

SECRET

of Future of Hong Kong 13
Origination China Policy
PM's Visit September 1982
Pt 2

RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND PREMIER
ZHAO ZIYANG AT THE GREAT HALL OF THE PEOPLE, PEKING ON THURSDAY
23 SEPTEMBER 1982 AT 0900

Present:

Prime Minister	H.E. Premier Zhao Ziyang
H.M. Ambassador, Peking	Mr. Huang Hua
Governor of Hong Kong	Mr. Zhang Wenjin
Mr. F.E.R. Butler	Mr. Jia Shi
Mr. A. Donald	Mr. Ke Hua
Mr. A.J. Coles	Mr. Wang Benzhuo
Mr. G. Clark	Mr. Lu Ping
Mr. A. Galsworthy	Mr. Wang Changyi
Mr. R. Peirce	Mr. Cao Yuanxin
	Mr. Zheng Yaowen

* * * * *

Invited to open the discussion on bilateral questions, the Prime Minister made the statement at Annex A to this record.

Mr. Zhao Ziyang said that he had listened very carefully to the considerations advanced on the British side. The Hong Kong question was an issue left over from history. China considered that the time had come when the issue must be settled. It was ready in a spirit of friendship to seek the co-operation of the British Government and resolve this problem properly. In order to enhance mutual understanding and arrive at a proper solution, he wished to expound China's views very candidly. The entire Hong Kong area, including Hong Kong Island and Kowloon, were part of Chinese territory. Since the founding of the People's Republic of China, its Government had stated that this problem, left over from history, would be settled in the proper way when conditions were ripe. Pending this, the status quo in Hong Kong was to be maintained. 140 years had elapsed since 1842 and 33 years had gone by since the founding of the People's Republic. By 1997, about 155 years would have elapsed - more than one and a half centuries. So it could be said that conditions were now ripe for settlement of the Hong Kong question.

SECRET

/ At this

At this point he must state formally that China could not but recover its sovereignty over Hong Kong in 1997 - and no later. It had been China's consistent position that the Chinese Government was not bound by treaties signed between the British Government and the Ching dynasty. The Chinese people had never recognised those treaties. By 1997 the legal basis on which Britain administered the New Territories would no longer exist. So the British Government would have no reason not to return the New Territories to China. Hong Kong Island and Kowloon were similarly inseparable from the territory of China. So the only wise and practical course was that the entire area, including Hong Kong Island and Kowloon, should be returned to China. Recovery of sovereignty over Hong Kong was an issue concerning Chinese sovereignty, territorial integrity and the national feelings of the Chinese people. The Chinese people would not permit the Chinese Government to fail to recover sovereignty over the territory by 1997, 48 years after the founding of the People's Republic. Any Chinese Government which failed to recover sovereignty would not be able to account to its people. On this issue there was no alternative and no leeway for the Chinese Government.

The Prime Minister had just said that the British side had difficulties, but it was not a question of greater or lesser difficulties for either side. The difficulties of the two sides were different in nature. He hoped that the Prime Minister and the British Government would understand this and that the two sides would work to solve the issue successfully in a spirit of friendship and co-operation. A settlement of the problem would mean not only the healing of a wound left over from history, but would also promote friendship and co-operation between the two countries.

The Chinese believed that solving the problem in this way would not only be in conformity with the interests of the Chinese people, but would also conform with British interests. From a fundamental and long term point of view, this would not adversely affect the prosperity of Hong Kong.

The Prime Minister had just referred to the need for both sides to maintain the prosperity and development of Hong Kong. China understood that. After the recovery of sovereignty,

the Chinese Government would take into full consideration the actual conditions in Hong Kong and would pursue special policies there designed to maintain stability and prosperity. Thus, in future, Hong Kong could become a special administrative zone administered by local people and its existing economic and social system and style of life could remain unchanged. The capitalist system in Hong Kong would remain, as would its free port, and its function as an international financial centre. The Hong Kong dollar would continue to be used and to be convertible.

China would take into proper consideration the economic relationship which existed between Hong Kong and Britain and would take into account British interests in industry, commerce, finance, shipping and aviation. The British Government functionaries could remain at their posts when the special administrative zone was set up.

To sum up, the basic policy of China on the question of Hong Kong was to recover the sovereignty of Hong Kong and maintain its prosperity. The two elements were inseparable and were a unity. But recovery of sovereignty was the pre-requisite. China could not place the maintenance of prosperity above this consideration. On the premise of recovering sovereignty, China could explore ways of maintaining and developing the prosperity of Hong Kong. He wished to repeat that China would not maintain the prosperity of Hong Kong and develop it at the expense of recovering sovereignty. China would not let others administer Hong Kong on its behalf nor place Hong Kong under the trusteeship of others.

