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HONGKONG'S FUTURE

That ring of confidence is fading

Talks between Britain and China over the future of Hongkong are deadlocked. The negotiations that started after Mrs Thatcher's visit to Peking last September have not proceeded beyond discussions about what the two sides should discuss. Hongkong's governor, Sir Edward Youde, and Britain's ambassador to Peking, Sir Percy Cradock, are in London for talks with the prime minister. Hongkong's most valuable asset—confidence in the future—is already seeping away. For the first time China seems to be worried that its golden goose may be ailing. But it is planning a unilateral solution, one that it believes will be welcomed in Hongkong. The British think otherwise. Can the world's mighty midget of free enterprise be saved?

Some time in the next few years China's leader, Mr Deng Xiaoping or his successor, could have to make one of the following uncomfortable statements to his politburo:

Comrades, we have run into serious difficulties with our modernisation programme. Since we decided to end the British administration of Hongkong our foreign earnings from it have decreased. The capitalists have moved to Singapore. All we stand to inherit is 5m troublemakers and a plot of land not much bigger than Peking's suburbs.

Or:

Comrades, while our sovereignty over Hongkong is sacred and now undisputed, we have asked the British to remain there for the foreseeable future. They have reluctantly agreed. Long live Chinese sovereignty.

Those who make money out of the anachronistic position of Hongkong as a British colony clinging improbably to the southern coast of mainland China, which means all who live there and many who don't, are asking how much longer things can go on as they are.

The uncertainty of Hongkong as a "borrowed place living on borrowed time" is growing as the countdown to the end of the lease in 1997 gathers pace. Everyone involved—the Hongkongers, the British, the Chinese, the investors, the competitors—knows that by then at the latest the curtain of history will come down and nobody can be sure what, if anything, will be there when it rises again. The unsolved problem is to work out a future which satisfies China's national pride and which the capitalists—in Hongkong and elsewhere—can believe in.

The issue of sovereignty

Although in the eyes of the British there is no legal obligation to change the status of the 30 square miles of Hongkong island, which were ceded to Britain in perpetuity by the treaty of 1842, or indeed the four square miles of the Kow-

loon peninsula on the Chinese mainland that were ceded in 1860, the Chinese have never seen it that way. The Chinese claim that, as the treaties were imposed by force when the British were trying to protect their highly profitable opium exports to China, they are illegal. The need to take back Hongkong has been a credo of the Chinese Communist party since it was founded in 1921, as it was of Sun Yat-sen, the father of modern China. The formal British position is that only the 375 square miles of mainland and islands which were secured on a 99-year lease in 1898—the area known as the New Territories—need be the subject of any discussion with China.

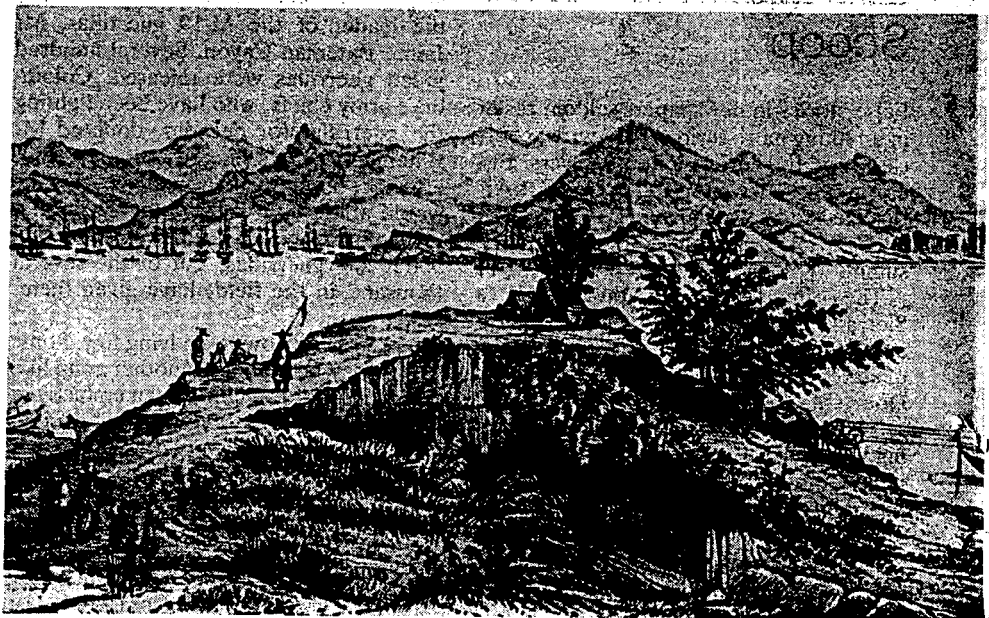
China might well have been able to allow this disputed status quo to continue, but for the looming shadow of 1997. Even now China has opened the can of worms reluctantly, prodded into action by Hongkongers alarmed about their fu-

