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RECORD OF A DISCUSSION BETWEEN THE PRIME MINISTER AND THE
GOVERNOR OF HONG KONG AND THE UNOFFICIAL MEMBERS OF EXCO
AT 0935 HOURS ON FRIDAY, 7 OCTOBER 1983 AT 10 DOWNING STREET

Present:

Prime Minister	Governor of Hong Kong
Foreign and Commonwealth Secretary	Sir Sze-Yuen Chung
Mr Luce	Mr O V Cheung
Sir Antony Acland	Mr R H Lobo
Sir Percy Cradock	Mr Li Fook Wo
Mr Donald	Mr M G R Sandberg
Mr Butler	Mr L Tak Shing
Mr Coles	Mr D Kennedy
	Miss L Dunn
	Mr Lee Quo-Wei
	Mr Chen Shou-Lam
	Miss M Tam Wai-Chu

The Prime Minister welcomed the Governor and the Unofficials. The object of the meeting was to consider our approach to the next round of talks with China about the future of Hong Kong. It was very important to get this right. She was deeply conscious of the possible consequences for the ordinary people of Hong Kong if we acted in such a way as to bring about confrontation with China. The aim of any negotiator must be to avoid situations from which it was impossible to recover. The people of Hong Kong were used to living with freedom and justice. We wanted them to be able to continue to do so. The next round of talks would be critical, especially in view of the Chinese attitude at the last round. The object must be to keep the talks going and to arrive at the point where we could probe Chinese proposals, as EXCO had wanted earlier.

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The Foreign and Commonwealth Secretary then summarised the outcome of his own meeting with the Unofficials on 6 October. The anxieties felt on both sides had been fully considered. The Unofficials had been briefed on the latest position of China, following his talk with the Chinese Foreign Minister in New York. The main current Chinese objection was that we were trying to retain British administration. If there was no adjustment to the British position there was a prospect of breakdown at the next round. We all recognised that the Chinese position was unreasonable. But the consequences of breakdown, whenever these occurred, could be very serious. Some of the Unofficials had felt that if confrontation was inevitable at some time, it should be faced now rather than later. This group had also argued that if we made a concession to the Chinese now they would simply try to extract more concessions. Others had felt, however, that it would be very difficult to justify confrontation when we had not yet fully explored all the possibilities for a negotiated settlement. They had argued that it would be better to face the possibility of confrontation at a time of our own choosing.

We had been working on a formula which would make some move towards the Chinese but without any prejudice to our ultimate right to take decisions. The final settlement could not in any case be prejudiced because the British Parliament was sovereign and it alone could decide whether to accept or reject it.

The Unofficials had shown willing to examine the formula with a view to establishing what progress could be made while retaining the substance of those arrangements which were at the roots of Hong Kong's present stability and prosperity.

/The Prime Minister

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The Prime Minister recalled that the Chinese had offered to guarantee any arrangement for a period of 50 years. If we proceeded to confrontation now, and it then emerged that the Chinese were willing to offer a reasonably satisfactory arrangement for 50 years, how would the ordinary people of Hong Kong react to the fact that we had not even explored this offer? What would they think if we had not explored the possibility of an agreement of this length which preserved not only Hong Kong's present economic arrangements but also freedom and justice?

Sir S-Y Chung said that the Unofficials were very grateful for the opportunity of a further meeting with the Prime Minister. He wished to make a brief statement which he thought represented the consensus of their views,

It was a year since the Prime Minister had visited Peking and it was now time to take stock. There had been no substantial progress in that period. HMG had tried various ways of promoting a meaningful dialogue, including the device of the Prime Minister's letter of 10 March to the Chinese Premier. But China had accepted every concession without giving anything away. Their attitude on the indivisibility of sovereignty and administration had hardened. They had stepped up their propaganda and fuelled the fears of the people of Hong Kong. Most people in Hong Kong believed that the Chinese plan would not work.

Hong Kong had experienced another panic during the week of 19 September. The value of the Hong Kong dollar vis-a-vis the US dollar went down from 7,9 on 16 September to 9,5 on 24 September, a drop of 20 per cent in a week. The Hang Seng index had fallen by over 150 points to the 1983 low of 780. The exchange rate of the Hong Kong dollar was now hovering between 8 and 9. The Hang Seng index had continued its downward

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trend and had broken the 700 barrier last Tuesday.