The Prime Minister had said that if China recovered sovereignty, then confidence and prosperity in Hong Kong would be destroyed.

The Prime Minister stated that this was not quite what she had said. She had stated that Hong Kong now flourished to the advantage of the people of Hong Kong, of China and of Sino/British relations. The present flourishing system in Hong Kong was due to British administration - including the predictability of British law and confidence in the Hong Kong currency. Its prosperity depended

/ and would

SECRET

-4-

and would continue to depend on British administration. Without a British administration, there would be no confidence. She was not talking about 1997. If when she reached Hong Kong during her current visit she said that there had been no meeting of minds about the future of British administration, what did the Chinese side think the effect would be? The consequences would occur not in 1997 but in 1982. We had to retain confidence now.

Resuming his statement, Premier Zhao Ziyang said that there were two principles - sovereignty and the prosperity and stability of Hong Kong. If it came to a choice between the two, China would put sovereignty above prosperity and stability. Sovereignty was a matter of principle, and no sovereign state would do otherwise. He had to say that he did not agree with the Prime Minister's statement that if China recovered sovereignty, prosperity would be destroyed and that large amounts of capital would leave Hong Kong. He did not think it impossible to maintain the confidence of investors and maintain the interests of the Hong Kong people in stability and prosperity after the Chinese Government had recovered the sovereignty. There were 15 years to go, and it was very important that the British Government should show a spirit of co-operation during that period. So long as both sides showed full co-operation he believed that it was possible to avoid confusion in Hong Kong during the transitional period. China did not want to see a mess in Hong Kong, and he believed that this would not be beneficial to the United Kingdom. The Prime Minister interjected that it would not be beneficial to China either. Continuing, Premier Zhao Ziyang referred to the Prime Minister's remarks about recent developments in Hong Kong markets. There were many reasons for those developments, but in the opinion of the Chinese Government the spread of the news that China would recover sovereignty over Hong Kong was not the main reason. Looking at the matter analytically, he had to say that if China pursued a policy of maintaining prosperity and stability in Hong Kong, there was no reason why Chinese investors should not stay there: where else were they to go? The Prime Minister interjected that they could go to Singapore, the Philippines, or even New York, and indeed were doing so now. She had an obligation to talk frankly to the Chinese Government because the people to whom they talked in Hong Kong would not

/dare

SECRET

SECRET

- 5 -

dare to do so. Premier Zhao Ziyang said that a few investors were putting money elsewhere, but not many; he repeated that he believed that if investors got benefits in Hong Kong, they would stay there.

Referring to the Prime Minister's suggestion that the British and Chinese Governments should maintain contact on this issue after the Prime Minister's visit, Premier Zhao Ziyang said that the Chinese Government had the same wish that both sides should continue discussions. These discussions should cover the question of recovery of sovereignty, and, on this premise, of how to maintain the prosperity and stability of Hong Kong. With regard to the Prime Minister's proposal of a public statement, Premier Zhao Ziyang suggested that she should discuss this with Vice Chairman Deng Xiaoping tomorrow.

The Prime Minister, responding to Premier Zhao Ziyang's statement, said that the British Government understood the Chinese Government's position on sovereignty. It was for that reason that the British Government had not for the last 10 years reported Hong Kong to the United Nations under the Colonial Sections of the UN Charter. Hong Kong was the only dependency which the British Government had omitted in this way. The British Government also agreed that by 1997 the legal basis for the British Administration of the new territories would end: the British Government honoured its agreements and accepted that this was the legal position. By the same token, the legal basis for British retention of Hong Kong and Kowloon would continue as a matter of international law. She understood that the Chinese Government wished this Treaty to be abrogated, but the Chinese Government had to recognise that abrogation would have to be achieved through a law passed by the British Parliament. The point which would be made was that, if the Chinese Government abrogated one agreement valid at international law, what assurance could there be that they would keep any other agreement. The British Government therefore preferred not to abrogate agreements, but to reach new ones which superseded them.

/ The

SECRET

SECRET

- 6 -

The Prime Minister said that her view was that now and for a long time in the future the prosperity and stability of Hong Kong would depend on confidence that the present administration would continue. Perhaps this would not be for all time, since things changed everywhere and would change in China. But British administration would certainly be needed for a long time beyond 1997. She was proposing that the two Governments should set out to consult and agree on how to achieve that: if they were successful, and she could commend the outcome to Parliament, then the British Government would consider the question of sovereignty. She was convinced that there was not so much difference between herself and Premier Zhao Ziyang as might appear from their opening statements, or, to put it another way, there was much in common between them.