ture. There have been three occasions since the second world war, at times when Anglo-Chinese relations were bad and Hongkong was weak, when China must have been tempted to recover the colony by force: immediately after the Communist victory in 1949, during the Korean war in 1951, and at the time of the cultural revolution in 1966-68. It did not do so.

In 1972 China asked the United Nations to remove Hongkong from its list of colonies to be liberated, stating grandly that the problem was "entirely within China's sovereign right" and would be dealt with "in an appropriate way, when conditions are ripe". Indeed, in the 10 years that Sir Murray MacLehose (now Lord MacLehose) was governor of Hongkong (1971-82), Anglo-Chinese relations improved: the politically embarrassing aspects of British rule were swept under the diplomatic carpet.

When concern about the long-term future eventually became evident, in 1979, Sir Murray was invited to Peking, where Mr Deng sought to give reassurance with his famous message: "Tell the investors in Hongkong to put their hearts at ease." This was too vague. As Lord Carrington, the then foreign secretary, said: "It's not their hearts they are worried about."

When 1982 arrived and the lease had no more than 15 years to run—a significant period in terms of commercial mortgages on property—investors began to demand a solution to the problem. The stock market panicked. In January, 1982, the Hang Seng index was above 1,400 (the all-time high of over 1,800 had been reached in July, 1981). By December it was halved. Perhaps more frighteningly,



This has possibilities

property prices and rents had also crashed. Hongkong's office rents, which once held the record of being the highest in the world, are now merely in fourth place, after New York, London and Tokyo. Hongkong could weather the world recession but not the threat to its future. Peking, too, was shaken and, during Mrs Thatcher's visit to China last September, Mr Deng and the Chinese prime minister, Mr Zhao Ziyang, had to agree to Anglo-Chinese discussions on the long-term "stability and prosperity" of Hongkong.

With each side claiming rights which the other rejects, a sensible solution seems remote. Some possibilities:

British Vatican. If China were disposed to see a small enclave, rather like Vatican City in Rome, as temporarily acceptable, and thus to be prepared to nourish it, it might be a means of retaining Hongkong as a financial centre, with an independent currency to be used in China's newly formed special economic zones where free enterprise is encouraged. (One Chinese suggestion is that Hongkong itself might be a special economic zone.) This might bolster the various economic activities that would continue in the Chinese-administered New Territories.

However, this would be unattractive as a permanent solution: It is hard to see that Hongkong island and Kowloon could survive on their own for long. The new border would pass right through the centre of Kowloon; the airport would be on the wrong side of it, as would the container port; nor would a mini-Hongkong be able to feed and water itself. It would be an administrative nightmare even with Chinese support.

A rejection by China of this option would underline the fact that sovereignty

is really a diminishing asset—valueless after 1997.

Independent city state. Britain's traditional and dignified method of dismantling its empire has been to grant independence to the components of it.

The Hongkong Chinese believe that if they had an independent city state they could do every bit as well as mainly Chinese Singapore. But even to test Hongkong opinion on this, or any other option, by referendum would be unacceptable to China. Even if Britain could legally give independence to the ceded territories it is questionable if it could assign the remaining 14 years of its lease over the New Territories to a new city state. In any case, China would never contemplate the creation of what would in effect be a second Taiwan; which is why Britain has never been able, under Tory or Labour governments, to take any steps towards devolved power through elected self-government.