All this had happened despite the improvement in Hong Kong's export led economy. The export of locally manufactured products had grown by 9 per cent in money terms for the first four months of 1983, 14 per cent in the first half of the year and 18½ per cent in the first eight months.

Most people in Hong Kong understood that Britain had no intention to keep Hong Kong as a colony. As the Prime Minister had rightly said in a recent interview, but for its special status Hong Kong would have been independent years ago and would have been another Singapore. Hong Kong had had a phased plan for 1949 for an elected legislative council with the ultimate aim of independence. But the plan was shelved due to the changed political scene in China,

China was able to seek the support of the Hong Kong people for its position on sovereignty and administration. But the British Government and the Unofficials had not thought it advisable to advocate in public the need for continuing British administration. They had to reflect rather passively the views and wishes of the Hong Kong people.

The Unofficials believed that the exchange rate of the Hong Kong dollar, the state of the securities market and the reactions of the Hong Kong people to the Chinese plan would eventually influence the Chinese position on the future of Hong Kong. For this reason, both HMG and the Hong Kong Government had been letting the state of confidence in Hong Kong find its own level. It had been their hope that this would shake the Chinese leaders and make them change their stand. But it now appeared that the Chinese were using this situation to test our own nerves.

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Basically there were three options open to the British Government:-

- a) To maintain the object of continuing British administration for as long as possible (there could be variations in the details to make this option more acceptable to the Chinese - one possibility would be to limit the period of British administration after 1997).
- b) To capitulate i.e. to agree to return to the Chinese in 1997 both sovereignty and administration over the whole of Hong Kong and try to get the best deal possible.
- c) A compromise between the first and second option.

China was well known for its hard bargaining. It was going all out to canvas support and influence public opinion. Those who did not know the Chinese mind found it difficult to resist such propaganda. Most of the people of Hong Kong wished to maintain the current state of freedom and rule of law and had no faith in Chinese Communist Government. They did not believe that the capitalist system and freedom could exist for long within Communist China unless there was some kind of effective guarantee or insulation.

It was the unanimous recommendation of the Unofficials that HMG should adopt the first option and seek to continue British administration after 1997 for as long as possible. But, if necessary, the Hong Kong people would accept a limited period during which China could develop a track record.

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The Unofficials were also unanimous that acceptance of capitulation would lead to a further deterioration in confidence in Hong Kong. Now was not the time for HMG to compromise on principle. This was particularly so since many Unofficials believed that there were signs of concern on the part of Chinese Communists in Hong Kong about the falling dollar and there was a distinct possibility that the Chinese might wish to have a short term conciliation.

As regards the next session of talks, the Unofficials had noted the view of Sir Percy Cradock that if HMG did not make a concession at the next round there was more than a 50:50 chance of breakdown. They believed that we should be firm on the principal objective and at the same time try to avoid a stalemate. The Unofficials were pleased to hear at their meeting yesterday that Sir Percy had found a formula which, without prejudice to the British position, might induce the Chinese to let us have details of their plan for examination. This would hopefully avoid a breakdown of the talks in October. But if a stalemate was inevitable, a large number of the Unofficials, after carefully weighing the pros and cons, believed that the risk must be accepted. If there were a breakdown in October or later, the Hong Kong people were aware of the possible consequences and were prepared for them. In an optimistic scenario the Hong Kong dollar and the property market would fall but the fall would not be very great and any panic would be short lived. More pessimistically there could be a sharp fall in the exchange rate coupled with a rather rapid rise in prices. This could spark runs on banks and supermarkets with a possible consequence of civil disturbance in some areas of Hong Kong. Under such circumstances, the

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Hong Kong Government might have to impose a curfew as it had done in the mid-60s. With the exception of one of their number the Unofficials were confident that Hong Kong would be able to survive this turbulence.

We should not forget that the Chinese were also assessing the risks of stalemate or breakdown. Disruption of Hong Kong would not serve China's interest.

As regards the Chinese propaganda campaign, the Unofficials did not think that a public confrontation with the Chinese would serve any useful purpose at this stage. But the people of Hong Kong needed some assurance from HMG. Mr. Luce's recent visit had been helpful in reaffirming Britain's commitment to finding a solution which was acceptable to the majority of the people of Hong Kong.

If at the end of the October talks, we did not obtain Chinese co-operation in issuing a reasonable statement, we could act to minimise the fall in confidence. One way would be to convey to the people of Hong Kong the British stance and determination in the negotiations. But the method of doing this, without causing confrontation, needed careful consideration.

