

I am glad that the programme on your recent visit went well. Whenever you come I will be happy to get people to lay on new items or revisit old places. We need the support in London of a well informed Hong Kong Association.

David Wilson
Governor

Henry Keswick Esq
Matheson & Co Ltd
3 Lombard Street
London EC3V 9AQ

PRIME MINISTER

CPM

You will want to see the attached letter from Kenneth James, inviting you to a dinner at Canning House between September 1989 and January 1990. You would be expected to speak.

There would be some advantages:

- it would give a fillip to those who trade with Latin America;
- it would be a way of demonstrating interest in a part of the world to which you have been able to devote relatively little attention;
- and if you contemplate a possible visit to Latin America in 1990/91, attendance at the dinner would be a good launch pad.

I have confirmed with Kenneth James that the Argentine representative would not be invited.

Is this something which you would be prepared to contemplate, say in the second half of January 1990?

C.D.P.

or before the end of 1989?

CHARLES POWELL
4 FEBRUARY 1989

mt.



FILE
DA
cc TCY
PC

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 February 1989

VISIT TO LONDON OF THE GOVERNOR OF HONG KONG

Thank you for your letter of 2 February about the visit of the Governor of Hong Kong. The Prime Minister could see Sir David Wilson at 5 p.m. on 22 February.

(C.D. POWELL)

R.N. Peirce, Esq.,
Foreign and Commonwealth Office.

5



51-
22 Feb.
ccf

Foreign and Commonwealth Office

London SW1A 2AH

2 February 1989

Dear Charles

Visit to London of the Governor of Hong Kong

The Governor of Hong Kong, Sir David Wilson, will be paying one of his regular consultation visits to London on 21-24 February.

As you know, he has not seen the Prime Minister since he called on her before taking up his appointment as Governor in April 1987. In view of the heightened and critical interest in Hong Kong which is being shown by the UK press, and of the House of Commons Foreign Affairs Committee's forthcoming enquiry on Hong Kong, the Foreign Secretary thinks that the Prime Minister may wish to take the opportunity of the Governor's visit to have a short meeting with him to discuss a range of current Hong Kong issues.

Yours ever

(R N Peirce)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street



Foreign and Commonwealth Office

London SW1A 2AH

30 January 1989

Den Charles

Hong Kong

In case you did not see it, I enclose a copy of the article by the Foreign Secretary in the Wall Street Journal (European and Asian editions) of 27 January. This was a response to the editorial in the Journal which Sir Geoffrey Howe discussed with the Prime Minister at their meeting on 25 January.

ms
R N Peirce
CAF
30/1

Tours over

Boston

(R N Peirce)
Private Secretary

C D Powell Esq
10 Downing Street

Sino-British Pact Preserves Hong Kong's Liberties

By SIR GEOFFREY HOWE

LONDON—A Wall Street Journal editorial "Maggie's Honor" (January 24) claimed that Britain imposed the 1984 Sino-British Joint Declaration on the people of Hong Kong without their consent and was now violating it. Nothing could be further from the truth.

Six years ago Hong Kong faced an uncertain political future. The 19th-century lease by which Britain held virtually all the territory of Hong Kong was due to expire in 1997, whereupon—in the absence of other arrangements—the place would simply have reverted to the world's largest communist society. Few people imagined then that Britain would manage to secure arrangements for Hong Kong to continue to exist beyond 1997 as a distinct, capitalist, free-enterprise society with its laws and liberties intact. And Hong Kong's poor economic performance reflected that lack of confidence.

When the draft of the Joint Declaration was published in September 1984 it was greeted in Hong Kong, and elsewhere, as the remarkable achievement it was. China had agreed to an international agreement guaranteeing that communism would not be imposed on Hong Kong after 1997, that Hong Kong people would govern themselves and that the Hong Kong way of life—its freedoms, its international connections, its stock markets, its foreign investments—would carry on as before.

The Joint Declaration was signed after it had been widely endorsed by Hong Kong people as the best negotiable deal for Hong Kong, not imposed without their consent. And far from being "relegated to history," as your editorial charged, it is the basis of every agenda item in the continuing negotiations with the Chinese. In every area dealt with so far, we have agreed to arrangements fully consistent with the terms and

spirit of the Joint Declaration.

The success of the Joint Declaration and its implementation to date is shown by the astonishing revival of Hong Kong's confidence since 1984—reflected in very strong economic growth (over 30% in three years), buoyant inward investment and ambitious development projects. Some people are emigrating, and I am well aware of concerns about this in Hong Kong. But the thriving Hong Kong Chinese communities around the world bear witness that this is not new; it is a phenomenon with which Hong Kong can cope.

Your editorial was critical of the pace of the development of representative government in Hong Kong, misquoting the Joint Declaration and urging Britain to have a confrontation with China over the Basic Law. The fact is that the process of developing representative government in Hong Kong is being conducted in accordance with the wishes of the people of Hong Kong. Whatever the critics may say, it was clear from a 1987 review that the majority support a gradual evolution of more representative government. They do not want to jeopardize the political stability on which Hong Kong's prosperity and its way of life depend.

The Basic Law discussions on the political system after 1997 are also based on extensive consultation of Hong Kong people.

Notable & Quotable

Freedom House director of hemispheric affairs Douglas W. Payne, writing in the January 1989 issue of Freedom at Issue:

[I]n Chile the U.S. proved that it could go beyond rhetoric and effectively promote democracy in the hemisphere, and that its interest in doing so ranged beyond Central America.

Your editorial omitted to mention the key point that the Basic Law Drafting Committee has just endorsed the important objective of universal suffrage for the election of the future Hong Kong legislature and the Chief Executive. Far from going back on the Joint Declaration, this actually goes beyond what that document said about the future political system. The Joint Declaration only said that the legislature "shall be constituted by elections," and that the Chief Executive "shall be selected by elections or through consultations. . . ." A second key point is that the Basic Law constitutional model which your author found inadequate is still a draft, which the committee has made clear can be amended in the light of the debate now under way in Hong Kong. The whole Basic Law text is still a draft. In general it reflects the Joint Declaration accurately. Substantial changes have been made to meet concerns expressed in Hong Kong and there is every reason to expect further improvement.

Consultation and negotiation is the way in which we, the Chinese and the people of Hong Kong are cooperating to build Hong Kong's future. It has worked well so far and will continue to do so. Confrontation would be disastrous for Hong Kong. Your other prescription—that Britain should open its doors to millions of Hong Kong people for settlement—would equally be a counsel of despair.

Hong Kong is a success story: a booming economy and a flourishing culture. We are as committed to this continuation of that success as the people of Hong Kong themselves. The government of China has been brought to share our perception and commitment. That is the best guarantee of Hong Kong's future liberty and prosperity.

Sir Geoffrey is the British Foreign Minister.



Me Pinn
19 a P

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

25 January 1989

SUBJECT CC MASTER

See Stephen.

HONG KONG

The Prime Minister and the Foreign Secretary had a brief exchange this evening on the subject of Hong Kong. The Prime Minister said that she had read the editorials in the Wall Street Journal and the Financial Times for 24 January on Hong Kong and found them worrying. She feared that there was some truth in the charges made: we were not moving towards democracy in Hong Kong because the Chinese did not like it. She detected a tendency to lower our sights as to what was achievable in Hong Kong. She hoped that the Foreign Affairs Committee would come back from Hong Kong and make a frank report. The Foreign Secretary said that both articles contained gross distortions. He would let the Prime Minister have a note of the real position.

you diary.
C.D. Powell
C.D. POWELL

Stephen Wall, Esq.,
Foreign and Commonwealth Office.

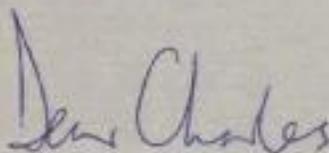
Pinn

Hong Kong
etc

Foreign and Commonwealth Office

London SW1A 2AH

16 January 1989



Hong Kong: Nationality

Thank you for your letter of 16 January about Portuguese nationals in Macau.

Our understanding is that Portuguese nationality law makes no distinction between those who derive their nationality status from a connection with Macau or from a connection with Portugal itself. Residents of Macau entitled to Portuguese nationality (whose numbers are variously estimated at between 50,000 and 100,000) thus can hold a full Portuguese passport and have the right of abode in Portugal itself. Like all other Portuguese nationals they can benefit from freedom of movement throughout the European Community, including in the UK, subject only to the transitional arrangements under which work permits are required in the UK until 1992.

This is not a new situation. It has however only recently come to public attention in Hong Kong, when the Portuguese authorities began issuing Portuguese passports in the common EC format to Portuguese nationals in Macau. The possession of these common format passports does not of course of itself confer additional rights on the holders. Their issue has however focused attention in Hong Kong on the fact that compared with BDMC passport holders in Hong Kong, Portuguese nationals in Macau have greater freedom to travel and settle not only in Portugal but in the United Kingdom.

The Prime Minister asked for an assessment of the reasons for the Portuguese Government's attitude. These reasons are largely historical and constitutional, in that we believe Portugal has always treated Portuguese nationals in its overseas territories on a par with those from Portugal itself. The numbers involved in the cases of Macau and Hong Kong are of course quite different - up to 100,000 Portuguese nationals in Macau compared with up to 3½ million BDMCs in Hong Kong.

/I attach

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/ I attach a proposed line for the Prime Minister to
// take if the question is raised in the House tomorrow. I
also attach copies of two replies given to questions on the
subject from Mr Foulkes.

I am copying this letter to Philip Mawer in the
Home Office.

Yours ever

R N Peirce

(R N Peirce)
Private Secretary

C D Powell Esq
10 Downing Street

CONFIDENTIAL



COHAKN

PROPOSED LINE TO TAKE

1. My understanding is that Portuguese nationality law makes no distinction between Portuguese nationals in Portugal and in Macau. That is not the case with British nationality law and Hong Kong.

2. It is not sensible to try to draw analogies between the two situations. Different historical and constitutional factors are reflected in long standing differences between national practices and legislation.

3. In the event the numbers involved are of a quite different order - up to 100,000 Portuguese nationals in Macau as opposed to up to 3½ million British Dependent Territories citizens in Hong Kong.

Minnesota, New Jersey, New York and Rhode Island—and defeated in six. Of the five states which enacted MacBride Bills in 1988, four passed Bills which were significantly amended in their passage through state legislatures. In no state is legislation pending or between houses.

Mr. McNamara: To ask the Secretary of State for Foreign and Commonwealth Affairs whether he will state in the *Official Report* the representations he has made to the United States of America concerning the investment of funds in companies which do not follow the MacBride principles in Northern Ireland; and in which cities.

Mrs. Chalker: We have consistently opposed the campaign based on the MacBride principles because it could adversely affect investment and the creation of new jobs in Northern Ireland. Our representatives in the United States have been in touch with local legislators where MacBride legislation has been in prospect. The United States Government oppose the imposition of the MacBride principles on United States companies operating in Northern Ireland.

Citizenship

Mr. Foulkes: To ask the Secretary of State for Foreign and Commonwealth Affairs what representations he has received regarding comparisons between citizenship, nationality and rights of abode of the people of Macao and people living in Hong Kong; and what response he has made.

Mr. Eggar: No representations have been received. No direct comparisons can be made, as historical and constitutional factors in the two cases are reflected in different national practices and legislation, as my noble Friend the Minister of State made clear at a press conference in Hong Kong yesterday.

ENERGY

British Coal (Subsidence)

Mr. Woodcock: To ask the Secretary of State for Energy if he will list those recommendations from the report of the subsidence compensation review committee (Waddilove) which have now been implemented by British Coal.

Mr. Michael Spicer: Actions taken or undertakings given by British Coal to implement fully or in part recommendations made by the Waddilove Committee are set out below (references in square brackets are to recommendations in the Waddilove report):

PREDICTION AND PREVENTION

Prediction

British Coal carries out detailed geological investigation where necessary [186(i)] and require their areas to give special attention to locations that are sensitive because of the possible environmental or social consequences of surface damage [186(iii)]. British Coal will also endeavour before mining begins to produce the best predictions possible, of the likely effect of subsidence damage on drainage systems in low-lying agricultural land. These predictions will serve as the basis for discussions with the farming community and water authorities on the scope for preventive and remedial work [186(iv)].

British Coal introduced additional measures in 1984 to ensure that subsidence costs are fully and consistently assessed and are included in the costing of proposed underground workings. Areas are expected to modify layouts or take prevention measures in order to reduce the likelihood of severe damage [186(vi)].

The corporation now normally seeks discussion with planning authorities and other interested parties on the likely environmental effects of British Coal's proposals before submitting planning applications for the development of new mines [187(ix)].

Preventive and Precautionary Work

British Coal assesses systematically the scope for, and costs of, preventive measures, especially for larger buildings, when considering future mining plans. The corporation is willing to explain the scope and limitations of such measures at public meetings following the publication of the annual notice about future working [188(x)].

NOTIFICATION AND PUBLICITY

Mining Intentions

British Coal now provides each planning authority in coal-mining areas with a copy of the annual press notice and a plan (revised annually) showing the areas of coal likely to be worked over the next 12 months. The corporation is willing to discuss this information with local authority associations [189(ii)].

If requested to do so by more than one interested body, British Coal will set up a technical liaison committee to discuss their plans. The corporation will also co-operate with local subsidence liaison committees established by residents [189 (iii)].

Mining Inquiries

Agreement has virtually been reached with the Law Society for a standard inquiry search form for use in England and Wales. In responding to the new form, the corporation will, once the new system is fully established, indicate whether there is a current claim outstanding and how many others were settled during the previous five years [191 (viii)]. The corporation and the Law Society of Scotland have agreed to draw up a standard inquiry form for use in Scotland.

THE REPAIR OF SUBSIDENCE DAMAGE

British Coal operates in accordance with the Waddilove recommendation that the board's primary duty should be to repair damages and to make payment in lieu only in exceptional circumstances [192 (i), 193 (ix)]. The corporation's commitment to provide a good standard of repair in all cases already goes a long way towards meeting the recommendation that damaged property should be restored to its pre-damaged condition so far as is practicable [192 (iii)].

It is now British Coal's practice to prepare a fully costed and itemised schedule of repairs for each case of subsidence damage for which they accept liability. Claimants are able to choose who should carry out repairs to their damaged property and land [193 (iv)]. Independent adjudication is available for straightforward disagreements over the initial schedule of works and costs. Wherever practical and completed repairs will be subject to final inspection jointly with the claimant, the claimant's agent or both [193 (v)].

Where British Coal decide to buy a property because the only realistic course of action is to demolish it, they will pay the full market value of the property as if the damage for which they had accepted liability had not occurred. After demolition of the property, the site will be kept tidy to minimise dereliction. Independent adjudication will be considered where there is a dispute over the purchase price [193 (x)].

Interim Repairs

Areas are required to make good damage with appropriate interim repairs if there are sufficient periods of stability between two mining operations, and will endeavour to ensure that property will not be left in a damaged state for long periods. Areas are required to send an explanatory letter to a claimant to whom a stop notice is issued indicating a likely timetable for final repairs [194 (xi)].

Temporary Accommodation

British Coal seeks to ensure that temporary accommodation is both suitable and acceptable to claimants who have had to leave their homes [195 (xii)] and accept responsibility for property vacated during repairs [195 (xiii)].

Assistance to Claimants

British Coal provides that any payment for specialist advice should be paid direct to claimants [196 (xv)].

SCOPE OF COMPENSATION PROVISION

12 JANUARY 1989

Mr George Foulkes (Carrick, Cumnock and Doon Valley): To ask the Secretary of State for Foreign and Commonwealth Affairs, what discussions he has had with the Government of Portugal or within the Council of Ministers regarding harmonisation of the citizenship and nationality arrangements for people in dependent territories of each member country of the European Community; and if he will make a statement.

No W79

MRS LYNDA CHALKER

None.

HONG KONG: Future pt 20





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SLH

bcpc

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 January 1989

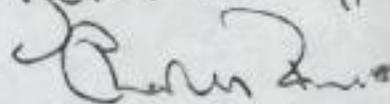
Dear Bob,

HONG KONG: NATIONALITY

The Prime Minister has commented on the recent report in The Times (copy enclosed) to the effect that the Portuguese have decided to issue passports to 100,000 of their Nationals in Macau. She would be grateful to know whether this is the case and, if so, for an assessment of the reasons which have led the Portuguese Government to decide to do this in contrast to our own much more restrictive attitude.

There is reason to believe that the Prime Minister may be questioned on this in the House tomorrow, 17 January. I should be grateful for an interim reply at least by then, suggesting how the Prime Minister should reply.

I am copying this letter to Philip Mawer (Home Office).

Yours sincerely,

 C D POWELL

R. N. Peirce, Esq.,
Foreign and Commonwealth Office

CONFIDENTIAL

...continued, will lead to Conventional Stability between the 23 member states of the Warsaw Pact and ... continued to dig in their heels over which parts of ... they should be excluded ... the prospective troop-
 upation areas.

... the other countries are fully in agreement — the ... should be drawn across ... oia, the south-eastern ... of Turkey which bor-
 with Syria, Iran and Iraq. Turkey wants that part to be ... ded from any future ... ment on troop levels ... se they argue that Turk-
 oldiers deployed in the ... are non-Nato.

... ese troops are concerned ... defending against incur-
 from the neighbouring ... ries, and not from the ... aw Pact.

... the Greeks object ... se that part of Turkey ... oods northern Cyprus, ... t, night, despite the ... ation of the rest of the ... ies, there was hope that ... mpromise could be ... ed, after the Greeks ... to talk to their Govern-
 and return for a late ... ng session.

... ryone knows that time is ... ng out, if the deadline ... ed by the Reagan ... nistration is to be met. ... tern diplomats said that ... e surprised everybody ... sisting that more of ... n Turkey should be ... ed in the area covered ... new talks on reducing ... ntional troops and

... British granting, has already been agreed.

The objectives are to elimi-
 nate East-West disparities in
 conventional forces in the area
 from the Atlantic to the Ural
 Mountains, to reduce to equal
 ceilings, and to have a vigor-
 ous verification regime.

Delegates have also agreed
 that nuclear and chemical
 weapons — and naval forces —
 are to be excluded from the
 talks.

A senior Western diplo-
 matic source in Vienna said
 yesterday: "Mr Shultz would
 like to attend the final meeting
 of the mandate talks on Janu-
 ary 17, 18 and 19.

"After that the whole deal
 will be off and it could be
 months before an agreement
 could be reached because the
 new Bush Administration will
 no doubt want to review the
 situation."

The conventional arms
 mandate talks are linked to
 the Helsinki review of the
 Conference on Security and
 Co-operation in Europe
 (CSCE), also in Vienna. These
 talks are also still being held
 up — mainly by Romania,
 which has introduced 17 last-
 minute amendments to the
 draft text of an agreement on
 human rights largely sup-
 ported by the 35 member
 states of the CSCE, but also by
 Canada, which has so far not
 agreed to a human rights
 conference in Moscow.

Diplomatic sources said that
 if necessary 34 nations would
 sign an agreement, leaving
 Romania out in the cold.



An elderly Armenian inspecting a line of other earthquake survivors yesterday. These busts of military commanders were rescued from the debris of the town hall amid the devastation of Spitak a month ago and have been placed along a wall. From left, they are Ghaya Gai, a divisional commander of 1910, and four leaders in the Second World War: Marshal Amazasp Babadjanyan, a tank commander; Admiral Ivan Isako; Air Marshal Sergei Khudyakov; and Marshal Ivan Bagramyan.

Hong Kong row over nationality

From Jonathan Braude, Hong Kong

Hong Kong officials have begun to question Britain's good faith after the disclosure that only eight locally hired civil servants and a handful of former servicemen have been granted UK citizenship under a clause of the 1981 British Nationality Act, which offers special consideration to loyal servants of the Crown.

The bitterness has been compounded by the decision of the Portuguese-administered territory of Macau, just 40 miles away, to issue full European Community passports to all 100,000 of its Portuguese nationals.

Under the Act, British nationals in Hong Kong are not even entitled to take up residence in the United Kingdom. Clause 4 (5) gives the Home Office discretion to waive the normal citizenship requirement of five years' residence in Britain for members of the administrative and security services. It was seen by many as a privileged escape route to

Britain once Hong Kong is handed back to Chinese jurisdiction in 1997.

Yet Foreign Office figures show that all but 54 of the approximately 700 applications from the Civil Service, the police and the armed services were turned down.

Rejected applicants have been reluctant to comment openly for fear they may suffer career setbacks after 1997 as a punishment for having applied to leave the territory.

But one civil servant, who would not give his name, argued that Britain had been unnecessarily cautious in its use of the waiver clause. "The question has never really been about abode in Britain. It is basically a matter of principle and of a promise made by Britain to those who have served the Crown with loyalty," he said. Mr Jack Edwards, a veteran campaigner on behalf of Hong Kong former servicemen, said that many of the old soldiers who

succeeded in getting passports under the clause did so after he approached Mrs Thatcher in 1986 with detailed accounts of their bravery and loyalty. Their wives were not granted citizenship at the same time and Mr Edwards is campaigning on their behalf as well as for the widows of many men who fell during the Second World War.

For one woman, the fight for a British passport has reopened old wounds. After 44 years, Mrs Doris Kotwall is still bitter over the way Britain has treated the memory of her war-hero husband, who was tortured to death in Hong Kong by the Japanese.

Jimmy Kotwall was born of a Purser father and a Chinese mother, yet he risked his life for Britain behind Japanese lines. The note he left his Chinese widow said: "I die for my God, my King and my country." But Britain would not give her full citizenship.

Mrs Kotwall, aged 72, broke

down yesterday as she told *The Times* of the uncaring attitudes she had seen after the war, when British officialdom and her husband's former friends turned down her pleas for help and support.

She said that even the Japanese had behaved better. A Japanese officer had come to visit her to apologize for what he said it had been his duty to do to his prisoner.

Mrs Kotwall was angry to learn that, while Hong Kong denies her a passport, Macau was giving all Portuguese nationals EEC passports and the right to live in the Community.

She said that, because of the handover to China in 1997, her children would be leaving Hong Kong to make new lives abroad. She wants to be able to join them on the strength of a British passport.

Mrs Kotwall added: "It's not that I fear the Chinese will be bad to me after 1997, but because I shall be lonely."

14/1/87 The Times

quality skins.
 Apart from our own
 include designs by
 St. Laurent, Bruce
 Karan.



- Examples:
- Russian Sable Jacket
 - Dark Mink Coat
 - Dark Mink Jacket
 - Demi Buff Mink Coat
 - Demi Buff Mink 7/8 Coat
 - Beaver Coat
 - Cashmere Coat
 - Raincoat
 - Shearling 7/8 Jacket
 - Shawls with Mink

Drug-linked murder shocks New York

S confronts generation without human values

from Charles Bremner
 New York

... York rarely has time for ... ver just one murder, since ... re more than five in the city ... by East End. For instance

Smith had lived for several weeks in a storage room in the hospital and masqueraded as an orderly. He had confessed and explained how he strangled Dr Hinnant with electric cable.

norm." Mr Herbert and other commentators also point out that blacks and other minority races are also the most frequent victims of violent crime.

shed is the dealers and their enforcers, who kill with a callousness that police cannot recall seeing before.

The figures vary, but police in big cities generally blame more than

regular wages. Mr Fulwood, who was giving his views to a group of editors, described a recent visit to address his old high school in the city. One youth told him he was

CONFIDENTIAL

②
Ri Hunter
CBP
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mf

PRIME MINISTER

21 December 1988

HONG KONG BUSINESSMEN

There is one aspect of this correspondence which worries me - the possibility that we might prepare a general written statement which could be handed to Hong Kong businessmen.

I am all for quietly bending the rules as far as we can in suitable cases and for reducing the qualifying period to the minimum. But general statements showing we are out to attract as many Hong Kong businessmen as possible could be very dangerous. As part of our continuing responsibility for Hong Kong we have the task of maintaining confidence there. We have a major interest in ensuring that the settlement with China works. If we were seen to be providing special inducements to Hong Kong businessmen - or if we were to produce a paper which could be represented as such - we could be seen to be pulling the rug out from under our own Agreement and the effect on confidence could be devastating. It would be like the life boat schemes we are urged to launch by those who argue that the Agreement is doomed. We have rejected these on the grounds that Hong Kong people wish to work and flourish in Hong Kong and that we have every confidence that they will continue to find the necessary conditions there.

To some extent we can have it both ways. But, as I see it, we should confine ourselves to information in individual cases, and avoid general statements which could fall into the wrong hands.



PERCY CRADOCK

CONFIDENTIAL

SUBJECT
CC MASTER



filed
adipc

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

20 December 1988

Dear Philip.

HONG KONG BUSINESSMEN

The Prime Minister and the Home Secretary had a further discussion this afternoon on the subject of settlement of businessmen from Hong Kong prepared to invest substantially in the United Kingdom.

The Prime Minister noted that the Home Secretary had already agreed to use his discretion to reduce the qualifying period for settlement in cases where someone was ready to invest £150,000 or more to three years. She thought that, in cases where significantly larger sums of investment were involved and the people concerned were able to contribute in a major way to Britain's interests and prosperity, the Home Secretary should be ready to reduce the qualifying period for settlement further still, for instance to two years.

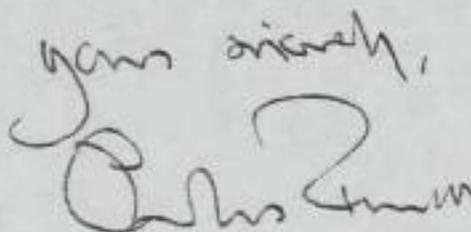
The Home Secretary recalled that the Immigration Rules required a period of four years' residence to qualify for settlement. He did not think it practicable to change the rules. But they did give him some flexibility and he would be ready to use that. The process of approaching people and encouraging them to seek settlement in the United Kingdom would have to be conducted very discreetly. If it was done too openly, it might be subject to challenge in the courts. Subject to this, he would be prepared to use his discretion in the way suggested by the Prime Minister including acceptance of a two-year qualifying period in special cases. But he would not wish to refer explicitly to the two-year option in print. It should not, therefore, be included in the written statement of the flexibility available to him, which was currently being revised, and could be handed to selected people in Hong Kong.

The Prime Minister was grateful for the Home Secretary's assurance. Taken with the other points already agreed and the regular reports on implementation requested in my letter of 19 December, she regards this as representing a satisfactory strengthening of our efforts to attract enterprise and investment from Hong Kong to this country.

AB

I am writing separately on the question of Vietnamese boat people.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office), Neil Thornton (Department of Trade and Industry), Alex Allan (Treasury) and Trevor Woolley (Cabinet Office).

Yours sincerely,


C. D. POWELL

Philip Mawer, Esq.
Home Office

PERSONAL

PRIME MINISTER

cc: Mr Turnbull

HONG KONG BUSINESSMEN

You are seeing the Home Secretary this afternoon. He does not want to discuss this subject: but it is a good chance to pin him down.

You have already squeezed quite a lot out of the Home Office but minuted yesterday that you thought we could get a bit more.

My suggestion is this. You have already persuaded the Home Secretary to reduce the period for settlement in cases where someone is ready to invest £150,000 or more to three years. You might say that when significantly larger sums of investment are involved and the people concerned are able to contribute in a major way to Britain's interests and prosperity, then the Home Secretary would be ready to reduce the qualifying period for settlement further still, to two years. You understand if he does not wish to write this down. But it must be a clear understanding between you.

C.P.P.

CHARLES POWELL
20 December 1988

EAMAKG

PRIME MINISTER

BILATERAL WITH THE HOME SECRETARY

The following subjects could be raised in the bilateral:

- (i) Contingency plans for disruption in prisons: the Home Secretary will want to brief you on the state of play.
- (ii) Hong Kong businessmen: the last proposal put to the Home Secretary was that the qualifying period for settlement could be reduced to two years rather than three which the Home Secretary had proposed. In the meantime, you have withheld consent to his proposal to allow a further 1,000 Vietnamese boat people to come to this country - see papers attached.
- (iii) Mr. Heath's personal protection: you agreed to discuss with the Home Secretary Mr. Heath's refusal to give up his personal protection. In my letter regarding the meeting, I asked the Home Secretary to consider the implications of extending protection to former Prime Ministers still active in public life.
- (iv) Security Service Bill and Official Secrets Bill: the Second Reading of the former was last week. You will want to hear from the Home Secretary how the debate went. I understand he was not called upon to offer an undertaking on the position of MPs, though expects this to come up in Committee. The Second Reading of the Official Secrets Bill is on Wednesday.

AT

ANDREW TURNBULL
19 December 1988

CONFIDENTIAL



SW2APN
cpc A cc Bsp

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

19 December 1988

See Philip.

HONG KONG BUSINESSMEN

Thank you for your letter of 16 December giving further advice on the subject of settlement for businessmen from Hong Kong prepared to invest substantially in the United Kingdom.

The Prime Minister has commented that this still falls short of the maximum which she believes we could do. I should be grateful if you would consider urgently therefore what scope there is for further incentives for Hong Kong businessmen to settle here. I suppose a further reduction in the qualifying period for settlement to two years is one possibility. There may be others. In addition the Prime Minister would want to see regular quarterly or six-monthly reports on the number of people who have received the revised statement and the number of cases in which the Home Secretary has used his discretion.

The Prime Minister has also noted the Foreign Secretary's views conveyed in Stephen Wall's letter of 16 December. She is still reflecting on whether we should admit a further 1000 Vietnamese boat people and is not yet ready to reach a decision on this.

BE 11

I should be grateful for a very early reply.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office), Neil Thornton (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

Yours sincerely,
C. D. Powell

(C. D. POWELL)

Philip Mawer, Esq.,
Home Office.

CONFIDENTIAL



Our Ref: NTY/88 387/986/1

HOME OFFICE
 QUEEN ANNE'S GATE
 LONDON SW1H 9AT

16 December 1988

Dear Charles,

HONG KONG BUSINESSMEN

Thank you for your letter of ~~8~~¹⁵ December, in response to the Home Secretary's minute of 2 December to the Prime Minister, in which you asked for advice on a number of further points.

On the first point, the Home Secretary's minute sets out the maximum that he can offer within the existing statutory framework as far as citizenship is concerned. He could, however, use his discretion under the Immigration Rules to grant settlement after less than four years in appropriate cases and this might be attractive to businessmen who wanted the security of settled status while retaining the option of continuing their business activities in Hong Kong. We could, for example, offer a three year period to all businessmen making a substantial investment here if they said that they found the present four year requirement difficult. I think that this also covers your third point.

On your second point, the Home Secretary sees no scope for a specific amendment to the Immigration Rules which would allow time spent in Hong Kong to qualify for settlement here, because of the controversy that this would attract. However, his exercise of discretion over absences can achieve the same end for businessmen who have established a business here.

On your final point, the Home Secretary did have a statement prepared in 1986 for handing to selected people. I enclose a copy. We can further revise this, but any general statement cannot by definition be tailored to an individual's circumstances. If it became widely known that settlement could become available in rather less than four years in certain circumstances, pressure would quickly mount to make that the norm, conveying the impression of some more general weakening of immigration control.

The Home Secretary will arrange for the statement to be revised on the lines of his minute of 2 December, seeking to make its tone more forthcoming. But in his view practical results will depend on instituting a programme of individual briefings on the lines suggested in that minute and, if this were agreed, officials in the Home Office, FCO and DTI could be instructed to prepare proposals accordingly.

I am sending copies of this letter to the Private Secretaries to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry and to Sir Robin Butler.

*Yours sincerely
Nick*

N C SANDERSON

C D Powell, Esq.