Continuing, the Prime Minister said that she had noted that in the record of the conversation between Mr. Edward Heath and Vice Chairman Deng Xiaoping, Deng Xiaoping had referred to the Nine Point Proposals when referring to Taiwan. If the British and Chinese Governments could reach a satisfactory agreement on Hong Kong, this might act as an example for others in dealing with other problems which China had.

The Prime Minister said that the Chinese Government had a principle about sovereignty: the British Government also had a principle, which ran strongly throughout the British character, about duty to those who for 140 years had put their faith, their future and their investment in Hong Kong under British administration. The British Government owed it to the people of Hong Kong to reach agreement through discussion and consultation with the Chinese Government. Nor was it only a question of Chinese and British investors in Hong Kong: there was much international money invested there because of confidence in British administration, the certainty of the British legal system and the existence of the Hong Kong dollar as an international currency. Did the Chinese Government suppose that a similar financial centre should be established under Chinese rule in, say, Shanghai or Canton?

/ Concluding

SECRET

SECRET

- 7 -

Concluding, the Prime Minister said that she hoped to carry forward the discussions in a constructive way. She was conscious that she was going to Hong Kong immediately after China. She wanted to be able to say something which would retain confidence there. For the time being she suggested that they could not carry their discussions any further, but that they should be resumed with Vice Chairman Deng Xiaoping tomorrow. Premier Zhao Ziyang agreed, saying that he would not be present at the talks with Vice Chairman Deng Xiaoping, but that Vice Chairman Deng Xiaoping would be fully informed of what had passed today.

The Prime Minister and Premier Zhao Ziyang agreed that the statement made to the Press today should be: "The two sides began discussions on Hong Kong today in a friendly atmosphere. The talks were useful. They will be continued tomorrow."

Guangdong Nuclear Project

Turning to other bilateral issues, the Prime Minister said that the British Government were deeply interested in the Guangdong Nuclear Project. They were ready to work with any nuclear partner of China's choice. She was glad to have been informed that a visit to the United Kingdom by the Guangdong Power Company and the China Light and Power Company had indicated that GEC would be competent to make turbine island.

Premier Zhao Ziyang said that there had been contacts between the Guangdong Power Company and interests in Hong Kong about the nuclear project, and there had also been contact with the British and French. If the prices and agreed terms were favourable, they were planning to use French-made reactor equipment and British generating equipment, although the arrangements had not yet been completed. The Prime Minister asked whether this was a decision: she understood that the Guangdong Power Company had been also considering the Americans as the partner in the project.

/ Premier

SECRET

SECRET

- 8 -

Premier Zhao Ziyang said that he had seen reports of contacts with the Americans, but his enquiries indicated that the Guangdong Power Company were not pursuing **formal contacts with the United States**. The Prime Minister said she was interested in this news. She was aware that Sir Walter Marshall had visited China for discussions with the appropriate Ministry.

Commercial Relations

The Prime Minister said that Britain shared China's wish to maximise trade between the two countries. She suggested that China's Minister for Economic Relations and Trade, Madame Chen Muhua, might visit London. Premier Zhao Ziyang said that China attached importance to developing trade and economic relations as well as an increase in contacts in the scientific and technological field. Although trade between Britain and China was not yet on a large scale, there was a broad prospect for further advances arising from China's determination to pursue a policy of modernisation. The Chinese Government would not change their policy of opening China to foreign trade. In the coming 20 years the Chinese Government wished to exploit their energy resources, to develop transport and communications, and to modernise their existing production capacity in a planned way. He hoped that British businessmen would pay attention to these areas in particular, and try to be competitive, since increases in cooperation on these matters depended not only on Government collaboration but on the **competitiveness** of businessmen. He also hoped that the British Government, like other countries such as Denmark and Belgium, would provide low rate long-term loans in the interests of promoting exports and cooperation in economic and technological matters.

Turning to specific issues, Premier Zhao Ziyang said that the joint venture for a float glass plant in Shanghai, in which Pilkingtons were involved, looked promising. The prospects

/ were

SECRET

were also good for the involvement of British companies in offshore oil exploration in the Yellow Sea, for which Shell and BP had both made bids: tenders had been opened and were now being assessed. In coal exploitation too, agreements of intent had been reached on joint ventures in Shandong Province and Guizhou. The Prime Minister welcomed these agreements of intent and expressed the hope that they would be carried forward to fruition.

Project 051

The Prime Minister referred to the Luda destroyer project, about which she had corresponded with the Chinese Ambassador. Premier Zhao Ziyang said that he knew that the Prime Minister had made efforts to ensure that the negotiations on the Luda destroyer were successful. Success had almost been achieved; there remained a problem about the clause covering fluctuations and costs. He hoped that the Prime Minister could help in finding a way of overcoming this problem. (At this point Premier Zhao Ziyang was handed a telegram indicating that British Aerospace were about to send a delegation to carry negotiations forward.) The Prime Minister said that she hoped that a solution to the problem could be found: Britain wanted to help with this project.