In conclusion, it was the unanimous view of the Unofficials that HMG should maintain its basic objective of continuing British administration after 1997. We should listen to any counter proposals that the Chinese might make but the chance of their doing so was remote.

The Chinese slogan was that sovereignty and administration were inseparable and everything else was negotiable. Our own slogan should be that the British link between HMG and the Governor was unseverable and anything else could be discussed.

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The Unofficials did not under-estimate the grave consequences of stalemate or breakdown but believed they could survive such turbulence. Many of the Unofficials also believed that the Chinese were concerned about the deteriorating value of the Hong Kong dollar. It would be unfortunate if we changed course at this crucial moment. We should continue with resolution and determination and not let down the people of Hong Kong.

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The Prime Minister said that the objectives of HMG and the Unofficials were the same. We were walking on a tightrope and had to make the right decision.

Mr. Cheung said that he entirely agreed with the Prime Minister's opening statement. He had been glad to hear Sir Percy Cradock say yesterday that his formula might keep the talks going. He himself saw no purpose in confrontation now and he would do all he could to avoid it for the reasons given by the Prime Minister and expanded on by Sir S.Y. Chung.

Last Friday the first Director of the New China News Agency in Hong Kong had sought out Sir S.Y. Chung and Mr. Lee. Although he had followed the usual Chinese line he had made some points which were perhaps significant. He had said that it was a pity that Britain and China were at loggerheads. This could only benefit third parties. He had further stated that it had been a mistake to start talks so early (though of course we had taken the initiative because we were worried about the termination of leases in 1997). The most practical suggestion he had made was that the two sides should devise a method for leasing land in the New Territories after 1997; this might stop the present erosion of confidence and restore the Hong Kong dollar.

This could be a significant departure in the Chinese attitude because Lord Maclehoze had been told in 1979 that any such suggestion was inappropriate. The impression derived from this conversation was that the Chinese wished to come back from the brink.

Sir E. Youde asked whether Mr. Cheung was aware that this incident had been checked in Peking and it had emerged that the person in question had not been authorised to speak as he did. Mr. Cheung said that this was surprising. But if a way could be found to organise such leases, this would be a good step forward. If it were possible to proceed on the basis of identifying areas of common interest, and thereby avoid breakdown, he would favour this course.

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/ Sir Percy Cradock

Sir Percy Cradock said that the Chinese had made it plain that unless we made a bow in their direction they were not prepared to enter into detailed discussion. So the immediate problem we faced was that unless we were able to modify our position we would face a breakdown.

The Prime Minister said that we could only envisage a conditional modification of our position. Any move would have to be on the condition that a satisfactory agreement was reached in the end. Our problem was that the Chinese had stated that they intended to announce their plan. We had had to work hard to stop this last June. Now the Chinese were threatening to announce their plan towards the end of 1984. If the talks broke down later this month the Chinese would be likely to announce their plan then and we would have no possibility of influencing the details. It was necessary to face up to the real meaning of a collapse of currency. It meant a collapse of society as well. We in Europe had seen this in the Weimar Republic. Sir S.Y. Chung said that this had also been seen in China at the end of 1940. Mr. Cheung said that he was fully in support of seeking a suitable formula.

The Prime Minister said that we could proceed to confrontation if we had better long-term cards. But the fact was that by the terms of the Treaties, the Chinese would obtain sovereignty and administration over the bulk of the area in 1997 by just sitting and waiting. There would then be a totally Communist regime. It was true that we could seek to retain sovereignty over Hong Kong Island and Kowloon. But that might only last for a few months. Meanwhile the currency and the existing systems would collapse.

As to why talks had been started last year, we were being bombarded with questions as to the future and had had no option. It was clear that there could be no stability and prosperity without freedom and justice. But we had to think of ways of saving China's face. The question was how we could walk the tightrope. It was a matter of tactics. We did not intend to give anything away.

Mr. T.S. Lo said that he understood the reasons for adopting a more moderate line and understood the dangers if we did not do so. But the people of Hong Kong, despite Chinese propaganda, were firm on retaining the British link. This should not be underestimated. Those people in Hong Kong who had voted with their feet knew that we were dealing with guerillas who understood one tactic only. Advance and make the other side retreat. He did not believe that we could gain with a more moderate line.

The Prime Minister said that she thought it would be well to look at a written formula. The text which we had drawn up for the instructions to the Ambassador in Peking did not go beyond the fundamental statement of our position in her letter of 10 March. It was to be noted that that letter had deliberately avoided referring to British administration because of the likely Chinese reaction.