BRITISH CITIZENSHIP:
THE USE OF THE HOME SECRETARY'S DISCRETION

1. The Home Secretary has some flexibility in considering an application for British citizenship. This relates primarily to the amount of time an applicant must spend in this country in the five years (or for those married to British citizens three years) before he applies. Those who are British Dependent Territories citizens have a right to registration as British citizens, but they must still meet the five year residence requirements.

2. The residence requirements are that the applicant must have been in this country on the exact date five (or three) years before the date of his application: and he must on the date of his application be free of any restrictions on his stay here under the immigration laws. There is no flexibility on either of these requirements. Because of the second requirement, an applicant for citizenship must first have been granted settlement here.

3. Settlement is granted by removing the time limits on a person's stay here. For self-employed businessmen and persons of independent means this is normally granted after four years in this country. In that four years, when a person's stay is subject to a time limit, absences for holidays and the like are disregarded. This is an area in which flexibility can be exercised. In exceptional circumstances, where for example there has been substantial investment, we will grant settlement despite quite long absences.

4. But long absences, while they may not necessarily affect an application for settlement, could affect a subsequent application for citizenship. This is because UK nationality law also lays down expectations about residence. It expects an

applicant for citizenship who is not married to a British citizen not to have been absent for more than 450 days in the five years before the application; nor more than 90 days in the last year; to have been free of any restrictions on his stay under the immigration laws for all of the last year; and not to have been here in breach of the immigration laws in the five year period. For those married to British citizens the period of permitted absences is 270 days in the last three years, but the requirements are otherwise the same.

5. The law allows the Home Secretary the discretion to waive these expectations if he thinks it right to do so.

6. In general we expect people to meet not only the statutory requirements but also the statutory expectations for citizenship. If they miss them by a few days, then this is normally disregarded. If the periods are much longer, we need to be satisfied that the applicant has really thrown in his lot with this country and put down roots here despite having been out of the country for longer than the statutory expectations.

7. There are also other requirements, for example that the applicant is of good character; has sufficient knowledge of English; and intends to make his principal home here. The Home Secretary has to use his judgment in deciding whether these are met. They do not apply to British Dependent Territories citizens with a right to registration, and only the character requirement applies to those applying on the grounds of their marriage to a British citizen.

8. The Home Secretary cannot give general undertakings about how his discretion would be exercised: each case must be looked at on its merits at the time when the application is made. But if an applicant has clearly thrown in his lot with the UK (that is he has firmly established himself here and has put down roots here) and assuming he met the statutory requirements for citizenship, then if he had good reasons for being out of the country longer than the normal expectations (e.g. on business) the Home Secretary would be prepared to consider flexibly the use of his discretion.

HONG KONG - Future PRO



(1)

PRIME MINISTER

HONG KONG BUSINESSMEN/VIETNAMESE BOAT PEOPLE

You asked the Home Secretary to consider ways in which he could make greater use of his discretion under the Immigration Rules to attract Hong Kong business talent to the United Kingdom. He has now replied. In brief, he says:

- He cannot amend the Immigration Rules to allow time spent in Hong Kong to qualify for settlement here. It would be too controversial.
- But he is willing to use his discretion to reduce the period to qualify for settlement from four years to three.
- He would also be ready to prepare a revised statement of the flexibility available to him, in more forthcoming terms, which could be handed to businessmen.

There is not as much as you wanted. But we have squeezed a bit more out of the Home Office lemon: and I think it is probably the case that we cannot do more without going to Parliament for specific amendments or conveying the impression that we are weakening immigration control. I have consulted Tim Flesher who agrees. Something which you might do, to keep up pressure on the Home Office, is to ask for regular quarterly or six monthly reports on the number of Hong Kong businessmen who have been encouraged to seek settlement here and the number of cases in which the Home Secretary has used his discretion.

Meanwhile, the Foreign Secretary has reverted to your wish to settle this question and that of admission of Vietnamese refugees from Hong Kong in parallel. He suggests that you now agree to his earlier proposal to admit 1,000 refugees over two-and-a-half years as part of a package deal. Your choice seems to lie between:

- accepting the Foreign Secretary's proposal as it stands;
- arguing that since our response on Hong Kong businessmen falls short of your wishes and expectations, you see no reason to be too generous on Vietnamese boat people, given all the problems they cause. You can only agree to, say, 750.

Agree to settle for what the Home Secretary offers on Hong Kong businessmen, with regular reports?

*1. Why we
can sponsor a letter
now on H-K*

Agree to take 1,000 Vietnamese boat people?

in return for 1,000

Or accept only reduced number of boat people?

*Otherwise we reduce
the no. we take.
not*

e.d.p.

C. D. POWELL
16 December 1988

DS2AMM



Foreign and Commonwealth Office

CONFIDENTIAL

London SW1A 2AH

16 December 1988

Dear Charles,

Hong Kong Businessmen/Resettlement of Vietnamese
Boat People

The Foreign Secretary has seen Nick Sanderson's letter to you of 16 December giving the Home Secretary's answers to the Prime Minister's further questions about ways of attracting Hong Kong business talent to the United Kingdom.

Sir Geoffrey Howe has little to add to the Home Secretary's advice. He suggests, however, that the briefing of selected individuals should, as far as possible, be oral and tailored to their individual circumstances rather than based on general guidance. There may be some limited use that can be made of a general statement along the lines envisaged by the Home Secretary. But this carries the potential disadvantages which he identifies: and there is the further risk that the text would be circulated indiscreetly or even leaked, in embarrassing circumstances, in Hong Kong.

Sir Geoffrey Howe hopes that we can now take a decision on the two issues of assistance to Hong Kong businessmen and resettlement of Vietnamese boat people. On the latter issue, there would be strong advantage in making an early announcement on the lines proposed by the Foreign Secretary and the Home Secretary in their joint minute of 1 December. This would enable the Prime Minister to reply in positive terms to the outstanding letter from Lydia Dunn on behalf of all Executive and Legislative Councillors; and Ministers here to reply to the many letters from Members of Parliament asking what action we propose to take on Miss Dunn's request. We would also be able to secure maximum political benefit in the context of the visit which Lord Glenarthur is due to pay to Hong Kong very early in the New Year.

We suggest that any announcement could best be made simultaneously to Parliament and in Hong Kong. For the best publicity in Hong Kong, the Prime Minister's reply to Miss Dunn should reach her by 21 December as the Legislative Council goes into recess on that day. The text could be withheld from public release until the Home Secretary had informed Parliament of our decision in reply to an inspired Parliamentary Question on the same day. We shall be ready to submit drafts on 19 December.

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I am sending copies of this letter to the Private Secretaries to the Home Secretary, the Chancellor of the Exchequer, the Secretaries of State for the Environment, for Employment and for Trade and Industry, the Minister for Overseas Development, and to Sir Robin Butler.

*Yours
Stephen Wall*

(J S Wall)
Private Secretary

C D Powell Esq
10 Downing Street

CONFIDENTIAL



H KONG

Future p⁴ 20

CONFIDENTIAL

FILE (MRN)

AAM

CC PC



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

8 December 1988

The Prime Minister has considered the Home Secretary's minute of 2 December about ways of attracting Hong Kong business talent to the United Kingdom. She has also seen the Foreign Secretary's minute of 6 December.

The Prime Minister accepts it would not be practical to amend existing legislation and that we must proceed by using the discretion given to the Home Secretary. But she would be grateful if the Home Secretary would consider further a number of points:

- Is the Home Secretary sure that what he proposes is really the maximum he can offer within the existing statutory framework?
- Would it be within the Home Secretary's discretion to deem time spent in Hong Kong with our encouragement or at our request as time spent here for the purposes of qualifying for settlement?
- Is there scope for altering the rules as opposed to the law? For instance, would it be possible for people investing a certain sum in Britain and providing employment to acquire settlement here in 3 years rather than 4? Any such change would have to apply to all nationalities not just Hong Kong.
- Can we not be more forthcoming and explicit in what we say about the opportunities available to Hong Kong businessmen? The Prime Minister would like the Home Secretary to draft a statement on the position which could be handed to selected people.

BF /
Depending on the Home Secretary's reply to these points, the Prime Minister may wish to have a meeting to discuss them.

I am sending copies of this letter to the Private Secretaries to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry, and to Sir Robin Butler.

C. D. POWELL

Philip Mawer, Esq.,
Home Office

rw

PRIME MINISTER

HONG KONG BUSINESSMEN

You asked the Home Secretary to look again at ways of attracting Hong Kong business talent to the United Kingdom.

His minute (attached) argues that counting time spent in Hong Kong towards the residence qualification for British citizenship is not a starter under the law as it stands. He advises strongly against trying to amend the law. He proposes instead that we make greater use of the discretion allowed him by the law.

In essence a businessman with £150,000 to invest here can obtain entry clearance, which allows him to live here, do business and come and go freely. His stay can be extended annually for four years, after which he has the right to stay permanently and apply for citizenship. Although the rules say he has to be settled for five years to qualify for citizenship, the Home Secretary in practice has wide discretion over how much absence from the UK would be allowed in that period. The Home Secretary suggests that we should make the facts, and the existence of some flexibility in the administration of the rules, more widely known in Hong Kong. He also claims that our practice is in fact not very different from the USA, Canada and Australia - a statement which is hard to justify in the case of Canada.

There are genuine difficulties. The whole purpose of our Immigration and Nationality legislation is to stop people coming here, not to encourage them. The same law cannot simultaneously exclude poor Bangladeshis and encourage wealthy Hong Kong businessmen, and an attempt to amend it in that direction would surely cause all sorts of problems. The only realistic course therefore is to see what exceptions can be made under it, by using the discretion given to the Home Secretary.

Here I think you might legitimately go back to the Home Secretary to try to extract a bit more on three points:

- is he sure that what he proposes is really the maximum he can offer within the existing statutory framework?

- is there scope for altering the rules, as opposed to the law? For instance could you make it possible for people investing a certain amount in Britain to acquire settlement here in ³two years rather than four? Any such change would have to apply to all nationalities, not just Hong Kong;

- can we not be more forthcoming and explicit in what we say about the opportunities available to Hong Kong businessmen? It's a question of how far we go out of our way to solicit them to come here. You might ask the Home Secretary to draft a statement of the position which could be handed to selected people.

Would you like me to pursue these suggestions in your name (although I fear that the second one is probably not a starter)?

Yes please

The point is the one

C.D.P.

(C. D. POWELL)
7 December 1988

I have previously made - if the person concerned, having come here with the necessary funds etc, is spending a considerable amount of time in Hong Kong at any explicit / implicit request that time should be deducted to be spent here

CONFIDENTIAL

Does the Home Sec's discretion allow him to do this? no



CE/C

PM/88/064

PRIME MINISTER

Hong Kong Businessmen

1. ^{top enc.} I have seen a copy of Douglas Hurd's minute of 2 December to you about how we can help wealthy Hong Kong businessmen who wish to acquire British citizenship.

2. It is clear from the data in the attachment to that minute that our rules on settlement and citizenship for investors are broadly in line with those countries (the United States, Canada and Australia) which are the main destinations for investment from Hong Kong. Our rules appear a little more restrictive than those of Canada; but they are significantly less restrictive than those of the United States. I doubt whether our rules and procedures are causing us to lose potential major investors to such countries: I suspect that other factors, such as the widespread perception of those countries as natural and desirable emigration destinations, and the existence of large and prosperous Chinese communities there, exert a compelling influence on many potential investors.

3. I am keen to do more for those very wealthy individuals in Hong Kong who might nevertheless opt for Britain for special (perhaps personal or family) reasons. It is encouraging that there is such wide scope for the Home Secretary to use his discretion within the existing law. I agree with Douglas Hurd that more use should be made of this flexibility in individual cases where it is clearly in the



national interest to do so. It should certainly be possible to apply the rules in such a way as to ensure that the individuals concerned will have no difficulty in fulfilling the requirements for settlement and eventual citizenship.

4. I also agree with Douglas Hurd that more should be done to make the position better understood, both in Hong Kong and in this country. There are channels through which the message can be conveyed, quietly and discreetly, to precisely the people whose investment and entrepreneurial skills we would welcome. I believe that it is important that it should be done in this way: we would not want the Home Secretary's readiness to use his powers of discretion to be misinterpreted as an overall weakening of the rules, which could have unwelcome implications for our immigration policy generally. Nor would we want our policy to be misinterpreted in Hong Kong as a sign that we were losing faith in the territory's future (which we certainly are not), still less a conscious attempt to benefit Britain at Hong Kong's expense (which would of course run counter to our responsibilities towards the territory and our obligations under the Joint Declaration).

5. I am therefore convinced that it would be right to proceed in the way set out in the Home Secretary's minute. We are already taking a number of measures to intensify the links between top Hong Kong Chinese businessmen and the UK: we have indicated our support for Mr Algy Cluff's Anglo Hong Kong Trust and David Young and Simon Glenarthur will be co-hosting the inaugural dinner at Lancaster House for the first delegation to come here under the auspices of the new Trust. There are also plans to invite to Britain a delegation of "young tycoons" - the up and coming generation of some of the wealthiest and most influential Hong Kong



Chinese business families in the territory. These visits will provide an excellent opportunity for us to get across to those concerned a better understanding of what is possible under our existing laws.

6. I am sending a copy of this minute to the Home Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and to Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

HONG KONG: February 20



TELEGRAPHIC ADDRESS:
MATHESON LONDON EC3
FACSIMILE: 01-623 5024
TELEX: 0953378 MANDCO
TELEPHONE: 01-526 4000

Matheson & Co. Ltd
3 Lombard Street,
London EC3V 9AQ

PERSONAL

2nd December, 1988

Dear Robin

BRITISH REPRESENTATION IN HONG KONG

Thank you for your letter of 18th November. I am sure the Hongkong Association greatly appreciates the serious consideration that you have given to the problem of the profound gap for British representation in Hong Kong. Your letter will be reviewed at our meeting on 13th December so this letter is only a personal one.

Your reply restates at great length and patience the Foreign and Commonwealth Office's policy which has ministerial endorsement and we are most grateful to the trouble you have taken.

I am sure the Association will fully support your three objectives for overall British Interests in Hong Kong.

In your summing up you lay great stress that the British Government must take the broader view. We feel you take a very narrow view on Britain's economic and commercial stake in Hong Kong. You lay great stress on the excellent results achieved by the British Trade Commissioner, ably backed up by British Ministers and D.T.I. officials, on improving two way trade. But you give no credit nor any great understanding for existing long standing British investment and other commercial and cultural activity in Hong Kong which holds a major stake in the economy of Hong Kong in the trading, retail, banking, communications, real estate, hotels, airline, insurance, legal, engineering, accounting and many other fields.

Cont/.....

Britain's competitors in these fields are given their own Government backing by strong Consul General offices and in the case of China the New China News Agency, (who have had many concessions). Britain's competitors have their case put vigorously to a devolved and independent Hong Kong Government while British interests are only represented by a senior British Trade Commissioner with narrow objectives and low status. Increasingly as Hong Kong moves to SAR status, the Hong Kong Government will understably support local domestic enterprises against foreign interests (for example airline licensing and T.V. franchise policy).

What is best for British interests will be at the mercy of masonic British Civil Servants in Whitehall and Government House with obvious conflicts of interests taking a "broad view" behind closed doors.

To sum up we feel that the advice that FCO is giving to British Ministers in not having a British Commissioner in Hong Kong with equal status to other Consul Generals is having a long term and progressively detrimental effect and is working against the Government's stated policy "to maximise Britain's economic and commercial stake in the territory".

As 1997 approaches we will have missed the opportunity to build up the new Consul General's office on a broad front which will then have to look after British interests when Sovereignty reverts to China. We will watch closely how firmly the FCO arranges a suitable site (at no cost) for the new Consul General office building while Britain still exercises sovereign power.

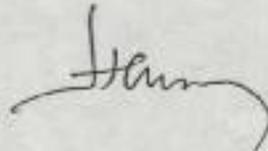
In the meantime British interests in Hong Kong will be (uniquely for the 16th largest trading nation in the world) not properly represented despite massive British investment and activity in the territory.

We hope while this serious gap exists the FCO in their regular "consultations" with the Governor of Hong Kong who, to use your words is a negotiating partner with objectives and priorities of his own and who under devolved power is responsible to the Hong Kong Executive & Legislative Council, will encourage the Hong Kong Government to take an evenhanded approach to British interests in the territory. It would be supremely ironic if, in their efforts to be fair, the Hong Kong Government and FCO under British Sovereignty, disadvantaged Britain and those British interests who since the territory's foundation had done so much to create the modern Hong Kong.

Cont/.....

In a recent letter to the Times (which we fully support), the Foreign Secretary in deploring an article which scandalously suggested that the FCO carried out anti British policies for their own reasons, also welcomed constructive and meaningful debate on important issues of Foreign Affairs. We feel the lack of British representation in Hong Kong is such an issue and we are sure you will now understand and welcome if we widen the debate in parliament, the media and other Government departments so that the right policy can be constructed both for Britain and in our view confidence building in Hong Kong.

Yours ever



HENRY KESWICK

R.J.T. McLaren Esq., C.M.G.,
Assistant Under Secretary responsible for
Asia and Pacific,

Room WH 323,
Foreign & Commonwealth Office,
King Charles Street,
LONDON, S.W.1A 2AH.

P.S. Happy Xmas in advance!

There is no need for a reply as I have exhausted my limited intellectual powers in trying to persuade you the FCO policy is wrong!



cepc

PRIME MINISTER**HONG KONG BUSINESSMEN**

You told me, on 10 November, about your concern that in the run up to 1997 Hong Kong's business, managerial and entrepreneurial talent is being attracted to countries such as Canada, Australia and the USA rather than to this country. You suggested, in particular, that we might consider counting time spent in Hong Kong towards the residence qualification for British citizenship.

2. The present law would not allow us to do that. The provisions of the British Nationality Act (BNA) about the acquisition of citizenship are cast in terms of periods of residence in the United Kingdom. It would be rash to try to amend legislation which, even if it could be confined to Hong Kong, would re-open much of the argument about the citizenship provisions of the agreement between ourselves and the Chinese which were embodied in the Hong Kong Act. We should, for example, be pressed hard again about the position of persons of Indian descent now living in Hong Kong.

3. But we can use, and make more widely known, the flexibility which is already available within the existing law. Without running the risk of being seen publicly to encourage emigration from Hong Kong (which would be damaging to confidence in the Colony) there is a considerable amount within the existing Immigration Rules and nationality legislation which we can do to help. The following paragraphs show how.

4. A hypothetical businessman investing £150,000 here, and creating at least two jobs, would experience no difficulty in obtaining entry clearance, which would allow him to enter and carry on his business in this country, and to come and go freely. (Those figures are likely to be revised upwards, but not to an extent which would be significant for the kind of businessman we have in mind.) When he entered, he would be admitted initially for a year, and could expect then to have his stay extended for a further three years, achieving settlement at the end of four years, assuming that his business activities here continued. Thereafter he could retain settled status indefinitely, travelling outside the United Kingdom as much as he wished, provided he was not away for longer than two years at a time. The same would apply, throughout the period, to his wife and minor children who could come and go as they pleased, together or separately.

5. He could, if he wished, apply for citizenship a year after being granted settlement. The BNA stipulates a total of five years' residence with no more than 450 days' absence, but I have discretion to accept longer absences and I frequently do so. We have to be careful about businessmen who want only the convenience of a British passport without living, paying tax or maintaining any long term investment in this country; but where a businessman is genuinely based here I often allow as much as two years' absence in the five year period. Where the facts of the case justified it, and did not call in question the genuineness of his residence, I could allow even more. Where the residence criterion is satisfied, a British Dependent Territories citizen (which category includes the great majority of those concerned) is entitled to British citizenship.

6. In short, many businessmen are content to come and go as business visitors without bothering to seek settled status. Those who have established themselves in business here find no difficulty in achieving settled status, which gives them security with maximum flexibility as to travel and they can apply for citizenship on the basis described above.

7. We have made some enquiries about the practice in other countries. The results are set out in the Annex to this minute and I believe our arrangements are not unattractive in comparison. Some of those who have tackled you (and me and other colleagues) on this subject may simply have been exerting deliberate and quite understandable pressure to get us to relax our practice even more in their favour or to change the law.

8. All that said, I recognise that there is considerable confusion and misunderstanding in Hong Kong about our immigration and nationality requirements and in particular the extent to which I have discretion in dealing with individual cases. Certainly Algy Cluff (with whom you are corresponding about his proposal to set up a Trust to promote two-way investment between the United Kingdom and Hong Kong) expressed this view when I explained the position to him.

9. Because nationality law is complex any description of its provisions framed in general terms sounds somewhat daunting. But specific advice related to the circumstances of a particular individual or family would often show it to be much less so. I therefore propose that we should seek to get across a more accurate, and a more favourable, understanding of our law in the following ways:

- (i) Ministers' Private Offices (especially in DTI and FCO) and senior officials in those Departments should be enabled to contact a senior member of the Nationality Division of my Department, who would be in a position to offer speedy and authoritative advice on the position of a particular individual who might, for example, be complaining that "the Canadians do it so much better";
- (ii) we shall provide briefing material, and the same point of contact, to the Hong Kong Trade Commission and any other contacts from whom

more general enquiries are received. My officials are in touch with those concerned in the DTI and the FCO to arrange for this to be done. Such briefing will be kept up to date, relying on the FCO and our own immigration contacts to warn of changes in procedures in competing countries.

10. I hope you and colleagues will agree that this is the best way to proceed.

I am sending a copy of this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry and to Sir Robin Butler.

*N. J. Sanderson
(approved by the Home
Secretary and signed
in his absence)*

2 December 1988

CONFIDENTIAL

OTHER COUNTRIES

We have concentrated our enquiries on the USA, Canada and Australia (which, we understand, would often be the first choice for many Hong Kong businessmen and investors for economic reasons).

2. We understand that investment and residence in the USA gives a businessman no avenue to citizenship however long his residence. Australia appears to be more in line with us in requiring three years' residence before application for citizenship, followed by a further two years' residence. The Australians recognise, as we do, that businessmen may have to travel abroad and the two year period need not be continuous. Periods of residence can be aggregated to make up the two years. In addition, businessmen are expected to meet requirements relating to good character and commitment to Australia. They need an initial investment of half a million Australian dollars, a proven track record and sufficient funds to cover settlement costs.

3. Canada appears to have one important difference compared with us (and others). It is still a country of immigration, and the normal terms of entry are to receive landed immigrant status on arrival. This is nearly equivalent to what we call settlement, but the fact that it is available immediately means that the person concerned can immediately resume residence in Hong Kong. The financial requirements for initial entry are stiffer than ours, and the qualifications for citizenship appear no more favourable than ours. Landed immigrant status is available to certain categories of self-employed (in the arts, sport or consultancy fields), to entrepreneurs (who must employ at least one Canadian and have been able to generate \$500,000 by their own efforts) and to investors (in the areas of tourism, high technology and development). They too need to show that they can generate \$500,000 of income and are required, in addition, to invest a sum in the region of \$250,000 for three years. These practices vary from province to province, with Quebec asking for a \$500,000 investment for five years.

CONFIDENTIAL

CONFIDENTIAL

2.

Thereafter the immigrant must have three years' residence in a five year period and must apply to a Court of Citizenship if he wishes to become Canadian. The Court expects, among other things, a knowledge of the official languages of Canada and evidence of the immigrant's commitment to the country. There is a right of appeal against refusal but apparently no flexibility or scope for discretion in applying the criteria.

CONFIDENTIAL

HONG KONG

future pt 20



Foreign and Commonwealth Office

London SW1A 2AH

Henry Keswick Esq
Chairman
Hong Kong Association
Swire House
59 Buckingham Gate
LONDON SW1E 6AJ

18 November 1988

Dear Henry,

BRITISH REPRESENTATION IN HONG KONG

Please refer to your letter of 11 October to David Gillmore about British representation in Hong Kong. I am replying, by agreement with him, in his absence abroad.

We are grateful for your Association's support for our decision to up-grade the post of Senior British Trade Commissioner in Hong Kong; and for your warm personal endorsement of Mr Reg Holloway. I believe the decision has been welcomed, both in Hong Kong and more widely, as a measure of our political commitment to the territory and of our determination to develop further our substantial commercial interests there.

I am sorry, however, that despite this important step forward you feel there is still a gap to be filled as far as British representation in Hong Kong is concerned. We have considered very carefully the comments which you have made and the proposals which your Association has put forward. We understand the concerns that underline them and appreciate the constructive way in which they have been expressed. Ministers have carefully considered the points which you raised, and have endorsed this reply.

You refer in your letter to overall British interests in Hong Kong. I would suggest that these might be defined in the following way:

- to assist in maintaining the stability and prosperity of Hong Kong up to 1997 and beyond; and to this end to uphold the authority of the Governor and the Hong Kong Government so long as HMG are responsible for the administration of the territory;

/ - to



- to maximise Britain's economic and commercial stake in the territory both in the immediate future and in the longer term;
- to plan for a suitably dignified and visible presence in Hong Kong after it reverts to Chinese sovereignty in 1997, as a base from which we can consolidate and further expand all our interests there.

I do not believe that your Association would dissent from any of these objectives. It is strongly in the interests of the international business community that Hong Kong should remain stable and prosperous, under a strong and authoritative local administration.

Where Britain's economic and commercial interests in the territory are concerned, these are being vigorously pursued in a range of ways:

- through the activity of the Senior British Trade Commissioner and his staff;
- through frequent visits by British Minister. Lord Young takes a close personal interest in Hong Kong. He visited the territory earlier this year; so too have four other Ministers with commercial responsibilities in just the last three months.
- through work by DTI officials to identify and exploit the commercial opportunities offered by Hong Kong's dynamic growth. Senior DTI officials are in fact visiting Hong Kong during this month, one to review the contribution British industry can make to major projects planned in the public and private sectors, and the other to consider trade promotion more generally.

These efforts are yielding results. British exports increased by 5.4% in 1987 to £1013 million. Twenty-four DTI-supported outward trade missions visited Hong Kong in 1987 and there were six supported British ventures at international exhibitions as well as one promotion of British consumer goods at Matsuzakaya, a Japanese department store. Twenty supported missions and eight joint venture exhibitions are planned for next year. We are not complacent, but we do think that some credit is due for this improvement.

In addition to this activity in direct pursuit of our economic and commercial interests in Hong Kong there is of course close and frequent contact between the British and Hong Kong Governments. Contrary to the impression

/which



which you give in your letter, the Governor keeps closely in touch with the Foreign and Commonwealth Office. He returns regularly to London for consultations with the Foreign Secretary and with other British Ministers.

I suggest that it is against this background of close contacts and vigorous trade promotion activities that your proposals need to be considered. I take them in turn.

(i) We do not believe that it would be appropriate to rename the post of the Senior British Trade Commissioner. To describe a commercial representative of the British Government in Hong Kong as Commissioner, with all the wider connotations of this term, could too easily convey the impression of a second, alternative source of British authority within the territory. This would detract from the position of the Governor: it could also all too easily be interpreted as an arrangement likely to be inherited by the Chinese Government, contrary to the terms of the Joint Declaration, after 1997. That would be in the interests of no-one, least of all those of the business community. The Hong Kong Commissioner in London, to whom you refer, is in a different position and has quite different functions.

(ii) I have described above how Britain's economic and commercial interests in Hong Kong are pursued by personal visits by British Ministers to Hong Kong, as well as through the visits of officials and the activity of the Senior British Trade Commissioner. Given the other, broader factors to which I have drawn attention, I do not think that a case can be made out for a change in the present system. The Hong Kong Government place great importance on their even-handed approach to all outside commercial interests. In our contacts with them, they assure us that this applies to British interests as to those of other trading partners.

(iii) The question of a site for a British Consulate-General is under direct discussion between the British and Hong Kong Governments. The Senior British Trade Commissioner is also playing a role in this preparatory work. I believe this arrangements is satisfactory.

(iv) In a similar way the sharing of defence costs and bilateral arrangements for air services are by their nature essentially matters for direct negotiation between HMG and the Hong Kong Government. Such matters are naturally also dealt with in our contacts with the

/Governor,



Governor, including on his regular visits to London. The Hong Kong Government has long enjoyed a high degree of autonomy in these areas. It is a negotiating partner with objectives and priorities of its own. There would be serious implications for the similar degree of autonomy which Hong Kong is due to enjoy after 1997, under the terms of the Sino-British Joint Declaration, if this long standing position was not acknowledged.

I should note in passing, in relation to your suggestion that defence installations may have been "given away", that all land occupied by the Ministry of Defence in Hong Kong is held by the Crown in the right of the Government of Hong Kong and automatically reverts to that government when there is no further defence requirement for it. The new Defence Costs Agreement signed this year runs till 1997. There should be no need for further substantive negotiations.

(v) The Senior British Trade Commissioner already takes the lead in drawing up the programme for British Ministers and officials with trade responsibilities when they visit Hong Kong. Such Ministers use the Trade Commission as their working base, for example for holding press conferences. The Senior British Trade Commissioner is also fully involved in visits to Hong Kong by FCO Ministers and briefs them on the work of his office in the promotion of British trade and investment.

(vi) I strongly agree with what you say about the importance of a higher level of British activity in Taiwan. But for both practical and political reasons, I do not think that it would be right to involve our Hong Kong Office in this. Instead we and others concerned - notably the Anglo Taiwan Trade Committee - have been looking at ways of doing more on the spot in Taipei. The ATTC will shortly be moving into new offices: it has plans to enlarge its staff. In the course of next year a start will be made on cultural promotion in Taiwan and, I hope, more efficient arrangements for handling visas will be put into place.

To sum up, we share your Association's desire for a strong British presence in Hong Kong before and after 1997. We share your expectation that this will help to promote confidence in the future. We will further our economic and commercial interests in the territory with all the means at our disposal. But it is the responsibility of the Government to take the broader view. We have to recognise and accommodate our wider responsibilities in Hong Kong; and that leads us to

/differ



differ from your Association over the exact form our representation should take. But I hope I have been able to demonstrate that within that framework we are at one over objectives in Hong Kong.

Yours ever,
RJTM

R J T McLaren

cc: Sir Adrian Swire
Vice-Chairman
Hong Kong Association

CF Have you got any pps?

edcc
24/10



Foreign and Commonwealth Office

London SW1A 2AH

24 October 1988

2-10 Newstr

ABA
24 X

Dear Algy

ms

Thank you for your letter of 5 October about Mr Algy Cluff's proposal to establish a Trust to promote two way investment between Britain and Hong Kong.

We have considered with the DTI how the Government could make a contribution to Mr Cluff's project. We propose to offer to bear the costs of the inaugural function at Lancaster House, which either Lord Young or Lord Glenarthur will host. The costs would be shared equally between the two departments. Further involvement by HMG in the project can best be considered at a later stage, when we are in a position to assess the initial response and the chances that it will get off the ground.

Lord Glenarthur is writing to Mr Cluff accordingly, incorporating the other points in my letter of 3 October, which the Prime Minister has endorsed.

We have taken careful note of the Prime Minister's comment about British citizenship for potential investors. The Foreign Secretary would also wish to be involved in any further consideration of this matter.

I am sending a copy of this letter to Neil Thorton (DTI) and Philip Mawer (Home Office).