Consulates

The Prime Minister welcomed the agreement between the Governments of the United Kingdom and China to open Consulates in Shanghai and Liverpool. The British Government hoped that it would be possible for the Chinese Government to provide premises which fitted the distinction of the Shanghai Consulate. It would not be satisfactory for the Consulate to be placed in a hotel. The British Government had had a nice Consulate building up to the time of the Cultural Revolution in 1967 and it would be a happy solution if that could be restored. Premier Zhao Ziyang said that there would be no difficulty in establishing the Consulate in Shanghai as soon as the preparatory work was finished. As regards the site, he regretted that another use had been found for the former Consulate building and it would not be possible to give it back. But compensation would be provided and the Office of Foreign Affairs in the Shanghai municipality would assist in providing premises.

SECRET

Technical Co-operation

Premier Zhao Ziyang said that the Chinese Government valued the arrangements for sending students to Britain but said that the Chinese Government were having to reduce the numbers because of the level of fees. He wondered whether the British Government could provide help with this, and referred to the assistance given by the United States Government in the form of provision of materials and bursaries. The Prime Minister said that if this was the form of technical co-operation which the Chinese Government wanted most she thought that it should be possible to do something about it and she would explore the possibilities.

Conclusion

The Prime Minister expressed her appreciation of the friendly and constructive atmosphere/^{of the discussions} with Premier Zhao Ziyang, and referring to their earlier discussion on Hong Kong reiterated her confidence that the two Governments would be able to reach a satisfactory agreement on the basis of consultation and co-operation.

23 September 1982

SECRET

SECRET

ANNEX A

OPENING STATEMENT BY THE PRIME MINISTER

"I should like to begin by saying how pleased I was with our full and fruitful discussions yesterday on international matters. I was grateful for the information you provided, especially about Chinese relations with the Soviet Union and the United States, and I was pleased to see that there was substantial agreement between us on many issues.

As I indicated to you yesterday, I should like with your permission to speak to you today about Hong Kong. It is a problem which affects us both. Moreover, I understand that you have taken a close personal interest in it.

Hong Kong is a unique example of successful Sino/British co-operation. It flourishes well. Against this background I hope we can solve the problem of how to agree about its future while maintaining its prosperity. I note that on previous occasions you and your colleagues have said that you want to solve the issue by consultation and co-operation. That is our approach too.

I have studied very carefully what you said to Mr. Humphrey Atkins when he came to China in April and Mr. Deng Xiaoping's private remarks to Mr. Heath in April.

If my understanding is correct the two main elements of the Chinese view concern sovereignty and the continued prosperity of Hong Kong. I believe those were your own words when you spoke to Mr. Atkins. The first of these elements - sovereignty - is likely to be a delicate matter for both sides and I should like to return to this point a little later.

First I should like to discuss the second element - prosperity. I note that you think that to maintain Hong Kong's prosperity it should continue as a free port and an international centre of commerce and finance and that there should be a continuity of systems. I agree with those points but general assurances that

SECRET

/ the present

SECRET

- 2 -

the present local systems will be preserved and that Hong Kong must be maintained as an international centre will not be enough by themselves to maintain confidence. This was seen very vividly recently in financial fluctuations in Hong Kong.

It is quite clear that the prosperity of Hong Kong depends on confidence. Of course this cannot exist unless we have good relations between Britain and China bilaterally and directly over Hong Kong. But confidence also depends on other things as well, such as:

- a stable and internationally respected currency
- a financial and tax regime favouring business enterprise and which is not liable to sudden change. As you know Britain derives no revenue from Hong Kong
- a formal and internationally respected system of law
- the maintenance of public order
- the freedom of its political and economic systems

/ British administration

SECRET

British administration has in fact provided efficient and consistent government policies and without them Hong Kong would not have developed the way it has.

Mr. Deng went on to make several points to Mr. Heath. First he said that sovereignty over Hong Kong would have to belong to China. He raised the possibility of Hong Kong becoming a special administrative zone of China with the name "Hong Kong: China" and with a local government formed by the inhabitants (whether Chinese, British or other nationality). He also said that Hong Kong could remain a free port and an international financial centre and expressed the view that foreign investment would not be affected under those new arrangements. And he said that the local government in Hong Kong could manage its own non-governmental trade and commercial relations with other countries.

