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 TO IMMEDIATE FCO
 TELEGRAM NUMBER 992 OF 6 SEPTEMBER

FOLLOWING FOR SIR E YOUDE FROM HADDON-CAYE.

MIPT: FUTURE OF HONG KONG.

FOLLOWING IS TEXT OF PAPER:

BEGINS

THE MAINTENANCE OF PROSPERITY AND STABILITY IN HONG KONG:
 WHY IS CONTINUING BRITISH ADMINISTRATION NECESSARY?

IN THREE DECADES HONG KONG HAS DEVELOPED FROM AN (FOLLOWING WORD UNDERLINED) ENTREPOT, TO A MAJOR LIGHT MANUFACTURING CENTRE (DOMESTIC EXPORTS ACCOUNTING FOR 80 PERCENT OF TOTAL EXPORTS), TO A DIVERSIFIED ECONOMY WITH AN INTERNATIONAL DIMENSION (THE FINANCIAL AND ALLIED SERVICES SECTOR ACCOUNTING FOR NEARLY A QUARTER OF THE GDP). THE HONG KONG ECONOMY IS, HOWEVER, AS EXTERNALLY ORIENTED AS EVER: AND, WITH DIVERSIFICATION, IT HAS BECOME HIGHLY VOLATILE.

2. THE CLASSIC DETERMINANTS OF THIS SUCCESS STORY ARE:

- (1) A CENTRAL GEOGRAPHICAL POSITION:
- (2) THE BEST PORT IN SOUTH CHINA, WITH SHIPPING SERVICES TO MATCH, COMPLEMENTED BY AN INTERNATIONAL AIRPORT:
- (3) A FLEXIBLE AND MOBILE, WELL EDUCATED AND TRAINED, AND MOTIVATED LABOUR FORCE:
- (4) RESOURCEFUL ENTREPRENEURS, WHO AMORTISE THEIR CAPITAL INVESTMENTS OVER THE ECONOMIC LIFE OF THE ASSETS CONCERNED AND WHO SEEK HIGH CAPITAL UTILISATION FACTORS:
- (5) THE PROXIMITY OF DEPENDABLE SOURCES OF RELATIVELY CHEAP BASIC FOODSTUFFS, RAW MATERIALS AND CONSUMER GOODS FOR LOCAL CONSUMPTION, AND THE AVAILABILITY OF A SUPPLEMENTARY WATER SUPPLY, FROM CHINA AND A RELIABLE SUPPLY OF SEMI-FINISHED INPUTS FROM JAPAN.

3. THESE ELEMENTS HELP TO MAKE UP FOR THE DISADVANTAGES OF A SMALL TERRITORY ALMOST WHOLLY LACKING IN NATURAL RESOURCES: WITH LIMITED LAND, MOST OF WHICH HAS TO BE FORMED AT CONSIDERABLE COST: ONE OF THE HIGHEST POPULATION DENSITIES IN THE WORLD: AND THE DISTANCE OF HONG KONG FROM ITS MAIN EXPORT MARKETS IN NORTH AMERICA AND EUROPE.

4. BUT THESE DETERMINANTS WOULD NOT BE OPERATIVE WITHOUT:

- (A) MFN RIGHTS OF ACCESS TO MAJOR FOREIGN MARKETS AND RESTRAINT AGREEMENTS NEGOTIATED UNDER THE MFA:
- (B) A COOPERATIVE RELATIONSHIP WITH CHINA, BASED ON MUTUAL BENEFIT:
- (C) A FISCAL AND SOCIAL ENVIRONMENT ENCOURAGING ENTERPRISE, HUMAN ENDEAVOUR, THE RETENTION OF WEALTH, THE SPREAD OF PROSPERITY, THE PRESERVATION OF THE COHESIVENESS OF THE FAMILY UNIT IN DECENT HOUSING, AND THE ENJOYMENT OF LEISURE AND, PERHAPS, ABOVE ALL ELSE
- (D) INTERNAL POLITICAL STABILITY.

