

PO-CH NL/0080 PEB

Part B.

SECRET

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Begins: 4/12/87
Ends: 24/2/88



PO -CH /NL/0080



PART B

Chancellor's (Lawson) Papers;

**ARRANGEMENTS FOR THE
TRANSITION OF THE
SOVEREIGNTY OF HONG KONG
IN 1997**

PO -CH /NL/0080

PART B

PART B

Disposal Directions: 25 Years

Andrew

27/7/95

CONFIDENTIAL

FROM : S A ROBSON
DATE : 4 DECEMBER 1987

CHIEF SECRETARY

c.c. Chancellor
Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Mr H Evans
Mr Turnbull
Mr Woodall
Mr Fox o.r.
Mr Call

pm

HONG KONG : DEFENCE COSTS AGREEMENT

There is no need for you to respond to the minute of 3 December from Sir Geoffrey Howe to the Prime Minister and Mr Powell's (No 10) letter of the same date. I understand you are sending the draft attached to Mr Woodall's minute of 3 December.

2. The Prime Minister and Sir Geoffrey both go along with the proposed way forward - i.e. stick to our position and send an official to Hong Kong. Unfortunately both are showing signs of a weakening resolve. In particular the Prime Minister is recorded as "not absolutely ruling out some gesture to go a little way to meet the Hong Kong side". I suspect the FCO will find some way to communicate this mood to the Hong Kong Government.

3. The problem for the Treasury will be to contain the cost of any concession with the defence budget. But we do not have to cross that bridge yet.

SAR

S A ROBSON



21/12/87.

CH/EXCHEQUER	
REC.	22 DEC 1987
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MO 6/19/1L

PRIME MINISTERHONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATIONS

As proposed in my minute of 1st December, and as subsequently endorsed by colleagues, Sir John Belloch, Second Permanent Under-Secretary at the Ministry of Defence, visited Hong Kong on 16th and 17th December. During that period he met three of the key Unofficial members of the Executive and Legislative Councils, and he also met the Governor with his three principal official advisers. He separately had two private discussions with the Governor.

2. From the discussions Sir John has received the clear impression that a shift in Hong Kong's favour, away from the present 75:25 apportionment of garrison costs, is necessary if the Governor is to muster the necessary support in Exco and Legco for a new Defence Costs Agreement. He found it much more difficult to gauge the size of the shift that would be needed to achieve this objective, especially in the light of my Department's own budgetary position (which Sir John was at pains to spell out to the Governor and his advisers). Hong Kong officials have been seeking to argue in the negotiations so far that while there could be flexibility in the incidence of payments, overall the costs of the garrison should be split 50:50. I think they now understand that such an outcome is simply not achievable and that, if there is to be a new apportionment, it will be at a level less favourable to them than that. There is also the point that Hong Kong could easily afford the sums implied by a continuation of the present arrangements - a point that the Governor and his advisers were prepared to acknowledge.



3. Given my Department's present budgetary position, I am clear that the magnitude of the shift that the defence budget can be expected to bear should be no more than about 5% of the total costs of the garrison between 1st April 1988 and 30th June 1997. I am also clear that the contribution provided by my Department should under no circumstances rise above £46 million a year, which is 25% of the estimated cost of the garrison in 1988-89, the first year of any new agreement. I propose to instruct officials to work up a negotiating position based on these principles in preparation for a further round of negotiations in the New Year. I should be grateful to know that you and the other members of OD(K) are content.

I am sending copies of this minute to members of OD(K) and to Sir Robert Armstrong.

A.Y.

Ministry of Defence
21 December 1987

CONFIDENTIAL



CH/EXCHEQ	
REC.	23 DEC 1987
ACTION	LS T
COPIES TO	

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

23 December 1987

Dear John,

**HONG KONG DEFENCE COSTS
AGREEMENT: RENEGOTIATIONS**

The Prime Minister has seen the Defence Secretary's minute of 21 December in which he proposes that we adjust our position in the negotiations for renewal of the Hong Kong Defence Costs Agreement, by conceding a small shift in Hong Kong's favour away from the present 75:25 apportionment of garrison costs. Subject to the views of the Foreign Secretary, the Prime Minister is content for the proposal in paragraph 3 of the Defence Secretary's minute to be worked up and put to the Hong Kong side.

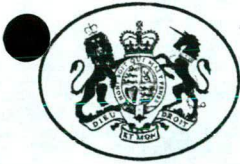
I am copying this letter to the Private Secretaries to Members of OD(K) and Trevor Woolley (Cabinet Office).

Yours sincerely,

C. D. POWELL

John Howe, Esq.,
Ministry of Defence

CONFIDENTIAL



PM/87/077

29/12/87.