I have to say that the changes envisaged in Mr. Deng's remarks to Mr. Heath are such that we are convinced that if that plan were to be introduced or even announced as a decision of your government, the effect on confidence in Hong Kong would be disastrous. You will obviously wish to know why we came to that conclusion. If any drastic changes in the administrative control of Hong Kong by the UK were to be introduced or announced now there would certainly be a wholesale flight of capital from Hong Kong. This is not something which Britain would prompt: indeed we should do everything we could to prevent it because the difficulties which it would cause us are nearly as great as those it would cause you. But the simple truth is that we could do nothing to control it.

I am referring not simply to British money, but to very large investments by local Hong Kong residents and to American, Japanese, Australian and many other foreign investments, the great majority of which are controlled by private companies and individuals and are free to move about the world. This money, having left Hong Kong, would not return.

/ It

SECRET

It would be impossible to revive the Hong Kong economy, should it collapse. We believe that the announcement of your plan would have the effect that what has been built up over years would be destroyed as the inevitable consequence of a single act. We are therefore in the position that we agree with the objective of maintaining prosperity but we do not agree with the means for achieving it. Indeed, we believe that that plan would lead to the collapse of Hong Kong as a financial centre.

I should also add that there would be very considerable financial hardship for many people, and deep alarm among some sections of the population. Many would seek to leave, and some of the skills and expertise which have made Hong Kong what it is today would no longer be there. A collapse of Hong Kong would be to the discredit of both Britain and China. It would have repercussions throughout the Far East and South East Asian region, as well as wider international implications. We feel that our two Governments would be cast in a very bad light if we had failed to reach a workable agreement that would maintain the prosperity of Hong Kong.

I realise that some of these points may be unwelcome. But I must be candid.

The most important point of all is that we should honour a moral obligation to the people of Hong Kong which British Governments have sustained for more than a century. We have long had a flourishing system. Many people went to Hong Kong, putting their faith in British administration. That gives us a moral obligation which we must honour.

Confidence in Hong Kong, and thus its continued prosperity, depend on British administration.

SECRET

/ Any drastic

SECRET

- 5 -

Any drastic change away from that would destroy confidence. We all admire the way in which the Chinese leaders and people have tackled the huge problems of modernisation: and much will no doubt change in the years to come.

But the problem is not what will happen by 1997 but what people believe now will happen in Hong Kong. We cannot wait until 1997 because investors have to consider investment now. If confidence cannot be sustained now, Hong Kong will not be prosperous in 1983, let alone 1997. Then the very things we seek to preserve might have disappeared by the time the lease ends. Against the background of recent Chinese history, and given China's political system which is so different from that in Hong Kong, time would be needed for people in Hong Kong and abroad to have sufficient faith in new and untried arrangements to keep their money and skills in the territory and make new investments. But we cannot wait for this.

It seems to us that our common objective of maintaining the prosperity of Hong Kong can only be achieved if people believe that the present arrangements for administering Hong Kong will continue for a long time. There would be a most damaging effect on confidence if changes in the administrative control of Hong Kong by the UK, were introduced or announced now.

So we have to do something very soon and agree what it will be.

Can I now return to sovereignty. The Chinese position on sovereignty is well-known, and I understand it, but it is politically difficult for me just as an assertion of your sovereignty is important to you. Acceptance of this would involve Britain abrogating by Act of Parliament the treaties under which the British administer Hong Kong.

To settle the future of Hong Kong by abrogating the treaties alone would be unthinkable. It would produce immediate panic in

/ Hong

SECRET

SECRET

Hong Kong. It would be a dereliction of British responsibility and would be rejected by the British Government and Parliament and by the people of Hong Kong.

But - and perhaps most important of all - if our two governments could agree defined arrangements about the future administration and control of Hong Kong, and I was satisfied that they would work, that they would command confidence, and that they were acceptable to the people of Hong Kong, and if I could justify them to the British Parliament, there would then be a new situation in which I could consider the question of sovereignty.

/ But

SECRET

But without agreement on concrete arrangements on administration and control, I could not make any recommendations to my Government on the question of sovereignty.

To sum up so far, if we did not keep confidence now, money will leave Hong Kong. It could collapse as an international financial centre. We have to make arrangements to maintain confidence by keeping British administration and we have to do it now. I could then consider making recommendations to the British Parliament on sovereignty - and I hope that the arrangements would be acceptable to both China and Britain as well as to the people of Hong Kong.

Because the situation is so sensitive and so immediate, I propose that we should start official talks to reach an agreement on arrangements for the administration and control of Hong Kong after 1997 which would meet the wishes of China, Britain and the people of Hong Kong and preserve its prosperity.

These discussions could cover whatever proposals China may wish to make about how present arrangements might be varied. The issues are complex and should be explored thoroughly by officials as soon as possible.

