

## HONG KONG STUDY

## ANNEX N

## CIVIL AVIATION AND SHIPPING

Civil AviationPresent Situation

1. Hong Kong's air services are managed within the colony by the Hong Kong Civil Aviation Department, but international air service relations and negotiations with other countries for traffic rights at Hong Kong are dealt with by the Department of Trade. The combination of Hong Kong with London air traffic rights makes the UK a very powerful negotiating party in bilateral bargaining for traffic rights.
  
2. At present two UK based airlines (British Airways (BA) and British Caledonian (BCal)) and one Hong Kong based airline (Cathay Pacific Airways (CPA)) operate a total of 20 weekly services between Hong Kong and London. BA also have an important interest in their service linking Hong Kong with Tokyo and Johannesburg, and CPA have a large network of services from Hong Kong to various points within South East Asia, the Far East, Australasia and the Middle East and, from next year, to points in Canada and Europe.
  
3. These airline operations give rise to substantial benefits to the UK balance of payments current account in the form of net overseas earnings secured by BA and BCal

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and dividends and other payments remitted to UK shareholders by CPA. The approximate annual benefits are as follows:

BA	:	London-Hong Kong service	£6.2 m
BA	:	London-Johannesburg service	£6.1 m
BCal	:	London-Hong Kong service	£0.5 m (net outflow)
CPA	:	Dividends and other payments to UK shareholders	£6.8 m

4. These operations also give rise to substantial flows in both directions in respect of the purchase of airframes and engines. In particular CPA has in recent years been spending an average of £30 m per annum on capital equipment in the UK much of which was Rolls Royce engines. Quite apart from its contribution to the UK balance of payments, CPA is also important as a predominantly UK owned overseas asset. It is owned by the Swire Group (70%) and the Hongkong and Shanghai Bank (30%). Its present total assets are valued at £142m.

5. Air services relations between the UK and China are governed by the terms of the UK/China Air Services Agreement (ASA) and two accompanying confidential Memoranda of Understanding. One of these governs services between London and Peking and allows BA and the Chinese airline CAAC to operate twice a week, although in fact neither operates more than once because the traffic available is very limited. BA's service is uneconomic: they have to operate the last leg Hong Kong-Peking (1235 miles) with only about 50 passengers, as a result of restrictive Chinese conditions.

6. Because of Chinese susceptibility about sovereignty, the ASA does not mention Hong Kong at all. Services between Hong Kong and China are operated under a second Confidential Memorandum of Understanding which extends the provisions of the ASA to such services 'without prejudice to the position of either Government with regard to the status of Hong Kong'. As a result of the disadvantageous terms of this Confidential Memorandum of Understanding CAAC now operate over 50 services a week from Peking, Shanghai and 6 other Chinese cities whilst CPA have 3 services to Shanghai only. With well over 90% of passengers to China originating in Hong Kong and enormous potential for growth the Department of Trade are currently engaged on a very difficult negotiation to improve CPA's share of this market, as well as the economic viability of BA's service.

7. The Chinese attitude is also that since Hong Kong is part of China, they do not acknowledge the UK's right to any share of Hong Kong/China traffic but will concede a small share grudgingly. Consistent with this they have questioned the UK's right to a monopoly of the traffic on the London-Hong Kong cabotage route, but they have not in practice contested it and have not questioned our right to determine landing rights for third countries at Hong Kong.

8. Hong Kong's present airport (Kai Tak) is among the World's top 20 for international traffic (8 million passengers per annum) and with rapid growth taking place it is expected to reach maximum capacity on its present site in Kowloon by about the

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end of the 1980s. It is built on reclaimed land technically in the New Territories. A new airport is being considered. This too would have to be in the New Territories. A move would require Chinese consent to new air traffic patterns, and some assurance of continued United Kingdom responsibility for air services to justify the very large investment (about £4 billion, including necessary associated investment) which could not possibly be recouped before 1997, let alone the finance raised in present circumstances. Thus, while uncertainty over the future continues, no decisions on the new airport can be taken.