Yours ever

R N Peirce

(R N Peirce)
Private Secretary

Mass Vails

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COVERING CONFIDENTIAL

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China: Relations 5

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Foreign and Commonwealth Office

London SW1A 2AH

17 October 1988

Dear Andrew

Mr
Prime Minister
CBP
17/x

The Foreign Secretary thinks that the Prime Minister
may be interested to see the enclosed report by Mr Patten
about his recent visit to China and Hong Kong. *→*

Yours ever

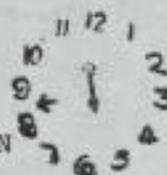
[Handwritten signature]

(R N Peirce)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

COVERING CONFIDENTIAL

13 OCT 1988



FROM: CHRIS PATTEN

DATE: 28 SEPTEMBER 1988

cc PS/All Ministers
 PS/PUS
 PS/Mr Caines
 Sir Alan Donald, Peking
 Sir David Wilson, Hong Kong
 Mr Ainscow
 ODA Under Secretaries and
 Heads of Profession
 Mr Gillmore
 Mr McLaren
 Mr Cooper
 Mr Hum
 Mr Graham-Harrison
 Mr Machin

Secretary of State :

Secretary of State

VISIT TO CHINA AND HONG KONG

A visit to China is far better value than a guinea a minute. This was my thirty sixth country since joining the ODA. Nowhere has excited me more - or anything like as much for that matter. (I daresay that one would be less than normal not to find a fifth of humanity rather interesting!) Nowhere have my hosts been warmer or more welcoming.

2. Its many unique qualities notwithstanding, China shares many characteristics of other developing countries. Its economy is still heavily agricultural; its infrastructure is inadequate; there are shortages of skills and, above all, there is poverty. At US\$300 per annum, China's per capita income is still low. But there are no glaring gaps between rich and poor. It seemed to me that ordinary people were better off than counterparts in, say, India : not only in the cities but in what little I saw of rural areas people on the whole appeared adequately fed, clothed and healthy.

/3.

3. The main purpose of my visit was to sign a second concessional financing arrangement for £300 million. This new facility has increased flexibility as compared with the first loan in offering the use of either mixed credit or soft loan, and in project identification/selection. There is every prospect of allocating funds so that projects can be signed more quickly than under the first loan. Our commitment is for three years, but I made clear that if the funds were allocated more quickly we would review the position.

4. I feel generally confident about prospects for ATP in China, because I fully expect to be able to rely on the Chinese to make sensible use of funds. I am, however, concerned about two things. First, it is important that we should not take too short term an approach to ATP proposals, and rush in to back any request virtually regardless of whether it is necessary to clinch a commercial deal or whether it is likely to open up further business opportunities. We need to bear in mind that the ATP budget is limited and that money committed to one project will not be available to support another (maybe better) project elsewhere. It is, moreover, only common-sense to take a view about which countries are likely to be the best long-term potential markets. China comes at the top of my list. Secondly, I am concerned by the degree of dependency on ATP of some UK firms. They are often all too ready to hint at or even offer more government support than we may wish to provide or than may be necessary to win the contract. Since all concessional financing is now governed by the same international rules, what really determines whether or not a company gets a contract is whether it is competitive itself, not whether government support is competitive.

5. I was able to see something of our TC programme. This seems to me to be, in several respects, a model of its kind. It is carefully focussed, on four key areas : technical consultancies, training in the UK, ELT and academic links. These are priorities for both the Chinese and ourselves. The bulk of this programme is managed - very capably - by the British Council, thus allowing scarce staff resources in ODA and the Embassy to be concentrated on ATP. The programme has been formulated with our commercial interest very much in mind but, quite rightly, taking a positive view of the long term benefits of activities such as ELT and training. It cannot - unfortunately - be readily replicated

/elsewhere;

elsewhere; we started virtually from scratch three or four years ago, unencumbered by the complex historical baggage which weighs on our aid relationship with recipients like India. The programme in China very clearly provides excellent value for money : perhaps more so than any other country I have visited. Aid is used highly effectively by the Chinese.

6. Our consultancies' programme focusses on specialised areas where China lacks expertise. I visited a canal irrigation and water supply system near Peking where the contributions of several British companies are clearly greatly valued, and also went to see a low cost housing project in Chengdu, Szechuan province. The consultancies programme makes an important contribution to Chinese projects and is valuable to UK companies in introducing firms to the China market and securing (non aid financed) equipment exports. This part of our programme is set to expand substantially, as is our ELT programme, through which we are currently supporting about 40 British experts, Chinese counterparts in UK, books and other materials. There is a strong Chinese commitment to increase knowledge of the English language, and I was both surprised and impressed by the number of my interlocutors who had at least a working knowledge. Our effort is carefully geared, by concentrating on key institutions, to secure the maximum multiplier effect. This is an area in which the UK has an obvious comparative advantage, and I saw good examples of our work in Chengdu and Shanghai.

7. I was impressed by the Universities I visited in Peking, Chengdu and (particularly) Shanghai, and we are building a valuable link programme between these and other Chinese institutions and British universities and other centres of excellence. In addition to these links (now nearly 100 in number), we support through several training programmes about 1,000 Chinese students in UK. I think that the planned expansion of the FCO SAS to provide 100 new senior fellowships for high fliers should be particularly valuable.

8. Shanghai was our last stop. Our time there was heavily curtailed by the cancellation of our flight from Chengdu : CAAC do not have a high reputation. But even a few hours was enough to convey a clear impression of a dynamic and rapidly developing city. Shanghai is starting to put in place the first of the building blocks that have helped other Asian cities to expand rapidly, eg modern hotels and better infrastructure. There will be several big projects (in addition to the metro) in Shanghai in the next few years and it would be a pity to miss out on these. Pilkingtons have led the way with their glass factory, a joint venture established without a penny of British taxpayers' money. It is a most impressive operation. We should aim to get a commercial foot in the door as Shanghai begins to take some of its environmental problems seriously. I am sure that our excellent Consulate there will keep us in touch with all the possibilities.

9. I have three general observations. First, no one mentioned the word Socialism to me once. I am all too inexperienced but it seems to me that China is set pretty firmly on the road to greater economic freedom, though the pace may vary from time to time for understandable reasons (eg the present concern about the effect of price reform on inflation, especially in the cities). Second, I have been nowhere else where the disjuncture between the size of our aid programme and the pursuit of the national interest is so manifest. With a market set to grow towards 300 billion dollars by the turn of the century, with the immense goodwill towards Britain that is shown at every level, with the Prime Minister's credit and your own so immensely high we should be running a programme on the same sort of scale as our operation in India. We cannot just find the money elsewhere; we are stretched pretty tight as it is, with a steady stream of new requests. Mind, British businessmen are not exactly demonstrating East India Company entrepreneurialism in China at the moment. At best, there seems to be a feeling that China can be "done" from Hong Kong; at worst, there is total inertia. This lack of interest is not shared by the Italians; or the French; or the Japanese. British firms, for example, have apparently declined to respond to Chinese entreaties to get involved in the development of the chemical industry. The lobby of the Great Wall Sheraton was full of svelte Italians from their chemical industry, in Peking to sew the future up with the help of "loadsalira" from their government. O me, O mi.

10. Third, while the Embassy staff are coping well, they do appear a little thin on the ground given the potentialities of the country. One cannot help but think of the scale of the enterprise at other posts, like Tokyo. Are the days gone forever when Peking could boast all at the same time a Fretwell, a Hurd, an Evans and a Donald, plus much more? Have all the young Sinologists gone to the city? None of my business, but it does strike a reasonably experienced itinerant like me as a bit rum. At the margin, Alan Donald is anxious to broaden the expertise within the Embassy with a seconded ODA officer, probably at First Secretary level. We shall see what we can do to help.

11. And so from China to Hong Kong, which illustrates just what the combination of Chinese hard work and entrepreneurial skill is capable of once those forces are allowed to flourish. It seems to me likely to become an increasingly explicit model for the rest of China - particularly the coastal cities like Shanghai. It is hard for the amateur to detect any supposed deterioration in confidence; the city hustles as busily as always, and ever more fanciful and daring buildings scrape the stars.

12. My main purpose in going to Hong Kong was to find out for myself about the Vietnamese boat people. In addition to spending a full morning visiting some of the camps (the detention centre at Hei Ling Chau and refugee camps at Tuen Mun and San Yick) I was able to discuss the situation with both the Governor and the Chief Secretary.

13. We have two major objectives to meet. First, we need to have a clear idea about the timetable for dealing with detainees and refugees, and to set our own agenda to the extent possible. Secondly, we need to be able to demonstrate to actual and potential critics that we are treating both groups fairly and reasonably. As far as the timetable is concerned, we are three-fifths of the way there. We have agreement on screening procedures; we have increasing liberalisation of refugees (who are now in the process of being let out of the camps to work or to attend schools); and we have UNHCR agreement on the status and treatment of non-refugees. (It is of course immensely valuable to have some sort of UNHCR legitimisation of our efforts).

14. Two formidable stages remain - further bilateral discussions with the Vietnamese, and multilateral discussions (an Asean Conference) probably in the Spring. This does not allow us the luxury of linking any action we might take with Vietnamese withdrawal from Cambodia; it is all moving too quickly for that. I am certain that we should not be drawn into discussions with the Vietnamese about long-term development assistance at this stage; but equally I think it certain that we shall need to offer some sort of rehabilitation assistance if a solution is to be found. I shall want to keep a very close grip on this. At present my thinking is that we should be aiming for (a) a financial contribution to the UNHCR operation in Hong Kong itself, (b) encouragement to the UNHCR to launch (at our expense) a small pilot scheme to return the first group of detainees to Vietnam, and (c) a contribution when the UNHCR appeals for its overall regional programme of assisting returning economic migrants. I mention the pilot scheme at (b) because I think it important to get something moving reasonably soon, and certainly before the Asean Conference, in order to reassure opinion in Hong Kong.

15. I think we are on reasonably good ground in presenting our treatment of refugees and detainees. For the first group, conditions in the closed camps are crowded, and in San Yick 2,800 refugees have been indoors in one building almost constantly for several weeks. But the end of the road (which began six years ago, in some cases) is now in sight for them, and their morale seems high. For the detainees, the problem is potentially more serious; they know that they will not be accorded refugee status, they have little with which to occupy their time, and violence could flare up at any time. The more we can secure the support of others, like the UNHCR and the Save the Children Fund, in running the camps, the more likely we are to avoid an incident and to secure at least some support for our position if one occurs. Such an incident may prove to be the recent allegations of ill-treatment at one centre, on which an independent commission is about to report. But our best defence must be that we are doing all we can to ensure that all categories of detainee and refugee are adequately housed and fed, and that they are treated in accordance with international law and humanitarian principle. All that I saw and heard suggested to me that we have a very good case, but of course we are to some extent in the hands of

/chance.

chance. An incident in one camp could bring down on all our heads the obloquy of the world's press. And inevitably one regards with little enthusiasm the publicity that will surround the journey home of the first group of reluctant returnees. But we must get ahead.

16. I am no Hong Kong watcher, but I was struck by similarities with the exotic politics of Ulster : the same incipient feeling of betrayal, the same introversion and navel watching, the same fascination with every twist and turn of politics, the same insatiable desire to be comforted and assured of boundless and unqualified affection.

17. I was delighted to be able to take Lavender with me on this trip; she enjoyed it every bit as much as I did, and she was made most welcome wherever we went. Alan and Janet Donald (whom I had already encountered in Jakarta) looked after us with great brio and kindness, and - as the wiser sort of American might say - the Chinese seem to be enjoying them every bit as much as they enjoy the Chinese! It was a great pleasure to spend nearly a week in their company; I hope they felt the same. Twenty-four hours was all too brief a time to spend with David and Natasha Wilson. But we crammed a good deal into that period, and we were entertained majestically. As the Princess Royal had been their guest the previous week-end, they had clearly had plenty of practice. It is nice to see the right people in the right job.

Chris

C P

Overseas Development Administration
28 September 1988

PERSONAL AND PRIVATE

Prime Minister

*An extract from
a letter from Henry
Kestwick to Lord*

HONG KONG (A political point)

*Glenastor. A more
unspoken
rendering
of the
points put
to you
by your
letter
Minister.*

I have just spent a fortnight in Hong Kong and I continue to feel uneasy and saddened on how British interests are being looked after there.

I am not alone in feeling British representation should be improved in the territory and I enclose for information only a copy of Adrian Swire's and my letter from the Hong Kong Association to the Foreign Office giving the Association's views. We hope the official reply will have strong Ministerial guidance.

The Hong Kong Association Committee represents the combined views of the principal British long-term investments in Hong Kong: Swires, Cable & Wireless, the Hong Kong Bank, Standard & Chartered Bank, Inchcape, Shell, P&O and Jardines. Hopefully we will all be there in 1997 when the British Government withdraws to only a Consul-General in the territory, a strong bridgehead for British influence and trade in the Asia Pacific area.

*CRM
14/X.*

My more cautious colleagues asked me to take out a political point from our letter to the PCO in case of a change of government but perhaps at the time of the Tory Conference I can make it privately.

*I must
speak to
the F.C.S.
There are
too many
loop holes*

The Conservative Party under Margaret Thatcher was elected for an unprecedented third term on a strong manifesto which included Decisive Government; Privatisation; a statutory regime of business ethics; and pride and leadership for British worldwide success. We are seeing at Brighton Minister after Minister pushing back the frontiers on these objectives set by the manifesto.

Like the local authorities in Liverpool and Brent the Hong Kong Government has the constitutional right under devolved government to go its own way in many areas and ignore Central Government policy, but unlike the Councillors of Liverpool and Brent who are elected, the senior members of the Hong Kong Government are British appointed Civil Servants who should know better. Britain's overall sovereignty of Hong Kong until 1997 is enshrined in the joint declaration.

On Decisive Government unnecessary slow decisions are being made on a new airport; infrastructure improvements and the provision of land for a new Consul-General's office. On Privatisation there is sullen resistance to entertain any privatisation of the Mass transit railway, Kowloon Canton Railway, Government office buildings and urban services. On Business Ethics, making

insider trading a criminal offence is being resisted. Powerful Chinese interests are being appeased to allow the Deputy Chairman of the quasi-Central Bank to continue in office despite being found by a judicial tribunal a culpable insider trader. On British Pride and Leadership, the Prime Minister promotes by her own personal energies British pride and success all over the world, but the Governor of Hong Kong shrivels from being pro-British. He can not even attend a lunch hosted by the DUKE of Gloucester for the British Association of Architects in case he gives the wrong impression!

It is for these political points that under a system of devolved government in Hong Kong there should be a British Commissioner to monitor and encourage Conservative Government policy and look after overall British interests.

14th October, 1988

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會協商工英中港香

THE HONG KONG ASSOCIATION

(A company limited by guarantee, registered in England, No. 703170)

TELEPHONE
01-821 3220
01-821 3221

SWIRE HOUSE
59 BUCKINGHAM GATE
LONDON SW1E 6AJ

11th October, 1988

HK/AD

PRIVATE AND CONFIDENTIAL

D. H. Gillmore, Esq., CMG,
Deputy Under-Secretary of State,
Foreign and Commonwealth Office,
Room W 37,
King Charles Street,
London SW1A 2AH.

Dear Mr. Gillmore

Prime Minister
This is further
amplification of the
views of
Peter Robinson put to
you previously, after
his return

BRITISH REPRESENTATION IN HONG KONG

I refer to your letter of 25th August which has now been discussed by the full Committee of the Hong Kong Association. May we say first of all that we very much welcome the up-grading of the British Trade Commission by re-grading Mr. Reg Holloway to ambassadorial rank as we feel this is an encouraging start to filling the very serious gap for British representation in Hong Kong. This new status will greatly assist Mr. Holloway in the first-class way he carries out his current brief.

visit to
Hong Kong
CDP
15/X

mt

Can we now go on to explain why we see a serious gap exists and what steps the FCO might consider to fill this gap.

Our understanding is that the Governor of Hong Kong is appointed by the Queen under advice from the Secretary of State but that after this appointment is made, the Governor is advised by the Executive and Legislative Council in Hong Kong whom he serves and to whom he owes his loyalty. We are often reminded that direct rule from Whitehall does not exist.

Overall British interests in Hong Kong have only limited representation except in the commercial field where up until recently they were looked after by a Senior Trade Commissioner, who was not even of ambassadorial rank. A whole range of other British interests are not supported at all which put our national interest at a disadvantage when compared with say the strong presence of an American or Japanese Consul General or in the case of the Peoples Republic of China of a significant presence in the New China News Agency.

As we have said, up-grading the British Trade Commission by re-grading the senior British Trade Commissioner is a start in filling this gap but our Association feel you might like to fill this gap even further by considering the following proposals.

1. To show his new authority you might consider re-naming the Senior British Trade Commissioner to be called the British Commissioner as Head of Mission in Hong Kong. (This will ease the path for the British Commissioner becoming the Consul General in 1997.) The Hong Kong Commissioner in London is not called the Hong Kong Senior Trade Commissioner.
- mt

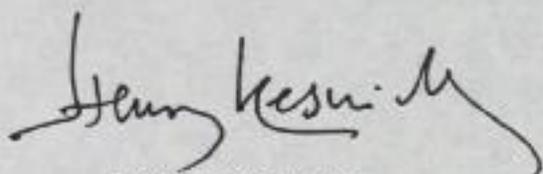
2. The British Commissioner will try and ensure that the Hong Kong Government was on all occasions even-handed in their attitude towards overall British interests in Hong Kong.
3. The British Commissioner would ensure that British interests are positioned at an early stage to play a major part in Hong Kong Government public sector construction contracts (we have in mind particularly the construction of a new airport and he should be watchful that unfair trade practices by foreign competitors do not arise).
4. The British Commissioner should be responsible for ensuring that a suitable site for a new Consul General's office is made available by the Hong Kong Government on satisfactory terms.
5. We believe the British Commissioner should in future be informed of defence negotiations in an attempt to minimise future unedifying squabbling between Whitehall and Hong Kong (we also feel the Ministry of Defence installations may have been given away to the Hong Kong Government without a suitable quid pro quo such as a suitable site for the new British Consul General's office.)
6. We believe that the British Commissioner should in future be kept advised of bi-lateral aviation negotiations in Hong Kong so that the United Kingdom position can be watched from an overall commercial view.
7. We feel that the British Commissioner and his Mission should, on all occasions, be substantially involved with U.K. Ministers and senior Civil Servants when they visit Hong Kong, and with the preparation of their programmes so that they can be briefed how British interests are involved (we feel this should include Foreign Office Ministers).

- ? 8. The British Commissioner might involve himself in trade and cultural relations with Taiwan where the U.K. has no official diplomatic ties. Trade opportunities in Taiwan are significant and a higher level of British activity there should not be an embarrassment to the People's Republic of China who are also increasing their trading and cultural links with Taiwan.

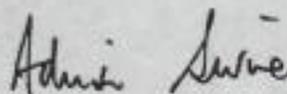
We look forward to your comments after you have had Ministerial guidance on what we hope will be seen as constructive suggestions as to how the gap for British interests in Hong Kong can be filled.

We see no reason why the joint Declaration cannot be implemented with honour and advantage for Britain, as a strong British presence in Hong Kong before and particularly after 1997 will in itself be a natural confidence builder for the future and should be welcomed and expected by both the people of Hong Kong and the People's Republic of China.

Yours sincerely



HENRY KESWICK
CHAIRMAN



SIR ADRIAN SWIRE
VICE CHAIRMAN

MJA



file
(no 2nd carbon)

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

10 October 1988

HONG KONG

The Prime Minister was grateful for your note and will reflect on it. She shares the concern about our failure to offer an 'insurance policy' to Hong Kong Chinese who would otherwise want to invest in the United Kingdom and will continue to pursue this with the Secretaries of State concerned. I think she is more sceptical of the practicality of having a High Commissioner as well as a Governor or of expecting major contracts deliberately to be steered in the UK's direction. Hong Kong's prosperity is based on free competition and that must be preserved.

Charles Powell

The Right Honourable Peter Morrison, M.P.

DS

MR WICKS

*Pm has spoken
to Home Sec.*

CF

~~XXXXXXXXXX~~

To keep in view

for next H. Sec

bilateral

N.

At her next bilateral with the Home Secretary, the Prime Minister want to revert to the subject of British citizenship for Hong Kong investors. But no need to warn him: she wants to ambush him!

CDP

Charles Powell

10 October 1988

Seen by CDP



THE MINISTER OF STATE

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211
Switchboard 01-211 3000

7. x. 88.

Dear Sir,

As I said earlier today my notes
on H.K. is now complete and enclosed.

Do please check it, if you think it is
not what the doctor ordered, or indeed not
correct.

Thank you for your help.

F
J



HOUSE OF COMMONS
LONDON SW1A 0AA

PERSONAL

PRIME MINISTER

Hong Kong

I have just returned from a visit to the Far East, where I spent a few days in Hong Kong. I am writing this note because I am genuinely concerned about the state of affairs there, and do not know how to persuade the Foreign Office to even consider that they may be building up considerable trouble for the future and well before 1997.

As you know, far better than I do, what has to be achieved is a delicate balancing act. For the moment that balance is just about in equilibrium, but I do not believe that it will remain so. As you would expect there is a marked exodus of the middle-class particularly to Canada and Australia. Lydia Dunn quantified that to the extent of £350 million per every 500 families leaving; Lydia, now the Senior Member of EXCO, and her husband, the former Attorney General of HK, are not one bit happy that all of this money should be going elsewhere other than to the UK. They both think that with a little bit of lateral thinking we could, at least, not seem to be the enemies of those who are buying their insurance policies in case 1997 does not go according to plan. They, and I agree with them, feel that what is currently a trickle of middle-management will turn into a torrent. They can neither understand nor know how to change our current policy which they do not agree with. They are concerned that if no change happens over the next year or two, then a backlash

against our agreement with China could easily take place, thus putting into jeopardy the smooth transition in 1997.

It is easy to state a problem, as I have done, but useless without giving possible solutions. It seems that there are two possible ways ahead;

Either to instruct the Hong Kong government to take more seriously into account the interests of Great Britain, thus restoring confidence of those Hong Kong Chinese who lean towards us. I suspect that the Hong Kong Chinese would favour this course, but given the difficulties for the Governor of holding the balance up to 1997, I think this is asking him to do the impossible.

Or to set up what would amount to our own High Commission in Hong Kong. As you know the status of the British Trade Commissioner, who incidentally does a very good job so far as he is allowed to, has recently been enhanced but not by anything like enough. He is still seen as very much the junior to the Governor, and not to speak for Britain. I favour this course of action because Beijing is doing precisely the same. First of all it would make the Governor's job very much easier. Currently, and unfairly so, he is not very popular, but that is because he is being asked to ride two horses and falling through the gap. If he is seen to be "the Governor of Hong Kong" and as such holding the ring, then he would be above the fray. Second, I am told by my Hong Kong Chinese friends that the Chinese leadership in Beijing would respect to a far greater extent the British standing up for their interests; as they do themselves.

I suppose that some would say that all this does not matter much if we can get to 1997 without too much trouble and get shot of our responsibilities. I cannot go along with that view when we have a major toehold in a part of the world which is becoming increasingly important. We have so many friends in Hong Kong who want to remain very close to Great Britain and it is because of that that I have written this note to you.

A handwritten signature in blue ink, appearing to be 'P. Morrison', with a large, stylized initial 'P' and a horizontal line extending to the right.

PETER MORRISON

7. x. 88.

PERSONAL

PRIME MINISTER

HONG KONG

Peter Morrison asked me to pass you this without going through the normal channels.

I am not quite sure what he is driving at. But I know that he spent a lot of his time in Hong Kong with Henry Keswick and suspect that he is to some extent reflecting Henry's views. These are in summary that we are not looking out sufficiently for British interests - in particular commercial interests - in Hong Kong. The Governor has to be even-handed and cannot promote the British interest or point of view. Our Trade Commissioner is too lowly to have much effect. In consequence we lose out to the Japanese etc. The answer is to appoint a British High Commissioner to look after specifically British interests, leaving the Governor to govern the colony in the best interests of its inhabitants. I see the problem but I am not sure this is the solution. It might cause confusion to have two centres of British representation. One could argue that the Governor and the Administration ought to tip major contracts rather more Britain's way instead of leaning over backwards to be fair. This is really what Henry Keswick and others want. There will be scandalised squawks if it is suggested: and anyway it is in Hong Kong's interest to have competition, not see the dice loaded unfairly for British companies.

The other aspect is that of an "insurance policy" for Hong Kong entrepreneurs and middle management. This is shorthand for making it easier for them to gain British citizenship. I think the time has come when we ought to look at this again. If we are ever going to get anywhere, I think that you have first got to break up the alliance between the Home Office and the Foreign Office. You may therefore want to get the Home Secretary in for a talk after the party conference. Agree?

CDP

Yes mf

Charles Powell
7 October 1988

SLHBAJ

CONFIDENTIAL



*File K10
at/c*

10 DOWNING STREET

LONDON SW1A 2AA

5 October 1988

From the Private Secretary

Jan Bob,

HONG KONG

The Prime Minister has seen your letter of 3 October setting out how we might reply to the letter from Mr. Algy Cluff proposing the establishment of a trust to promote two-way investment between Britain and Hong Kong. She would be grateful if Lord Glenarthur could reply on her behalf along the lines set out in your letter but she has two comments. First, she does not think it right to leave Mr. Cluff to bear all the financial costs: the Government should make some contribution. Secondly, she very much agrees that the issue of British citizenship for potential investors is likely to come up. She continues to believe that we could adjust our policy on this and will wish to discuss this again with the Home Secretary.

I am sending a copy of this letter to the Private Secretaries to the Secretary of State for Trade and Industry and the Home Secretary.

*Yours sincerely
Charles Powell*

CHARLES POWELL

R. N. Peirce, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

LB



Foreign and Commonwealth Office

London SW1A 2AH

ccfc

(1)

CONFIDENTIAL

3 October 1988

Hong Kong

You will recall that the Chairman and Chief Executive of Cluff Oil, Mr Algy Cluff, wrote to the Prime Minister on 8 July proposing the establishment of a Trust to promote two way investment between Britain and Hong Kong. The Prime Minister agreed with the recommendation in my letter of 20 July that Mr Cluff should be invited to call on Lord Glenarthur to explain in greater detail the thinking behind his idea.

Mr Cluff duly called on Lord Glenarthur on 28 July. As a result of that meeting and subsequent correspondence we are now a little clearer about what he has in mind. We have discussed the proposal in depth with officials of the Department of Trade and Industry. We have also consulted the Governor of Hong Kong and the Senior British Trade Commissioner there.

Mr Cluff advocates more investment from this country in Hong Kong, so as to underline Britain's commitment to the territory and to the Joint Declaration. He is equally keen to stimulate investment by Hong Kong Chinese businessmen in Britain. He sees the Trust as the vehicle for achieving these aims.

The immediate role of the Trust would be to foster better relations between leading figures in the Hong Kong Chinese community and British politicians, businessmen and bankers. Mr Cluff plans to invite groups of, say, a dozen prominent Hong Kong citizens to visit Britain. The Trust would be supported by certain merchant banks and the visit would include discussions at those banks to examine opportunities for two way trade and investment.

/The

CONFIDENTIAL

We can't leave it to take all the financial cost - we must share half.

Cluff
Prime Minister

Dear Charles

Agree with the proposed reply?

(Although I wonder whether we should not contribute to the costs.)

ccfc
JX.



CONFIDENTIAL

The highlight of each visit would be a lunch or dinner in honour of the visitors, to which leading British figures would be invited. Some would have a business or banking background. Others would not. Some journalists would also be involved. Mr Cluff suggests that such functions might be held at Lancaster House or on equivalent venue and hosted by a Minister. He envisages up to six such functions per year.

Mr Cluff would take on responsibility for all the costs involved including the Lancaster House funding. There would be no financial implications for the Government. But the Government are being asked to give the venture their blessing and to support it to the extent of Ministerial involvement in the Trust's functions. The visitors might also ask to call on Ministers in the course of their visit.

Mr Cluff does not apparently regard the availability of British citizenship to potential investors as a necessary element in all this, although he believes that the matter would inevitably be discussed. But he understands what the legal and political difficulties are.

The Governor of Hong Kong and the Senior British Trade Commissioner see attractions in the proposal. The Governor has commented that provided the objective is to promote two way trade and investment there would be little political risk in the initiative; and that there might be some benefit in terms of demonstrating UK interest in Hong Kong.

The Foreign Secretary considers that Mr Cluff's ideas add up to a helpful and generous initiative, which we should support. It remains to be seen whether there is indeed an untapped reservoir of important Hong Kong Chinese businessmen who would be willing to invest in Britain. But it would do no harm to put the theory to the test. Mr Cluff's target of six functions a year looks over ambitious and we suspect that in practice the frequency will be considerably less than that. At the very least the exercise should help to generate good will and confidence in Britain's commitment to the territory.

/A

CONFIDENTIAL



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A formal reply to Mr Cluff is now needed. The Foreign Secretary considers that this might best go as a letter from Lord Glenarthur making the following points:

- we welcome Mr Cluff's initiative and share his objective of promoting two-way trade and investment between Britain and Hong Kong;
- we note that Mr Cluff and his associates would take on all the funding and organisation of the proposed Trust;
- we value opportunities to demonstrate our continuing commitment to Hong Kong. We welcome the work the proposed Trust could do in promoting high-level contacts between Britain and Hong Kong;
- we would accordingly be willing to indicate our support for the venture by a Minister hosting an inaugural lunch or dinner at Lancaster House. Lord Glenarthur would be happy to do this. We would of course wish to be consulted about the guest list;
- provided that the first function proved to be a success, we would be ready in principle to consider some form of Ministerial participation in subsequent visits in the series.

I am copying this letter to the Private Secretaries of the Secretary of State for Trade and Industry and the Home Secretary and would be grateful for their concurrence too. I understand that Lord Young has already been consulted and believes that we should give the idea a fair wind.

Yours ever

R N Peirce

(R N Peirce)
Private Secretary

C D Powell Esq
10 Downing Street

CONFIDENTIAL

Charles. — For information only
no reply expected.

With Compliments

from

Henry Heswick



Foreign and Commonwealth Office
Room W37
London SW1A 2AH

25 August 1988

H N L Keswick Esq
Matheson & Co Ltd
3 Lombard Street
London
EC3V 9AQ

Dear Mr Keswick,

I wished to write to you, in your capacity as Chairman of the Hong Kong Association, to give you advance notice of planned changes in our commercial representation in Hong Kong. On 31 August it will be announced in London and Hong Kong that the status of the British Trade Commission has been up-graded. It will in future be headed by a member of the Senior Grade of the Diplomatic Service. The present Senior British Trade Commissioner, Mr Reg Holloway, has been appointed to the Senior Grade and will remain in charge of the post.

The up-grading of the status of the British Trade Commission reflects the importance which the British Government attach to the promotion of our economic and commercial relations with Hong Kong. As your Association will be aware, two-way trade and investment is running at an unprecedented level. For some years, the Trade Commission has been expanding in size and in the service it provides to British companies. The up-grading of the post is a further step in the same direction.

The change should also be seen in the context of the continuing commitment of Her Majesty's Government to Hong Kong. We regard the territory and its future as an important political priority. The new arrangements for our commercial representation there are an acknowledgement of Hong Kong's economic importance to Britain, and a demonstration of our confidence in its future as a financial and economic focal point of the Far East.

You may wish to circulate my letter to the members of your Association.

Yours sincerely,
D H Gillmore

D H Gillmore

HOTEL
INTER-CONTINENTAL
SYDNEY

CDP
9/8

Dear Charles.

I am keeping an
eye on you!
I go tomorrow
to stay with
McAlpine in Perth and
up at Broome and
then on to today to
Scotland, thank heavens.

Many thanks for
putting my letter before
the P.M. I have
subsequently had a meeting
with Simon Grenier and
enclose my letter to
him.

I hope your Melbourne
experience was not as
starming as it looked.