There is a further point we must consider. Since I am going to be pressed hard on this issue in Hong Kong and London I hope that we can reach agreement during our talks both on the next steps in handling the problem and on what we should say in public. What we say in public is very important. Confidence in Hong Kong will be affected by what I say at my Press Conference here in Peking and later, and by any statement made on the Chinese side. I therefore propose:

- (a) that we make it clear that our common objective is to strengthen and maintain the prosperity of Hong Kong
- (b) that we should agree on a very early date for the start of official talks on how that objective can be maintained
- (c) that before I leave for Peking we should make a public announcement to this effect.

SECRET

- 8 -

Finally, may I stress that my purpose is to reach an arrangement acceptable to China and the United Kingdom and which will preserve Hong Kong's flourishing economy to the advantage of the people of Hong Kong. I believe that we can achieve that in a spirit of co-operation."

SECRET

GR 1400
SECRET
FM PEKING 231500Z SEP 82
TO IMMEDIATE FCO
TELNO 588 OF 23 SEP 82.

cc Future of Hong Kong 14
original in China: Policy in
PM's visit Sept 1982
Pre

PERSONAL FOR PS TO SECRETARY OF STATE
FROM PRIVATE SECRETARY TO PRIME MINISTER.

PRIME MINISTER'S TALKS WITH ZHAO ZIYANG: FUTURE OF HONG KONG.

1. THE PRIME MINISTER BEGAN THE SECOND SESSION WITH ZHAO ZIYANG ON 23 SEPTEMBER WITH A STATEMENT ON HONG KONG, RECALLING WHAT ZHAO HAD TOLD MR ATKINS IN JANUARY AND DENG XIAOPING'S REMARKS TO MR HEATH IN APRIL SHE SAID SHE HAD IDENTIFIED TWO MAIN ELEMENTS IN THE CHINESE THINKING. THE FIRST WAS SOVEREIGNTY WHICH WAS LIKELY TO BE A DELICATE MATTER SEMICOLON SHE WOULD RETURN TO THAT LATER. THE SECOND WAS THE NEED TO MAINTAIN THE PROSPERITY OF HONG KONG.

2. THE PRIME MINISTER DESCRIBED WHAT SHE SAW AS THE FUNDAMENTAL ELEMENTS ON WHICH CONFIDENCE IN HONG KONG DEPENDED. BRITISH ADMINISTRATION HAD PROVIDED THESE. CHANGES SUCH AS THOSE ENVISAGED IN DENG'S REMARKS TO MR HEATH WOULD IF IMPLEMENTED OR EVEN ANNOUNCED AS A DECISION OF THE CHINESE GOVERNMENT HAVE A DISASTROUS EFFECT UPON CONFIDENCE IN HONG KONG. THERE WOULD BE ECONOMIC COLLAPSE, A FLIGHT OF CAPITAL FROM THE TERRITORY, MANY PEOPLE IN HONG KONG WOULD SUFFER FINANCIAL HARDSHIP, MANY WOULD SEEK TO LEAVE, THERE WOULD BE INTERNATIONAL REPERCUSSIONS AND BRITAIN WOULD HAVE FAILED IN ITS DUTY TO HONOUR ITS OBLIGATIONS TO THE PEOPLE OF HONG KONG WHO HAD LACED THEIR FAITH IN BRITISH ADMINISTRATION FOR MORE THAN A CENTURY. THE PROBLEM WAS NOT WHAT WOULD HAPPEN IN 1997, BUT WHAT PEOPLE BELIEVED NOW IN 1982 WOULD HAPPEN TO THE FUTURE ADMINISTRATION OF HONG KONG. THE COMMON OBJECTIVE OF THE TWO SIDES TO MAINTAIN THE PROSPERITY OF HONG KONG COULD ONLY BE ACHIEVED IF PEOPLE BELIEVED THAT THE PRESENT ARRANGEMENTS FOR ADMINISTERING HONG KONG WOULD CONTINUE FOR A LONG TIME, BEYOND 1997. A CHANGE AWAY FROM BRITISH ADMINISTRATION WOULD HAVE A VERY DESTRUCTIVE EFFECT.

