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PRIME MINISTER

c Sir Robert Armstrong

OD(K): Hong Kong: Pensions

BACKGROUND

As in the case of undertakings to Hong Kong people, discussed at the last meeting of OD(K)), pensions is a matter for Her Majesty's Government to decide and, apart from one aspect dealt with in paragraph 3 below, does not concern the Chinese Government.

2. The problem can be simply stated. The Governor of Hong Kong would like HMG to accept a contingent liability after 1997 for pensions earned in Crown service before that date in the event of default by the future Government of the Hong Kong Special Administrative Region (SAR). For reasons of precedent and prudence, the Foreign and Commonwealth Secretary cannot agree. The most that he is prepared to recommend is a statement designed to reassure members of the Hong Kong public service but falling well short of a binding commitment. The Governor has reluctantly acquiesced.

3. There is one aspect of this matter which is likely to be of increasing interest to the Chinese Government as 1997 approaches. The Chinese might react adversely to any indication that the Hong Kong Government were raiding the reserves before 1997 in order to reduce the contingent liability for pensions after that date. Such a misunderstanding could arise because, as explained in paragraph 9 of Sir Geoffrey Howe's minute, the Hong Kong Government is considering amendments to update present pension arrangements which, while no doubt justified in themselves, would have the

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effect of increasing the short-term cost to the reserves as well as reducing the long-term liability. While the latter would be welcome both to HMG and the Chinese Government, it would be unfortunate if it led to the undermining of the agreement by arousing Chinese hostility. It is a point which needs to be watched.

4. The Chancellor of the Exchequer will be represented by the Economic Secretary and the Secretary of Trade and Industry by the Minister for Trade (Mr Channon). The Lord President of the Council, the Attorney General and the Minister of State, Foreign and Commonwealth Office (Mr Luce) are unable to attend. The Solicitor General is available to deputise for Sir Michael Havers but in view of the subject matter of the meeting and the fact that Sir Patrick Mayhew is entirely unbriefed on this subject, the view has been taken that his presence is not essential.

HANDLING

5. You should invite the Foreign and Commonwealth Secretary to introduce the discussion. The main points to establish are -

a. Statement of assurance

Do colleagues agree that HMG should not accept a contingent liability for pensions after 1997 in the event of default by the Hong Kong SAR? If so, can they accept Hong Kong's preferred formulation of the statement of assurance, as recommended by the Foreign and Commonwealth Secretary, and authorise the Governor to make it when the agreement is published? Do they accept that, although it includes the words "responsibilities", this is not misleading in relation to a default after 1997?

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b. Changes to Hong Kong pensions arrangements between now and 1997

Do colleagues agree that the Hong Kong Government should be encouraged to make changes to update current pension arrangements before 1997 which would also have the effect of reducing the long term cost of the pensions scheme and, in consequence, the contingent liability? Are there any steps that could be taken to allay possible Chinese suspicions of an unjustifiable depletion of the reserves before 1997?

CONCLUSION

6. Subject to points made in discussion, you might guide the Sub-Committee to the following conclusions -

- i. authorise the Governor to make his preferred statement of assurance on publication of the agreement;
- ii. note that, in the event of default by the Hong Kong SAR after 1997, there would be strong pressure on the Government of the day to accept liability for pensions if all else failed but that a future Government would have to take its own decisions in the light of the circumstances;
- iii. note that while the Hong Kong Government should be encouraged to update present pension arrangements, which would have the effect of reducing the contingent liability after 1997, such changes should be so handled as to minimise any risk to the smooth implementation of the agreement with the Chinese Government.

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