Regards

Algy

4 August, 1988

Lord Glenarthur
Foreign and Commonwealth Office
Whitehall
London SW1
UNITED KINGDOM

Dear Simon,

At our meeting last Thursday I promised to elaborate on the various points which I raised with you and, in particular, the need to encourage the commitment of British capital to Hong Kong by enlarging the UK trade base in the Colony itself by implementing a signal increase in the status of the UK Trade Commission in Hong Kong. There exists great concern that the Governor seems detached from business, and particularly British business whereas - at the risk of repeating myself - the greatest vote of confidence in Hong Kong's future obviously lies in the commitment of British capital to the Colony.

The increase in the status of the Commission will clearly need to include the appointment of an energetic and distinguished figure from the business or political world as, say, Commissioner-General for Trade. I also suggest that a new Trade Commission building be constructed on a site made available by the Hong Kong Government on favourable terms (as I believe the site for the new Bank of China building was made available). Such a building would have a strong symbolic force as well as a practical use.

I also believe it essential for the UK's good name and for the wider appreciation of the value of the 1997 Agreement that a genuine and immediate effort is launched to generate a two-way traffic involving not only increased UK investment in Hong Kong but also the fostering of relations with leading Hong Kong citizens by British politicians and businessmen which may lead to investment in the UK and from the UK but, at the very least, would demonstrate we are extremely concerned that notwithstanding 1997 the British regard continued contact and friendship with Hong Kong's leaders as being of paramount importance. In other words, to at all costs avoid the Foreign Office's "let's get out of here as soon as possible" approach adopted so crassly in most other colonial divestments. Far from weakening the principles of the 1997 Agreement nothing could strengthen it more in

the eyes of the P.R.C. Government, the Hong Kong people and the rest of the world than the evidence that the Hong Kong Chinese and the British are seeking ways of engendering two-way business without the seduction of the passport.

I propose, therefore, the establishment of an Anglo-Hong Kong Trust, the Chairman of which would be an individual who has no venal interest in Hong Kong but who is well known to the Chinese community. I suggest that the immediate activity of the Trust should be the hosting of, say, six lunches or dinners per year to be held at Lancaster House. A selection of a dozen or so Hong Kong citizens should be invited together with their counterparts in the UK, some of whom will have had experience of business in Hong Kong whilst others will not. The Trust would be supported by interests including certain merchant banks and the visit would include discussions at those banks to examine opportunities for two-way trade. In my capacity as Chairman of The Spectator I would also make a point of involving leading journalists in an attempt to defuse the increasing hostility which has developed ahead of the Agreement. Discussion of the passport question must also be confronted.

The formation of such a Trust is a preliminary step, but an important one. It should have no connection with the Hong Kong Association which, although certainly worthy, exists solely for the use of British businesses active in Hong Kong.

The funding of the Trust would be my responsibility and there would be no financial burden on the UK Government unless it so elects. I would expect that various friends of Hong Kong would be only too happy to contribute to the Trust but, if not, I should be pleased to underwrite any costs involved.

I return to London from Australia on August 12th and will be in my office on August 15th before going on holiday to my home in Aberdeenshire on August 16th. My office number in London is 493 8272 and my number in Scotland is 04646331. Simon, I think you will be on holiday close by - we may be able to meet in Scotland, if not before.

CONFIDENTIAL



FILE

KK

bc PC.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

5 July 1988

HONG KONG

The Prime Minister has read with interest Lord Young's minute of 4 July about his visit to Hong Kong and Macao, which she finds generally reassuring. She has heard it said that we do not press the claims for British companies hard enough when it comes to major public works contracts in Hong Kong. She is therefore grateful for Lord Young's efforts reported in paragraph three of his minute, but hopes that these will be followed up very vigorously and in every possible way.

I am sending copies of this letter to Tony Galsworthy (Foreign and Commonwealth Office) and Alex Allan (Treasury).

(C. D. POWELL)

Neil Thornton, Esq.,
Department of Trade and Industry.

JKW

cc/PC (2)

Prime Minister

CONFIDENTIAL

Some senior British business men agree that we do not press the claims of British companies hard enough when it comes to major public works contracts: we are too open & above-board.

PRIME MINISTER

HONG KONG

I visited Hong Kong from 19-22 June. The objective of the visit was to promote UK business interests generally and the UK interest in a number of projects. While in Hong Kong I made much of the fact that it was my only port of call (and not part of a longer trip) and this was undoubtedly warmly received.

point where we lose out

2 I was encouraged by the widespread recognition of our economic achievements and of our increased international competitiveness. We are winning good project business in Hong Kong, some of it against Japanese competition. And there was much praise for the performance of UK companies carrying out the work. For instance, the Chairman of the Hong Kong Mass Transit Railway told me that he considered Westinghouse, who supply signalling equipment, to be technologically two or three years ahead of their international competition.

unnecessarily. Do you wish we to investigate this further?

CBP 4/7

3 Hong Kong's position within China after 1997, combined with its geographical advantages and international outlook compared with Tokyo, suggests that it could play a significant new role in the region - almost a New York to Beijing's Washington. There are already many companies - such as IBM and Salomon Brothers - which are favouring Hong Kong over Tokyo for their Pacific basin headquarters.

Yes no

4 Many new projects are now under consideration in Hong Kong. These include a new airport/port complex likely to cost £2-3 billion a third university and major road projects amounting to some £5 billion in the next five years. I am confident of the ability of UK companies to play a major part in these

CONFIDENTIAL

developments and pressed our interests accordingly.

5 I also paid a brief visit to Macao where I discussed with the Governor the UK's interest in participating in various projects there. The most significant of these is a major international airport.

6 Hong Kong is also a major market for consumer goods. Marks & Spencer recently opened their first branch in Asia there and they announced a second during my visit.

7 UK exports to Hong Kong last year exceeded £1 billion for the first time. Its fast-growing economy makes it a major market in its own right. And with the opportunities for onward sales into China, the potential further growth is extremely attractive both for visible exports and for invisibles. However, I believe that UK businessmen may well be discouraged from attacking the Hong Kong market by the emphasis in the UK media on the political aspects. The Press in other countries are likely to be less concerned with this. I therefore intend to stress to British companies that 1997 should not be viewed as a closing of an era but as the continuation and indeed the widening of the present trade and investment opportunities.

8 The Governor told me that Ian Hay-Davison's recommendations for reform of the financial markets had been generally well received and that they would be implemented as soon as was reasonably practical. I strongly, but informally encouraged him in that direction.

9 In addition to meetings with the Governors of the Hong Kong and Macao, I visited major project sites and had discussions with leading businessmen and bankers. I also addressed the Hong Kong British Chamber of Commerce.



the department for Enterprise

CONFIDENTIAL

10 I should like to express my appreciation for the hospitality of the Governor, Sir David Wilson, and for the arrangement and conduct of the programme by the Senior British Trade Commissioner, Mr Holloway.

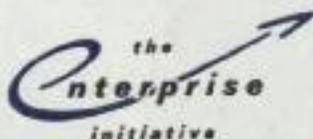
11 I am copying this minute to Geoffrey Howe and Nigel Lawson.

D Y

4 July 1988

DEPARTMENT OF TRADE & INDUSTRY

DWLAGI



CONFIDENTIAL



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3

MO 6/19/1E

20 June 1988

Dear Bob

HONG KONG: DEFENCE COSTS AGREEMENT

The Foreign and Commonwealth Secretary will wish to be aware of the outcome of the latest round of negotiations over the Hong Kong Defence Costs Agreement which took place last week in London.

The negotiations have been constructive and fruitful, and have resulted in a Memorandum of Understanding, agreed by both sides, that sets out the arrangements for financing the Hong Kong garrison between 1st April 1988 and 30th June 1997. We are satisfied that these arrangements are consistent with the outline agreement endorsed by Ministers in March, and in particular that they do not involve any further financial penalty to the Ministry of Defence. The MOU itself has been encapsulated in Heads of Agreement which, I understand, the Hong Kong Government will submit to the Executive Council for approval on 21st June.

I am sending a copy of this letter to the Private Secretaries to the Prime Minister, the Home Secretary, the Trade and Industry Secretary, the Chief Secretary, the Lord President, the Attorney General, and Sir Robin Butler.

Your sincerely

(B R HAWTIN)
Private Secretary

Bob Peirce Esq
Foreign and Commonwealth Office

CONFIDENTIAL

SECRET 18A



etc

SLIF

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

17 June 1988

Dear Bob,

**HONG KONG: FORMATION OF THE FIRST SPECIAL
ADMINISTRATIVE REGION GOVERNMENT**

The Prime Minister has considered the Foreign Secretary's minute of 15 June proposing a number of adjustments in our proposals on the formation of a first government of Hong Kong after 1 July 1997. She is content for these to be put to the Chinese later this month.

I am copying this letter to the Private Secretaries to the Lord President, Home Secretary, Lord Privy Seal, Defence Secretary, Attorney General and Sir Robin Butler.

Yours sincerely,
Chris Powell

C D POWELL

R. N. Peirce, Esq.,
Foreign and Commonwealth Office

SECRET

SLW



PM/88/025

PRIME MINISTER

Prime Minister
Content its own
proposals?

COM 15/10

Hong Kong: Formation of the First Special
Administrative Region (SAR) Government

1. I minuted to you on 25 February, ^{plus} setting out ideas which we proposed to put to the Chinese on the formation of the first government of the Hong Kong SAR after 1 July 1997.

2. These have since been the subject of intensive exchanges with the Chinese at Ministerial and official level. We have succeeded in engaging the Chinese in a serious dialogue on the matter. We have also made some progress towards our objectives of continuity in 1997 and influence over the appointment of those who will serve immediately thereafter. Discussions have come to focus on arrangements for the legislature. We expressed concern about Chinese ideas, subsequently included in the draft Basic Law, which would have represented a considerable break in 1997. We suggested instead that members of the last Legislative Council before 1997 should be elected in a way which would permit them to remain in office across the change of sovereignty. This would involve holding elections in 1995 which would serve two purposes: they would produce the last LegCo and, under the separate supervision of a body established by the Chinese Government, they would produce the first SAR legislature. This would be established on 1 July 1997, with the existing members confirmed in office.

3. The initial Chinese reaction to these ideas has been reasonably positive. I propose that we pursue our exploration of them in forthcoming contacts with the

/Chinese



Chinese. To assist progress towards a mutually satisfactory outcome we would signal our readiness in principle to accept Chinese proposals for the establishment shortly before 1997 of a Preparatory Committee of mainland and Hong Kong members to prepare for the change of sovereignty, but only on condition that they are reconciled with our own ideas for continuity in the membership of the legislature. If this works, we shall have achieved an extremely important boost to confidence that Hong Kong's system of government will continue beyond 1997; currently, partly because of uncertainties created by the Basic Law, there are real worries about this.

4. It is also necessary to consider an adjustment in our position on the first Chief Executive of the SAR. We had earlier suggested to the Chinese that a special post might be created at an appropriate stage before 1997; that the functions to be exercised by the future Chief Executive would be gradually transferred to it; and that the Chief Executive (Designate), once selected following consultation with the Chinese, would occupy it in advance of 1 July 1997. The Chinese feel it would be inappropriate for the Chief Executive (Designate), once selected, to occupy a position within the Hong Kong Government. This considerably weakens the argument for creation of a special post, since it cannot achieve the continuity in 1997 which we seek. I propose that we should now offer alternative ideas. These would aim for continuity by giving the Chief Executive (Designate) briefing and involvement outside the formal government structure, rather as a President-elect of the United States is briefed in the period before he formally takes office. If we decide that certain powers of the Governor should still be devolved or delegated before 1997, it would be open to us to transfer them to the Chief Secretary.



5. These revised ideas would be put to the Chinese in a further paper, as a basis for a planned series of important contacts in the last week of June.

6. I am copying this minute to the Lord President of the Council, the Home Secretary, the Lord Privy Seal, the Defence Secretary, the Attorney-General and Sir Robin Butler.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
15 June 1988

HKONG future pt 20



CONFIDENTIAL



CDP
1/6

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

27 May 1988

Dear Secretary of State

HONG KONG DEFENCE COST AGREEMENT

Thank you for copying to me your letter of 19 May to Geoffrey Howe.

I share your concern both at the slow progress being made to settle this issue and at the apparent attempt by the Hong Kong Government to unpick the basis of the outline agreement negotiated with them in good faith. As you say, it is necessary to make it crystal clear to the Governor that we disapprove of these tactics and are not prepared to accept any agreement which has financial or operational penalties beyond those we have already conceded: Geoffrey's impending visit to Hong Kong is a useful opportunity for ensuring that this message is clearly understood.

I am copying this letter to the Prime Minister, Geoffrey Howe, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew and Sir Robin Butler.

Yours sincerely

19 JOHN MAJOR

(Approved by the Chief Secretary
and signed in his absence)

How's How's

Future

PART 20



FCS/88/106SECRETARY OF STATE FOR DEFENCECOP
25/5Hong Kong: Defence Costs Agreement

1. Thank you for your minute of 19 May about the implementation of the measures approved by Ministers for a new Defence Costs Agreement (DCA) with the Hong Kong Government.
2. I share your regret that progress on this has been slow. I do not however believe that the Hong Kong Government would accept your description of their aim in the exchanges which have taken place since agreement was reached, on the key features of the new DCA. It would in our view have been possible to make greater headway if expert discussions had been better prepared and there had been greater willingness to explore positions by telegram. But I understand that your negotiators are now in more effective contact with their Hong Kong counterparts and that a further round of negotiations is in prospect.
3. I hope it will be possible for the negotiations now to be brought quickly to a conclusion, without fresh issues of substance being raised on either side which would have the effect of causing the exchanges to drag on. Although I do not propose to involve myself in the detail of the matter, I shall certainly make this clear while I am in Hong Kong at the end of this week. I fully understand your concern to preserve the position that Ministers have approved.



4. I am sending copies of this minute to the Prime Minister, the Secretaries of State for the Home Department and for Trade and Industry, the Lord President, the Chief Secretary, the Attorney General and Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
25 May 1988

HONG KONG FARM PT 20





MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

MO 6/19/1V

TELEPHONE 01-218 9000
DIRECT DIALING 01-218

19H May 1988

070
 Sir Geoffrey,

BF || Amet FCS rny
 92

HONG KONG: DEFENCE COSTS AGREEMENT

I am becoming increasingly concerned at the slow progress of discussions aimed at implementing the measures approved by Ministers in late March for a new Defence Costs Agreement (DCA) between the Ministry of Defence and the Hong Kong Government (HKG).

My Department's position is, I believe, quite clear. Ministers have considered the issues and reached a decision on them. We are prepared to sign either Heads of Agreement recording the changes endorsed by Ministers and Exco; or a new Memorandum of Understanding consisting of the existing document amended to reflect these changes; or both. But if, as the HKG seem to wish, the agreement is to include additional points of substance, then these must be formally negotiated and submitted for Ministerial approval before any agreement can be signed.

Ever since the outline agreement was endorsed by Ministers, the HKG's aim appears to have been to unpick it and to secure additional financial or administrative advantages for themselves. If successful, this process would result in equivalent disadvantages to us. I am simply not prepared to accept the imposition of any further financial penalties on the Department, over and above those we have already conceded. In embarking on the further full round of

The Rt Hon Sir Geoffrey Howe QC MP



negotiations that now appears to be necessary, the MOD team will be instructed to negotiate tenaciously in order to preserve the position that Ministers have approved. If the HKG are insistent on introducing new issues of substance, there are numerous and significant points that we ourselves would intend to introduce. The negotiation of such important issues of substance cannot be undertaken by telegram, but we stand ready to welcome the HKG team to London once more.

The HKG seem to have some difficulty in understanding this position and it is obvious to me that it needs spelling out to them again as unambiguously as possible. I hope you will agree that this should be done forthwith. I understand that you yourself will be visiting Hong Kong shortly and this will provide a useful opportunity to ensure that the HKG are in no doubt about HMG's position.

I am sending copies of this letter to the Prime Minister, the Secretaries of State for the Home Department and for Trade and Industry, the Lord President, the Chief Secretary, the Attorney General and Sir Robin Butler.

Yours very,

George Younger

Charles - In case any body
in the F.C.O. thinks we do not
have confidence in the future of Hungary!
With Compliments

from

Henry ~~Westwick~~

MATHESON & Co., LTD

6/5

LONDON

Price Analyst
CSP

South China Morning Post

Founded in 1903

FRIDAY, MAY 6, 1988

Jardines' land deal: from sinner to saint

FOUR years ago the Jardines group of companies was the target of wide criticism over its so-called desertion of Hongkong through announcing that it was shifting its financial base to the safer haven of Bermuda. That decision was taken when there was a crisis of confidence in the territory, prior to the signing of the Sino-British Joint Declaration.

Now, as Hongkong again shows ~~worries~~ about the future this time over the text of the Basic Law - Jardines is prominent once more. However, this time the corporate manoeuvres should have the opposite effect to those made back in 1984. Whereas Jardines was attacked then, it should be praised today.

That Jardines, a major British-controlled company, has spent \$1.8 billion to ensure its hold on Hongkong Land against locally-controlled companies, can be seen as a significant vote of confidence in the territory, particularly for the business community.

When Mr Li Ka-shing, Mr Lee Shau-kee and Mr Cheng Yu-tung called on Mr Simon Keswick on Wednesday afternoon it was to make him an offer they hoped he could not refuse. They offered to buy out the Keswick family's stake in Hongkong Land, the territory's biggest landlord. The tycoons, three of the richest men in Hongkong,

wanted to add the Keswick shares to the eight per cent they owned.

If anyone thought a British company would not want to have such a big share of its assets confined to the property sector at a time of uncertainty they were wrong. Mr Keswick demonstrated his faith in the future of Hongkong. He refused to sell, instead buying their shares and extracting from them a pledge not to buy any major stakes in Keswick family companies for seven years.

The action by Mr Keswick - who certainly had the company's commercial interests at heart, with property prices so strong at present - could not have come at a better time for Hongkong. "Perhaps now people will believe us," said Mr Keswick. "We are part of the fabric of Hongkong. We are here to stay." His declaration comes as many are feeling uncertain about and sensitive to any hint of change related to the transfer of sovereignty in 1997. This week the Government appointed a task force to investigate the number of local people seeking new homes abroad. The greatest worry is not so much that some people are leaving, but that a majority of them are from the talented, middle-management sector of the workforce.

The move by Jardines will not stem the tide on its own. But it should be taken for what it is - a positive sign on a clouded horizon.

W

A

File

DAS
cc PC



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

17 March 1988

Dear Brian,

HONG KONG DEFENCE COSTS: RENEGOTIATION

The Prime Minister has considered your Secretary of State's minute of 14 March, agreed with the Foreign Secretary, about the stage reached in the negotiations over Hong Kong defence costs. She takes the view that we cannot, in present circumstances in Hong Kong, press the Hong Kong Government for further concessions and that we must therefore accept their offer as it now stands. Since there appear to be insuperable legal obstacles to waiving payment of VAT, it will be for the Ministry of Defence and the Foreign and Commonwealth Office to finance the remaining shortfall and the two Secretaries of State should discuss the apportionment of this between them.

I am copying this letter to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretaries of State for the Home Department and Trade and Industry, the Lord President, the Attorney General and Sir Robin Butler.

Yours sincerely,
Chris Zeman

C D POWELL

Brian Hawtin, Esq.
Ministry of Defence

GA

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CCPC
(2)



FROM: CHIEF SECRETARY
DATE: 17 March 1988

Ric Hunter

CCP

mt

17/3

PRIME MINISTER

HONG KONG DEFENCE COSTS: RENEGOTIATION

I have seen George Younger's *with CCP?* minute of 14 March.

2. It is most unfortunate that the negotiations are still some £7 million short of a substantive 70-30% split. It would appear that neither George nor Geoffrey Howe believe we should press Hong Kong any further.

3. George raises the possibility of some "waiver" of VAT. I am afraid that would not be possible. The VAT in question arises quite normally when MOD purchase equipment and stores from their suppliers. The fact that some of those purchases are used by the Hong Kong garrison provides no legal basis for a waiver.

4. I would not press for further negotiation with Hong Kong if it is accepted that there should be no claim on the reserve in respect of the shortfall by comparison with a true 70-30% apportionment. As George says, the gap amounts to less than £1 million a year over the life of the Agreement. Such a sum must be containable within existing budgets. It does occur to me that, as the reasons for not pressing Hong Kong any harder are essentially foreign policy ones, Geoffrey might like to consider making some compensatory payment to George out of the cash limits on the 1988-89 diplomatic and aid programmes.

5. I am copying this minute to Geoffrey Howe, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew and Sir Robin Butler.

John Major

JP JOHN MAJOR

(Approved by the CST and signed in his absence).

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PRIME MINISTER

HONG KONG DEFENCE COSTS AGREEMENT

The attached minutes deal with the stage reached in the Hong Kong Defence Costs negotiations.

The essence is that we have virtually got the 70-30 split we wanted, but there is still a difference of some £8-10 million over the period up to 1997 (i.e. £1 million a year). This arises mostly from VAT on military equipment purchased in the UK for use in Hong Kong.

The Foreign Secretary and Sir Percy Cradock take the view that the Hong Kong Government have been pushed to the brink (EXCO is already split) and that it would be damaging to our relations with Hong Kong to press them any further. The Defence Secretary accepts this assessment but does not want to get stuck with the bill. The Chief Secretary thinks that the MoD and FCO have negotiated without much gumption. But he is not going to stand in the way of what is proposed provided that the Treasury are not expected to find the money.

You have indicated privately that you agree that we should not ask more of Hong Kong. The question is therefore how we find the missing £8-10 million. The options seem to be:

- to ask the Treasury to accept that VAT should not be chargeable in these circumstances;
- to ask the MoD and FCO between them to find the extra £1 million a year on their budgets; or
- to make it a charge on the Reserve.

In practice non-payment of VAT is not an option: we are legally bound by various EC directives to levy it. So the real choice is between telling the MoD and FCO to find the extra money (and leaving them to fight out the division

①
Why is VAT payable - see below.
Usually we have discretion to make a concession, not published.

Why - VAT is not usually charged on items which are large exports

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between them) or turning to the Reserve (which may not be feasible, given that these are annual payments stretching well beyond the present public expenditure projections).

You will have to pronounce to break the log-jam. Agree to instruct MoD/FCO to find the extra funds?

C.D.P.

(C. D. POWELL)

16 March 1988

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PRIME MINISTER

15 March 1988

HONG KONG DEFENCE COSTS AGREEMENT

DEFENCE SECRETARY'S MINUTE OF 14 MARCH

1. Following your instructions of 2 February, our negotiators have had another round with Hong Kong. They have done well and have almost closed the gap between the two sides. The remaining difference amounts to £8-10m, just under 1% of the total estimated cost of the garrison up to 1997. It would mean a payment of a little under £1m a year over the life of the next Defence Costs Agreement.

2. Hong Kong, however, have stuck at this point and the Defence Secretary himself recognises that there is no prospect of persuading them to move further. We are at an impasse.

3. We now have to weigh the costs above against the political effect of trying to extract further concessions from Hong Kong. The Foreign Secretary believes we would be running disproportionate political risks by taking this course. Given the sensitive state of Hong Kong opinion, their disposition to believe that our commitment is slipping and that we are ready to subordinate our Hong Kong interests to our Chinese interests, I believe he is right. The issue is aggravated by the fact that the bulk of the remaining money at issue, £7m of the £8-10m, represents the payment of VAT on military equipment purchased in the UK for use in Hong Kong. Hong Kong have never considered that VAT is a legitimate charge in defence costs arrangements. They feel strongly that they should not pay a UK tax for services and goods provided in Hong Kong. You will see that Exco and S Y Cheung in particular have seized on the point. It would be very damaging to try to override them. If we do insist,

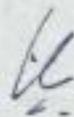
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there is the danger outlined in paragraph 5 of the Defence Secretary's minute, ie that Legco would refuse to vote the necessary funds, that there would be an open crisis between Hong Kong and London, and that the Governor's personal position would be damaged.

4. I do not believe this would be worth it. Even if we stop now the Governor will have some difficulty in getting the package through Exco. He has to depend on the unofficial members and has only a slim majority there. He thinks he can manage it, but we cannot reasonably ask him to do more.

5. If this reasoning is accepted the best course will be to ask the Treasury to accept that VAT would not be chargeable in the circumstances. This will not be agreeable, but in my view it is the lesser evil.



PERCY CRADOCK



c/r

MO 6/19/11

PRIME MINISTERHONG KONG DEFENCE COSTS: RENEGOTIATION

As foreshadowed in the exchange of Ministerial correspondence last month, Ministry of Defence officials returned to Hong Kong on 23rd February to resume the adjourned fourth round of negotiations on the future apportionment of defence costs. Discussions took place between 25th-29th February; the MoD team have reported following their return to the UK; and I have subsequently discussed the outcome with the Foreign and Commonwealth Secretary. This minute has been agreed with him.

2. As instructed, the MoD team pressed hard for an effective 70/30 apportionment, while being prepared to consider devices that would enable this to be presented as a 65/35 split in Hong Kong. After some tough negotiations, the Hong Kong side finally tabled proposals that went a long way towards meeting our requirements; these proposals (annotated to clarify the real value of the offer as far as the MOD is concerned) are outlined at Annex A. The MoD team, for their part, left with the HKG side a range of illustrative options that would have allowed our requirements to be met comfortably; these options are set out at Annex B. The team did not at that stage feel that an impasse had been reached, and were prepared to continue substantive discussions, but the HKG side were unwilling either to move beyond the position they had taken up or to discuss any further options. The MoD negotiators therefore undertook to return to London to put to Ministers the position that had been reached; and the HKG side, for their part, undertook to report to the Executive Council.



3. The proposal tabled by the HKG fell short of a true 70/30 apportionment by some £8-10 million, equivalent to just under 1% of the total estimated cost of the garrison to 1997 (although we do not yet have precise figures, this gap may have been increased by the effects of the recent HKG budget). The gap could easily be bridged by making use of any one of a number of devices, including or additional to those set out at Annex B. But it appears that the HKG are, for local political reasons, unwilling or unable to be seen to be conceding the whole amount at issue. Moreover, they perceive the difference between the sides as a point of principle as to whether they should pay a share of input VAT on military equipment and stores purchased in the UK for use in Hong Kong (this would cost them £7 million over the period of the DCA). This is evidently a point of particular importance for Exco.

4. In terms of an agreement lasting to 1997, the remaining difference between the sides may be small; but to neither side is it insignificant. We have already conceded that the apportionment should be changed from 75/25 to 70/30, which equates to an increased burden of some £53 million over the period to 1997 - a substantial sum in the context of current defence budgetary problems. Furthermore, the offer that the HKG have now made will require further calls on the defence budget. First, if future VAT is excluded from any new DCA the full cost will nevertheless fall to the defence budget. Second, £19 million of the compensating devices that the HKG have offered in return for an apparent 65/35 apportionment would be paid next financial year in final settlement of the 1987/88 accounts. This is less valuable to MoD in the form of an immediate lump sum than it would be if it accrued over future years, since it is not in FY 1988/89 that I expect the main pressures on the defence budget to arise. (There were, of course, alternative devices, some of which are set out at Annex B, which would have had an equivalent value to the proposed £19 million cash settlement and would have constituted a more satisfactory package from MoD's point of view).



5. It seems clear, from what the Governor has reported about the Exco discussion, that the HKG offer on the table is effectively a final one, and that it would be politically difficult, and in the Foreign and Commonwealth Secretary's view virtually impossible, for them to improve it. We must therefore accept that we are effectively at an impasse in the negotiations. If a roll-over of the present 75/25 agreement is politically impracticable, the possible courses of action open to us are as follows:

- a. to accept the HKG's 65/35 proposal, and the measures they have offered to move this towards a true 70/30 apportionment; but to insist on the full extent of movement towards 70/30, leaving the HKG to suggest ways of closing the remaining 1% - by, for example, drawing on any of the devices that are so far unexploited, including those at Annex B, or by agreeing to continue to share the costs of the Training Team Brunei and Nepal works services.
- b. if the HKG prefer not to find ways of closing the remaining gap, to require them to accept that the apportionment of the future DCA would not be 65/35 but (counting down from 70/30) a slightly less favourable split, such as 66/34;
- c. to accept the HKG offer as it now stands.

The third option would leave me in some difficulty in defending its impact, in defence budgetary terms, against auditors' and Parliamentary enquiries. This difficulty could of course be reduced if it were possible to find other ways of protecting the defence budget against the detriments referred to in paragraph 4 above. If this was not possible, the budgetary implications are such that I would have no option but to recommend that we press the HKG for further concessions (ie, a. or b. above), despite the limited likelihood of a successful outcome.



6. The Foreign and Commonwealth Secretary very much hopes that a solution to my budgetary difficulties can be found which will enable us to settle on the basis of Hong Kong's offer (c. above), perhaps by the Treasury agreeing to waive the VAT. Our negotiators have achieved a result which is very close indeed to our agreed objective of a 70/30 split. The remaining gap amounts to less than £1 million a year over the life of the next agreement covering a total estimate of over £1 billion.

7. He wishes to underline the point in paragraph 5 above about the political difficulties faced by the HKG; these are real and should not be underestimated. He believes that we would be running quite disproportionate political risks if we sought to push the HKG any further to bridge the remaining gap. In his judgement, the Governor has gone to the limits of what in local terms is politically feasible. He considers that it is of particular significance that Sir S Y Chung, the senior unofficial member of Exco, has already formally dissociated himself from support of the present HKG position precisely because that involves the concession of a compensating payment of the sum in dispute for VAT under the present DCA. This departure from consensus within Exco is highly unusual and demonstrates how close Exco is to outright rejection of the package. If we were to insist on further concessions, it is very likely that some members of Exco would refuse to commend the package, and as a consequence Legco would refuse to vote the necessary funds. The resulting open crisis between Hong Kong and London would weaken HMG's authority and local confidence at a time when it is vital for both to be sustained through the difficult years ahead. There would also be serious implications for the Governor's personal position.

8. I should be grateful for your views on the way forward. Once a solution is identified, officials will be instructed to reconvene with the HKG side in order to draw up Heads of Agreement which would be reflected in the necessary amendments to the existing MOU.



9. I am sending copies of this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of States for the Home Department and for Trade and Industry, the Lord President, and the Attorney General and to Sir Robin Butler.

C.Y.

Ministry of Defence

14th March 1988



ANNEX A

<u>Offer Proposed by Hong Kong Government (EM)</u> (annotated by MoD)	<u>HKG Figs</u>	<u>(MoD Figs)</u>
Total Estimated Cost of Garrison to 1997	1,059	(1,069)
<u>Items to be funded by HKG</u>		
Works Services in Hong Kong	72	
Local taxes and beneficial services ("Revenue Forgone")	51	
<u>Items to be funded by MoD</u>		
Training Team Brunei ("TTB")	10	
Works Services in Nepal	<u>6</u>	<u>139 (+VAT @ 10)</u>
Total Estimated Cost of New DCA	920	
HKG's Share @ 65%	598	
+ Cost of Works Services and Revenue Forgone	<u>123</u>	
Total Cost to HKG	<u>721</u>	
MoD's Share @ 35%	322	
+ Cost of TTB and Nepal Works Services	<u>16</u>	
Total Cost to MoD	<u>338 (+VAT: 348)</u>	
<hr/>		
MoD's Required Share of Total Estimated Cost of Garrison = 30% of 1,059 (1,069)	318	(321)
Shortfall to be Made Up	20	(27)
<u>HKG Offer:</u>		
Payment Equivalent to Arrears of Past VAT	16	
Refund of Past Salaries Tax on Allowances	<u>3</u>	
	19	
Effective MoD Apportionment = $\frac{319}{1,059} = 30.1\%$	$(\frac{329}{1,069} = 30.8\%)$	

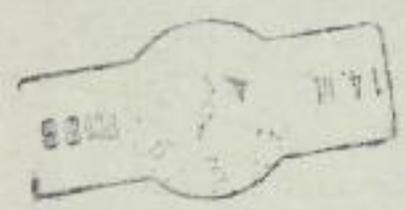
ANNEX BOptions Set Out by Ministry of Defence

The following proposal by the Ministry of Defence represents an illustrative DCA package that makes full use of all the elements that have individually been discussed. A variety of selections from these elements is possible to make up the full value of the compensating adjustments needed to allow movement from a true 70/30 apportionment to an apparent 65/35.