3. SOMETHING HAD TO BE DONE VERY SOON. THE PRIME MINISTER WAS FAMILIAR WITH THE CHINESE POSITION ON SOVEREIGNTY, BUT SHE COULD ONLY MAKE RECOMMENDATIONS TO HER GOVERNMENT ON THE QUESTION OF SOVEREIGNTY IF THERE WAS AGREEMENT BETWEEN THE TWO SIDES ON CONCRETE ARRANGEMENTS FOR THE ADMINISTRATION AND CONTROL OF HONG KONG AND SHE WAS SATISFIED THAT THEY WOULD COMMAND CONFIDENCE AND WERE ACCEPTABLE TO THE PEOPLE OF HONG KONG. THE PRIME MINISTER PROPOSED THAT OFFICIAL TALKS SHOULD BEGIN SOON TO SEEK AGREEMENT ON SUCH ARRANGEMENTS WHICH WOULD MEET THE WISHES OF CHINA, BRITAIN AND THE PEOPLE OF HONG KONG AND PRESERVE THE PROSPERITY OF HONG KONG. SHE PROPOSED THAT THESE TALKS SHOULD BEGIN VERY EARLY AND THAT THERE SHOULD BE A PUBLIC ANNOUNCEMENT TO THIS EFFECT BEFORE SHE LEFT PEKING.

4. ZHAO ZIYANG SAID THAT THE CHINESE GOVERNMENT HAD ALL ALONG STATED THAT THIS PROBLEM LEFT OVER FROM HISTORY WOULD BE SETTLED IN THE PROPER WAY WHEN CONDITIONS WERE RIPE. IT COULD BE SAID THAT CONDITIONS WERE RIPE NOW. CHINA COULD NOT BUT RECOVER ITS SOVEREIGNTY OVER HONG KONG, NO LATER THAN 1997. CHINA DID NOT ACCEPT THE TREATIES BUT IN ANY CASE BRITAIN WOULD HAVE NO LEGAL BASIS TO ADMINISTER THE NEW TERRITORIES AFTER 1997. HONG KONG ISLAND AND KOWLOON WERE SIMILARLY INSEPERABLE FROM THE TERRITORY OF CHINA, SO THE ONLY WISE AND PRACTICAL COURSE WAS THAT THE WHOLE TERRITORY SHOULD BE RETURNED TO CHINA. THE CHINESE PEOPLE WOULD NOT PERMIT THE CHINESE GOVERNMENT TO FAIL TO RECOVER SOVEREIGNTY OVER HONG KONG BY 1997, 48 YEARS AFTER THE FOUNDING OF THE PEOPLE'S REPUBLIC. ANY CHINESE GOVERNMENT WHICH FAILED TO RECOVER SOVEREIGNTY WOULD NOT BE ABLE TO ACCOUNT TO ITS PEOPLE. ON THIS ISSUE THERE WAS NO ALTERNATIVE AND NO LEEWAY FOR THE CHINESE GOVERNMENT. THE DIFFICULTIES OF BOTH SIDES ON THIS QUESTION WERE DIFFERENT IN NATURE.

5. ZHAO SAID THAT AFTER THE RECOVERY OF SOVEREIGNTY THE CHINESE GOVERNMENT WOULD PURSUE SPECIAL POLICIES DESIGNED TO MAINTAIN STABILITY AND PROSPERITY IN HONG KONG. HONG KONG COULD BECOME A SPECIAL ADMINISTRATIVE ZONE ADMINISTERED BY LOCAL PEOPLE AND ITS EXISTING ECONOMIC AND SOCIAL SYSTEM AND LIFE STYLE COULD REMAIN UNCHANGED. THE CAPITALIST SYSTEM IN HONG KONG WOULD REMAIN AS WOULD THE FREE PORT AND THE INTERNATIONAL FINANCIAL CENTRE. THE HONG KONG DOLLAR WOULD CONTINUE TO BE USED AND TO BE CONVERTIBLE. CHINA WOULD TAKE INTO PROPER CONSIDERATION THE ECONOMIC RELATIONSHIP BETWEEN BRITAIN AND HONG KONG, BRITISH GOVERNMENT FUNCTIONARIES COULD REMAIN AT THEIR POSTS WHEN THE SPECIAL ADMINISTRATIVE ZONE WAS SET UP.

6. TO SUM UP THE TWO ELEMENTS OF CHINA'S BASIC POLICY ON THE HONG KONG QUESTION - RECOVERY OF SOVEREIGNTY AND MAINTENANCE OF PROSPERITY - WERE INSEPERABLE, BUT RECOVERY OF SOVEREIGNTY WAS THE PREREQUISTIE. ON THE PREMISE OF RECOVERING SOVEREIGNTY, CHINA COULD EXPLORE WAYS OF MAINTAINING AND DEVELOPING THE PROSPERITY OF HONG KONG. ZHAO SAID THAT CHINA WOULD NOT MAINTAIN AND DEVELOP THE PROSPERITY OF HONG KONG AT THE EXPENSE OF THE RECOVERY OF SOVEREIGNTY. CHINA WOULD NOT LET OTHERS ADMINISTER HONG KONG ON ITS BEHALF, NOR PLACE HONG KONG UNDER OTHERS TRUSTEESHIP.