CH/EXCHEQUER	
REC.	30 DEC 1987
ACTION	CST
COPIES TO	

✓ 30/12

mp

PRIME MINISTER

Hong Kong Defence Costs Agreement: Renegotiations

1. I have seen George Younger's minute to you of 21 December about negotiations with the Hong Kong Government over the Defence Costs Agreement.
2. In my minute of 3 December I set out my view of the political realities of the situation. It must also be recognised that Hong Kong does face an increased burden in expanding its police force in line with the phased withdrawal of the garrison. Against this background I share the Defence Secretary's conclusion that a shift in Hong Kong's favour, away from the present 75:25 apportionment of garrison costs, is necessary if we are to reach agreement on a new Defence Costs Agreement and avoid a damaging political row with Hong Kong. Of course it takes two to make an agreement and I am pleased that Sir John Blelloch was apparently able to dispel some of the illusions in Hong Kong about what they can hope to achieve during his recent visit to the territory.
3. I am generally content that a new negotiating position should be developed along the lines set out in paragraph 3 of George Younger's minute. But I am not sure that a modest change in the apportionment, of the kind he has in mind,

/will

CONFIDENTIAL



will turn the trick. I hope that the Ministry of Defence negotiators will have sufficient flexibility to enable them to achieve an agreement which is both politically acceptable in Hong Kong and compatible with the MOD budgetary constraints, of which I am very conscious.

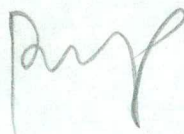
4. I am sending copies of this minute to members of OD(K) and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
29 December 1987

CONFIDENTIAL



FROM: S H WOODALL

DATE: 4 January 1988

1. MR FOX
2. CHIEF SECRETARY

cc: Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Kemp
 Mr H P Evans
 Mr Turnbull
 Mr Robson
 Mr Call

copies attached for: Chancellor
 Economic Secretary

HONG KONG DEFENCE COSTS AGREEMENT (DCA): RENEGOTIATIONS

In his minute of 21 December to the Prime Minister, the Secretary of State for Defence reports that Sir John Blelloch's visit to Hong Kong failed to secure movement in Hong Kong's position on the DCA renegotiations. He therefore seeks colleagues agreement in principle to some increase in the UK's contribution subject to the preparation of a detailed negotiation brief by officials.

Background

2. The current DCA (which expires in March 1988) provides that the UK and Hong Kong share the cost of the garrison on the basis of a 75/25 split in the UK's favour. From the outset of the negotiations the Hong Kong Government has maintained that there is severe local political opposition to the continuation of such an agreement despite the fact that the current agreement contains a clause that the existing arrangement be continued for a further 5 years if the two sides failed to reach agreement at the review point. Although the legal status of this clause is not robust, it was included in the existing DCA at the request of the Hong Kong Government. However, they have steadfastly held to the view that a 50/50 split is appropriate and have tabled no serious proposals.

3. HMG for its part, argued that the Hong Kong Government should contribute at least 75 per cent on the grounds that the role of the garrison was increasingly restricted to internal security (as opposed to external security) and this was properly a cost to Hong Kong. The UK side did table proposals both for securing savings in the cost of the garrison and for so restructuring the arrangements to provide presentation benefits in Hong Kong. These proposals failed to satisfy the Hong Kong Government and it was against this background that Sir John Blelloch

visited the dependency. It is important to note, however, that in approving the visit, the Prime Minister, in her private secretary's letter of 1 December did not rule out the possibility of some small concession if the negotiations reached an impasse.

Mr Younger's Proposals

4. Mr Younger is proposing that the UK contribution should increase by no more than 5 per cent of the total costs of the garrison between 1 April 1988 and 3 June 1997 ie a move on average from a 25 per cent contribution to 30 per cent. However, there would be a maximum ceiling on the UK's contribution of £46 million a year (ie 25 per cent of the cost of the garrison in 1988-89) in any year.

5. In proposing such a scheme, the MOD have in mind that they would be able to maintain a 25 per cent share of the cost over the next 3-4 years at the price of backlogging the 5 per cent concession at a time when garrison costs are scheduled to start falling markedly. Over the period to 1997 an arrangement of this sort would add some £50 million to defence expenditure.

6. This approach has two main advantages. First it preserves the existing defence budget commitment to the costs of the garrison over the next few critical years. Second, by imposing an overall ceiling of £46 million in any year, it leaves the Hong Kong Government with the risks associated with a failure to run down the garrison at the rate currently envisaged.

7. On the other hand, we shall be left picking up a very heavy proportion of the costs of the garrison just at a time when its function is most clearly that of internal security rather than guarding against an external threat. Given this, it is not impossible that we might face presentational problems in the UK towards the end of the garrison's life if we were seen to be dramatically increasing our percentage share of the costs.