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5. IN MORE DETAIL THE MAINTENANCE OF (C) AND (D) INVOLVES:

- (I) SOUND AND FAIR (IE NOT ARBITRARY) GOVERNMENT, BUT NOT TOO MUCH OF IT. BUT POLICY MUST HAVE DUE REGARD TO HONG KONG'S STATUS AS A MAJOR INTERNATIONAL FINANCIAL CENTRE, THE GROWING SOPHISTICATION OF HONG KONG AS A SOCIETY AND THE FACT OF RISING EXPECTATIONS:
- (II) A KNOWN AND WELL DEVELOPED SYSTEM OF LAW WHOSE PRACTICE IS INTERNATIONALLY ACCEPTED AND UNDERSTOOD, BACKED UP BY
- (III) THE IMPARTIAL ADMINISTRATION OF THE LAW THROUGH AN EFFICIENT POLICE FORCE:
- (IV) CONSERVATIVE BUDGETARY POLICIES (RESULTING IN THE ACCUMULATION OF FISCAL RESERVES) AND A SYMPATHETIC TAX REGIME:
- (V) A CURRENCY WHICH IS FULLY BACKED WITH FOREIGN EXCHANGE ASSETS, FREELY CONVERTIBLE AND INTERNATIONALLY ACCEPTED AND TRADED:
- (VI) AN EDUCATION SYSTEM GEARED TO PROVIDING THE TECHNOLOGISTS AND TECHNICIANS REQUIRED.

6. HONG KONG WOULD CONTINUE TO BENEFIT FROM ITS NATURAL GEOGRAPHICAL ADVANTAGES WHATEVER ITS CONSTITUTIONAL STATUS OR FORM OF GOVERNMENT. MOST OF THE OTHER DETERMINANTS IN ITS SUCCESS LISTED IN PARAGRAPHS 2, 4 AND 5 COULD, IN THEORY, BE PRESERVED IF HONG KONG BECAME A CAPITALIST ENCLAVE WITHIN SOCIALIST CHINA, PROVIDED IT WAS ACCORDED GENUINE AUTONOMY AND THE GOVERNMENT WAS EFFICIENT AND ENLIGHTENED: IT CANNOT BE ARGUED THAT THEY WOULD NECESSARILY DISAPPEAR WITH BRITISH CONTROL AND ADMINISTRATION. BUT HONG KONG'S MFN RIGHTS (PARA 4(A)) ARE ENTIRELY DEPENDENT UPON THE UK'S MEMBERSHIP OF GATT: EQUALLY SATISFACTORY SUCCESSOR ARRANGEMENTS WOULD BE EXTREMELY DIFFICULT, IF NOT IMPOSSIBLE, TO NEGOTIATE. IT IS ALSO VERY HARD TO ENVISAGE HOW THE HONG KONG DOLLAR COULD BE MAINTAINED AS A FULLY CONVERTIBLE CURRENCY (PARA 5(V)) IF HONG KONG WERE NO LONGER JURIDICALLY DISTINCT FROM CHINA.

7. MOREOVER, AND MOST IMPORTANTLY, INVESTMENT (AND REINVESTMENT) AND INTERNATIONAL PARTICIPATION IN THIS EXTERNALLY ORIENTED, VERY COMPLEX ECONOMY ARE WHOLLY DEPENDENT UPON CONFIDENCE AND THAT IN TURN IS DEPENDENT ON:

- (A) A GENERAL BELIEF IN THE EFFICIENCY AND CONSISTENCY OF, IN PARTICULAR, THE PROCESS OF GOVERNMENT (IN PARTICULAR, BUDGETARY AND FISCAL POLICIES AND THE SYSTEM OF LAW): AND
- (B) AN EXPECTATION OF STABILITY AND CONTINUITY.

8. BY 1997 CHINA MAY HAVE BUILT UP A SOUND TRACK RECORD OF CONSISTENT, PRAGMATIC ADMINISTRATION: THE OPEN DOOR MAY HAVE BECOME A PERMANENT FEATURE OF A GENERALLY PRO-WESTERN (OR AT ANY RATE NOT ANTI-WESTERN) FOREIGN POLICY. IN SUCH CIRCUMSTANCES, CONFIDENCE IN THE CONTINUATION OF HONG KONG AS A PROSPEROUS CAPITALIST ENCLAVE WITHIN CHINA MIGHT SURVIVE THE WITHDRAWAL OF BRITISH ADMINISTRATION. BUT THIS IS NOT THE POINT AT ISSUE NOW. THE KEY QUESTION IS THE EFFECT ON DOMESTIC AND INTERNATIONAL CONFIDENCE OF AN EARLY ANNOUNCEMENT THAT BRITISH ADMINISTRATION WOULD END IN OR BEFORE 1997 AFTER A TRANSITIONAL PERIOD.