Condominium. There have been suggestions that there could be joint government between China and Britain. This envisages Hongkong as an "independent special zone" within China under the Chinese flag, but with a governing committee to be headed alternately by a Chinese and a Briton. Not only would it be hard to establish clear lines of responsibility between Britain and China (as has been shown in other condominiums), but joint authority would merely emphasize China's lack of sovereignty over part of what it claims is its own territory.

Leaseback. Hongkong opinion is almost unanimous that for Britain to hand over sovereignty would be a small price to pay for a long-term solution. Although Mrs

Thatcher has reasserted the validity of British sovereignty, this is seen in both Hongkong and Peking as no more than a negotiating position. Some British politicians, however, suggest that, although she may be intellectually convinced of the need to trade sovereignty, she is at present neither emotionally nor politically ready to do so—certainly not before she wins the next British election (assuming she does).

It is asking a lot of politicians, whether British or Chinese, to make commitments for 14 years ahead. It is still harder to ask them to yield ground without something to show. It would be politically impossible for Mr Deng to be seen formally to renew anything resembling the old treaties.

An interim solution might include the early transfer of sovereignty to China—which would presumably be a political bonus for Mr Deng—in return for continuing British administration of both the ceded and the New Territories. If the agreement were to continue until 1997 it would remove none of China's existing options. To set a date beyond 1997 would at present be asking too much of China. It might be possible to play for time by setting 1997 as the date, but with an option for both sides to renew the arrangement for another 15 years in 1990. Politically, the best to hope for might be an agreement for continued British administration without time limit, thus removing the dreaded countdown to 1997, replacing it with an agreement that China could ask the British to leave at any time—an option that has in fact existed for the past 30 years. Some Hongkong people would settle for a rock-solid promise that the status quo would endure until at least 1997; one financier has remarked that you can do a lot in 14 years.

China's plan

The idea that Britain and China should thrash out a mutually acceptable solution of all problems, including sovereignty, to ensure the "prosperity and stability" of Hongkong, may be Mrs Thatcher's view of the negotiations; but it is clearly not that of the Chinese. They want the British to accept that sovereignty is non-negotiable before discussions on details of the takeover are started. The negotiations now going on are certainly not seen by China as a discussion between equals.

At the end of the talks, which both sides expect to take at least a year, the Chinese plan to announce unilaterally a detailed package of proposals for the future, whether or not Britain accepts it. They envisage a Hongkong Chinese as governor, responsible to Peking. The proposals will also cover currency ques-



Didn't we do well!

THE ECONOMIST MARCH 12, 1983

HONGKONG

Everyone an expert

Finding a sensible solution to the problems of Hongkong depends partly on the personalities and abilities of the negotiators, particularly on the Chinese side. Apart from Mr Deng and his lieutenants, a key figure is Mr Liao Chengzi, a Cantonese party veteran recently appointed to the politburo who has for many years led the state committees for overseas Chinese affairs and for Hongkong and Macao. It was Mr Liao who sat with Mr Deng at the MacLehose meeting in 1979.

The top Chinese civil servant dealing with European relations in Peking is Mr Yao Guang, former ambassador in Paris. Mr Zhang Wenjin, an ex-deputy foreign minister who is now ambassador in Washington, may also play a part; so may Mr Wang Kuang, who as head of the New China News Agency is Peking's top man in Hongkong. Mr Ke Hua, who is China's ambassador in London, will also be important, if, as is expected, he

takes over the news-agency job or becomes deputy to Mr Liao.

In Peking the British side of the negotiations is being handled by Britain's ambassador, Sir Percy Cradock. Sir Edward Youde, who succeeded Sir Murray MacLehose as governor of Hongkong, knows China well: he was Sir Percy's predecessor in Peking. Hongkong has no elected government and the top consultative body is the governor's executive council, known as Exco, which has on it the six top British officials in Hongkong, and nine unofficial members who are local tycoons, six of them Chinese. Exco wants a veto on any settlement but its role will be purely advisory. Other views come from academics, journalists, businessmen and 30 forceful young middle-class Chinese, called the Hongkong Observers, who are the closest Hongkong gets to a dissident group. Mrs Thatcher is herself keeping a firm grip on the political direction of the negotiations.

tions (including control over Hongkong's reserves, capital movements and the position of foreign investors), the legal system, the media, language, citizenship and travel arrangements for Hongkongers. The Chinese are confident that their package will prove acceptable to the people of Hongkong.