2. Items to be removed from the new DCA and wholly funded by one side or the other

	<u>Total Estimated Cost (£M)</u>
a. <u>To be funded by the MoD</u>	
Works Services in Nepal	6
Training Team Brunei	10
UK Input VAT	10
b. <u>To be funded by the HKG</u>	
Works Services in Hong Kong	72
Revenue Forgone	51
3. <u>Payments to be made by the HKG outside the new DCA</u>	
Arrears of VAT (sum variable depending on the extent to which interest is included)	16-23
Refund of past salaries tax on allowances	3
4. Waiver by the HKG of claim for reimbursement of share of value of equipment and stores backloaded from Hong Kong to UK (estimated)	20
5. The cost of the items remaining in the DCA to be shared between the two Governments on a 65/35 apportionment.	

HONG KONG : Future PT20 . . .



COAST GUARD

C.D.P.
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162561
MDHIAN 0769

CONFIDENTIAL
FM HONG KONG
TO DESKBY 070900Z FCO
TELNO 0945
OF 070330Z MARCH 88

FOLLOWING FOR GILLMORE, DUSS, FROM MCLAREN

DEFENCE COSTS AGREEMENT

1. IT MAY BE HELPFUL, AS MINISTERS CONSIDER THE WAY AHEAD, IF I GIVE MY PERSONAL ASSESSMENT OF THE POSITION WHICH WE HAVE REACHED. THIS IS MY OWN VIEW AND NOT (NOT) THAT OF THE HONG KONG GOVERNMENT, ALTHOUGH I HAVE NATURALLY DISCUSSED THE ISSUE WITH THE GOVERNOR.

2. I HOPE THE SUBSTANCE OF THE HONG KONG GOVERNMENT POSITION IS NOW ENTIRELY CLEAR TO THOSE CONCERNED IN LONDON. I HAVE HOWEVER SUGGESTED TO THE GOVERNOR THAT HE SETS IT OUT AGAIN IN A SEPERATE TELEGRAM FOR THE AVOIDANCE OF ANY POSSIBLE DOUBT.

3. WITHOUT DETAILED KNOWLEDGE OF THE NEGOTIATIONS, AND INDEED OF THE MAKE-UP OF THE CURRENT DCA, IT IS VERY DIFFICULT TO COMMENT USEFULLY ON THE DIFFERENT PERCEPTIONS OF THE TWO SIDES AS REVEALED IN THE EXCHANGES OF TELEGRAMS. BUT AS I UNDERSTAND IT THERE IS A CAS DIFFERENCE OF AROUND POUNDS 8 MILLION BETWEEN THE MOD REQUIREMENT AND WHAT THE HKG ARE PREPARED TO PAY. THIS GAP COULD BE CLOSED IF THE HONG KONG GOVERNMENT WERE PREPARED TO INCLUDE PAYMENT OF VAT AS A COST IN THE NEW DCA. THEY ARE NOT HOWEVER WILLING TO DO SO. THERE IS A DEEP-ROOTED OBJECTION HERE TO MAKING A PAYMENT TOWARDS A BRITISH TAX INCURRED ENTIRELY IN THE UK. THIS OBJECTION, WHICH IS ONE OF PRINCIPLE, REMAINS WHETHER THE SUM IS REGARDED AS A DIRECT PAYMENT OR AS A PAYMENT IN LIEU. FOR THAT REASON IT IS, I AM AFRAID, UNHELPFUL TO STATE, AS IN THE MOD'S UN-NUMBERED TELEGRAM OF 4 MARCH, THAT VAT IS NOT AN ISSUE OF PRINCIPLE SO LONG AS THE FULL DIFFERENCE IS COVERED. THE SUM OF POUNDS 8 MILLION COULD (COULD), IT IS TRUE, BE DEALT WITH IN SOME DIFFERENT MANNER BUT THE HKG DO NOT BELIEVE THAT THEY COULD GET AWAY WITH EVADING THE ISSUE IN THIS WAY.

4. IT WOULD EQUALLY BE A MIS-READING OF THE SITUATION TO SUGGEST THAT POUNDS 8 MILLION IS AN INSIGNIFICANT SUM WHICH THE HONG KONG GOVERNMENT COULD MAKE UP WITHOUT DIFFICULTY. BUDGETARY DISIPLINES ARE AS TIGHT IN HONG KONG AS IN THE UK, AND CASH FOR GOVERNMENT

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DEPARTMENTS AS HARD TO COME BY. BUT THE ARGUMENT THAT HONG KONG IS A WEALTHY TERRITORY WHICH COULD AFFORD TO PAY MORE IS IN ANY CASE OF LIMITED RELEVANCE.

5. THE ISSUE MUST OF COURSE BE SEEN IN A WIDER CONTEXT. SEEN FROM LONDON, IT IS THE MOD WHICH HAS SHOWN FLEXIBILITY IN THE NEGOTIATIONS BY MOVING FROM 75:25 TO 70:30 WHILE THE HONG KONG SIDE'S MOVEMENT (FROM AN UNREALISTIC OPENING POSITION) HAS BEEN MORE APPARENT THAN REAL. THE PERCEPTION HERE IS VERY DIFFERENT. IT IS MY ASSESSMENT THAT THE HONG KONG GOVERNMENT HAVE NOW BEEN PUSHED TO THE LIMITS OF WHAT, IN LOCAL TERMS, IS POLITICALLY FEASIBLE. IT IS OF PARTICULAR SIGNIFICANCE THAT SIR S.Y. CHUNG, THE SENIOR UNOFFICIAL MEMBER OF EXCO, HAS ALREADY FORMALLY DISSOCIATED HIMSELF FROM SUPPORT FOR THE PRESENT HONG KONG GOVERNMENT POSITION, PRECISELY BECAUSE THAT INVOLVES THE CONCESSION OF A COMPENSATING PAYMENT OF THE SUM IN DISPUTE FOR VAT UNDER THE EXPIRING DCA. THIS DEPARTURE FROM THE CUSTOMARY CONSENSUS IS HIGHLY UNUSUAL, AND DEMONSTRATES HOW CLOSE EXCO IS TO OUTRIGHT REJECTION OF THE OUTCOME OF THE NEGOTIATIONS.

6. EVEN WITH THE PRESENT RELUCTANT EXCO SUPPORT FOR THE HONG KONG GOVERNMENT'S POSITION, IT WILL BE TOUCH AND GO WHETHER LEGCO SUPPORT CAN IN TURN BE SECURED. COMMENTS FROM LEGCO MEMBERS OVER THE PAST FEW DAYS HAVE ALREADY MADE IT CLEAR THAT A NEW DCA OF THE SHAPE NOW EMERGING WILL FACE A HOSTILE RECEPTION IN THE FINANCE COMMITTEE. IT IS MY JUDGEMENT THAT IF WE NOW PRESSED FOR PAYMENT OF THE FINAL POUNDS 8 MILLION EXCO WOULD BE VERY UNLIKELY TO ADVISE THE GOVERNOR TO MAKE ANY FURTHER CONCESSION AND MIGHT WELL REFUSE. IN THESE CIRCUMSTANCES WE COULD BE CERTAIN THAT EXCO UNOFFICIALS WOULD REFUSE TO COMMEND TO LEGCO ANY OUTCOME WHICH WE SOUGHT TO IMPOSE UPON THEM: AND THAT IN TURN THE FINANCE COMMITTEE WOULD REFUSE TO VOTE THE NECESSARY FUNDS. THE OPEN CRISIS IN RELATIONS BETWEEN HONG KONG AND LONDON WHICH WOULD THEN ENSUE COULD ONLY WEAKEN HMG'S AUTHORITY AND LOCAL CONFIDENCE AT A TIME WHEN IT IS VITAL FOR BOTH TO BE SUSTAINED IF HONG KONG IS TO BE STEERED THROUGH THE DIFFICULT YEARS AHEAD. THE SERIOUS IMPLICATIONS FOR THE GOVERNOR'S PERSONAL POSITION DO NOT NEED TO BE SPELT OUT.

7. IN THE MOST RECENT ROUNDS WE HAVE NEGOTIATED TENACIOUSLY, IN ACCORDANCE WITH MINISTERS' INSTRUCTIONS. WE HAVE SECURED A SUBSTANTIAL SHIFT IN THE HONG KONG GOVERNMENT'S POSITION WHICH COMES CLOSE TO BRIDGING THE WHOLE GAP BETWEEN THE TWO SIDES. THE REMAINING SHORT-FALL AMOUNTS TO LESS THAN POUNDS 1 MILLION A YEAR OVER THE PERIOD OF THE NEW AGREEMENT. WE WOULD BE RUNNING QUITE DISPROPORTIONATE POLITICAL RISKS IF WE SOUGHT TO PUSH THE HONG KONG

PAGE 2
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GOVERNMENT ANY FURTHER.

8. YOU MAY WISH TO PASS THIS TELEGRAM TO THE MOD (COUSINS, AUS(F))
AND THE TREASURY (ROBSON).

WILSON

YYYY

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PS/LORD GLENARTHER

PS/PUS
MR GILLMORE
MR MCLAREN

ADDITIONAL 2

MR B COUSINS, AUS/MOD

MR S ROBSON, H M TREASURY

NNNN

SECRET ¹⁶

162544
MDHIAN 0768

SECRET
FM HONG KONG
TO DESKBY 071300Z FCO
TELNO 965
OF 071130Z MARCH 88

FOLLOWING FOR PAUL, HKD FROM GOVERNOR

DEFENCE COSTS AGREEMENT.

I UNDERSTAND FROM CHRISTOPHER HUM THAT THE MOD HAVE SAID THEY ARE STILL NOT CLEAR ABOUT HKG'S OFFER IN THE 4TH ROUND OF THE NEGOTIATIONS.

2. DETAILS WERE SET OUT IN MY TELNO 882. THE OFFER WAS MADE AD REFERENDUM THE EXECUTIVE COUNCIL. AS MY TELNO 881 MADE CLEAR THE OFFER WAS SUBSEQUENTLY ENDORSED BY EXCO. TO RECAP, IT IS -

A) THERE SHOULD BE A CORE APPORTIONMENT OF 65:35 APPLIED TO THE NEW DCA:

B) OUTSIDE THIS CORE, HKG SHOULD BEAR ALL THE COSTS ASSOCIATED WITH WORKS SERVICES AND REVENUE FOREGONE IN HONG KONG:

C) SIMILARLY, MOD SHOULD BEAR ALL THE COSTS ASSOCIATED WITH THE TRAINING TEAM BRUNEI AND WORKS SERVICES IN NEPAL:

D) HKG WOULD CONTRIBUTE AS A RECONCILIATION ON THE PRESENT DCA SUMS EQUIVALENT TO GBP16 MILLION AS A COMMERCIAL SETTLEMENT OF THE DISPUTE OVER PAST VALUE ADDED TAX (VAT) AND GBP3 MILLION FOR PAST SALARIES TAX ON ALLOWANCES, NEXT WORD UNDERLINED, BUT HKG WOULD NOT MAKE ANY PAYMENTS IN RESPECT OF VAT UNDER THE NEW DCA.

3. I HAVE SEEN THE UNNUMBERED TELEGRAM OF 4 MARCH FROM SEC(O)(C) COMMENTING ON THE HONG KONG ACCOUNT OF THE NEGOTIATIONS SENT TO YOU. THERE ARE FOUR GENERAL POINTS WHICH ARE IMPORTANT AND NEED TO BE DEALT WITH:

(1) THE REMAINING DIFFERENCE BETWEEN THE TWO SIDES DOES INDEED APPEAR TO BE THE SUM ATTRIBUTABLE TO VAT. WHETHER OR NOT THIS SUM IS INCLUDED AS A LEGITIMATE CHARGE ON THE DCA ALTERS THE CALCULATION OF THE BASE LINE COST. WE HAVE WORKED ON A BASE LINE

PAGE 1
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699
COST OF POUNDS 1059 MILLION. OUR FIGURES FLOW FROM THAT. THEY SHOW, AS I HAVE POINTED OUT IN MY TELEGRAMS, THAT WE HAVE OFFERED COMPENSATING ADJUSTMENTS OF POUNDS 52 MILLION TO GIVE AN OVERALL DIVISION OF COSTS OF 69.1 - 30.1. THE MOD ADD POUNDS 10 MILLION, ATTRIBUTABLE TO FUTURE VAT, TO THEIR BASE LINE. CONSEQUENTLY THEY COME UP WITH DIFFERENT ANSWERS ON OTHER FIGURES.

(II) THE ISSUE OF VAT IS IMPORTANT TO HONG KONG. WE HAVE NEVER ACCEPTED IT AS A LEGITIMATE CHARGE UNDER THE OLD AGREEMENT. WE DO NOT ACCEPT IT AS A LEGITIMATE CHARGE UNDER THE NEW ONE.

(III) MOD NEED HAVE NO CONCERN ABOUT WHETHER A COMPLETE ACCOUNT OF THEIR POSITION WAS GIVEN TO EXCO. I UNDERTOOK TO DO SO. IT WAS DONE. THEIR POSITION WAS FULLY CONSIDERED BY EXCO. MEMBERS OF EXCO COULD, OF COURSE, SEE IMMEDIATELY THAT THE DIFFERENCE BETWEEN THE TWO SIDES CENTERED ON WHETHER OR NOT A SUM ATTRIBUTABLE TO FUTURE VAT WAS INCLUDED AS A LEGITIMATE COST.

(IV) BREAKDOWN OF COSTS INTO GENERAL CATEGORIES IS IMPORTANT, PARTICULARLY FOR EXCO BUT PROBABLY ALSO FOR LEGCO. MISS LYDIA DUNN, THE SENIOR MEMBER OF LEGCO, TAKES A VERY KEEN INTEREST IN THIS POINT. SO DO OTHERS. FOR SUGGESTIONS SEE MIFT.

4. I DO NOT PROPOSE TO COMMENT ON OTHER DETAILS IN THE MOD TELEGRAM FROM SEC(O)(C), NOR ON THE TONE ADOPTED IN IT. I TAKE IT THAT THE TELEGRAM WAS REALLY INTENDED FOR A WHITEHALL AUDIENCE RATHER THAN THE HONG KONG GOVERNMENT. THE ONLY POINT THAT NEEDS TO BE MADE IS THAT, IF THE MOD FEEL THAT THE POINTS IN THE TELEGRAM ARE SUBSTANTIVE AND IMPORTANT, THEY COULD HAVE BEEN RAISED DURING THE 4TH ROUND OF NEGOTIATIONS. I UNDERSTAND THAT THEY WERE NOT.

WILSON

YYYY

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PAGE 2
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→ Tony

SECRET ¹⁵

155575
MDHIAN 0471

A.L.

V. Persemanic

Our joint note with
mod must be right

And (P) yes

See this, I think?

SECRET
FM HONG KONG
TO DESKBY 031230Z FCO
TELNO 0921
OF 031200Z MARCH 88
INFO IMMEDIATE NEW DELHI

NEW DELHI FOR (PERSONAL FOR LORD GLENARTHUR)

FOLLOWING PERSONAL FOR PAUL, HKD, FROM GOVERNOR

YOUR TELNO 618 : DEFENCE COSTS AGREEMENT

1. I AM DISTURBED BOTH BY THE TONE AND THE DETAIL OF THE MOD AND TREASURY REACTION. I HOPE IT IS REALISED WHAT A NARROW TIGHTROPE WE ARE WALKING HERE AND HOW CLOSE WE ARE TO THE MARGIN OF WHAT IS POLITICALLY POSSIBLE.
2. YOU WERE CORRECT IN YOUR UNDERSTANDING OF THE HONG KONG POSITION. THE OFFER MADE BY THE HONG KONG TEAM WAS A 65:35 APPORTIONMENT WITH COMPENSATING ADJUSTMENTS WHICH AMOUNT TO A TOTAL OF POUNDS 52 MILLION DETAILS OF THE ITEMS IN QUESTION ARE IN PARA 3 OF MY TELNO 882 USING A BASELINE ESTIMATE FOR THE TOTAL COST OF THE NEW DCA OVER 9 YEARS OF POUNDS 1,059 MILLION THIS GIVES AN OVERALL APPORTIONMENT OF 69.9:30.1. THE BASELINE ESTIMATE DOES NOT (NOT) INCLUDE A FIGURE FOR VAT. THIS PROPOSAL WAS ENDORSED BY EXCO: BUT VERY RELUCTANTLY AND AFTER A LONG ARGUMENT. MANY MEMBERS THOUGHT THAT THE HONG KONG OFFER HAD ALREADY GONE FURTHER TO SATISFY HMG'S NEEDS THAN WAS EITHER RIGHT OR POLITICALLY SALEABLE IN HONG KONG. ALL MEMBERS WERE ADAMANT IN THEIR VIEWS THAT THERE COULD BE NO JUSTIFICATION FOR INCLUDING VAT AS A COST IN THE NEW DCA.
3. YOU WILL REMEMBER THAT THE COLLECTIVE MINISTERIAL DECISION CONVEYED TO ME IN YOUR TELNO 346 SAID THAT THE PREVIOUS HONG KONG POSITION OF A STRAIGHT 65:35 APPORTIONMENT MEANT THAT THERE WAS NOW A GAP OF POUNDS 50 MILLION BETWEEN THE TWO SIDES. WHEN THE LATEST ROUND OF TALKS RESUMED THE MOD CLARIFIED THIS BY SAYING THAT POUNDS 50 MILLION WAS A ROUND FIGURE. THE CORRECT FIGURE WAS POUNDS 53 MILLION.
4. WE HAVE NOW OFFERED COMPENSATING ADJUSTMENTS OF POUNDS 52 MILLION. GIVEN THAT WE ARE DEALING WITH ESTIMATES, NOT PRECISE COSTS, THIS IS WITHIN A WHISKER OF REAL APPORTIONMENT OF 70:30. I SHOULD

MAKE IT CLEAR THAT OUR POSITION RESTS AT A 65:35 APPORTIONMENT WITH COMPENSATING ADJUSTMENTS. A 70:30 APPORTIONMENT IS THE MOD DESIDERATUM, NOT (NOT) A METHOD OF CALCULATION WE HAVE ACCEPTED. OUR UNDERTAKING WAS TO CONSIDER CAREFULLY AND IN GOOD FAITH MOD PROPOSALS FOR PUTTING MINISTERS' REQUIREMENT FOR A 70:30 APPORTIONMENT INTO A FORM ACCEPTABLE IN HONG KONG AND TO PUT FORWARD SUGGESTIONS FOR BUILDING ON A 65:35 APPORTIONMENT IN A MANNER ACCEPTABLE IN LONDON. I BELIEVE WE HAVE COMPLETELY FULFILLED THAT UNDERTAKING.

5. ON THE POINTS OF DETAIL RAISED BY MOD/TREASURY:

(I) IT IS DIFFICULT TO FOLLOW THE ARGUMENTS ABOUT LOCAL TAXES IN PARA 2 OF TUR. UNDER THE PREVIOUS DCA, VAT HAS ALWAYS BEEN IN DISPUTE. RATES WERE SPECIFICALLY DEALT WITH AS PAYABLE BY HM FORCES BECAUSE THEY REPRESENT A PAYMENT FOR SERVICES RATHER THAN A TAX. A SIDE LETTER TO THE PREVIOUS AGREEMENT SPELLS THIS OUT. WE ARE NOW SUGGESTING THAT, UNDER THE NEW AGREEMENT, WE WILL TAKE NO ADVANTAGE (AS WE DID IN THE PREVIOUS ONE) FOR REVENUE FOREGONE FROM LOCAL TAXES, FEES AS CHARGES. SIMILARLY, WE DO NOT EXPECT TO HAVE TO PAY ANYTHING TOWARDS LOCAL UK TAXES, I.E. VAT.

(II) MOD ARE CORRECT IN SAYING THAT OUR FIGURE OF 69.9. PERCENT ARISES BECAUSE WE EXCLUDE VAT FROM THE TOTAL. WE HAVE MADE THIS CLEAR. THE MOD OVERALL BASELINE, INCLUDING VAT, AMOUNTS TO POUNDS 1,069 MILLION. ON THIS BASIS OUR PROPOSAL IS ARGUABLY FOR 69.3. PERCENT. WE CANNOT UNDERSTAND HOW THEY GET A FIGURE OF 69.1 PERCENT. THEY DID NOT SET OUT AN ARITHMATICAL BASIS FOR THEIR CALCULATIONS SO WE CANNOT CHECK. OUR OFFER WAS HOWEVER PUT TO THE MOD WITH DETAILED MATHEMATICAL CALCULATIONS WHICH WERE NOT DISPUTED BY THEM.

(III) PAYMENT OF VAT IS A REAL PROBLEM AND A MATTER OF PRINCIPLE. IT IS HARD TO SEE HOW AN INTERNAL UK TAX IS A FAIR CHARGE FOR A DEFENCE COST AGREEMENT WHICH OPERATES OUTSIDE THE UK. FURTHERMORE IT IS A POINT TO WHICH EXCO WILL UNDOUBTEDLY CONTINUE TO ATTACH GREAT IMPORTANCE. IT IS UNREAL TO BELIEVE THAT PAYMENT OF VAT UNDER SOME OTHER HEADING COULD SIMPLY BE CONCEALED EVEN IF WE WISHED TO.

(IV) IT IS SURPRISING THAT MOD DO NOT ACCEPT THAT THE QUESTION OF VAT IS NOW THE ONLY ISSUE SEPERATING THE TWO SIDES. THEY CONFIRMED IN TERMS TOWARDS THE END OF THE FINAL MEETING THE FINANCIAL SECRETARY'S STATEMENT THAT THIS WAS THE CASE.

6. TWO ADDITIONAL POINTS ARE WORTH NOTING:

(I) WE ARE DEALING WITH ESTIMATES COVERING LARGE SUMS OVER A 9-YEAR PERIOD. IT MAKES LITTLE SENSE TO ARGUE ABOUT TENTHS OF ONE PERCENT.

(II) THE BUDGE SURPOLUS ANNOUNCED YESTERDAY IS IRRELEVANT TO THE POLITICAL PROBLEM WE ARE TRYING TO TACKLE. I UNDERSTAND THE CHANCELLOR OF THE EXCHEQUER ALSO FACES EMBARRASSINGLY HEALTHY PROSPECTS FOR HIS BUDGET: I DO NOT INTEND TO USE THIS AS AN ARGUMENT.

7. THE ESSENTIAL POLITICAL POINT REMAINS THAT WE SHALL HAVE DIFFICULTY GETTING A NEW DCA APPROVED BY A POLITICISED FINANCE COMMITTEE. WE ARE ALREADY BEYOND THE LEVEL OF APPORTIONMENT WHICH I COULD WITH CONFIDENCE SAY WOULD BE POLITICALLY SALEABLE. TO GET THROUGH THE PROPOSAL WHICH WE HAVE NOW PUT FORWARD WITH A PROSPECT OF SNIPING RATHER THAN EITHER BRUISING POLITICAL ATTACK OR FAILURE REQUIRES THE SUPPORT OF UNOFFICIAL MEMBERS OF EXCO. I ONLY JUST HAVE THAT FOR THE HONG KONG OFFER (AND EVEN THEN DO NOT HAVE THE SUPPORT OF THE SENIOR MEMBER, SIR S Y CHUNG, BECAUSE OF THE COMPENSATING PAYMENT OF THE SUM IN DISPUTE FOR VAT UNDER THE OLD AGREEMENT). THEIR SUPPORT CANNOT BE ASSUMED FOR ANYTHING LESS.

WILSON

YYYY

DISTRIBUTION

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NNNN



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

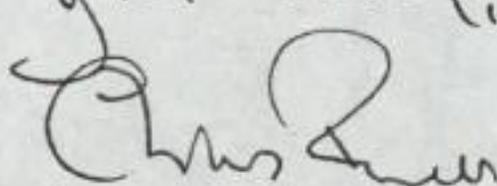
29 February 1988

Dear Tony,

HONG KONG: FORMATION OF THE FIRST SPECIAL ADMINISTRATIVE
REGION GOVERNMENT

The Prime Minister has considered the Foreign Secretary's minute of 25 February setting out a number of proposals which we might put to the Chinese Government affecting the formation of the First Special Administrative Region Government in 1997, together with the draft of the paper which it is intended to hand to the Chinese. She is content to proceed in the way set out in the Foreign Secretary's minute and has no comments on the paper for the Chinese.

I am copying this letter to the Private Secretaries to the Lord President, the Home Secretary, the Lord Privy Seal, the Defence Secretary, the Attorney General and Sir Robin Butler.

Yours sincerely,

(C. D. POWELL)

A. C. Galsworthy, Esq., C.M.G.,
Foreign and Commonwealth Office.

PRIME MINISTER26 February 1988HONG KONG: FOREIGN SECRETARY'S MINUTE OF 25 FEBRUARY

1. Now that we have overcome the problem of direct elections, the current most delicate issue between ourselves and the Chinese concerns the formation of the first Government of the Special Administrative Region (SAR), ie the first Government after July 1997.
2. The Chinese want to emphasise the change of sovereignty and have tended to think in terms of a new Government waiting in the wings to take over. This would constitute an alternative source of authority in the delicate run-up to the hand-over and would be very damaging to confidence.
3. We want to have the key figures, in particular the future Chief Executive, in place well before the hand-over so that there would be maximum continuity and in effect the train would go over the international frontier with a barely perceptible bump. This would mean consultations with the Chinese about appointments before 1997 but in return would maximise our chances of influencing the situation post-1997.
4. The process of persuading the Chinese is likely to take time. The first step is to avoid language in the Basic Law which would prevent the kind of transition we have in mind. Passages in the present draft Basic Law, due to be published in May, arouse our anxieties. We need therefore to put our ideas forward as soon as possible and the Chinese have in effect invited us to do so. The subject will be discussed during the visit of the Chinese Foreign Minister to this country next month and probably at the next meeting of the Sino-British Joint Liaison Group in Hong Kong between 8 and 11 March.

SECRET

5. The draft attached to the Foreign Secretary's minute meets our requirements. I recommend you approve the Foreign Secretary's proposal.



PERCY CRADOCK

SECRET

*Foreign Secretary's
paper signed
ms*

PRIME MINISTER

HONG KONG: FORMATION OF THE FIRST POST-1997 GOVERNMENT

The attached note by the Foreign Secretary deals with arrangements for the smooth transfer of Government in Hong Kong in 1997.

The background is that the latest proposals put forward by the Basic Law Drafting Committee would involve a rather sharp dividing line between the pre-1997 Government and its successor. We want to see the maximum continuity and have put our concerns to the Chinese, who have invited us to put forward some detailed proposals. So, although one is looking ahead some ten years, we have an excellent opportunity to influence Chinese thinking.

It is suggested that we put a paper to the Chinese covering the appointment of the first Chief Executive, of senior officials, of members of the Executive Assembly and the election of the first Legislature.

The general idea is to build on the proposal you have already approved of gradually transferring the powers to be held by the post-1997 Chief Executive to a Deputy Governor (who would be our appointee). From 1996, this post would be filled by a Chief Executive Designate, who would be selected after consultation with the Chinese. From 1995, we would start to inform the Chinese of high-level appointments in the Hong Kong Civil Service and from 1996 would put the Chief Executive Designate's nominees into their future posts, so that they could gain a year's experience in them. Similarly, we would try by consultation to ensure that members of the first Executive and Legislative Assemblies after 1997 will have served for at least a year before 1997.

In essence, we would be giving the Chinese a say over appointments from 1996 in the hope of (a) ensuring continuity and a smooth transition; and (b) giving us some say over the

SECRET

- 2 -

choice of people to run Hong Kong after 1997. By 1996, it will be only realistic to give the Chinese such a say (while we, of course, retain full responsibility). But equally we should extract as much benefit as we can from recognising the reality.

Sir Percy Cradock agrees with the proposals. His comments are attached.

C.D.P.

C D POWELL

26 February 1988

DASII

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C/SK
11A

PM/88/007

Agreed
ms.PRIME MINISTERHong Kong: Formation of the First Special Administrative
Region (SAR) Government

1. On 19 November 1986 OD(K) considered arrangements for the transfer of powers from the Governor of Hong Kong to the Chief Executive of the Hong Kong SAR in 1997. The sub-committee agreed that the post of Deputy Governor should be created at an appropriate time, with the possibility of the post being filled by the Chief Executive (Designate) at a later stage. I was invited to discuss the proposal with the Chinese Government without commitment.
2. A paper describing our proposal in general terms was duly passed to the Chinese Government. It has clearly been carefully studied: on a number of occasions our Chinese interlocutors have expressed interest in our ideas, while signalling that they would have difficulty in any arrangement which might tend to limit the range of possible candidates for the post of Chief Executive. But there has been no formal response.
3. OD(K) also concluded that it would be necessary to influence the Chinese drafting of the Basic Law so that it did not exclude the possibility of the post of Chief Executive (Designate) being established before 1997 with powers devolved by the Governor. We have sought to do so through various channels, emphasising to the Chinese the importance of institutional continuity during the transition of power over 1997. The Chinese have fully subscribed to the principle of continuity and a smooth transition while making it clear that the change of sovereignty must be appropriately marked.



4. However, the Basic Law Drafting Committee's latest proposals on arrangements for the formation of the first SAR Government include ideas which would represent a considerable break in 1997 and which would deny us influence over the structures and institutions to be put in place thereafter. These ideas, which are supported by some Hong Kong members of the BLDC, may appear in an Annex to the first full draft of the Basic Law, which is due to be published in May.

5. We have expressed our concern to the Chinese over that development. In response the Chinese have now told us that they would welcome it if we put forward our own detailed proposals on arrangements for the formation of the first SAR Government: Vice Foreign Minister Zhou Nan recently told our Ambassador in Peking that we should put forward our ideas as soon as we could, so that those could be considered by those responsible for the drafting of the Basic Law. We thus have an important opportunity to exert influence on Chinese thinking at a crucial stage in the Basic Law drafting process. Swift action will be needed if our ideas are to stand any chance of being taken on board before Chinese thinking firms up in ways which run counter to our objectives, and which could affect confidence in Hong Kong.

6. Our own objectives are:-

- (i) to shape Hong Kong's future, and in particular its post 1997 system of government in ways which ensure that the system is durable and meets Hong Kong's requirements;
- (ii) to ensure a smooth transfer of government in 1997;
- (iii) to achieve the maximum effectiveness of government until then;
- (iv) to maintain confidence in Hong Kong by demonstrating that we are achieving these objectives, in co-operation and harmony with the Chinese Government.



7. The attainment of these goals implies a significant degree of continuity through the period immediately before and after 1997; and hence a requirement for the Chinese to accept the continuation in office after 1997 of individuals appointed by us before 1997. They will not unreasonably require in return to be consulted about the selection of such people in the period immediately before 1997. To a large extent this is unavoidable as 1997 approaches, and indeed essential if confidence is to be maintained. In terms of British and Hong Kong interests it would be to our advantage to exploit this in ways that maximise our influence after 1997.

8. With these considerations in mind, my officials have prepared the attached draft paper, in consultation with the Hong Kong Government. It has been approved by ExCo. The paper would be put forward to the Chinese without commitment as no more than a basis for informal and confidential discussion.