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9. IN PRACTICE, LOCAL AND INTERNATIONAL INVESTORS WOULD NOT BELIEVE IN SUCCESSOR ARRANGEMENTS NOT INVOLVING CONTINUED BRITISH ADMINISTRATION IF THEY WERE ANNOUNCED SOON. THIS IS BECAUSE OF:

- (A) THE TURBULENCE OF CHINESE HISTORY OVER THE PAST 30 YEARS, IN PARTICULAR THE RECENT EXPERIENCE OF THE CULTURAL REVOLUTION:
- (B) CHINESE LACK OF PRACTICAL EXPERIENCE POST-1949 IN RUNNING A LIBERAL CAPITALIST ECONOMY:
- (C) THE ABSENCE OF ANY PRECEDENT FOR THE OPERATION OF A FREELY CONVERTIBLE CURRENCY IN PARALLEL WITH A NON-CONVERTIBLE ONE: AND ABOVE ALL
- (D) THE INCOMPATIBILITY (ENDLESSLY DECLARED IN CHINA) OF CAPITALISM WITH COMMUNIST THEORY AND PRACTICE, THE HOSTILITY WITH WHICH MANY COMMUNIST OFFICIALS VIEW HONG KONG AND, THEREFORE, THE SEEMING INEVITABILITY OF INTERFERENCE.

10. IN SHORT, THERE WOULD BE NO BASIS FOR THE BELIEF IN CONSISTENCY AND EFFICIENCY AND THE EXPECTATION OF CONTINUITY REFERRED TO IN PARA 7 ABOVE: THEY CAN ONLY BE BUILT UP THROUGH EXPERIENCE OVER A LONG PERIOD.

11. THE INESCAPABLE CONCLUSION IS THAT, FOR THE FORESEEABLE FUTURE, CONFIDENCE IS DEPENDENT ON THE PRESERVATION OF THE PRESENT ADMINISTRATIVE ARRANGEMENTS WHICH HAVE PROVED TO BE EFFICIENT, PREDICTABLE AND CONSISTENT: BRITISH CONTROL IS THE CEMENT WHICH BINDS THEM ALL TOGETHER AND PROVIDES CONTINUITY. ITS REMOVAL WOULD LEAD TO A SLIDE IN CONFIDENCE, THE WITHDRAWAL OF CAPITAL, THE ABRUPT DRYING UP OF NEW INVESTMENT, THE COLLAPSE OF THE EXCHANGE VALUE OF THE HONG KONG DOLLAR AND (PROBABLY) DISORDER. IT IS NO ANSWER FOR THE CHINESE TO ARGUE THAT THEY WOULD ACCEPT AN INITIAL "DOWNTURN", FOR ONCE CONFIDENCE BEGAN TO SLIDE, WITH ALL THE ASSOCIATED CONSEQUENCES, IT WOULD BE IMPOSSIBLE TO RESTORE THE SITUATION WITHOUT A REVERSAL OF POLICY INVOLVING THE RETURN OF THE (NEXT THREE WORDS UNDERLINED) STATUS QUO ANTE WHICH IT WOULD THEN BE TOO LATE TO ARRANGE EVEN IF IT WERE POLITICALLY ACCEPTABLE TO THE CHINESE AND BRITISH GOVERNMENTS.

ENDS.

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September 1982

PRIME MINISTER'S VISIT TO THE FAR EAST

16-29 SEPTEMBER 1982

Brief by Foreign and Commonwealth Office

THE FUTURE OF HONG KONG

[The Background part only of this Brief is attached.

The Points to Make will follow separately.]

14 SEP 1982

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BACKGROUND

1. This is contained in the following Annexes:

Annex A: Text of the Treaty of Nanking by which Hong Kong Island was ceded by China in perpetuity in 1842.

Annex B: Text of the First Convention of Peking by which the Kowloon Peninsula and Stonecutters Island were similarly ceded in 1860.

Annex C: Text of the Second Convention of Peking by which China leased the New Territories to Britain for 99 years in 1898.

Annex D: A note on the extent of interdependence of the ceded areas and the New Territories.

Annex E: The 'Nine Principles' for the reunification of Taiwan and China outlined by Ye Jianying, Chairman of the Standing Committee of the National People's Congress, in September 1981.

Annex F: The record of a meeting between Mr Humphrey Atkins (then Lord Privy Seal) and Ji Pengfei in Peking on 5 January 1982 (paragraphs 11 - 13).

/ Annex G:

Annex G: The record of a meeting between Mr Humphrey Atkins and Zhao Ziyang in Peking on 6 January 1982.

Annex H: The record of a meeting between Mr Edward Heath and Deng Xiaoping in Peking on 6 April 1982.

Annex I: A paper by Hong Kong's Chief Secretary, endorsed by the Governor on 'Why the Continuation of British Administration is necessary for the maintenance of prosperity and stability in Hong Kong'.

Annex J: A chronology of major events and Chinese statements concerning Hong Kong.

Annex K: Statements by HMG and the last Labour Government on the commitment to Hong Kong.