7. ZHAO THEN MISQUOTED THE PRIME MINISTER AS SAYING THAT IF CHINA RECOVERED SOVEREIGNTY, CONFIDENCE AND PROSPERITY IN HONG KONG WOULD BE DESTROYED. THE PRIME MINISTER CORRECTED THIS, REITERATING THAT THE PRESENT FLOURISHING SYSTEM IN HONG KONG DEPENDED UPON BRITISH ADMINISTRATION. SHE STRESSED AGAIN THAT THE URGENT NEED WAS TO RETAIN CONFIDENCE NOW. IF WHEN SHE REACHED HONG KONG AFTER LEAVING CHINA SHE HAD TO SAY THAT THERE HAD BEEN NO MEETING OF MINDS ABOUT THE FUTURE OF BRITISH ADMINISTRATION, CONFIDENCE WOULD FAIL NOW.

8. ZHAO REPEATED THAT THE CHINESE PUT THE RECOVERY OF SOVEREIGNTY BEFORE THE MAINTENANCE OF PROSPERITY. NO SOVEREIGN STATE COULD DO OTHERWISE. HE COULD NOT AGREE WITH WHAT THE PRIME MINISTER HAD SAID ABOUT THE PROSPERITY OF HONG KONG BEING DESTROYED IF CHINA RECOVERED SOVEREIGNTY. HE THOUGHT THAT AS LONG AS THE TWO SIDES SHOWED FULL COOPERATION, IT WOULD BE POSSIBLE TO AVOID CONFUSION IN HONG KONG DURING THE TRANSITIONAL PERIOD. HE THOUGHT THAT "RECENT DEVELOPMENTS" IN HONG KONG DERIVED FROM MANY REASONS, BUT THE MAIN REASON WAS NOT (UNDERLINED) THE SPREAD OF THE NEWS THAT CHINA WOULD RECOVER SOVEREIGNTY. HE DID NOT BELIEVE THAT CHINESE INVESTORS WOULD FIND BETTER PLACES FOR THEIR MONEY IF CHINA PURSUED POLICIES TO MAINTAIN THE PROSPERITY AND DEVELOPMENT OF HONG KONG. THE PRIME MINISTER INTERJECTED THAT DISINVESTMENT WAS ALREADY IN PROGRESS. ZHAO REJOINED THAT PERHAPS A FEW, BUT NOT MANY WERE DISINVESTING.

9. ZHAO SAID THAT THE PRIME MINISTER HAD PROPOSED THAT AFTER HER VISIT THE TWO SIDES SHOULD MAINTAIN CONTACT ON HONG KONG. CHINA HELD THE SAME VIEW. BOTH SIDES SHOULD CONTINUE TO DISCUSS THE RECOVERY OF SOVEREIGNTY OVER HONG KONG AND, ON THIS PREMISE, HOW TO MAINTAIN THE STABILITY AND PROSPERITY OF HONG KONG.

10. THE PRIME MINISTER REITERATED THE DIFFICULTIES OF THE SOVEREIGNTY ISSUE FOR BRITAIN. THE TWO SIDES NEEDED TO CONSULT AND AGREE ABOUT HOW TO ACHIEVE A CONTINUATION OF BRITISH ADMINISTRATION IN HONG KONG. SUCH AN AGREEMENT WOULD ENABLE HER TO CONSIDER THE QUESTION OF SOVEREIGNTY. SHE THOUGHT THAT THERE WAS MUCH IN COMMON BETWEEN THE TWO SIDES. SHE HAD NOTED CHINA'S NINE POINT PROPOSALS ON TAIWAN. IF BRITAIN AND CHINA COULD REACH A SATISFACTORY AGREEMENT ON HONG KONG THIS COULD BE AN EXAMPLE. THE PRIME MINISTER SUGGESTED THAT BOTH SIDES SHOULD NOW REFLECT ON WHAT HAD BEEN SAID AND THAT DISCUSSIONS ON HONG KONG SHOULD BE RESUMED WITH DENG XIAOPING ON 24 SEPTEMBER. ZHAO AGREED.

11. THE PRIME MINISTER AND ZHAO AGREED TO ISSUE THE FOLLOWING STATEMENT TO THE PRESS. "THE TWO SIDES BEGAN DISCUSSION OF HONG KONG TODAY IN A FRIENDLY ATMOSPHERE. THE TALKS WERE USEFUL. THEY WILL BE CONTINUED TOMORROW."

12. THE PRIME MINISTER WISHES THE CONTENT OF THIS REPORT TO BE VERY CLOSELY GUARDED. IT SHOULD THEREFORE BE GIVEN EXTREMELY RESTRICTED CIRCULATION.

13. PLEASE COPY TO NO. 10 DOWNING STREET.

CRADOCK

NNNN