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TELNO 202 OF 6 APRIL

INFO PRIORITY HONG KONG (PERSONAL FOR GOVERNOR).

MR HEATH'S CALL ON DENG XIAOPING: HONG KONG

1. MR HEATH RAISED THE QUESTION OF HONG KONG DURING HIS CALL ON DENG XIAOPING THIS MORNING, RECALLING THAT HE HAD FIRST RAISED IT WITH MAO ZEDONG AND ZHOU ENLAI IN 1977 IN DENG'S PRESENCE. MAO HAD SAID THAT NOTHING SHOULD HAPPEN BEFORE 1997, AND THEN THE YOUNGER MEN PRESENT COULD SETTLE THE ISSUE. THERE WERE NOW ONLY 15 YEARS TO GO. WHAT THOUGHT HAD THE VICE-CHAIRMAN GIVEN TO THE INTERIM PERIOD WHEN INVESTORS WERE WORRIED ABOUT THEIR INVESTMENTS?
2. DENG FIRST ASKED FOR MR HEATH'S IDEAS. THE LATTER REPLIED THAT WE SHOULD WORK ON THE PREMISE THAT WE WANTED PEOPLE TO KEEP THEIR INVESTMENTS IN HONG KONG: IT WAS PARTICULARLY GOOD FOR CHINA THAT HONG KONG PEOPLE WERE MAKING LARGE INVESTMENTS IN CHINA. IT WAS NECESSARY TO CONVINCE THE POPULATION THAT THEIR INVESTMENTS WOULD BE SAFE AFTER 1997, AND THIS REQUIRED HELP FROM THE PRC GOVERNMENT.
3. DENG THEN ASKED WHETHER MR HEATH THOUGHT THAT IT WOULD BE POSSIBLE TO BASE OURSELVES ON THE SPIRIT OF THE NINE POINT PROPOSALS FOR TAIWAN, AS APPLIED TO HONG KONG. THIS WOULD MEAN THAT SOVEREIGNTY OVER HONG KONG WOULD BELONG TO CHINA, BUT THAT HONG KONG ITSELF COULD REMAIN A FREE PORT AND AN INTERNATIONAL FINANCIAL CENTRE. FOREIGN INVESTMENT WOULD NOT BE AFFECTED. HONG KONG WOULD BE MANAGED BY ITS INHABITANTS, INCLUDING SUCH FOREIGNERS AS WERE RESIDENT THERE, BUT SOVEREIGNTY WOULD BE CHINESE.
4. MR HEATH SAID THAT HE SUPPOSED THAT IN SUCH CIRCUMSTANCES BRITAIN WOULD STILL BE ABLE TO MAKE ITS CONTRIBUTION TO HONG KONG'S PROSPERITY, WHICH WAS ALSO SO MUCH TO THE ADVANTAGE OF CHINA. DENG REPLIED THAT THERE COULD BE A LOCAL GOVERNMENT IN HONG KONG. THE NEW CHINESE STATE CONSTITUTION WOULD SPECIFICALLY ALLOW FOR THE CREATION OF SPECIAL ADMINISTRATIVE ZONES. THE LOCAL GOVERNMENT WOULD BE FORMED BY THE INHABITANTS, WHETHER CHINESE, BRITISH OR OF OTHER NATIONALITY. SUCH PEOPLE COULD EITHER BE EMPLOYED BY THE LOCAL GOVERNMENT OR THEMSELVES BE MEMBERS OF THE LOCAL GOVERNMENT. THE "VARIOUS SYSTEMS" OF HONG KONG WOULD REMAIN UNCHANGED. IT COULD USE THE NAME "HONG KONG: CHINA" AND COULD MANAGE ITS OWN NON-GOVERNMENTAL TRADE AND COMMERCIAL RELATIONS WITH OTHER COUNTRIES.

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5. DENG WENT ON TO SAY THAT THE PROBLEM OF THE EXODUS OF CHINESE FROM THE MAINLAND TO HONG KONG WOULD BE EASIER TO SOLVE UNDER SUCH A REGIME. THERE WERE NOW QUOTAS AND MANY PEOPLE WISHED TO SETTLE IN HONG KONG. UNDER SUCH AN ARRANGEMENT THE UK MIGHT SUFFER A LOSS OF TAXATION REVENUE FROM HONG KONG, BUT TRADE AND COMMERCE WOULD NOT SUFFER.

6. MR HEATH SAID THAT BRITAIN RECEIVED NOTHING FROM HONG KONG AND SUGGESTED THAT BRITAIN MANAGED HONG KONG FOR THE BENEFIT OF CHINA AND OF MANKIND. DENG REPLIED THAT IN THAT CASE THE MATTER WOULD BE EVEN EASIER TO SETTLE. AS A FRIEND OF LONG STANDING HE COULD TELL MR HEATH THAT IF CHINA DID NOT RECOVER HER SOVEREIGNTY OVER HONG KONG SHE COULD NOT BE ACCOUNTABLE TO HER OWN PEOPLE. MR HEATH SAID THAT THE QUESTION OF SOVEREIGNTY WAS VERY CLEAR IN THE TREATIES. DENG SAID THAT HE WAS REFERRING TO SOVEREIGNTY OVER THE WHOLE AREA OF HONG KONG AND NOT JUST THE NEW TERRITORIES. IT WOULD INVOLVE ABROGATING THE PAST UNEQUAL TREATIES.

7. MR HEATH CONCLUDED BY SAYING THAT THESE WERE INTERESTING IDEAS WHICH HE WOULD CONSIDER. HE HOPED THAT THE CHINESE SIDE WOULD SHOW FLEXIBILITY IN NEGOTIATIONS.

