

SECRET

cc AJC

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Foreign and Commonwealth Office

London SW1A 2AH

Discussed with the Prime Minister  
who agreed the telegram of instruction  
provided the Foreign Secretary and  
the Chancellor were content. 11 October, 1983

Dear John,

FEB

Hong Kong 17.10.

As you know, the Governor of Hong Kong will be discussing with his Executive Council on 12 October the scheme which has been devised to stabilise the Hong Kong dollar. I enclose a copy of a telegram which we have sent this evening to the Foreign Secretary in Athens to bring him up-to-date on the background. As you will see, there may be a need for some very quick decisions on 12 October. We will be in touch as necessary during the course of the day. Meanwhile we would welcome any initial views you may have on the issues raised in the telegram.

I am copying this letter to John Kerr (HM Treasury), Richard Hatfield (Cabinet Office) and John Bartlett (Bank of England), with the same request.

Yours ever

(J E Holmes)  
Private Secretary

A J Coles Esq  
10 Downing Street

SECRET



OUT TELEGRAM

Classification and Caveats

Precedence/Deskby

SECRET

IMMEDIATE

ZCZC 1 ZCZC  
 GRS 2 GRS  
 CLASS 3 SECRET  
 CAVEATS 4  
 DESKBY 5  
 FM FCO 6 FM FCO OCT 83  
 PRE/ADD 7 TO IMMEDIATE ATHENS

TEL NO 8 TELEGRAM NUMBER *Bone from*  
 9 Following Personal for Private Secretary

10 HONG KONG: PROPOSED FINANCIAL MEASURES

11 1. On 12 October the Governor of Hong Kong proposes to put  
 12 to the Executive Council <sup>the</sup> ~~a~~ scheme to stabilise the Hong Kong  
 13 dollar. There is a possibility (no more) that EXCO will be  
 14 opposed to the scheme. No decisions are required now since  
 15 Sir E Youde will report his discussion with EXCO before any  
 16 action is taken. But the Secretary of State may wish to have  
 17 some of the background now since urgent decisions may be  
 18 required by the evening of 12 October on whether to support the  
 19 Governor in the event that he wishes to introduce the sheme in  
 20 the face of EXCO's opposition. Even if EXCO are content, the  
 21 Secretary of State will be asked to approve a proposal that  
 22 \$250 million should be transferred from the Exchange Fund to  
 23 General Revenue Account to enable the scheme to go ahead.

24 2. The Secretary of State is aware of the general background.  
 25 In the view of Treasury officials the proposed measures are

|                              |                          |                  |  |
|------------------------------|--------------------------|------------------|--|
| FINLEN ends telegram         | BLANK                    | Code word        | technically  |
| File number                  | Desk                     | Distribution     | PS — PS/A/LUCE<br>HKD PS/PUS<br>Mr Burrows <i>As Liffard</i><br><i>As Donald</i> |
| Directed by (Block capitals) | JOHN HOLMES              | Telephone number |  |
| Authorised for despatch      | <i>John Holmes 27/10</i> | Time of despatch |  |
| Comcon reference             |                          |                  |  |