9. Sovereignty is critically important in the context of air services. Article 1 of the Chicago Convention 1944, to which the United Kingdom and China are both signatories, recognises 'that every State has complete and exclusive sovereignty over the air space above its territory'. Article 2 defines territory of a State as 'the land areas and the territorial waters adjacent thereto under the sovereignty, suzerainty, protection or mandate of such State'. On these foundations all air services have to be agreed by the States exercising sovereignty over the territories concerned, and it is normal to share the services on an approximately equal basis where they are international services but to reserve them for national carriers only where they are 'cabotage services linking points in a country's own territory'.

/Possible

Possible ChangesRecognition of Chinese Sovereignty with Continuing British Administration

10. This would be in some respects the kind of relationship which HMG have had with a number of territories where the United Kingdom has never had sovereignty, eg the Gulf States prior to 1971. The aim would be to ensure that Hong Kong would be a territory whose foreign relations were conducted by HMG under rights conferred by treaty, and so part of UK territory for the purpose of the Chicago Convention and for the grant of air traffic rights. For the avoidance of doubt any agreement on these lines would need to state specifically either that Hong Kong was under the protection of the United Kingdom for the purposes of Article 2 of the Chicago Convention, or that China agreed to the conduct of Hong Kong's international aviation relations by the United Kingdom and agreed to a regime defining what was intended in regard to international aviation relations as between China and the United Kingdom for Hong Kong. For the United Kingdom to conduct these relations effectively, this regime would require Chinese acceptance that any rights for a Chinese airline to carry traffic to or through Hong Kong would have to be negotiated with the United Kingdom and that the Chinese would not themselves be able to sell rights at Hong Kong in exchange for rights for their airline elsewhere.

11. The consequence of this would be the maintenance of

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the status quo or something very much like it. Although HMG would still wish to establish a better understanding than we have at present as to the proper share of services on the routes between Hong Kong and China, the Chinese might seek a monopoly of such services. We should resist this but some realistic accommodation may be necessary.

Hong Kong as a Special Administrative Region (SAR) of China

12. If Hong Kong became an SAR it would still be necessary for HMG to retain responsibility for the conduct of external relations. If this was not done, the results would be highly damaging for UK-based and Hong Kong-based airlines:-

- (i) CPA's position as a Hong Kong-based airline would be totally dependent on whether the Chinese Government was prepared to designate them for services to and from Hong Kong and to negotiate rights for them with foreign governments. The Chinese government might wish to have these services operated in large measure by their own airline instead, and if they were prepared to designate CPA to operate any of them, they would no doubt demand a financial quid pro quo;
- (ii) UK-based airlines would be entitled to about half the services between London and Hong Kong (say 10 out of 20 instead of British Airways and British Caledonian's 13 now).

/Since

Since the Air Services Agreement provides for the designation of only 1 United Kingdom airline, it might well be difficult to retain access for more than one;

- (iii) we would have to negotiate with the Chinese for the retention of British Airways and British Caledonian's rights to carry traffic between Hong Kong and the intermediate and beyond points on their London-Hong Kong services. No doubt we should have to make corresponding concessions at London to CAAC;
- (iv) British Airways profitable Tokyo-Hong Kong-Johannesburg service could only survive if it could be accommodated (improbably) as part of a new roundabout service between London and Hong Kong, for which the present ASA makes no provision. Again there would have to be corresponding concessions to CAAC, if indeed the route could be negotiated at all;
- (v) if as a result it was decided not to build the new airport (see paragraph 8), the growth of air services would probably begin to be constrained by congestion at Kai Tak within 5-10 years.

#### Conclusion

13. HMG's requirement is to retain their civil aviation rights under the Chicago Convention. This could be met by an agreement making the UK responsible for the conduct of

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Hong Kong's external relations, and in particular for its civil aviation international relations. Such an agreement would need to be concluded at the same time as any more general agreement recognising Chinese sovereignty. If Hong Kong became an SAR without the United Kingdom obtaining responsibility for the conduct of external relations, then the United Kingdom would lose all its civil aviation rights stemming from the right to control access to Hong Kong.

### Shipping

#### Present Situation

14. Hong Kong harbour is a key factor in Hong Kong's development and prosperity. Strategically located on Far East trade routes and in the Asia-Pacific basin, and served by 150 major shipping lines, it is the seventh largest port in the world in terms of tonnage, cargo and passengers.

