

CONFIDENTIAL

Prime Minister

MR. COLES ✓ *12/1*

HONG KONG

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A pattern is beginning to emerge out of the fog of the Peking negotiations. The Chinese tactics appear to be to threaten us with the stick of a break down in the talks if we do not accept their premise that sovereignty and administration are indivisible, and at the same time to tempt us with the carrot that, once we have accepted their premise, we will find them reasonably forthcoming about the practical details of the administration of Hong Kong. The heart of the indivisibility premise is of course that, however much local autonomy Hong Kong might have under Chinese sovereignty, all links with London would be cut.

Our tactics are, of course, precisely the opposite. We are trying to involve the Chinese in a detailed discussion of each and every aspect of the administration of Hong Kong, the basis for its financial and commercial success etc in order to build the pyramid in such a way that, before we reach the top, the Chinese will be convinced that some organic links with London are necessary in order to maintain stability and prosperity post 1997.

It is clearly in our interests to maintain our approach to the negotiations for as long as possible, in order to give the local leadership in Hong Kong the maximum amount of time to digest and acquiesce in the need for change. The latest account of their views suggests that there is a longish way to go in this process. If we conceded the Chinese premise prematurely, there would be an immediate crisis of confidence in Hong Kong. If we hold out too long and the Chinese force a break down of the talks, this will also cause a crisis of confidence.

It seems to me that this tactical balance should form the basis for our discussion with Percy Cradock and Teddy Youde when they return to London in early September.

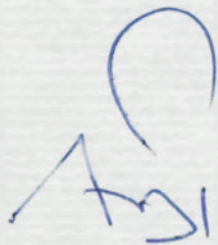
The following are the main questions in my mind;-

1. Is there a hope that the Chinese are bluffing and that they will eventually concede that their sovereignty should be titular and that a large measure of British administration should continue? Personally I doubt it.

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2. If the Chinese are not bluffing, have they got the sense to realise that they need to continue to play the negotiations fairly long in order to nurse Hong Kong opinion into the need to accept radical change?
3. If not, how soon are the Chinese likely to force a deadlock if we continue to refuse to accept their premise about indivisibility?
4. If we hold firm and the talks break down on this point, what will the effects be in Hong Kong?
5. If we accept the Chinese premise some time this autumn and then start discussing practical details with them on the basis of the maximum of local autonomy for Hong Kong under Chinese sovereignty but without links to London, what effect will this have on Hong Kong opinion and confidence?



A.D. PARSONS
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