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Classification and Caveats

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 2 technically feasible. The Chancellor has not sought to  
 3 dissuade the Governor from going ahead. The Prime Minister has  
 4 noted the Hong Kong Government's intentions.  
 5 3. The scheme has three components:  
 6 (i) to issue and redeem against US dollars, at an  
 7 exchange rate fixed by the authorities, the  
 8 Certificates of Indebtedness issued by the Exchange  
 9 Fund to banks issuing Hong Kong dollar notes;  
 10 (ii) a simultaneous abolition of the withholding tax on  
 11 interest on Hong Kong dollar deposits;  
 12 (iii) a transfer of HK\$250 million from the Exchange Fund  
 13 to General Revenue Account in order to make up for  
 14 the resulting loss of revenue. (The Secretary of  
 15 State's approval is required).  
 16 4. The Governor believes that EXCO might possibly be opposed  
 17 to his proposals. The scheme would place the banks in the  
 18 front line. The burden of higher interest rates would fall on  
 19 borrowers, notably home buyers and such highly-g geared companies  
 20 as those in the distressed property sector. In the Governor's  
 21 view pressure on the banks and on interest rates would be  
 22 preferable to pressure on the Exchange Fund and the exchange  
 23 rate. He would put this view strongly to EXCO, as well as  
 24 the point that such an arrangement would help HMG's stance  
 25 in the negotiations. However, EXCO might not agree, since  
 26 banking and property interests are strongly represented amongst  
 27 them.  
 28 5. The Governor is empowered to act in opposition to the  
 29 advice given to him by EXCO if he deems this right but has  
 30 to report to the Secretary of State on the grounds and reasons  
 31 for his action. He will thus be seeking political backing  
 32 vis-a-vis EXCO members rather than formal authorisation to  
 33 proceed. But it is highly unusual for the Governor to act  
 34 against the advice of EXCO. We cannot find any precedent for

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Classification and Remarks

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- 2 the past 20 years.
- 3 6. The Governor is very conscious of the significance and
- 4 difficulty of such a step now. Clearly it would harm his
- 5 relationship at a particularly awkward moment. However he
- 6 only intends to act against EXCO's advice if the financial
- 7 position makes this absolutely necessary and after every effort
- 8 to persuade them.
- 9 7. There is one potential legal difficulty. Article 4 of the
- 10 Exchange Fund Ordinance requires banks to pay to the Fund the
- 11 'face value' of Certificates of Indebtedness, expressed in
- 12 Hong Kong dollars. The proposal however is that banks should in
- 13 future be required to pay in US dollars. However, the Hong Kong
- 14 Government and its legal advisers do not see any immediate need
- 15 for amending legislation.
- 16 8. In the rather unlikely event of a legal challenge the
- 17 matter could be regularised by legislative amendment, which
- 18 could if necessary be retrospective. If the LEGCO refused to
- 19 cooperate such legislation could be adopted by Order in Council
- 20 under the powers reserved to the Crown.
- 21 9. The proposed transfer from the Exchange Fund to General
- 22 Revenue Account does not appear to raise any legal or financial
- 23 problems.
- 24 10. EXCO will meet on the morning of 12 October. The idea is
- 25 to implement the measures after markets close for a long
- 26 weekend on the evening of 13 October. If the Secretary of State's
- 27 support needs to be sought by the Governor, this will be during
- 28 the day of 12 October.
- 29 11. The initial view here is that it would be right, in the
- 30 event that the Governor decides to act despite EXCO's opposition,
- 31 to back him up. This might take the form of authority to the
- 32 Governor to inform EXCO that the British Government have
- confidence in his judgement. If this step is to be taken, we
- will want to be sure that at least the Prime Minister and

EXCO 10/10/79

10/10/79

Chancellor



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Classification and Caveats

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1 <<<<  
 2 Chancellor are content before a final decision is taken. We  
 3 are warning their offices accordingly.  
 4 12. If we proceed as in paragraph 11 above, it will be  
 5 clear that HMG have given their approval to the scheme  
 6 and parliamentary and other questions will be answered  
 7 accordingly. If, on the other hand, EXCO agree with the  
 8 scheme, the immediate problem will be less but there may  
 9 still be parliamentary interest (especially if <sup>the scheme</sup> subsequently  
 10 goes wrong). Ministers may be <sup>asked</sup> ~~pressed~~ as to whether or not  
 11 they gave the scheme their approval. We therefore need  
 12 consciously to decide whether to put ourselves in a position  
 13 where we would answer such a question in the affirmative,  
 14 or whether to take the view that we regarded this as a  
 15 matter for the Hong Kong government on which HMG as such  
 16 was not called upon to take a view. ~~We shall be considering~~ <sup>These are the two ends</sup>  
 17 ~~this further with the Department.~~ <sup>of the question. The department are considering what form</sup>  
 18 <sup>of words the Secretary of State might most helpfully and</sup>  
 19 <sup>accurately use in practice.</sup>  
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11 OCT 1983



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