8. I SHALL SEND CONSIDERED COMMENT TOMORROW AFTER MR HEATH HAS LEFT. MR HEATH AND HIS PARTY REALISE THE SENSITIVITY OF THE ABOVE, AND HAVE AGREED TO SAY NOTHING PUBLICLY. AT THIS MORNING'S PRESS CONFERENCE HE RECALLED THE 1977 MEETING WITH MAO, AND SAID THAT HE HAD REMINDED THE CHINESE OF THE URGENCY OF SUPPORTING CONFIDENCE IN HONG KONG. HE REFUSED TO BE DRAWN ON DENG'S REPLY.

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MR GIFFARD  
MR DONALD  
MR URE

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TO PRIORITY F C O

TELNO 209 OF 7 APRIL

INFO PRIORITY HONG KONG (PERSONAL FOR GOVERNOR).

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(14) MY TELNO 202: MR HEATH'S CALL ON DENG XIAOPING: FUTURE OF HONG KONG

1. THIS IS MUCH THE MOST IMPORTANT AND REVEALING STATEMENT WE HAVE HAD FROM THE CHINESE SIDE ABOUT HONG KONG. DENG HAS CLEARLY BEEN GIVING SOME THOUGHT TO THE ISSUE AND IN OBLIQUE CHINESE FASHION WAS USING THE VISIT OF A DISTINGUISHED, BUT NON-GOVERNMENT, VISITOR, TO PUT FORWARD WHAT IS IN EFFECT A TENTATIVE OFFER IN ADVANCE OF THE PRIME MINISTER'S VISIT.
2. AS MIGHT BE EXPECTED, IT HAS GOOD AND BAD PARTS. THE GOOD IS THAT, AS WE GUESSED, THE CHINESE LEADERS ARE READY TO PUT HONG KONG IN THE FRAMEWORK OF THEIR LIBERAL TAIWAN PROPOSALS, NO DOUBT HOPING THIS MAY BE AN INDUCEMENT TO TAIWAN. THIS HAS ADVANTAGES FOR US IN THAT THE CHINESE WILL HAVE AN INTEREST IN SHOWING THEMSELVES GENEROUS.
3. THE BAD IS THAT, ALTHOUGH DENG'S PROPOSALS DO NOT ENTIRELY PRECLUDE THE POSSIBILITY OF CONTINUED BRITISH ADMINISTRATION, THEY SHOW CONTINUED MISUNDERSTANDING OF THE WAY THE HONG KONG ECONOMY WORKS AND WHAT INVESTORS WILL ACCEPT. THERE IS ALSO THE DELUSION THAT THE UK TREASURY RECEIVES TAXATION REVENUE FROM HONG KONG. WE MUST CORRECT CHINESE MISCONCEPTIONS AND TRY TO EXPLAIN TO THEM HOW TO AVOID KILLING THE GOOSE THAT LAYS THE GOLDEN EGGS.
4. DENG'S REMARKS ON SOVEREIGNTY FURTHER UNDERLINE THAT THIS WILL BE FOR THE CHINESE AN ESSENTIAL CONDITION OF PROGRESS.
5. MR HEATH UNDERTOOK TO CONSIDER DENG'S IDEAS AND MAY BE IN TOUCH WITH YOU. BUT IN ANY CASE WE CANNOT IGNORE WHAT IS IN EFFECT AN OFFER MADE AT THE HIGHEST LEVEL. FORTUNATELY THE IDEAS IN IT STILL LOOK TENTATIVE AND WE SHOULD GET BACK AND FEED IN OUR OWN THOUGHTS BEFORE THE CHINESE IDEAS CONGEAL. AS A FIRST STEP I RECOMMEND THAT I SPEAK TO HUANG HUA SOON, SAYING THAT WE HAVE NOTED WITH INTEREST DENG'S WORDS TO MR HEATH WHICH WE THINK MIGHT PROVIDE A BASIS FOR DISCUSSION. AS A FIRST STEP WE SHOULD LIKE TO GIVE THE CHINESE SIDE A FULLER PICTURE OF HOW HONG KONG'S FINANCES WORK. HERE I SHOULD LIKE TO HAND OVER A PAPER WHICH NO DOUBT YOU AND HONG KONG COULD PREPARE SETTING DOWN THE ESSENTIALS AND IMPLYING, THOUGH NOT NECESSARILY STATING, THE CRUCIAL VALUE OF BRITISH ADMINISTRATION IF PROSPERITY IS TO BE MAINTAINED. SOMETHING IN WRITING ON THE FINANCIAL SCENE IS, I THINK, NEEDED TO AVOID THE HAZARDS OF ORAL TRANSMISSION.

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6. AS A SECOND LINE WE SHOULD MAKE MAXIMUM USE OF CHINESE VISITS TO HONG KONG TO EDUCATE THE CHINESE FURTHER IN THE REALITIES. A BANK OF CHINA VISIT, IN RETURN FOR MR BREMRIDGE'S VISIT, MIGHT BE ONE POSSIBILITY. WE SHOULD ALSO CONSIDER AN INVITATION TO A MEMBER OF WESTERN EUROPEAN DEPARTMENT OF THE MINISTRY OF FOREIGN AFFAIRS, WHO ARE SHORTLY TO LOSE THEIR ONLY HONG KONG EXPERT.

7. BUT THE MAIN THING IS TO RESPOND TO DENG BEFORE CHINESE IDEAS HARDEN.

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