9. The paper covers the following areas:

(i) The first Chief Executive. The proposals are consistent with those in the earlier paper. A special post would be created at an appropriate stage and the functions to be exercised by the future Chief Executive gradually transferred to it. The Chief Executive (Designate) would be selected during 1996 following consultation with the Chinese and would occupy the special post until he was formally appointed Chief Executive on 1 July 1997;

(ii) Principal Officials. From about 1995 the Chinese might be informed of appointments made at the highest levels in the Hong Kong Government. In the last year before the change of sovereignty the Chief Executive (Designate)'s nominees would be brought into the posts which they were destined to occupy after 1 July 1997;

(iii) The Executive Assembly. Nominees of the Chief Executive (Designate) might be brought into ExCo in the final year before 1 July 1997 so that they would have acquired some experience before



they formed his first Executive Assembly after the change of sovereignty;

(iv) The Legislature. The members of the last Legislative Council might be elected in ways which would permit them to remain in office across the change of sovereignty. This would involve conducting the elections on the basis of provisions in the Basic Law. The Chinese would need to be indirectly involved in an appropriate way: they might for example be allowed to nominate some Hong Kong members of an independent body to supervise the election.

10. It is important to put a paper to the Chinese in time to take advantage of opportunities for discussion which will arise in the next month. These are the visit to Britain by the Chinese Foreign Minister, with whom I am due to discuss Hong Kong affairs on 11 March, and the impending meeting of the Sino/British Joint Liaison Group in Hong Kong between 8 and 11 March.

11. I am copying this minute to the Lord President of the Council, the Home Secretary, the Lord Privy Seal, the Defence Secretary, the Attorney-General and Sir Robin Butler.

A handwritten signature in blue ink, appearing to read 'G. Howe', is written over a faint circular stamp.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

25 February 1988

SECRET

ROBAHK

FORMATION OF FIRST SAR GOVERNMENT

DRAFT OF MAIN PAPER

INTRODUCTION

This paper considers how, in the context of the resumption by China of the exercise of sovereignty over Hong Kong, a smooth transfer might be achieved in 1997 in terms of the institutions of government. It considers in turn the following four areas: the method of selection of the first Chief Executive; principal officials; the executive assembly; and the formation of the legislature.

METHOD OF THE SELECTION OF THE FIRST CHIEF EXECUTIVE

In their paper on the Governor and the Chief Executive, handed over to the Chinese side in December 1986, the British side emphasised the importance of maintaining continuity of administration before and after 1997, and of ensuring that the first Chief Executive of the SAR was thoroughly familiar with his responsibilities. Members of the Executive Council, the Legislative Council, the public service and the public in general should become accustomed first to the existence of the post and subsequently to the person of the Chief Executive (designate), before the formal transfer of authority. The paper suggested that one way of achieving these objectives would be to create, before 1997, an office to be occupied at some future point by the Chief Executive (designate). The paper envisaged that, as a first stage, the British Government could create a post of Deputy Governor within the Hong Kong Government and make an appointment to it some time before the choice of a Chief Executive (designate). The functions which would be exercised by the Chief Executive after 30 June 1997 could be gradually transferred from the Governor to the occupant of the post of Deputy Governor. The British Government, through the Governor, would retain the ultimate authority for the Government of Hong Kong. At a later date, nearer 1997, the post of Deputy Governor could be retitled Chief Executive (designate) and filled by the person who would hold office after 1997 as the first Chief

Executive of the Hong Kong SAR. The paper noted that it would be necessary for the British and Chinese Governments to consult on the method of selection of the Chief Executive (designate).

The British side continue to believe that an arrangement along these lines offers the best means of giving expression to the resumption by China of the exercise of sovereignty over Hong Kong and of ensuring a smooth transfer of government. In particular they believe that the transfer from the Governor of those functions which are to be exercised by the Chief Executive of the SAR, to a post which will in due course be occupied by the Chief Executive (designate), should take place gradually before 1997: this would allow ample time for an orderly transfer of powers and responsibilities and for the civil service to become accustomed to new lines of authority.

The means of putting in place such an arrangement might be as follows:

- (a) At an appropriate stage the British side would create a special post in the Hong Kong Government to which those functions of the Governor which are to be exercised by the future Chief Executive would be gradually transferred. The emphasis at this stage would be on organisational change. If it was necessary to deal with public speculation it would be made clear that the first incumbent of the post should in no way be regarded as the Chief Executive (designate). The aim would be to complete the transfer of functions before the end of 1996 so that the person occupying the post would then be exercising, in full, the powers and functions provided for the Chief Executive under the Basic Law.
- (b) This might then be an appropriate juncture at which to identify the individual who would in due course become the Chief Executive. He would be appointed to the special post which would be re-titled Chief Executive (designate).

In accordance with the Joint Declaration, the British Government, through the Governor, would retain the ultimate authority for the government of Hong Kong up until 30 June 1997 and, in particular, the specific responsibility for defence and foreign affairs.

The British side accept that the appointment of the first Chief Executive of the Hong Kong SAR will be a sovereign act of the PRC and must be seen to be so in Hong Kong. It is also important that the individual concerned should have the requisite abilities and experience to carry out the responsibilities of the post effectively and in a manner which will command the support and confidence of the people of Hong Kong.

These considerations would suggest that during 1996, there should be consultations between the two sides, within the framework of the Joint Liaison Group, in order to identify one or more candidates for the post of Chief Executive (designate). Once a suitable candidate or candidates had been identified a formal procedure of selection would be carried out on a basis fully consistent with the arrangements for the selection of the Chief Executive of the SAR laid down in the Basic Law. At the end of the selection process there would be a formal announcement, with which the Chinese Government would be suitably associated, of the identity of the successful candidate. He would then be appointed to the post of Chief Executive (designate). On 1 July 1997 the Chief Executive (designate) would be appointed by the CPG to the office of First Chief Executive of the Hong Kong SAR.

PRINCIPAL OFFICIALS

In order to avoid a break in continuity of administration or loss of efficiency, the British side believe that it is important that the individuals who are to fill the posts of principal officials in the first SAR Government should already be in post in the period before 1 July 1997 and should remain in post for a reasonable period thereafter. To facilitate such an arrangement, the British side would be prepared to inform the Chinese side in detail on the selection of individuals who seem likely to remain in

principal official posts after 1997.

As a first stage (in say 1995), the Chinese side would be informed of which individuals then at the level of Branch Secretary or above, or expected to be promoted to that level before 1 July 1997, were likely to remain in the administration beyond 1997. The Chinese side would then be informed, in advance, of all subsequent appointments and promotions to posts designated as "principal officials" under the Basic Law.

As a second stage, once the Chief Executive (designate) has been appointed in that capacity, he would formally advise the CPG which individuals he proposed to recommend to occupy particular principal official posts on 1 July 1997. The Hong Kong Government would then so far as possible ensure that the individuals concerned held their respective posts before 1 July 1997, so as to gain experience before the transfer of Government. The Hong Kong Government would let it be known that their appointments had been made on the recommendation of the Chief Executive (designate) and with the CPG's concurrence. On 1 July 1997 they would be appointed by the CPG as principal officials of the Hong Kong SAR and would take up office on that basis.

EXECUTIVE ASSEMBLY

The British side have noted that the latest version of the draft Basic Law provides that the selection and appointment of members of the Executive Assembly of the future SAR will be a matter for the Chief Executive. In this regard it would greatly assist the achievement of a smooth transition if the first Chief Executive were able to benefit from the advice of influential members of the community who were already experienced in and familiar with the workings of Government. Specifically it would be desirable for those individuals selected by the Chief Executive to be members of the first Executive Assembly on 1 July 1997 to have served as members of the last Executive Council before that date.

Such an arrangement would be possible if, once the Chief Executive (designate) had been appointed in that capacity, and

also to the Executive Council, he informed the CPG which individuals he proposed to appoint to be the members of the first SAR Executive Assembly. The Governor, on the advice of the Chief Executive (designate), would so far as possible appoint those individuals identified by the Chief Executive (designate) to the Executive Council. The Chief Executive would then appoint his nominees as members of the first Executive Assembly of the SAR on 1 July 1997, after he had been formally appointed to the office of Chief Executive by the CPG.

FORMATION OF THE LEGISLATURE

In the paper handed over by HMA Peking on 20 January 1987, the British side emphasised that it would greatly enhance perceptions of the stability of Hong Kong, both locally and overseas, if there were in existence, immediately following the resumption of sovereignty, a body capable of functioning as the first legislature of the SAR. The possibility that there might be a pressing need, shortly after the resumption of sovereignty, to enact laws or authorize essential expenditure should also not be overlooked.

With these considerations in mind it would seem desirable, in principle, to devise arrangements which enable all members of the last Legislative Council, who are eligible under the terms of the Basic Law, to become members of the first Sar legislature. Such arrangements would offer the best means of ensuring stability, confidence and continuity in legal authority. They would also avoid the possibly unsettling impact on the community of holding new elections to the legislature immediately upon, or shortly after, the transfer of government. It would be important in this area too to mark the resumption by China of the exercise of sovereignty over Hong Kong in an appropriate way, for example by requiring the members of the new legislature to swear allegiance to the Hong Kong SAR.

These considerations would suggest that if the Chinese side were prepared to agree to such arrangements, the British side should take all necessary steps to ensure that the members of the last Legislative Council, before 1997, were elected in ways which are

fully consistent with the arrangements for the future SAR legislature laid down in the Basic Law. Such steps might include:

- (a) Changing the term of office of the Legislative Council from three to four years in line with the Basic Law. (Similar changes would be made to the terms of the Municipal Councils and the District Boards): and
- (b) Conducting the final set of Legislative Council elections on the basis of provisions in line with the corresponding provisions in the Basic Law for the election of the SAR legislature.

Such an arrangement would also include the establishment by the British side of procedures which would enable the Chinese side to be appropriately involved in the preparation for and supervision of the final set of Legislative Council elections. Such arrangements might include the establishment of an independent Electoral Affairs Commission, with members from Hong Kong jointly selected by both sides, to supervise the conduct of the last Legislative Council elections and possibly also those of the Municipal Councils and District Boards held in the immediately preceding twelve months. Those elected to the last Legislative Council would be sworn in as members of the SAR legislature on 1 July 1997 and serve the remainder of their four year term.



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-930 7022
XXXXXXXX 01-218 2111/3

Prime Minister

CDP 23/2

22nd February 1988

MO 6/19/1L

Dear Charles,

HONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATION

Following the exchange of correspondence between Ministers earlier this month which rests with your letter to me of 2nd February, officials from the Ministry of Defence, the Foreign and Commonwealth Office and the Treasury have met to consider the terms on which the MOD team might return to Hong Kong to resume the adjourned fourth round of negotiations on the future apportionment of defence costs. There has also been an exchange of telegrams between the FCO and the Governor. You will wish to know where matters now stand.

As a result of these exchanges, the Governor accepts that the Hong Kong Government team should now discuss how HMG's requirement for an effective 70/30 apportionment could be made acceptable in the Colony. In return, the MOD team will consider how their proposal for a 65/35 split could be presented as such in Hong Kong in a form which would be acceptable to our Ministers. The Defence Secretary believes that this would provide a satisfactory basis for the team to return to Hong Kong. There can, of course, be no absolute guarantee that the discussions will result in an acceptable agreement but the team will be negotiating within the remit agreed by Ministers for an effective 70/30 apportionment. The intention is that they will travel to Hong Kong tomorrow evening and that negotiations will resume on Thursday, 25th February.

I am sending copies of this letter to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Home Secretary, the Trade and Industry Secretary, the Lord President, the Chief Secretary, the Attorney General and to Sir Robin Butler.

*Your sincerely
Brian Hawtin*

(B R HAWTIN)
Private Secretary

Charles Powell Esq
10 Downing Street

HONG KONG: Autumn 1920

MINISTRY OF DEFENCE
GENERAL INVESTIGATION



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Hong Kong (White Paper)

3.31 pm

The Secretary of State for Foreign and Commonwealth Affairs (Sir Geoffrey Howe): With permission, Mr. Speaker, I should like to make a statement about the White Paper on Hong Kong.

A Hong Kong Government White Paper, "The Development of Representative Government: The Way Forward" was published in Hong Kong earlier today. Copies of the White Paper have been placed in the Library of the House.

The publication of the White Paper marks the end of a wide-ranging review of developments in representative government. A Green Paper, published in May 1987, sought the views of the Hong Kong community. It set out a range of options for possible change; none was ruled out in advance. The Green Paper elicited a widespread public response. We were also able to benefit from a wide range of views expressed in the House during the debate on 20 January.

The White Paper discusses the full range of issues raised in the review. The main decisions which it announces are as follows:

- (a) ten directly elected members will be introduced into the Legislative Council in 1991;
- (b) in 1988 the number of appointed members in the council will be reduced from 22 to 20, and the number of members elected by functional constituencies will increase from 12 to 14. In 1991, the present system of election by members of District Boards will be abolished; but the urban and regional councils will each continue to elect one member to the council;
- (c) links between the urban district boards and the urban council will be strengthened;
- (d) the Governor will continue to be the President of the Legislative Council for the immediate future.

We are committed to the steady development of representative government in Hong Kong. We believe that the decisions set out in the White Paper mark an important step in that direction and that they represent a balanced and reasonable response to the views expressed by the people of Hong Kong and their representatives.

Mr. Gerald Kaufman (Manchester, Gorton): Since the Secretary of State a week ago poured cold water on our request for a statement, we are glad that our renewed request for a statement has met with a better response today.

This is a very timid White Paper. It has been long anticipated, with considerable expectation and hope, and now that it is available it will come to many as a considerable let-down. For the most part, it does little more than tinker with the status quo.

The proposals for direct elections to the Legislative Council are distinctly inadequate. It is not simply that those elections are not to take place until 1991, rather than 1988, as many in Hong Kong campaigned for. Although I advocated 1988, I can understand, if not agree with, the Government's decision to be cautious in the light of the divisions of opinion in Hong Kong about timing. It is even more regrettable that, when direct elections are introduced, they will apply to only 18 per cent. of the Legislative Council—10 Members—rather than 25 per cent., the figure that many of us expected this year.

I cannot understand why the whole electorate of Hong Kong, whose potential number is 3,300,000, is to be given

only 10 Members to elect when, under the new arrangement, accountants in Hong Kong—who cannot be especially numerous—are to have a Member of the Legislative Council all to themselves.

Mr. James Lamond (Oldham, Central and Royton): There are a lot of accountants there.

Mr. Kaufman: But not 330,000.

Even at this late stage, I hope that the Government will reconsider the number of directly elected Members of the Legislative Council, even if the date of the election is immutable. The Government should consider reallocating the places of the two new functional Members to the directly elected section and increasing that number to a minimum of 12. In the event of a change of Government in this country before 1991, we would discuss the feasibility and desirability of increasing the number of elected Members of the Legislative Council with the Government of the People's Republic of China.

Hong Kong can and must afford lively controversy, and no doubt there will be lively controversy there over the contents of the White Paper. However, having registered our criticism of the White Paper's contents, it is right that I should say to the people of Hong Kong that, whatever disappointment there may be, the colony is at a turning point in its history and it cannot afford deep and lasting divisions. It is essential that everyone in Hong Kong unites to ensure that the new arrangements work and are successful. I am confident that that is what they will do.

Sir Geoffrey Howe: I am grateful to the right hon. Gentleman for his modest, but appropriate, thanks for our willingness to offer the statement this afternoon. I am also grateful to him for his expression of support for the need for steadiness and unity among the people of Hong Kong. They have always manifested that, to their great credit and to the greater success of the territory.

I do not accept the right hon. Gentleman's proposition that this represents a timid decision. It is an appropriate decision in response to the very careful and full consideration given to the matter in Hong Kong. Our key objective throughout has been to design a structure that will not be temporary or fallible, but one that will endure beyond 1997. I want to make it absolutely clear that the White Paper is entirely in line with the commitments given by the Government when the matter was last discussed. No commitment was made to introduce direct elections in 1988. It is nonsense to say—as some people said earlier today—that the White Paper means the postponement of direct election plans. The commitment in 1984 was to review in 1987. We have done that.

I note what the right hon. Gentleman has said about the number of directly elected Members. However, 14 elected Members from the functional constituencies will exist alongside the 10 directly elected Members. That is close to 50 per cent. of all the Members of the Legislative Council. We believe that they will represent a proper blend of continuity and change when the time comes. I am also grateful for the right hon. Gentleman's encouragement to the people of Hong Kong, after their mature reflection that has brought us this far, to continue to sustain the constitution in the way in which we would all wish.

Sir Peter Blaker (Blackpool, South): Is my right hon. and learned Friend aware that the decision to introduce an element of direct elections to the Legislative Council in

1991 will be welcomed by the majority of Conservative Members and, I believe on the evidence, by the majority of people of Hong Kong? Is he also aware that BBC radio news reported this morning that the Government of Hong Kong and this Government have gone back on an undertaking to introduce an element of direct elections in 1988? Will he make it perfectly clear that no such undertaking has ever been given?

Sir Geoffrey Howe: I am grateful to my right hon. Friend for his commendation of the decisions announced. I am grateful to him also for giving me the opportunity to set beyond doubt the fact that those reports had no foundation. As I said in my earlier answers, there was no commitment beyond that to undertake a review, and there is no foundation for the suggestion that we have gone back on any commitment. It is very important that that proposition should be nailed now and nailed firmly.

Dr. John Marek (Wrexham): Is the Foreign Secretary aware that he has caused considerable disappointment and a sense of betrayal among a large section of the Hong Kong community? Is he aware that democracy demands tradition and roots and that that implies a move to direct elections this year and a majority of elected members by 1991? Is he aware that his lame statement and his sell-out will make the eventual transition of Hong Kong in 1997 harder rather than easier? Finally, is he aware that it is a very risky course that he wishes to pursue in the next few years?

Sir Geoffrey Howe: The intemperance of the language used by the hon. Gentleman, with phrases such as "sell-out", puts the value of his judgment in the right perspective. There is no case for such emotional and inaccurate phraseology, nor is there any suggestion that the Government are proceeding with undue caution. We have proceeded, as we have always advertised here, along an evolutionary rather than a revolutionary line, on the basis that each step should be carefully considered and that changes should command wide support and confidence in the community. What we said in the last White Paper is what has been said in this White Paper: these changes, after full consideration of all the views expressed, are well judged to command wide support and confidence and to ensure continuity, which is the foundation of stability.

Mr. David Howell (Guildford): Further to the comments of my right hon. Friend the Member for Blackpool, South (Sir P. Blaker) about the BBC, is my right hon. and learned Friend aware that the report this morning also stated as a bland fact that the decisions about elections had been made in deference to Beijing? Will my right hon. Friend take every step to see that that nonsense is flatly refuted? Will he strongly underline the commitment, in his own words, to the steady development of representative government in Hong Kong? Will he confirm beyond all doubt that there is no going back on the spirit and aim of the 1984 accord or on our very strong determination and commitment to see Hong Kong flourish as a free-enterprise society for many decades ahead?

Sir Geoffrey Howe: I am grateful to my right hon. Friend for what he has said. He rightly drew attention to the importance of the joint declaration between the United Kingdom and the People's Republic of China. One of its

provisions, designed to ensure the stability and prosperity of Hong Kong, was the proposition that the legislature of the Hong Kong special administrative region shall be constituted by election. That is the direction represented by the changes which I have announced today.

It is wrong to suggest that the decisions we have announced today are decisions of anyone other than ourselves. Clearly we have taken account of the wishes of the people of Hong Kong. Clearly some of those people themselves have wished to take account of the development that has taken place on the Basic Law which is being prepared by China. All these matters are important to the continuity which we want to achieve. That continuity is designed to secure the survival of Hong Kong as a prosperous, stable, free enterprise society in accordance with the joint declaration.

Mr. A. J. Beith (Berwick-upon-Tweed): Is the Foreign Secretary really suggesting that direct elections earlier than 1991, and of a larger proportion of the legislature, would be revolutionary? If it is not he who thinks that, is it Beijing that thinks so, and has he received representations to that effect? What chance does he see for establishing two systems in one country if the democratic system is not firmly established in Hong Kong before the changeover?

Sir Geoffrey Howe: The hon. Gentleman must come back to reflect on the pattern that prevailed in Hong Kong until the first steps were taken in the direction of representative government only a few years ago. What is now proposed is a substantial and important further step in that direction. The mood of the people of Hong Kong was rightly expressed in the last White Paper, when it was noted that there was considerable general public concern that too rapid progress towards direct elections could place the future stability and prosperity of Hong Kong in jeopardy. In summary, there was strong public support for the idea of direct elections but little support for such elections in the immediate future. That was the position a couple of years ago. Against that background, we have announced today the introduction of direct elections in 1991 and made it clear that we think that that is the right pace at which to proceed.

Several Hon. Members rose—

Mr. Speaker: Order. I hope that the House will think it fair if I now give preference to those who were not called in the debate on Wednesday 20 January.

Hon. Members: Hear, hear.

Mr. James Cochrane (Gillingham): Is my right hon. and learned Friend aware that the White Paper will be seen widely as an elegant compromise between the apprehensions of the traditionalists, who have viewed direct elections with considerable concern, and the more radical and adventurous section of the community that wanted direct elections much more swiftly and for a much greater proportion of seats? My right hon. and learned Friend will be aware that timetabling the introduction for 1991 shows a much greater grasp of the realities involved in trying to arrange direct elections in a hurry than those who wanted the introduction in 1988?

Sir Geoffrey Howe: I am grateful to my hon. Friend. We have striven to balance the two factors to which he has drawn attention. As a result, we will have contributed to the prospect of continuity, stability and prosperity.

Mr. Jack Ashley (Stoke-on-Trent, South): Will the Foreign Secretary recognise that, if he does not think that the statement is timid, some talented and energetic people in Hong Kong will think it is, and that it will provide impetus to their wish to emigrate? To avoid that danger, will the Foreign Secretary accept and tell our friends in China that the higher the proportion of seats that become directly elected, the greater the prospect for stability and progress in Hong Kong?

Sir Geoffrey Howe: I have no doubt that the right hon. Gentleman is correct to say that there are some talented and energetic people in Hong Kong who disagree with the conclusions I have announced. That was implicit in the question asked by my hon. Friend the Member for Gillingham (Mr. Couchman). We have striven to reach an answer that provides the best balance between all the opinions expressed and the anxieties felt in Hong Kong. I believe that that will prove to be the basis for continuity and stability of the system of government and continuity on the path towards and through 1997. I believe that it will prove to be the best way of retaining in Hong Kong the largest quantity of talent of the sort the right hon. Gentleman has in mind. It is a matter of judgment. I respect those who argue in the opposite direction, but I think that we have struck the right balance for the future.

Mr. Roger Sims (Chislehurst): Is my right hon. and learned Friend aware that many hon. Members consider themselves friends of Hong Kong and that many of us will feel that the proposals, although we understand the mixed views about them, are in the best interests of the people of Hong Kong and the territory's future? Is he aware that it was only a few years ago that a number of people from Hong Kong were seeking advice from us as to how they should move forward to representative government? Indeed, the first elections were held only two and a half years ago under the functional constituency system—an ingenious device that seemed particularly appropriate for Hong Kong and appears to have worked successfully. Can my right hon. and learned Friend confirm that the number of functional constituency seats is to be increased forthwith and that there will still be functional constituencies alongside directly elected Members after 1991?

Sir Geoffrey Howe: I am grateful to my hon. Friend for his tribute to the balance of the conclusions we have reached. He is right to point out that it was only recently that moves were made in the direction of representative government against the historical background of Hong Kong. He is right to draw attention to the importance of the functional constituencies. The change that is taking place as a result of my statement today will take effect by the addition of 10 directly elected seats and a continuation of the functional constituencies in 1991.

Mr. Pat Wall (Bradford, North): Does not the Secretary of State's statement mark only a further extension of the long process of denying the Chinese people of Hong Kong a say in the running of their lives, both in relation to the rightful reunification with China and to the social and economic conditions in the colony? Does that not show that the Government have more in common with one-party totalitarian Stalinism than they have with democracy throughout the world?

Sir Geoffrey Howe: I dare say that, if I wanted advice about one-party Stalinism, I should turn to the hon.

Gentleman. I can assure him that the pattern of development in Hong Kong, the security that has been provided for the people of Hong Kong and the framework within which there has been an explosion of prosperity on a massive and demonstrative scale are a tribute to the free enterprise system which has underlain it and to the framework of government that has brought it thus far. The changes that we are making now are, in themselves, a further extension of the novelty of representative government which the hon. Gentleman appears to commend. I cannot see why he should complain about our movement in the direction of an increasingly democratic, free-enterprise society.

Mr. James Hill (Southampton, Test): My right hon. and learned Friend will be aware that we have heard a great deal about the lobby for 1988. I was recently on a private visit to Hong Kong, where I found that there were several other opinions, particularly in the business community. That community was looking forward to stability after the difficulties with the stock exchange and the devaluation of the Hong Kong dollar. It would have been a most inopportune time to bring forward a sweeping political change. My right hon. and learned Friend must have taken all that into account in the decision making that had to take place. I should have thought that today's decision was the right one, but I hope that my right hon. and learned Friend will say something about the timetable of the Basic Law; we cannot have democratic elections without a Basic Law. There must be tremendous co-operation with the Governor of Hong Kong and the Chinese authorities.

Sir Geoffrey Howe: My hon. Friend draws attention to another of the strands of opinion in Hong Kong, which emphasises the extent to which there are sharp divisions and variations in opinion there. That is one of the strong arguments for not making a major constitutional change in 1988, when opinion is divided in this way, but for proceeding along the timetable that he has commended.

My hon. Friend is also right to draw attention to the importance of the role of the Basic Law. As I have already said, the preparation of that is for the Government of the People's Republic of China, but it is being undertaken with the help of a Basic Law drafting committee on which Hong Kong people are well represented. I understand that the full text of the draft Basic Law will be formally published after refinement in May of this year and that Hong Kong people will then have four months to comment on it, before it is revised further. That other half of the equation is being carried forward quite sensibly.

This pattern of behaviour underlines the extent to which there is a fallacy in some people's thinking—that a choice must be made between the interests of Hong Kong and good relations between Britain and China. The truth is that we cannot have one without the other, and we are endeavouring to achieve both.

Mrs. Gwyneth Dunwoody (Crewe and Nantwich): Is it not clear that only when directly elected Members are in place will they have the authority to speak on the basis of democratic representation? Does it not ill become a Government who are supposed to be committed to democracy to say to other people, "You must wait for the system that we shall put in place and it will be only a short time before the final changeover takes place."?

Sir Geoffrey Howe: If life were that simple, what the hon. Lady says might be true. But life is not so simple. In making those changes from a system of government which has prevailed in Hong Kong, placed as it is historically and geographically, we are moving in the direction that she would wish, after the fullest possible consultation with the people concerned, on a time scale consistent with balance and continuity. We have done the best we can to take account of the diversity of opinion. With all humility, I believe that we have got the judgment about right.

Mr. Robert G. Hughes (Harrow, West): Does my right hon. and learned Friend accept that there will be a wide welcome in Hong Kong for the calm and considered way in which he presented his arguments today? Does he accept also that there will be some disappointment at the fact that there will be no direct elections in 1988? Does he agree that there will be some concern that what he has said today may not be the best way in which to ensure stability? Does he accept that there will be puzzlement about the fact that the small scale of what is proposed for 1991 falls short of the expectations not only of those who want direct elections this year but of those who are hostile to direct elections at any time?

Sir Geoffrey Howe: I have no doubt that my hon. Friend articulates the opinions of some people on the matter—I emphasise some opinions of some people. We have made the best judgment that we can on the basis of an extensive survey and on the basis of debates in every conceivable representative institution and authority in Hong Kong. In almost all of them, as in the House, opinion was pretty evenly divided between both ends of the argument. The judgment that we have struck is as near right as one could get.

Mr. Dennis Skinner (Bolsover): Is the Foreign Secretary aware that it will not be lost to the British electorate that the Government who are handing over Hong Kong are the same Government who fought for the Falklands? They will be drawn to the irresistible conclusion that, whereas the Government were prepared to fight for the Falklands, they dare not do anything with Hong Kong because there are 1 million Chinese around the corner? *[Interruption.]* Sorry—1 billion Chinese around the corner. There will be only 18 per cent. participation in the elections. The Government are demanding that trade unions, tied hand and foot, must ballot for everything. Eighteen per cent. would not do service to the Iowa caucus. Before long, the hon. and right hon. learned Gentleman, if he is still in the job, will make arrangements for a one-party state in Hong Kong.

Sir Geoffrey Howe: The people of this country will learn from the hon. Gentleman's intervention that, if they seek one of the longest possible interconnections of wholly unconnected topics, founded upon a wholly misleading over-simplification, they have no better champion of that type of behaviour than the hon. Gentleman.

Mr. Tim Rathbone (Lewes): Does my right hon. and learned Friend accept that the mixture of direct representation and functional representation is an intriguing experiment in proportionality? Does he consider that it bears particular study by her Majesty's Government?

Sir Geoffrey Howe: I am not quite sure in what respect that kind of sophisticated proportionality is to be

commended. It might be commendable for the future tribulations of the parties that once constituted the alliance.

Mr. Alex Carlile (Montgomery): Does the right hon. and learned Gentleman agree that the existence and popular expectation of representative government will do much to strengthen prospects for Hong Kong's institutions in 1997? Does he expect evolution to be speeded up a little between 1991 and 1997?

Sir Geoffrey Howe: The pattern of development that has so far been identified seems to commend itself to the people of Hong Kong. We shall look forward to their experience in operating it when we consider the prospect for any further changes.

Mr. Nicholas Soames (Crawley): I congratulate my right hon. and learned Friend on achieving a judicious and skilful balance in his paper. Will he reassure the people of Hong Kong that it patently shows that we have absolutely no need to suck up to the People's Republic of China?

Sir Geoffrey Howe: The idea that Britain should be obliged to have a confrontation with the People's Republic of China or be obliged, in my hon. Friend's elegant phrase, to "suck up to" the People's Republic of China is an unusually uncharacteristic over-simplification, of which my hon. Friend is not often guilty.

Dr. Jeremy Bray (Motherwell, South): Is the right hon. and learned Gentleman aware that he has weakened the authority of, and undermined confidence in, the Government of Hong Kong by so palpably bowing to pressures from the People's Republic of China in a matter in which that country has no legitimate interest and which relates entirely to a period long before the handover?

Sir Geoffrey Howe: I am sorry to tell the hon. Gentleman that his view is dramatically over-simplified and foolish. As I said in the last debate on this matter, and again today, all the evidence shows that Hong Kong prospers when London and Beijing can work in harmony. The overriding need for Hong Kong is to secure a foundation for lasting future stability and prosperity. That cannot be founded on confrontation between Britain and China; it can be founded, as it sensibly has been, on a continued understanding and the implementation of the joint declaration, to which we are both committed.

Mr. Michael Marshall (Arundel): Does my right hon. and learned Friend accept that the whole future of Hong Kong—like its past—is based on its economic viability, which in turn is based on confidence? Is not the greatest threat to confidence in Hong Kong ill-considered statements urging on it a Westminster model, as some hon. Members have done, and as has been heard in some of the extreme statements of the Members of LegCo?

Sir Geoffrey Howe: I am sure my hon. Friend is right to remind the House of the importance of confidence as a foundation for stability—above all else—in Hong Kong. One of the remarkable things is the extent to which the people of Hong Kong and their representatives have, to a large degree, appreciated that, as is shown by the moderation and wisdom of what they say. That is a proposition that should be borne firmly in mind by Members of LegCo, this House and all others who are concerned to uphold prosperity, stability and continuity in Hong Kong.