That Peking could administer Hongkong competently is not in dispute. The problem is what Chinese administration would mean in political and economic terms. For example, China does not have an independent judiciary or a free press. Would China be able to resist raiding Hongkong's considerable financial reserves, which are greater than its own reserves of foreign currency? China would no doubt expect to take over Hongkong as a going concern, although Britain might be tempted to move Hongkong's moveable assets out of China's reach.

However much Peking claims that there would be no interference, nobody in Hongkong believes it. Hongkong businessmen do not believe that Peking can successfully operate a free enterprise system; they point to China's own laboratories of capitalism, the special economic zones nearby at Zhuhai and Shenzhen, where the concept of the quota still burdens production. If China incorporated these zones into Hongkong in the hope that some western alchemy would operate, it would suspect political sabotage if they failed.

Peking has suggested that British civil servants would be welcome to stay on after China had taken over; even the possibilities of management agreements

have been mooted. This is an irrelevance. As one senior civil servant put it: "Hongkong's government could be run by Eskimos, provided the authority of the governor derives from the British crown—that is, the guarantee of freedom from interference".

Mrs Thatcher has emphasised "Britain's commitment to the people of Hongkong". Although most wealthy Chinese have contingency plans to get themselves out of Hongkong, Britain's commitment stops short of allowing the rest of the 5.5m citizens, 57% of whom were born in Hongkong, to move to Britain.

Peking has, over the past 12 months attempted to reassure Chinese leaders in Hongkong about its intentions. The Hongkong Chinese have not been reassured. They are distressed by the way the Hongkong government has kept a Whitehall-inspired low profile while the Chinese are waging a propaganda war. They are worried when China tells them that they are part of the Chinese people—fearing that this suggests that their standard of living would drop to that of the adjacent Chinese province of Guangdong. Old China hands are reminded of the fate of businessmen when the Communists took over in Shanghai in 1949. Those who stayed on or were invited back were purged.

The worst of worlds

The colony's worst fear is that, once it seems unlikely that a formula for "stability and prosperity" can be agreed upon, there will be a rapid economic slide. Investment will dry up. Money will flee—it has already started to do so. Australia

and Singapore, among other countries, are canvassing investors nervous about Hongkong's future. But it is the loss of local investment that is the real risk. During the past 10 years this has been 10 times greater than foreign investment. Already some local manufacturers are entering joint ventures overseas rather than remaining in Hongkong. Unemployment, which in Hongkong is still only 3%, could grow and, with it, so would political trouble. Riots could follow. The British would then want to withdraw. Peking would be unwilling to take over. The Hongkong government's only negotiating card is its ability to maintain order. However, senior police officers are already worrying about the morale of local police officers in the present climate of uncertainty, and the crime rate is rising.

China has a strong motive to settle the Hongkong problem amicably: it wants to reunite Taiwan with the motherland. Unlike Hongkong, where the British can be forced out at any time, the Taiwanese will have to be persuaded to rejoin the family. China's hope of regaining Taiwan peacefully may seem to outsiders an exercise in optimism. But a faction in Taiwan favours unification, and it will watch how things go in Hongkong.

There must also be some concern in Peking at the economic weight a reintegrated Hongkong would give to southern China. The regional warlords of China are no distant memory. In recent times Shanghai was the power base of the Gang of Four and during the cultural revolution Peking nearly lost control of Guangdong. Confusion in Hongkong would endanger not only China's current foreign exchange earnings from Hongkong (which include a half of China's total income from tourists), but also its investments in the territory. During the past five years China has spent nearly £500m buying property in Hongkong and the 13 Peking-owned banks there have a profitable 30% of the business.

Dragon's breath

The traditional way of fighting Chinese wars was to bang drums and flash dragon shields in the face of the enemy. Often whoever made most show won the war without bloodshed. Mrs Thatcher is not likely to be intimidated by these tactics, but Hongkong's investors may be. The Chinese publicly emphasise their friendship for Britain and privately suggest that the problem can be resolved between friends. But their present approach, if translated into eventual action, would kill off the Hongkong golden goose. In the meantime they could succeed in frightening it to death. This cannot be what they want.