Mr. Lo reiterated that if the Chinese thought we were retreating they would go on pushing. The Prime Minister replied that in 1997 China could anyway acquire 92% of the territory under the terms of the Treaties. There was a period through which we could try to seek arrangements to preserve freedom and justice and the continuation of a link with Britain. We should not throw this opportunity away. Mr. Lo said that the Chinese would not begin to negotiate until they saw our bottom line - and our willingness to go to confrontation would be a test of that. The Prime Minister reminded the Unofficials that the Chinese had once said that they would rather have sovereignty over a poverty-stricken Hong Kong than a prosperous Hong Kong over which they had no sovereignty. Miss Dunn said that it was a question of tactics. She accepted all that the Prime Minister had said. But she did not believe that there was no flexibility in the Chinese position. We would never see what leverage there was if we kept on retreating. She was not advocating confrontation. But the only way to extract some flexibility was to show at some point that we too had a bottom line. The Prime Minister commented that her letter of 10 March was our bottom line.

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But if the talks broke down we would never be able to explore such flexibility as there might be in the Chinese position.

The Foreign and Commonwealth Secretary said that he had been struck by the very careful words used by the Chinese Foreign Minister at the end of their recent meeting. He had emphasised that Britain could play a great role and that if the current British position was modified, detailed discussion on all practical aspects could begin immediately.

The Prime Minister then suggested that there should be a break in the meeting while the Unofficials considered the draft instructions to H.M. Ambassador in Peking. This had been drafted with a view to publication if necessary - because it was not possible to continue to allow the Chinese to monopolise public statements on the talks.

After an interval of some 30 minutes, the Governor and the Unofficials returned to the meeting. Sir S.Y. Chung said that it was the unanimous view of the Unofficials that the text represented an excellent position in its attempt to get the Chinese to present their view without conceding elements of our own position. The Unofficials were glad ^{that we} were prepared to publish the document in the event of a Chinese leak.

The Prime Minister said that she was most grateful. She wished to draw attention to the following points. The opening words of paragraph 5 reiterated the fundamental principles of her letter of 10 March. That paragraph made plain that we had presented substantial material in support of our view that British administration was the best basis for continued stability and prosperity and that our view had not changed. The text emphasised that the future of Hong Kong could be assured only on the basis of a negotiated settlement. Paragraph 6 was based on a summary of the Chinese proposals and stressed our interest in a continuing important role for Britain and the 50-year guarantee. Paragraph 7 was explicitly stated to be in pursuance of the Prime Minister's letter of 10 March and without

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prejudice to any final agreement. If we could not obtain what we wanted, we would retain the option of confrontation. The rest of the document was designed to persuade the Chinese to conduct talks on this basis. The proposals in paragraph 7 referred back to paragraph 6.

Mr. Lo commented that the document was very good.

The Prime Minister said that she hoped it would unlock the door to reasonable talks at the next round. We would let the Chinese Government know that the Ambassador wished to call on his interlocutor before the formal talks. Sir Percy Cradock said that the object of this was so that the Chinese negotiators could obtain instructions in good time. He would stress the great importance of the message and the vital need for secrecy, adding that if the talks misrepresented the British position we should be bound to explain ourselves publicly. The Prime Minister said that the hope was that the text of the instructions could remain confidential. Agreeing, Mr. Sandberg said that the Chinese might try to suggest that we could climb down. Sir S.Y. Chung said that in the past Peking had leaked their version of the talks. If they did so again, we must counter-attack. Mr. Newbigging said that the document was excellent and he was glad that we were willing to publish it if necessary. In that event it would be worth considering whether it would also be useful to publish the Prime Minister's letter of 10 March. The Foreign and Commonwealth Secretary said that we should not think in terms of publishing unless this was absolutely necessary. The Prime Minister agreed. Publication was a fall-back.

The meeting then agreed a press statement to be issued at the end of the talks.

Sir S.Y. Chung stated that the Unofficials much welcomed the appointment of Sir Percy Cradock to the post of adviser to the Prime Minister on Foreign Affairs and to a post in the Foreign and Commonwealth Office supervising the conduct of negotiations with Hong Kong. The Unofficials

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had every confidence in him and in the Government.

The Unofficials were greatly encouraged by the Prime Minister's resolution and determination. The Prime Minister said that we in our turn were encouraged by the loyalty and understanding of the Unofficials.

The meeting ended at 1125.

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