Mr. Andrew Faulds (Warley, East): Will the right hon. and learned Gentleman accept my reassurance that I think that he has got it just about right — which can only mean that the Prime Minister's uninformed intervention has not been allowed to play upon this particular matter? Is not the blunt fact that the major considerations up to 1997 must be both the maintenance and success of Hong Kong's economy and the realisation that we must go along with the Chinese Government's acceptance of the scale and speed of change?

Sir Geoffrey Howe: I am always glad to accept a compliment from the hon. Gentleman, however much it may be accompanied by the thorns that he sometimes feels obliged to offer at the same time. He puts his finger on it precisely when he says that the future must be built on exchanges and understandings of the mutual interest of the United Kingdom, China and the people of Hong Kong. If what we are building now is to be stable and survivable, it needs to be built in that way.

Several Hon. Members *rose*—

Mr. Speaker: Order. I will call the four hon. Members who have been standing, to put their questions briefly.

Mr. Ivan Lawrence (Burton): As any lingering doubt that my right hon. and learned Friend may have had about the good sense of his policy will have been confirmed by the support of the hon. Member for Warley, East (Mr. Faulds), and as everyone — including the People's Republic of China — is agreed that Hong Kong should have direct elections, why should they not be held as widely and as soon as possible so that the tender seed of democracy is planted in 1991? It may not be strong enough to withstand any of the winds by 1997.

Sir Geoffrey Howe: The tender seed of democracy was first planted in the form of indirect elections as recently as 1985, and the judgment that we have formed is that to make a further change with the addition of direct elections only three years after that will be to hasten the process of maturation too quickly. I recognise that it is a matter of judgment. I do not think it would be easily possible to produce a conclusion that commended itself to the enthusiastic support of my hon. and learned Friend and, simultaneously, of the hon. Member for Warley, East (Mr. Faulds)—but I have to try my best.

Mr. Bowen Wells (Hertford and Stortford): Will my right hon. and learned Friend accept that the selection of a six-year period for partially elected representational government, instead of the nine-year period that was available to him, brings into question whether there is enough time to establish and experience representative government on a firm basis through direct elections, in

addition to the ministerial system which must still come? Will he carefully consider his fine judgment of today and reflect on whether he ought not to speed up that process?

Sir Geoffrey Howe: The arguments advanced by my hon. Friend are perfectly legitimate. I do not want to let him think, however, that we are likely to embark on a reconsideration of this matter. The important thing is to proceed with this next step, to get the process under way on a settled basis.

Mr. Alastair Goodlad (Eddisbury): Does my right hon. and learned Friend accept that his statement today will be broadly welcomed in Hong Kong and that it reflects the vast majority of the voices that spoke in the recent debate about the need for continuity and a measure of caution in these arrangements? As the right hon. Member for Manchester, Gorton (Mr. Kaufman) said, the people of Hong Kong will make the new arrangements work, and they will have the full support of this House in so doing.

Sir Geoffrey Howe: My hon. Friend's experience of the people and colony of Hong Kong ends great authority to his observations. I am glad to endorse and accept them.

Mr. Robert Adley (Christchurch): Thank you, Mr. Speaker, for giving me the last word.

Is it not a fact that, for more than a century, stability and autocracy have gone hand in hand in Hong Kong? Is there not a degree of illogicality in the words of those who say that the best way to maintain stability is fundamentally to change the system as a matter of urgency? Is there not also a certain illogicality in the proposition advanced by the Opposition Front Bench that, on the one hand, the document and the future discussions up to 1997 should be based purely on decisions taken in this House, as though the People's Republic of China did not exist and, on the other, to say, as did the right hon. Member for Manchester, Gorton (Mr. Kaufman), that if there is to be a change of Government before 1991, the first thing that he will do is to consult Beijing? Is my right hon. and learned Friend aware that most people think that he has got it right?

Sir Geoffrey Howe: I thank my hon. Friend very much for that closing tribute. The least likely problem to affect the future of the people of Hong Kong is the prospect of the election of a Labour Government in the United Kingdom.

Mr. Tam Dalyell (Linlithgow): On a point of order, Mr. Speaker.

Mr. Speaker: I shall take the application under Standing Order No. 20 first.

STATEMENT ON THE WHITE PAPER ON HONG KONG.

TO BE MADE BY THE SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS, SIR GEOFFREY HOWE IN THE HOUSE OF COMMONS ON WEDNESDAY 10 FEBRUARY 1988.

With permission, Mr Speaker, I should like to make a statement about the White Paper on Hong Kong.

A Hong Kong Government White Paper, "The Development of Representative Government: The Way forward" was published in Hong Kong earlier today. Copies of the White Paper have been placed in the library of the House.

The publication of the White Paper marks the end of a wide-ranging review of developments in representative government. A Green Paper, published in May 1987, sought the views of the Hong Kong community. It set out a range of options for possible change; none was ruled out in advance. The Green Paper elicited a widespread public response. We were also able to benefit from a wide range of views expressed in this House during the debate on 20 January.

The White Paper discusses the full range of issues raised in the review. The main decisions which it announces are as follows:

- (a) ten directly elected members will be introduced into the Legislative Council in 1991;
- (b) in 1988 the number of appointed members in the Council will be reduced from 22 to 20, and the number of members elected by functional constituencies will increase from 12 to 14. In 1991

the present system of election by members of District Boards will be abolished; but the Urban and Regional Councils will each continue to elect one member to the Council;

(c) links between the urban District Boards and the Urban Council will be strengthened;

(d) the Governor will continue to be the President of the Legislative Council for the immediate future.

We are committed to the steady development of representative government in Hong Kong. We believe that the decisions set out in the White Paper mark an important step in that direction; and that they represent a balanced and reasonable response to the views expressed by the people of Hong Kong and their representatives.

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 February 1988

Dear Brian,

HONG KONG DEFENCE COSTS AGREEMENT

The Prime Minister has considered the Defence Secretary's minute of 1 February about the point reached in negotiations with the Hong Kong Government on future apportionment of defence costs. She has also seen the comments by the Foreign Secretary and the Chief Secretary.

The Prime Minister agrees that our aim should be to achieve in substance a 70/30 split, even if that requires us to accept devices which would allow the Hong Kong side to present it as 65/35. She would want our team to negotiate tenaciously for this result. They should not give the Hong Kong side any reason at all to think that we would be prepared to go further. Were a complete deadlock in practice to be reached, our negotiators would have to consult Ministers in London.

I am copying this letter to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor, the Home Secretary, the Trade and Industry Secretary, the Lord President, the Chief Secretary, the Attorney General and to Sir Robin Butler.

Yours sincerely,
Charles Powell

(C. D. POWELL)

Brian Hawtin, Esq.,
Ministry of Defence.

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PRIME MINISTER

*Seen e approved by PM
C.D.*

HONG KONG DEFENCE COSTS

You earlier approved my note on how we should handle the next round of negotiations (A).

The Chief Secretary has belatedly minuted wanting a firmer line (B).

Obviously we want the best result that we can get. But equally we do not want a row over Hong Kong at present.

The answer may be to send our negotiators back with instructions to get a solution, and with no indication that further concessions will be forthcoming. But at the end of the day, they will have to refer back if there is an impasse: and it will be a political decision whether to make a further concession.

Agree that I should minute out as attached?

C.D.P.

(C. D. POWELL)

2 February 1988

B

C.P.C.



FROM: CHIEF SECRETARY

DATE: 2 February 1988

PRIME MINISTER

HONG KONG DEFENCE COSTS AGREEMENT : RENEGOTIATION

I have seen copies of George Younger's ^{final} minute to you of 1 December and Geoffrey Howe's of the same date.

2. We started these negotiations with the aim of getting Hong Kong to pay at least 75% of the costs of the garrison over the period to 1997. We had a good case in principle, as George made clear in his minute of 1 December, for asking Hong Kong to pay a higher share than under the present agreement. The settlement with China had reduced the external threat to Hong Kong. As a result the role of the garrison is increasingly directed to internal security. It is entirely appropriate for Hong Kong to bear the cost of its own internal security. Hong Kong certainly could afford to meet the full costs of the garrison.

3. Such an approach had, of course, to be tempered by the political considerations. Your private secretary's letter of 3 December recorded that you "would not absolutely rule out some gesture to go a little way to meet the Hong Kong side if negotiations reach an impasse". In fact we have made quite a generous move towards Hong Kong by asking them to pay 70%, rather than at least 75%. This cost the UK £50 million.

4. Hong Kong's reaction is not surprising. They have responded like the good negotiators they undoubtedly are. They have tabled a counter proposal which is significantly more to their advantage, and they are seeking to put political pressure on us to make further concessions.

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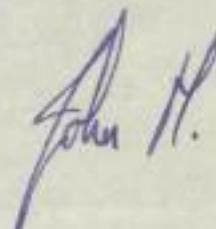
5. Geoffrey Howe commented that the Governor is "vitally dependent on the unofficial members of the Council" to secure the passage of a new agreement. I understand that, when MOD's 2nd Permanent Secretary visited Hong Kong in December, he had discussed with unofficial members and they told him that "a real movement in Hong Kong's favour was needed in the new DCA [by comparison with the present 75%] but the fact of movement was more important than the quantum". This suggests our move to 70% should be quite satisfactory. They also commented that "disaffected Legco members would seek any stick to beat HMG with (and that, failing the DCA, another would be found), and that in any event other issues would claim their attention in due course".

6. I am encouraged that, in the light of the latest negotiations, George's officials consider a settlement could be obtained on the basis of a split of 70%-30%. As George says, there is also the provision in the present DCA to roll forward the present 75%-25% split for another five years. Geoffrey appears to see little value in this provision but I do not find it easy to reconcile this with the insistence of the Hong Kong negotiators in 1980 to embody it in the DCA. We need to make more of it in the negotiations.

7. I agree with George that there is no justification for conceding anything more to Hong Kong than a split of 70%-30%. I would not rule out, subject to discussion between officials, devices of the sort he describes which could ease presentation in Hong Kong while retaining 70%-30% in substance. The tactics of the next stage of negotiations need to be considered carefully by officials. In my view negotiations should not be resumed until we have a clear indication from Hong Kong that they are willing to settle for a substantive split of 70%-30%.

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8. I am copying to Geoffrey Howe, George Younger, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew, Lord Glenarthur and Sir Robin Butler.


JOHN MAJOR

HONG KONG : Fukun P120

02.11 1988

CONQUEROR

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MO 6/19/1E

PRIME MINISTERHONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATION: FOURTH ROUND

1. Following the recent round of correspondence on the way ahead in negotiations with the Hong Kong Government (HKG) over future arrangements to cover defence costs after the end of March, my officials have spent the last week in Hong Kong. They took with them the concession which we had agreed, to adjust the present 75/25 cost sharing formula in favour of the HKG, to 70/30. They also had available - and presented as options - a variety of compensating offsets which would have allowed further apparent movement in favour of the HKG, even as far as 62.5/37.5, had they wished to adopt these for local presentational purposes. This would still have given us a 70/30 split in reality.
2. On their return last week, my officials reported that some encouraging progress was made initially in discussion with their counterparts along these lines. But, part way through the round the HKG side appeared to take a sharp step backwards, their attitude hardening in support of an arrangement the effect of which would be a straight 65/35 apportionment. On the final day, they tabled a proposal on these lines, described as the last firm offer to be made in this round of negotiations and which they have, as I understand, now reported to EXCO.
3. The Governor has also spoken on the telephone to the Second Permanent Secretary here, Sir John Belloch, in terms which closely reflect the written offer made in Hong Kong although he was careful to reserve his own position on any particular apportionment.



4. Thus there lie on the table the options put forward by my officials based on the negotiating position we agreed and also the proposal tabled subsequently by the HKG which, even with the most favourable gloss that could be placed upon it, represents a straight 65/35 apportionment. My officials would of course be quite willing to return to negotiations based on the line we have previously agreed and indeed the public position is that the Fourth Round has been adjourned whilst both sides report to their respective authorities. But the fact remains that, as things stand at present, the gap is still a wide one.

5. I am of course aware that the Governor anticipates difficulties in getting through his Executive and Legislative Councils any arrangements which in their eyes do not represent a significant improvement on the current DCA. At the same time, however, it must be said that this was specifically why we agreed that a concession should be offered. For my part, I can see no justification for conceding anything further to the HKG at the expense of the Defence Budget, given the strength of the Hong Kong economy and the opportunity contained within our proposals for suitable associated arrangements to meet their presentational needs. To move to a straight 65/35 formula would cost £50M over and above the cost of a 70/30 split. I am not prepared to make the cuts in my programme that such a concession would require.

6. What then is to be done? Notwithstanding the failure to agree on them so far, my officials believe that, given the will on both sides, there remains scope for options which would secure the apportionment of 70/30 we have agreed on the one hand, whilst at the same time providing a presentation that would be satisfactory in HK terms on the other. For example, it should be possible for the HKG to pay an additional sum in relation to the current agreement to offset a move to 65/35 under a new agreement. Failing that, there remains the provision in the present DCA that the existing arrangements and apportionment will continue for a period of five



years if agreement on changes cannot be reached between the two sides. The Foreign and Commonwealth Secretary will no doubt wish to comment upon whether, given the powers and likely attitude of the Hong Kong legislature, this is in fact a practical alternative and I should be grateful for colleagues' views upon how we should proceed.

7. I am sending copies of this minute to Geoffrey Howe, Nigel Lawson, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew, Lord Glenarthur and Sir Robin Butler.

LY.

Ministry of Defence

1st February 1988

af



PM/88/006

PRIME MINISTER

Hong Kong Defence Agreement: Renegotiation

with COP?

1. I have seen George Younger's minute to you of 1 February about the fourth round of negotiations with the Hong Kong Government over the defence costs agreement.
2. These have been difficult and frustrating negotiations. But I believe it is important to appreciate their full political dimension in Hong Kong. At the end of the day we have to secure an outcome which the Governor can commend and the Executive and Legislative Councils will accept. The alternatives of a breakdown or an imposed settlement would carry grave political and constitutional dangers.
3. The Governor has reported to me that he had the greatest difficulty in persuading Exco to support the final offer tabled by the Hong Kong negotiators. He is constrained by the advice of Exco and vitally dependent on the unofficial members of the Council to persuade their Legco colleagues to vote the necessary funds under a new agreement. He fears that an apportionment less favourable than the present Hong Kong offer would fail to receive support, with all the consequences of breakdown and a damaging public confrontation between Hong Kong and London.



4. The Defence Secretary referred to the provision in the present agreement for roll-over in the event of failure to reach agreement on changes. The interpretation of the relevant provision in the agreement is disputed by the Hong Kong Government; the agreement is not enforceable by law; as a political reality we could not impose this or any other outcome on Hong Kong; the Legislative Council would certainly refuse to vote the funds. To pursue this course would lead straight to constitutional crisis.

5. Instead I am sure we must concentrate on securing an agreed outcome which satisfactorily protects our interests and is capable of being sold in Hong Kong. I entirely understand the pressures on the defence budget, and very much sympathise with the difficulty of making further money available from within it. But equally we must take into account all the factors which affect political perceptions of the issue in Hong Kong:

- the newly assertive spirit of Legco, which has to be persuaded and certainly cannot be railroaded;
- the increasing costs which the Hong Kong Government will incur in expanding the local police;
- the fact that while this is happening the cost of the garrison will steadily decline;
- the Joint Declaration provision that after 1997 China will meet all the costs of its garrison in Hong Kong;
- the widespread suspicion that British commitment to Hong Kong is waning.

In the latter connection, I am particularly concerned that a crisis over the DCA might coincide with publication of the Hong Kong White Paper on representative government, when



a vociferous minority is bound to accuse HMG of pursuing our own interests at the expense of Hong Kong. The recent visit here of Mr Martin Lee demonstrated how unsettling the effect of such attacks can be, in Parliament and the media here, as well as in Hong Kong.

6. I agree with the Defence Secretary that there remains scope for the presentational aspects of an eventual package to be further explored. The idea of moving to a 65/35 apportionment against payment by the Hong Kong Government of an offsetting sum under the current agreement is certainly one option worth pursuing; although I do not know how feasible it would be in terms of Hong Kong budgetary practices or what amount could realistically be handled in that way. We must also recognise that however the package is presented, Hong Kong Councillors will be looking closely at the effective apportionment underlying it; and there is a limit to what can be achieved, particularly with a Hong Kong audience, by means of "creative accounting".

7. I nonetheless agree that our negotiators should be instructed to explore further all such avenues which might possibly assist presentation of the outcome to Legco. But I judge that something more may well be needed. I hope therefore that the negotiators can also be given scope to go a little beyond mere presentational adjustments if they judge this necessary to achieve a settlement, for example by flexibility over the exact size of the sum which we would seek to claw back to offset a 65/35 split in a new agreement.

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8. I am sending copies of this minute to the Chancellor of the Exchequer, the Secretaries of State for Defence, for the Home Office and for Trade, the Lord President, the Attorney General and Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
1 February 1988

CONFIDENTIAL

CONFIDENTIAL

PRIME MINISTER

1 February 1988

HONG KONG DEFENCE COSTS AGREEMENT

1. Minutes from the Defence Secretary and Foreign Secretary.
2. We have reached the crunch foreshadowed in my minute of 29 January to Charles Powell. Though not immovable Hong Kong have been less flexible than we had hoped. We have to decide whether we are ready to face a public row or for political reasons are prepared to provide the extra money to bridge the gap.
3. I sympathise with the Defence Secretary's problems: Hong Kong are being difficult. On the other hand the Governor genuinely believes he cannot get anything better, from our point of view, through the Executive and Legislative Councils, and we must take his word on this. I see much force in the arguments at paragraph 5 in the Foreign Secretary's minute. My discussions in Hong Kong last December with Exco members bear them out. Defence costs is always a sensitive matter there and particularly so when the Colony is restive and only too ready to believe that our commitment is slipping, or that we are ready to subordinate Hong Kong interests to Chinese interests. We face some criticism already over the issue of direct elections and we do not want battles on two fronts at the same time. The hard fact is that we cannot just now afford a public confrontation between London and Hong Kong.
4. Against this background I think our negotiators should be asked to make one further effort to improve on the presentational aspects. The idea that Hong Kong might pay an additional sum in relation to the current agreement in order to offset a move to 65/35 under the new agreement has

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apparently only recently occurred to the Ministry of Defence. But in the end these are cosmetic devices which Hong Kong will see through rapidly. We should add to these instructions the contingent authority to settle if need be at 65/35. Alternatively, we could ask our side to explore but then telegraph back for final instructions, on the understanding among ourselves that if need be, we would be ready to make the concession rapidly. The worst of all worlds would be a row and then a concession publicly wrung out of us.



PERCY CRADOCK

CONFIDENTIAL

Jp 0489

MR POWELL

Hong Kong Defence Costs

We may be approaching the crunch in these negotiations. The latest round has ended with Hong Kong refusing to move beyond a 65/35 apportionment. They have not been immovable but have not moved as far as we would like. The Governor's view is that this is as far as they can be pushed.

2. The Defence Secretary is preparing to minute to the Prime Minister. He may well propose that we seek some further compromise. But this is likely to be cosmetic. Our negotiators will need to be given flexibility to settle around the 65/35 mark if we are to avoid a row.

3. You will recall that, following my visit to Hong Kong, the Prime Minister agreed that we should be ready to make a small but real concession. Whether the concession now in issue is small is arguable; but there is unlikely to be much more give. Without having seen the detail in the Defence Secretary's minute it is hard to comment fully. But there are strong political arguments for avoiding bad blood with Hong Kong. There is the general proposition that we must show ourselves supportive in the run-up to 1997. This is reinforced by the forthcoming publication of the White Paper on representative government, on which, with the help of Martin Lee and the like, we are likely to face criticism. We do not want two battles on our hands at the same time. The Governor will also need our support in facing a new and more restive LegCo.

4. My argument is likely to be that we give our negotiators flexibility to settle for something like 65/35.

29 January 1988
PERCY CRADOCK

A ①

PRIME MINISTER

HONG KONG DEFENCE COSTS AGREEMENT

The Defence Secretary has reported on the latest round of negotiations on the Hong Kong Defence Costs Agreement. Our team offered the concession of moving from the present 75/25 cost sharing formula to 70/30. This was not enough to satisfy the Hong Kong team whose bottom line is 65/35. The Defence Secretary is most reluctant to accept this, calculating that it would cost an extra £50 million (I take it over the period up to 1997). He thinks, however, that it may be possible by further negotiation to make various associated arrangements which would give us the substance of a 70/30 split while allowing the Hong Kongers to present it as 65/35. But he is adamant that he is not prepared to finance more than 70/30 out of the Ministry of Defence budget.

The Foreign Secretary and Sir Percy Cradock, whose minutes are also attached, point to the strong arguments for avoiding a public confrontation with Hong Kong, particularly at the moment when there are already problems over direct elections. Both are prepared to see another round of negotiation. But they would want to see us concede the 65/35 split as a last resort. Against this, the Defence budget is genuinely under pressure and it is going to be difficult to persuade the Defence Secretary that he must pay up more for this purpose.

It must be right to authorise further negotiations to see if a solution which is acceptable to both sides can be found - even at the cost of some fudging - in the hope that the Defence Secretary may find that if a further small concession has to be made, he can live with it. But ordaining here and now that the negotiators must if necessary accept the Hong Kong terms and that the defence budget must stump up is more difficult. It might be better to say that, if there is still a deadlock, they must telegraph for fresh instructions. Ministers would then have to meet, weigh the interests at stake and decide how to fund any further concession.

Agree?

CDP
CHARLES POWELL

1 February 1988

DG2CNB

Yes mt



Foreign and Commonwealth Office

London SW1A 2AH

18 January 1988

Alan Charles

ms

Prime Minister

*CDP
10/1*

Hong Kong: Representative Government

Thank you for your letter of 11 January confirming that the Prime Minister is content with the Foreign Secretary's proposals on direct elections to the Legislative Council in Hong Kong. They are included in the enclosed complete draft text of the White Paper, which the Foreign Secretary's minute of 6 January said would be circulated in due course.

Apart from the decisions on direct elections, the draft embodies the following decisions on relatively minor residual matters:

(a) Composition of the Legislative Council

There will be no changes this year in the overall size of the council, which now comprises 57 members. There will continue to be ten official members. The number of appointed members will be reduced from 22 to 20. The number of members elected from functional constituencies will be increased from 12 to 14. There will continue to be 12 members elected on a geographical basis by the electoral college.

(b) The District Boards and Municipal Councils

(i) There will be no change in the role and composition of the District Boards. However, their advisory role will be developed by requiring government departments to consult the Boards on all district matters. The Boards will also be provided with additional resources.

(ii) Links between the District Boards in urban areas and the Urban Council will be strengthened. In March 1989, each of the ten Urban District Boards will elect a representative to sit on the Urban Council. As a result the size of the Urban Council will be increased from 30 to 40 members in 1989. Urban Councillors will then cease to be ex-officiomembers of the Urban District Boards. This will bring arrangements for District Board representation on the Urban Council in line with arrangements for the Regional Council.

/(iii)



(iii) There will be no change in the role and composition of the Regional Council.

(c) The Presidency of the Legislative Council

The Governor will continue to be the president of the Legislative Council for the immediate future.

(d) Practical aspects of elections

(i) The sequence of elections will be changed so that elections to the District Boards, the Municipal Councils and the Legislative Council are held in that order.

(ii) The age of entitlement to vote and of eligibility for office will remain at 21.

(iii) A preferential elimination system of voting (as described in the Green Paper) will be adopted in this year's Legislative Council elections.

(iv) The limits on election expenses will be reviewed regularly.

These relatively minor changes fully reflect the broad consensus of opinion which has emerged on these matters in the course of last year's public consultation exercise in Hong Kong. They are in line with our own strategy for the steady and gradual development of representative government in Hong Kong. The Foreign Secretary believes that it is right that the Hong Kong Government should proceed in this way.

I am copying this letter to the Private Secretaries of members of OD(K) and to Sir Robin Butler.

Done now

R N Culshaw
(R N Culshaw)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

CONFIDENTIAL

cc PC



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

CAP
 19/1

18 January 1988

Dear Secretary of State,

HONG KONG DEFENCE COST AGREEMENT

5 flap

Following my letter of 6 January, our officials have met and there has been an exchange of telegrams with the Governor of Hong Kong.

I have seen the telegram from the Governor. I do not find it particularly encouraging but I understand that, in the light of it, your senior officials think a deal is achievable in the area set out in your letter of 21 December. On the assumption that you share this view, I am content for the UK negotiating team to go to Hong Kong.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.

Yours sincerely,

John Major

pp JOHN MAJOR

(Approved by the Chief Secretary
 and signed in his absence).

HONG KONG
Future pt 20





MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-930 7022

MO 6/19/1L

6 January 1988

CD
10/1

Dear Robert

HONG KONG: REPRESENTATIVE GOVERNMENT

Mr Younger has seen the Foreign and Commonwealth Secretary's minute of 6th January about the White Paper on Representative Government in Hong Kong. He is content with the proposals set out in the minute.

I am sending copies of this letter to the Private Secretaries to other members of OD(K) and to Sir Robin Butler.

I C F Andrews
I C F Andrews
(I C F ANDREWS)
Private Secretary

Robert Culshaw Esq
Foreign and Commonwealth Office

9



file Kb
abv PC

10 DOWNING STREET
LONDON SW1A 2AA

11 January 1988

From the Private Secretary

Dear Tony,

HONG KONG: REPRESENTATIVE GOVERNMENT

[Handwritten scribble]

The Prime Minister has considered the Foreign Secretary's minute of 6 January about the White Paper on Representative Government in Hong Kong due to be published in February. She is content with the decisions regarding direct elections set out in the draft and with the way in which the Foreign Secretary proposes to handle this.

I am copying this letter to the Private Secretaries to members of OD(K) and to Sir Robin Butler (Cabinet Office).

Yours sincerely,
[Signature]

CHARLES POWELL

A. C. Galsworthy, Esq., C.M.G.,
Foreign and Commonwealth Office.

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CDP
9/11

COPY NO 1.. OF 2..

CDP 011

PRIME MINISTER

8 January 1987

HONG KONG: REPRESENTATIVE GOVERNMENT

1. Foreign Secretary's minute of 6 January. *attached*
2. As the Foreign Secretary says, this is a good outcome, the result of skilful handling of the Chinese. We reflect public opinion in Hong Kong and avoid a clash with the Basic Law.
3. You can safely agree with the draft and the proposed course of action.



PERCY CRADOCK

SECRET

cc/c.



MO 6/19/1L

MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-930 7022

7th January 1988

wbjpm

Dear Jill,

HONG KONG DCA: RENEGOTIATION

Before his departure for India, my Secretary of State had seen the replies from the Prime Minister and the Foreign and Commonwealth Secretary to his minute of 21 December on the subject of the negotiations with the Hong Kong Government (HKG) over the Defence Costs Agreement (DCA). He had noted their reactions to his proposal for a change in apportionment in Hong Kong's favour, subject to the constraint that the Defence Budget should not be expected to bear a shift of more than about 5% of the total costs of the garrison between 1988 and 1997 without any compensation from the HKG.

He had been prepared to instruct the MOD's negotiators accordingly. But in his letter of 6th January, the Chief Secretary expressed his concern that the HKG might reject any concession and hold out for something more. Whilst it is apparently common ground between Ministers that a concession of about 5% on the apportionment would be acceptable if it resulted in a settlement, it is clear that discussions need to take place between officials of our two Departments, as suggested by the Chief Secretary, before negotiations with the HKG can be resumed. Whilst my Secretary of State is anxious that there should now be genuine negotiations, with both sides having some room for manoeuvre, he would, I am sure, wish these discussions to take place as soon as possible in the hope that the Chief Secretary's concerns can be resolved. Officials here stand ready for an early meeting.

I am sending copies of this letter to the Private Secretaries to other members of OD(K) and to Trevor Woolley (Cabinet Office).

[Handwritten signature]
 (I. F. ANDREWS)
 Private Secretary

Jill Rutter
 HM Treasury

HONG KONG · Future PT20



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cc PC



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Yes

PM/88/002

Prime Minister
Endorse the White Paper &
the proposed decision on direct
elections? (Sir P. Craddock has
looked at it in detail & is content).

PRIME MINISTER

Hong Kong: Representative Government

CDP
1/2

1. The Hong Kong Government's White Paper on representative government is due to be published in February. The text on the introduction of a directly elected element into the Legislative Council now needs to be finalised.
2. As you know, the recent Review of representative government in Hong Kong showed substantial support for the principle of direct elections. But on timing opinions are divided. No clear majority trend in favour of direct elections in 1988 has emerged.
3. We have secured from the Chinese a private commitment that if direct elections are not introduced until after the promulgation of the Basic Law in 1990, it will contain an appropriate provision for them. They have also agreed that the White Paper could state, with an "appropriate reference" to the Basic Law, that direct elections will be introduced in 1991. The outcome of the Review enables us to proceed in this way.
4. The Hong Kong Government have now sent us drafts of the key chapters in the White Paper on direct elections and the way forward. These drafts, which have been discussed with officials here, are attached. They embody the decision that an element of direct elections to the Legislative Council will be introduced in 1991, in the form of 10 directly elected seats in geographically based single seat constituencies. These would replace the seats currently elected indirectly by the District Boards. They take into account a first round of discussion with ExCo. There may still be some further minor changes of wording and presentation.

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5. In view of the part they have to play in this, the wording on the Basic Law should be shown to the Chinese in good time. I therefore propose to ask our Ambassador in Peking to pass the Chinese a paper on the pattern previously established illustrating how we intend to deal with direct elections in the White Paper, including the references to the Basic Law. Because of the tight timetable before publication, he will need to do this as soon as possible.

6. The outcome which is now emerging is a very satisfactory one, both from our point of view and for Hong Kong. We have overcome Chinese resistance to the principle of direct elections; we are on course to achieve an element of direct elections in the Hong Kong Legislative Council well before 1997; and we are set to secure a commitment to direct elections in the Basic Law for post 1997 Hong Kong. I believe that the course proposed is a fair reflection of public opinion and is in the best interests of the territory's future stability and prosperity. I therefore hope that you and OD(K) colleagues will endorse the decisions regarding direct elections set out in the drafts. The remaining chapters of the White Paper are being drafted in slower time: I will circulate a complete draft text of the White Paper in due course.

7. I am copying this minute to members of OD(K) and to Sir Robin Butler.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

6 January 1988

CHAPTER III

DIRECT ELECTIONS TO THE LEGISLATIVE COUNCIL

PUBLIC RESPONSE TO THE GREEN PAPER

Of all the questions raised in the Green Paper, the subject of direct elections to the Legislative Council produced by far the greatest public response. The Survey Office received 124,228 submissions on the matter from individuals and groups of individuals, representing the views of 137,217 people in all. It also received 605 submissions from associations and other bodies. 164 public opinion surveys of various sorts addressed the issue, and 21 signature campaigns collected over 200,000 signatures. The Legislative Council debated the subject and the Municipal Councils and all District Boards discussed it.

The bulk of the views expressed was in favour of introducing directly elected members into the Legislative Council. Even allowing for the fact that many people did not express any views it is plain that there is a strong trend in public opinion in favour of developing the present system to include a directly elected element at the central level of government, and doing so well before 1997.

On the question of whether a directly elected element should be introduced in 1988, however, opinion was sharply divided. Those who favoured introduction in 1988 argued that direct elections were important for the development of more open, accountable and representative government and should be introduced as early as possible. Those against argued that introduction in 1988 was too soon because it could endanger stability and continuity: it would involve a second major reorganisation in three years and the system of elections to be used after 1997 had not yet been established in the Basic Law.