8. The critical issue is whether the kind of movement which Mr Younger suggests will assuage the Hong Kong Government or merely be taken as a indication that we are willing to move yet further. While Mr Younger's proposal might be acceptable as a final outcome (assuming that any additional costs were absorbed within the Defence Budget), the timing of any movement on our side will be critical. So far the UK has made all the running in the negotiations and the Hong Kong's side has largely confined itself to saying "No". The risk is that

Any sign of movement on our side will simply be seen by them as a new base for further negotiations. They are likely to reject the proposal out of hand and stick to their opening bid of a 50/50 split holding out for a further concession.

9. In view of these dangers, some serious thought needs to be given to:

- a) whether Hong Kong would settle for the Younger proposal; and
- b) if so, how we get from the present position to such an outcome.

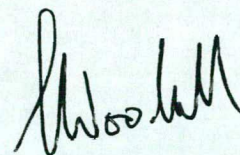
It would be quite unwise for the UK to table anything now until we are clear on these points.

10. One other point deserves mention. The case for a concession on the DCA is usually seen in terms of keeping Hong Kong sweet in the run up to the 1997. It was, however, made clear to Blelloch that those in Hong Kong who are causing the problem on the DCA will simply find another cause to use to attack the UK Government if the DCA is resolved. There is nothing to be done about this but it does mean that we should be sceptical of appeals for the UK to make concessions to keep the Hong Kong show on the road.

Conclusion

11. Mr Younger's proposal might be acceptable as a final outcome, provided that any additional costs were absorbed within the Defence Budget. However, at present it is far from clear that it will achieve this. The risk is that this will be the first of a series of concessions. We need a clearer view of whether the concession will buy agreement before agreeing it should be put into play.

12. A draft reply is attached.



S H WOODALL

DRAFT LETTER FROM THE CHIEF SECRETARY

CONFIDENTIAL

Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

HONG KONG DEFENCE COSTS AGREEMENT

You sent me a copy of your minute of 21 December to the Prime Minister.

In principle, I could accept your proposal if it resulted in a settlement of the DCA and on the basis that the additional costs were contained within a defence programme consistent with the PES 87 control totals. I certainly share your view that no larger concession should be made.

Unfortunately it is far from clear to me whether your proposal would achieve a settlement. The UK has so far made most of the running and there must be a real risk that Hong Kong will reject any concession and hold out for something larger.

In these circumstances, before we make any concession we need a clearer view on the likelihood of reaching a agreement within the terms you have descibed and of the way we avoid the risk of having to make larger concessions. I suggest our officials examine the issues and report back before any concession is tabled.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.



cc:
 Chancellor
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Kemp
 Mr H P Evans
 Mr Fox
 Mr Turnbull
 Mr Robson
 Mr Call
 Mr Woodall

Treasury Chambers, Parliament Street,

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

Prop.

6th January 1988

Dear George

HONG KONG DEFENCE COSTS AGREEMENT

You sent me a copy of your minute of 21 December to the Prime Minister. I have also seen the Foreign Secretary's minute of 29 December.

In principle, I could accept your proposal if it resulted in a settlement of the DCA and on the basis that the additional costs were contained within a defence programme consistent with the PES 87 control totals. I certainly share your view that no larger concession should be made.

Unfortunately it is far from clear to me whether your proposal would achieve a settlement. The UK has so far made most of the running and there must be a real risk that Hong Kong will reject any concession and hold out for something larger.

In these circumstances, before we make any concession we need a clearer view on the likelihood of reaching an agreement within the terms you have described and of the way we avoid the risk of having to make larger concessions. I suggest our officials examine the issues and report back before any concession is tabled.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.

Yours Ever,
John
 JOHN MAJOR



SECRET

CH/EXCHEQUER	
REC.	06 JAN 1988
ACTION	MISS O'MARA
COPIES TO	EST SIR P. MIDDLETON SIR G. LITTLE MR ANSON MR MOUNTFIELD

PM/88/002

PRIME MINISTER

6/1/88 -

Hong Kong: Representative Government

1. The Hong Kong Government's White Paper on representative government is due to be published in February. The text on the introduction of a directly elected element into the Legislative Council now needs to be finalised.
2. As you know, the recent Review of representative government in Hong Kong showed substantial support for the principle of direct elections. But on timing opinions are divided. No clear majority trend in favour of direct elections in 1988 has emerged.
3. We have secured from the Chinese a private commitment that if direct elections are not introduced until after the promulgation of the Basic Law in 1990, it will contain an appropriate provision for them. They have also agreed that the White Paper could state, with an "appropriate reference" to the Basic Law, that direct elections will be introduced in 1991. The outcome of the Review enables us to proceed in this way.
4. The Hong Kong Government have now sent us drafts of the key chapters in the White Paper on direct elections and the way forward. These drafts, which have been discussed with officials here, are attached. They embody the decision that an element of direct elections to the Legislative Council will be introduced in 1991, in the form of 10 directly elected seats in geographically based single seat constituencies. These would replace the seats currently elected indirectly by the District Boards. They take into account a first round of discussion with ExCo. There may still be some further minor changes of wording and presentation.