#### Port Administration

15. The port of Hong Kong is administered not by a port authority but by the Marine Department of the Hong Kong Government. Most wharves and terminals as well as the Kwai Chung container terminal (the third largest in the world in terms of throughput of containers) are operated by private enterprise. Hong Kong is an important centre

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for recruiting seamen, more than 18,000 of whom serve on ships throughout the world. There is considerable traffic with Macau and China.

#### Ship Registration

16. Hong Kong is a port of registry for British ships under the UK Merchant Shipping Acts; ships registered in Hong Kong (of which there are about 200) fly the British flag on exactly the same footing as those registered in London or Liverpool. However, administration of the register so far as Hong Kong registered ships are concerned is undertaken almost entirely by the Hong Kong authorities. Nearly 1,500 vessels are Hong Kong owned but registered outside the territory. Of these, about 120 fly under the British flag.

17. For some time there has been pressure from ship owners to establish a separate Hong Kong registry. The Hong Kong Government have indicated informally that they do not have the resources to cope with this.

#### Possible Changes

##### Recognition of Chinese Sovereignty with Continuing British Administration

18. If there was recognition of Chinese sovereignty, with continuing United Kingdom administration over Hong Kong, the territory could continue as a Port of Registry for British ships.

Hong Kong as a Special Administrative Region (SAR)

19. If Hong Kong became an SAR, it could again continue to be a Port of Registry for British ships so long as there was continuing UK administration. In such a situation, however, the establishment of a separate Hong Kong registry with a separate Hong Kong flag could be envisaged as an expression of increased local autonomy. This would not create any difficulties for HMG.

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**A SPECIAL STUDY**

**BY THE FOREIGN & COMMONWEALTH OFFICE**

**AUGUST 1982**

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FUTURE OF HONG KONG

SPECIAL STUDY

Contents

Paragraph No.

MAIN PAPER

PART I

The Problem	1
British Interests	6
The Chinese Position	8
Interests of the People of Hong Kong	12

PART II

Strengths and weaknesses in the British and Chinese Positions	14
Time Factor	18
Impracticable Options	20

PART III

British Aim	21
Possible approaches to the problem of sovereignty	22
A possible solution	26
Detailed Studies	31
Conclusions	33

PART IV

Recommendations for the Prime Minister's visit to Peking	34
Public Presentation	44

Contents (continued)

ANNEXES

- A. Treaties of 1842 and 1860
- B. Convention of 1898
- C. Map showing the New Territories
- D. Chinese Proposals on Taiwan
- E. Consultation in Hong Kong
- F. Options for Solution and Legislative Requirements
- G. Constitutional Position of Hong Kong
- H. External Relations
- I. Currency and Finance
- J. Defence and Internal Security
- K. Citizenship, Nationality and Immigration
- L. Legal System
- M. External Trade
- N. Civil Aviation and Shipping
- O. Crown Land Leases in the New Territories
- P. Illustrative Questions and Answers following the Prime Minister's Visit to China



PRIME MINISTER  
FIRST LORD OF THE TREASURY

FUTURE OF HONG KONG

SPECIAL BRIEFING

To Be Retained  
Do Not Destroy

FUTURE OF HONG KONG

LIST OF BRIEFS

1. Introduction. Tactics
2. Labour Government Statements on HMG Commitment
3. Draft Press Statement on Hong Kong
4. Draft Aide Memoire
5. Chronology of Major Events and Statement
6. Draft Opening Statement
7. Form and Structure of Negotiation
8. Further Defensive Points
9. Possible Acceptable Package
10. Possible Concession which might be made during negotiation
11. Possible Chinese objections and suggested responses
- 11a. Answers to Criticisms Chinese Leaders may make
12. FCO Special Study
  - (a) Treaty of Nanking 1842
  - (b) Text of Second Convention of 1898
  - (c) Map of New Territories
  - (d) Chinese Proposals on Taiwan
  - (e) Consultation on Hong Kong
  - (f) Options and Solution and Legislative Requirements
  - (g) Constitutional Position of Hong Kong
  - (h) External Relations
  - (i) Currency and Finance
  - (j) Defence and Internal Security
  - (k) Citizenship, Nationality, Immigration
  - (l) Legal System on Hong Kong
  - (m) External Trade
  - (n) Civil Aviation and Shipping
  - (o) Crown Land Leases in New Territories
  - (p) Illustrative Questions and Answers Following Prime Minister's Visit to China.