Most submissions to the Survey Office from individuals, groups and associations were against the introduction of direct elections in 1988. The two public opinion surveys commissioned by the Survey

Office produced a similar result. Other public opinion surveys and signature campaigns were generally in favour of introduction in 1988. Opinions among Legislative Councillors, Municipal Councillors and District Board members differed widely.

Taken as a whole, the public response to the Green Paper showed that there is wide support among the people of Hong Kong for the principle of introducing directly elected members into the Legislative Council, but that the community is divided over the timing of this move.

Few opinions were expressed on how direct elections might be organized. Those who commented were on balance in favour of having several constituencies rather than a single territory-wide constituency. They also tended to favour having direct elections in addition to, rather than instead of, the present system of indirect elections by an electoral college.

Stability and Transition

There is a strong consensus in the community over the importance of stability. Stable government has always been crucial to Hong Kong. It will remain crucial in the years leading up to 1997 and beyond. Stability is essential for public confidence in the Government and in the future of the territory, as well as for overseas business confidence in Hong Kong.

The maintenance of stability requires that the development of Hong Kong's system of representative government should continue to be evolutionary rather than revolutionary: that each step should be carefully considered: and that changes should command wide support and confidence in the community.

Such evolution must also be compatible with a smooth transfer of government in 1997. There will be changes in 1997 arising from the restoration of Hong Kong to China. But the interests of the community require that there should be a high degree of continuity and that the form of government in particular should continue to be one with which the people of Hong Kong are familiar and in which

they have confidence. In considering the development of Hong Kong's system of representative government before 1997, account must be taken of the relevant stipulations of the Sino-British Joint Declaration and the deliberations of the Basic Law Drafting Committee over how those provisions should be implemented after 1997. In this connection the government has taken note of the fact that all the options in the latest draft of the Basic Law concerning the election of the future legislature include an element of direct elections.

Introduction of Direct Elections

The government has concluded that the introduction of a number of directly elected members into the Legislative Council before 1997 would be a logical and desirable further step in the development of Hong Kong's system of representative government. It would be welcomed by the community and would be conducive to the maintenance of stability.

The government has further concluded that it would not be right to make this major constitutional change in 1988, given that opinions in the community on this point are so divided. The argument that the Legislative Council should continue for one more term with its present forms of membership, rather than undergo a second restructuring in three years, is strong. At the same time, there are good reasons for leaving sufficient time before 1997 for the new form of election to become firmly established. The government has therefore decided to introduce directly elected members into the Legislative Council in 1991.

The government considers that direct elections should be on the basis of single-seat geographical constituencies. It does not believe that indirectly elected members representing geographical constituencies should in these circumstances be retained. It is difficult to see any advantage in having two parallel systems of geographical representation in the Legislative Council, directly and through District Boards. To have both would substantially increase the size of the Legislative Council and upset its overall balance. The Government has therefore decided to introduce ten directly



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elected seats in 1991, in place of the ten currently filled by indirect elections from the District Boards. The future of the remaining two electoral college seats - those elected by members of the Municipal Councils - is discussed in Chapter V of this White Paper.

Detailed arrangements for the conduct of direct elections, including the drawing up of constituencies, will be devised over the next two or three years. The public will have the opportunity to comment on them.

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CHAPTER VIII

THE WAY FORWARD

The public response to the 1987 Green Paper showed that there is a strong demand among the community for the system of representative government to be developed further. The forms of representation developed over the years have proved to be effective and to have firm popular support. The three-tier structure of government received strong endorsement in the 1987 review and there is a clear wish among the people of Hong Kong to retain and strengthen this system. At the same time there is clear concern that future development should take the form of a prudent and gradual evolution, to ensure stability between now and 1997 and a smooth transfer of government in 1997.

The decisions announced in this White Paper reflect all these considerations, and take full account of all the views expressed during the course of the review. A continuing, steady evolution of Hong Kong's system of representative government is clearly in the best interests of the community, both to meet the developing needs of our society and to maintain confidence in our future. Such a process plainly has broad support within the community.

The White Paper charts the course of further development of representative government between now and 1991. The framework of government after 1997 will be incorporated in the Basic Law which will be promulgated in 1990. Further development will be necessary between 1991 and 1997 to ensure that there is continuity and a smooth transition in 1997. Decisions will need to be taken during that period to enable Hong Kong's system of government to evolve in a way that is compatible both with the framework set out in the Basic Law and with the aspirations of the Hong Kong community. These decisions will require further public consultation though not necessarily in the form of a review such as that just concluded.

The system of government in Hong Kong is unique, and has

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developed in the way that it has because of the unique circumstances of the territory. The system of government for the future Hong Kong Special Administrative Region, which was set out in broad outline in the Sino-British Joint Declaration and which will be elaborated in more detail in the Basic law, will also be unique. Hong Kong after 1997 will continue to require a structure of government tailored to its own special circumstances. The overriding aim of the Government is that Hong Kong's system of representative government in the years between now and 1997 should be able to evolve gradually from the present system to ensure a smooth transition in 1997. This should be done in a manner that commands the full confidence of the people of Hong Kong and ensures that government is both effective and responsive.

SECRET



whgm

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

6th January 1988

Dear George

HONG KONG DEFENCE COSTS AGREEMENT

You sent me a copy of your minute of 21 December to the Prime Minister. I have also seen the Foreign Secretary's minute of 29 December. *at flap*

In principle, I could accept your proposal if it resulted in a settlement of the DCA and on the basis that the additional costs were contained within a defence programme consistent with the PES 87 control totals. I certainly share your view that no larger concession should be made.

Unfortunately it is far from clear to me whether your proposal would achieve a settlement. The UK has so far made most of the running and there must be a real risk that Hong Kong will reject any concession and hold out for something larger.

In these circumstances, before we make any concession we need a clearer view on the likelihood of reaching an agreement within the terms you have described and of the way we avoid the risk of having to make larger concessions. I suggest our officials examine the issues and report back before any concession is tabled.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.

Yours Ever,
John
 JOHN MAJOR

HONG KONG: Future
Pt 20



Prime Minister 6
CDP 21/11

Foreign and Commonwealth Office

London SW1A 2AH

31 December 1987

Joan Chambers

MR

Hong Kong Stock Exchange: Investigation by the Independent Commission Against Corruption (ICAC)

I wrote to you on 11 December about covert investigations which are being undertaken by the Independent Commission Against Corruption (ICAC) into alleged illegal activities by Committee members and staff of the Hong Kong Stock Exchange.

These investigations have been progressing smoothly. One of the officials implicated has been co-operating fully with the ICAC, who are ready to take action against the other suspects.

This action is now planned for the morning of Saturday 2 January (not the original date of 4 January). This is to give Hong Kong longer to put suitable arrangements for the management of the Stock Exchange in place over the weekend. Mr Ronald Li (who ceased to be Chairman of the Stock Exchange in mid-December and is now one of the Vice-Chairmen) and four others will be arrested on 2 January for questioning. Letters will also be issued to the new Chairman, Mr Charles Sin, and all other members of the Stock Exchange Listings Committee and its staff informing them that the ICAC will also wish to question them.

Thereafter the operation should proceed along the lines set out in my letter of 11 December. If the Chairman and Committee of the Stock Exchange are willing to co-operate, management of the Stock Exchange will be handed over to a newly formed management sub-committee. If they do not co-operate the Hong Kong Government will pass legislation on Sunday 3 January to put into place new arrangements: in practice this will mean establishing an interim management committee nominated by the Governor.

We shall ensure that No 10 are kept informed as necessary of significant developments over the holiday and weekend period.

I am copying this letter (not yet seen by the Foreign Secretary) to Alex Allan and to the Governor of the Bank of England.

Yours ever

Adrian (Culshaw)

(R N Culshaw)
Private SecretaryC D Powell Esq
PS/No 10 Downing Street



PM/87/077

CDL
29/11/77

PRIME MINISTER

Hong Kong Defence Costs Agreement: Renegotiations

1. ^{Has} I have seen George Younger's minute to you of 21 December about negotiations with the Hong Kong Government over the Defence Costs Agreement.
2. In my minute of 3 December I set out my view of the political realities of the situation. It must also be recognised that Hong Kong does face an increased burden in expanding its police force in line with the phased withdrawal of the garrison. Against this background I share the Defence Secretary's conclusion that a shift in Hong Kong's favour, away from the present 75:25 apportionment of garrison costs, is necessary if we are to reach agreement on a new Defence Costs Agreement and avoid a damaging political row with Hong Kong. Of course it takes two to make an agreement and I am pleased that Sir John Blemloch was apparently able to dispel some of the illusions in Hong Kong about what they can hope to achieve during his recent visit to the territory.
3. I am generally content that a new negotiating position should be developed along the lines set out in paragraph 3 of George Younger's minute. But I am not sure that a modest change in the apportionment, of the kind he has in mind,

/will



will turn the trick. I hope that the Ministry of Defence negotiators will have sufficient flexibility to enable them to achieve an agreement which is both politically acceptable in Hong Kong and compatible with the MOD budgetary constraints, of which I am very conscious.

4. I am sending copies of this minute to members of OD(K) and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
29 December 1987

HONG KONG. Futun PT20



CONFIDENTIAL



File 88
CCPC

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

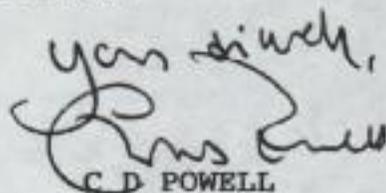
23 December 1987

Dear John,

HONG KONG DEFENCE COSTS
AGREEMENT: RENEGOTIATIONS

The Prime Minister has seen the Defence Secretary's minute of 21 December in which he proposes that we adjust our position in the negotiations for renewal of the Hong Kong Defence Costs Agreement, by conceding a small shift in Hong Kong's favour away from the present 75:25 apportionment of garrison costs. Subject to the views of the Foreign Secretary, the Prime Minister is content for the proposal in paragraph 3 of the Defence Secretary's minute to be worked up and put to the Hong Kong side.

I am copying this letter to the Private Secretaries to Members of OD(K) and Trevor Woolley (Cabinet Office).

Yours sincerely,

C. D. POWELL

John Howe, Esq.,
Ministry of Defence

CONFIDENTIAL

88



MO 6/19/1L

PRIME MINISTER

CCPC
①
Prime Minister
I think this
meets your request
for a gesture.
Agree?

Tes mt

CDDP 22/12.

HONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATIONS

As proposed in my minute of 1st December, and as subsequently endorsed by colleagues, Sir John Belloch, Second Permanent Under-Secretary at the Ministry of Defence, visited Hong Kong on 16th and 17th December. During that period he met three of the key Unofficial members of the Executive and Legislative Councils, and he also met the Governor with his three principal official advisers. He separately had two private discussions with the Governor.

2. From the discussions Sir John has received the clear impression that a shift in Hong Kong's favour, away from the present 75:25 apportionment of garrison costs, is necessary if the Governor is to muster the necessary support in Exco and Legco for a new Defence Costs Agreement. He found it much more difficult to gauge the size of the shift that would be needed to achieve this objective, especially in the light of my Department's own budgetary position (which Sir John was at pains to spell out to the Governor and his advisers). Hong Kong officials have been seeking to argue in the negotiations so far that while there could be flexibility in the incidence of payments, overall the costs of the garrison should be split 50:50. I think they now understand that such an outcome is simply not achievable and that, if there is to be a new apportionment, it will be at a level less favourable to them than that. There is also the point that Hong Kong could easily afford the sums implied by a continuation of the present arrangements - a point that the Governor and his advisers were prepared to acknowledge.

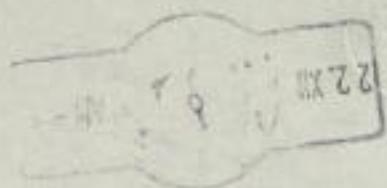


3. Given my Department's present budgetary position, I am clear that the magnitude of the shift that the defence budget can be expected to bear should be no more than about 5% of the total costs of the garrison between 1st April 1988 and 30th June 1997. I am also clear that the contribution provided by my Department should under no circumstances rise above £46 million a year, which is 25% of the estimated cost of the garrison in 1988-89, the first year of any new agreement. I propose to instruct officials to work up a negotiating position based on these principles in preparation for a further round of negotiations in the New Year. I should be grateful to know that you and the other members of OD(K) are content.

I am sending copies of this minute to members of OD(K) and to Sir Robert Armstrong.

Ministry of Defence
21 December 1987

A.Y.



Hungary

to the

PT 20

CONGRUENT



LONDON



Foreign and Commonwealth Office

London SW1A 2AH

11 December 1987

John Charles

[Handwritten mark]

*Pinehurst
CDP 11/12*

Hong Kong Stock Exchange: Investigation by the
Independent Commission Against Corruption (ICAC)

We have just learnt from the Governor of Hong Kong that for some time the Independent Commission Against Corruption (ICAC) have been covertly investigating allegations about illegal activities conducted by Committee members and staff of the Hong Kong Stock Exchange. These investigations have reached the point where action is imminent.

The main allegations concern the part played by these officials in connection with the listing of new shares. It is alleged that they have insisted on being given the opportunity to purchase secretly a number of the shares on offer. The ICAC believe that this may involve a number of criminal offences.

The ICAC have identified one of the officials implicated whom they believe will agree to cooperate with them. They plan to take him in for questioning on 12 December. If he agrees to cooperate he will be removed to London, under a cover story, for a more thorough debriefing: action would then be taken against the other suspects on 4 January.

The Hong Kong Government have also drawn up plans against the contingency that the individual concerned declines to cooperate. In that event the Governor will call in the Chairman of the Stock Exchange (who is one of those implicated) on Monday 14 December. The Committee of the Stock Exchange will be invited to remove themselves from the management of the Exchange until investigations are concluded. Control and management will instead be vested in the Chief Executive and a sub-committee chosen by the Hong Kong Government. If the Stock Exchange officials are not prepared to cooperate the Government will pass legislation the same evening to put in place new arrangements for the management of the Stock Exchange.

/We



We cannot exclude the possibility that news of the ICAC investigation will come out as early as the weekend, as soon as the first suspect is taken in for questioning. If he does cooperate, there is still a continuing danger of leaks: if he does not, and the contingency plans are put into effect, the action taken by the Hong Kong Government will need to be announced on the evening of 14 December Hong Kong time. We shall ensure that we are ready to respond to any press interest here.

In whatever way news of the investigation becomes public, Hong Kong's standing as an international financial centre is bound to be affected. It is hard to assess the precise effects on confidence, and in particular financial confidence, but these could possibly be severe. We and the Hong Kong Government will have to do all we can to emphasise that as soon as these irregularities came to light swift and determined action was taken to investigate them and to deal with those against whom the allegations have been made. We shall ensure that you are kept aware of developments, if necessary over the coming weekend.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer and the Governor of the Bank of England.

Done over

(Signature)

(R N Culshaw)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

CONFIDENTIAL

SEPC



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

CM,
 2/12

Dear George,

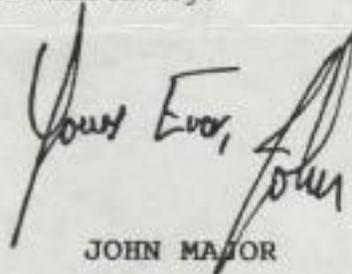
4 December 1987

HONG KONG DEFENCE COSTS AGREEMENT

You sent me a copy of your minute of 4th December to the Prime Minister.

I agree that we should hold firmly to our existing position - namely that Hong Kong should pay at least 75 per cent of the cost of the Garrison. On that basis, I have no objection to a senior official being sent to Hong Kong to explore the position as you suggest.

I am sending copies of this letter to the Prime Minister, to other members of OD(K) and to Sir Robert Armstrong.

Yours Ever,

 JOHN MAJOR

HONG KONG FULLEN P120





SOPC

CDP
3/12.

PM/87/068

PRIME MINISTER

Hong Kong: Defence Costs Agreement

at
Hq

1. I have seen George Younger's minute to you of 1 December about the negotiations with the Hong Kong Government over the Defence Costs Agreement.
2. I am grateful to the Ministry of Defence negotiators for the patience with which they have clarified the issues and identified the possible features of a new DCA. I note however that the two sides remain divided over the fundamental question of the apportionment of costs between HMG and the Hong Kong Government.
3. George Younger rightly points out the political pressures in Hong Kong for a more favourable apportionment of the cost. I stressed these in my minute of 27 August, and I need not repeat them now. We are gradually creating more democratic machinery in Hong Kong, and rightly so. The corollary is that we must also be ready to cope with the political reality which arises from that machinery.



4. While it may be arguable that the Hong Kong Government could afford to meet the full costs of the garrison, it is also the case that, as in the Falklands, HMG remains responsible for the defence and security of Hong Kong as a British dependent territory: there are in addition our treaty obligations to China in the Joint Declaration on Hong Kong. There is therefore no difficulty in justifying a contribution by the UK. More to the point, Hong Kong financial provision for a new DCA can only be authorised by the Hong Kong Legislative Council, and the Hong Kong Government clearly cannot give their consent to an agreement unless they are confident of obtaining that authorisation. The Governor does not consider that he will obtain the Legislative Council's endorsement on the basis of the present apportionment.

5. As the Defence Secretary recognises, any agreement must have the Hong Kong Government's consent: we certainly cannot impose an agreement on Hong Kong. Failure to reach one would leave us logically with little alternative but to pay ourselves, or to run down our forces faster than we consider safe. That would be unacceptable to the Chinese, who would, with justification, see it as contrary to our treaty obligations. It is not a road we could realistically embark on.

6. I therefore very much hope that George Younger will continue his efforts to reach an agreement which is politically presentable in Hong Kong as well as here. I



am content for a senior official, presumably from MOD, to go to Hong Kong to pursue this. He will naturally need to argue the UK case very strongly: but I hope he will also have sufficient flexibility to explore solutions which the Hong Kong Government could realistically expect to present successfully to the Legislative Council.

6. I am copying this minute to OD(K) colleagues and to Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
3 December 1987

HONGKONG. Futue pt 20



CONFIDENTIAL



file VC
bc: PC

10 DOWNING STREET
LONDON SW1A 2AA

cc LFO LbD
F CO H.S. CO
HO CO
HHT
LPS
DTI

From the Private Secretary

3 December 1987

Dear John,

Hong Kong Defence Costs Agreement

The Prime Minister has seen the Defence Secretary's minute of 1 December about the negotiations with the Hong Kong Government over the Defence Costs Agreement.

Subject to the views of colleagues, the Prime Minister is content with the line proposed for the time being. But she would not absolutely rule out some gesture to go a little way to meet the Hong Kong side if the negotiations reach an impasse.

I am copying this letter to the Private Secretaries to other members of OD(K) and to Sir Robert Armstrong.

Yours sincerely,

(CHARLES POWELL)

John Howe, Esq.,
Ministry of Defence.

CONFIDENTIAL

CDT

CCPC
✓ (1)



Prime Minister

MO 6/19/1L

PRIME MINISTER

1. think that we
might have to make
some gesture to go a little
way to meet them.

Agree that we should
stand firm, insisting that
Hong Kong continue to
bear 75% of the
garrison costs up
to 1997.

HONG KONG DEFENCE COSTS AGREEMENT

I thought that I should write, as a matter of some urgency, to let you and our OD(K) colleagues know the position that has been reached in the negotiations with the Hong Kong Government over the Defence Costs Agreement.

2. There have now been three full rounds of talks, together with a number of working level discussions. The two sides have reached a good understanding of each other's position, and have discussed in detail some of the technical aspects of a possible future DCA. But it has become increasingly clear that the two sides remain divided by one fundamental issue; that of the apportionment of the cost of the Hong Kong garrison.

3. The principal objective of the Ministry of Defence, which was reaffirmed by you and our OD colleagues after the second round of talks in July, was that our share of costs should fall at least in line with the overall costs of the garrison; in other words, that the MOD should be at least as well off, taking one year with another, as if the present agreement had continued unchanged until 1997. The Hong Kong Government's position has been that their share of garrison costs must fall substantially in real terms. It has now become clear that the issue for them as much as for us is one of cash; in addition to which they are seeking a presentational advantage. They have suggested that they required a shift from the present 75:25 apportionment to about 50:50; but they have also hinted that they would be prepared to settle for a fall in their contribution from 75% to at most 62.5% of garrison costs. The difference between 75% and 62.5% is equivalent to about £125 million at constant prices over the period to 1997.



4. It has, of course, always been arguable that, for the remainder of the period to 1997, the HKG should be expected to meet the full cost of the garrison, since it will be devoted largely to meeting their own security requirements. I therefore remain of the view that the HKG's position is quite unreasonable, and that we are fully justified in continuing to require them to bear at least 75% of the costs of the Hong Kong garrison. There is no doubt, however, that Exco and Legco have been brought to expect a change in apportionment in their favour, and that there may be a disinclination to approve any financial arrangements that do not incorporate, and make manifest, such an improvement. I am quite clear, however, that the defence budget should not be expected to bear such an additional commitment.

5. As I see it, therefore, we now have few options. The simplest would be to persuade the Hong Kong Government to accept a new DCA having the same effect in apportionment terms as the existing arrangements; or, to the same end, to continue with the present arrangements, as is provided for in the existing agreement. Any other method would have in the end to come down to the same thing in apportionment terms. An approach could in theory be made at a more senior level than that of the negotiations so far but, as I have explained, the fundamental issue remains that of the apportionment.

6. In the absence of a move by one or both sides on this issue, it is difficult to see how, no matter what the level of the next exchanges, the consent of the Hong Kong Government could be forthcoming. It is, however, for consideration whether, as a final gesture on our part, a senior official might be sent to Hong Kong to explore with the Government whether the basis for such consent might exist; and I propose that we should now take this step urgently.



I should be glad to know whether you and our OD(K) colleagues agree. I am sending copies of this minute to them and to Sir Robert Armstrong.

Ministry of Defence

1 December 1987

A handwritten signature in blue ink, appearing to read "C. Chilcote", written over a horizontal line.

Private Secretary

(Approved by the Defence Secretary
and signed in his absence.)

CONQUEROR

LONDON

4
COP

Foreign and Commonwealth Office

London SW1A 2AH

29 October 1987

Sean Charles,

COP
29/11

Hong Kong: Representative Government

The Foreign Secretary ^{at Hong}minuted to the Prime Minister and to OD(K) colleagues on 6 May about the handling of the Review of Representative Government which has been taking place in Hong Kong over the summer. The period of public consultation ended on 30 September. The report of the Survey Office established to collect public reactions is due to be published on 4 November. The Prime Minister may find it useful to have an indication of the outcome of the Review and of how we now see the way forward.

The Governor of Hong Kong has received an advance copy of the Survey Office report and has briefed the Foreign Secretary on that basis. As we expected, the question of introducing a directly elected element into the Legislative Council dominated the Review and generated considerable public interest. It is clear that a substantial body of public opinion supports the introduction of an element of direct elections in principle. But on timing significant numbers are against their introduction in 1988, preferring to see this happen after 1990 when the Chinese Government will promulgate the Basic Law for post 1997 Hong Kong. The submissions received by the Survey Office and the private opinion polls conducted on the Office's behalf both show that only a minority wish to see direct elections introduced in 1988. There is also a substantial number of "don't knows".

On the other matters raised in the Review, it is clear that there is strong support for keeping the voting age at 21 years and for retaining the Governor's role as President of the Legislative Council. There is also some support for a slightly enlarged role for the District Boards.

This outcome accords generally with our expectations. In particular the views expressed on direct elections will enable us to take a decision in line with Hong Kong public opinion to delay their introduction until after 1990, thereby avoiding a damaging public disagreement with the Chinese. This would mean direct elections starting in 1991 or 1992. The outcome on the other matters raised by the Review is also satisfactory.

Throughout

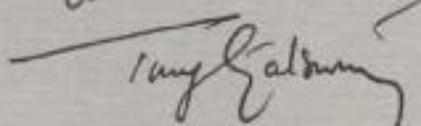


Throughout the summer we had been under pressure from the Chinese not to introduce direct elections in 1988. They had made it clear that their objection was not to direct elections as such but rather to their introduction before their own drafting of the Basic Law was complete (which would have given the appearance of direct elections having been forced on China). We consistently declined to give the Chinese any assurance on this point, on the ground that the Review must be a genuine one.

However by September it was becoming clear that public opinion in Hong Kong was shaping up the way which I have described in the preceding paragraphs. This enabled the Foreign Secretary to brief the Chinese Foreign Minister, Wu Xueqian, on the likely outcome; and the Governor of Hong Kong subsequently took parallel action with Vice Foreign Minister Zhou Nan on a visit to Peking. As a result we have secured from the Chinese a private commitment that if direct elections are not introduced until after the promulgation of the Basic Law, there will be an appropriate provision for them in the Basic Law. The Chinese also agreed that the Hong Kong Government White Paper to be published next February could state with an "appropriate reference" to the Basic Law that direct elections will be introduced in 1991 or 1992. The existence of this understanding remains very sensitive.

The next step is the publication of the Survey Office Report on 4 November. We are taking steps to brief MPs and the press as necessary so as to ensure that they properly understand its contents and its significance. Nothing will of course be said about our understanding with the Chinese. Thereafter work will begin on the Hong Kong Government White Paper. There will need to be discussion with the Chinese over the precise wording of the reference in the White Paper to direct elections and the Basic Law. We may encounter difficulties over this, but we believe they should be surmountable.

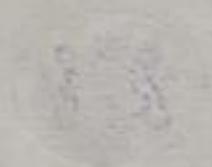
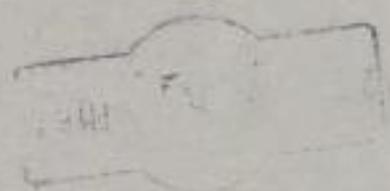
I am copying this letter to Private Secretaries of members of OD(K) and of Sir Robert Armstrong.

Yours ever,


(A C Galsworthy)
Private Secretary

C D Powell Esq
 10 Downing Street

HONG KONG - Future pt 20



SUBJECT
CC MASTER.

SECRET



10 DOWNING STREET
LONDON SW1A 2AA

23 October 1987

From the Private Secretary

HONG KONG

The Chancellor this morning outlined to the Prime Minister the problems faced by Hong Kong, particularly the heavy exposures and potential losses in the stock index futures market. The Prime Minister stressed to the Chancellor her very great concern about the possibility of severe financial difficulties in Hong Kong. This would strengthen the position of "the Left" in China and could put at risk the agreement with the Chinese Government about the future of Hong Kong.

DAVID NORGROVE

Alex Allan, Esq.,
H.M. Treasury.

SECRET



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

5 October 1987

HONG KONG: REPRESENTATIVE GOVERNMENT

The Prime Minister has considered the Foreign Secretary's minute of 2 October forecasting the likely outcome of the public consultation exercise on the future of Representative Government in Hong Kong, and detailing our exchanges with the Chinese on the introduction of a directly elected element into the Legislative Council. She agrees that the outcome is highly satisfactory and attaches particular importance to having secured Chinese agreement to provide for direct elections in the Basic Law.

CHARLES POWELL

A.C. Galsworthy, Esq., C.M.G.,
Foreign and Commonwealth Office.

1. [Signature]



Prime Minister
the assurance of
direct elections
after 1997 is
surely with a delay
of three years in
introducing them
now.

FCS/87/055

I agree - it
would be a great
triumph to have

PRIME MINISTER

them provided for in the
Basic Law. [Signature]

Hong Kong: Representative Government

CDP
2/x

1. I minuted to you on 6 May about the forthcoming Review of Representative Government in Hong Kong, and summarised our exchanges with the Chinese on the question of the introduction of a directly elected element into the Legislative Council.

2. The Green Paper was published on 27 May; the period of public consultation ended on 30 September. The independent Survey Office established to collect public comment will submit its report to the Governor by the end of October. Proposals will then be made in a White Paper to be published early in 1988.

3. The issue of direct elections has dominated the Review: the public response has far exceeded any previous such consultation, including that on the Joint Declaration. Sir David Wilson is now clear, from the trend of the public debate in Hong Kong and following informal indications from those responsible for the Survey, that the conclusion on direct elections will almost certainly be that a significant majority of public opinion supports their introduction in principle; but that those in favour are sharply divided on the timing of their introduction, with no clear majority

/for



for introduction next year rather than at a later date. A substantial body of Hong Kong opinion believes that direct elections should not be introduced until after 1990, when the Chinese Government will promulgate the Basic Law for post-1997 Hong Kong. The discussion throughout has been about direct elections for a proportion only of the seats in the Legislative Council.

4. During the summer, the Chinese have continued to represent to us their view that we should not introduce direct elections in 1988: they have made it clear that if we did, they would be obliged to dissociate themselves from the action, and have sought an understanding that we would not do so. They have however made it clear that their objection is not to direct elections as such, but to the principle of the British Government introducing them before the Chinese Government's own exercise of drafting the Basic Law in consultation with the people of Hong Kong is complete, and thus appearing to force them on China.

5. We have throughout declined to give the Chinese any such assurance on the grounds that the Review must be genuine, and that until we knew its outcome we could not give any commitment as to the conclusions we would draw from it.

6. However, the clear indication that the Review will not produce a majority in favour of introducing any element of direct elections in 1988 has enabled us to take the matter further with the Chinese. It was essential to do this at this stage in order to head off the possibility of a hostile public response from the Chinese to the publication of the Report. I saw the Foreign Minister in New York last week, and Sir David Wilson, who was visiting Peking, held talks with his deputy. We briefed them in strict confidence on the likely outcome of the Review. We proposed that, if the outcome of the Review is indeed as expected, the White Paper in early 1988 should acknowledge public support in principle

/for



*agreed by 1990, should be not
later than 1992 - would
- what be a possible formula? m*

for an element of direct elections, and state, with an appropriate reference to the Basic Law, that these would be introduced in 1991 or 1992. For their part the Chinese would make it clear that the Basic Law would permit an element of direct elections to the Legislative Council into the years after 1997. The Chinese replied that if direct elections were not introduced until after the promulgation of the Basic Law, the Chinese Government would see that there was appropriate provision for them in the Basic Law. They also agreed that the White Paper in 1988 should give the commitment we had suggested.

7. This would be a highly satisfactory outcome. We could well have faced a difficult choice between introducing direct elections in 1988 in the teeth of Chinese opposition (and probably thereby ensuring a Chinese commitment to dismantle them after 1997) and declining to introduce them in the face of Hong Kong public opinion to the contrary. The effect on confidence in Hong Kong either way would have been very severe. As it is, we are set to secure the introduction of a measure of direct elections well ahead of 1997 with Chinese support and a guarantee of their survival thereafter. The Chinese have hitherto resisted giving any such guarantee.

8. A vociferous minority in Hong Kong will attack any failure to introduce direct elections in 1988, irrespective of the report on public opinion. However the Governor believes that the outcome will come as a considerable relief to the public in general in Hong Kong, and that it can be handled politically. It will need to be carefully explained at Westminster.



9. There is still room for this to go wrong: the final report of the Survey Office might contain some surprises, though the Governor does not think this likely. Equally when it comes to establishing the exact terms in which the White Paper should speak of the introduction of direct elections, there could still be difficulties with the Chinese. But I am now optimistic about the outcome.

10. I wanted to let you know immediately how we stood. However because of the extreme sensitivity of the information which the Governor has obtained from the Survey Office about the public consultation exercise, and indeed of this whole subject in Hong Kong, I am not at this stage copying this minute to colleagues. I propose to circulate a paper to members of OD(K) once the report of the Survey Office is delivered to the Hong Kong Government.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
2 October 1987

Hansa Konk. future

A 19



PART 19 ends:-

SS/Mod To FCS 9.9.57

PART 20 begins:-

FCS To PM 2.10.57