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5. In view of the part they have to play in this, the wording on the Basic Law should be shown to the Chinese in good time. I therefore propose to ask our Ambassador in Peking to pass the Chinese a paper on the pattern previously established illustrating how we intend to deal with direct elections in the White Paper, including the references to the Basic Law. Because of the tight timetable before publication, he will need to do this as soon as possible.

6. The outcome which is now emerging is a very satisfactory one, both from our point of view and for Hong Kong. We have overcome Chinese resistance to the principle of direct elections; we are on course to achieve an element of direct elections in the Hong Kong Legislative Council well before 1997; and we are set to secure a commitment to direct elections in the Basic Law for post 1997 Hong Kong. I believe that the course proposed is a fair reflection of public opinion and is in the best interests of the territory's future stability and prosperity. I therefore hope that you and OD(K) colleagues will endorse the decisions regarding direct elections set out in the drafts. The remaining chapters of the White Paper are being drafted in slower time: I will circulate a complete draft text of the White Paper in due course.

7. I am copying this minute to members of OD(K) and to Sir Robin Butler.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

6 January 1988

CHAPTER III

DIRECT ELECTIONS TO THE LEGISLATIVE COUNCIL

PUBLIC RESPONSE TO THE GREEN PAPER

Of all the questions raised in the Green Paper, the subject of direct elections to the Legislative Council produced by far the greatest public response. The Survey Office received 124,228 submissions on the matter from individuals and groups of individuals, representing the views of 137,217 people in all. It also received 605 submissions from associations and other bodies. 164 public opinion surveys of various sorts addressed the issue, and 21 signature campaigns collected over 200,000 signatures. The Legislative Council debated the subject and the Municipal Councils and all District Boards discussed it.

The bulk of the views expressed was in favour of introducing directly elected members into the Legislative Council. Even allowing for the fact that many people did not express any views it is plain that there is a strong trend in public opinion in favour of developing the present system to include a directly elected element at the central level of government, and doing so well before 1997.

On the question of whether a directly elected element should be introduced in 1988, however, opinion was sharply divided. Those who favoured introduction in 1988 argued that direct elections were important for the development of more open, accountable and representative government and should be introduced as early as possible. Those against argued that introduction in 1988 was too soon because it could endanger stability and continuity: it would involve a second major reorganisation in three years and the system of elections to be used after 1997 had not yet been established in the Basic Law.

Most submissions to the Survey Office from individuals, groups and associations were against the introduction of direct elections in 1988. The two public opinion surveys commissioned by the Survey

Office produced a similar result. Other public opinion surveys and signature campaigns were generally in favour of introduction in 1988. Opinions among Legislative Councillors, Municipal Councillors and District Board members differed widely.

Taken as a whole, the public response to the Green Paper showed that there is wide support among the people of Hong Kong for the principle of introducing directly elected members into the Legislative Council, but that the community is divided over the timing of this move.

Few opinions were expressed on how direct elections might be organized. Those who commented were on balance in favour of having several constituencies rather than a single territory-wide constituency. They also tended to favour having direct elections in addition to, rather than instead of, the present system of indirect elections by an electoral college.

Stability and Transition

There is a strong consensus in the community over the importance of stability. Stable government has always been crucial to Hong Kong. It will remain crucial in the years leading up to 1997 and beyond. Stability is essential for public confidence in the Government and in the future of the territory, as well as for overseas business confidence in Hong Kong.

The maintenance of stability requires that the development of Hong Kong's system of representative government should continue to be evolutionary rather than revolutionary: that each step should be carefully considered; and that changes should command wide support and confidence in the community.

Such evolution must also be compatible with a smooth transfer of government in 1997. There will be changes in 1997 arising from the restoration of Hong Kong to China. But the interests of the community require that there should be a high degree of continuity and that the form of government in particular should continue to be one with which the people of Hong Kong are familiar and in which

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they have confidence. In considering the development of Hong Kong's system of representative government before 1997, account must be taken of the relevant stipulations of the Sino-British Joint Declaration and the deliberations of the Basic Law Drafting Committee over how those provisions should be implemented after 1997. In this connection the government has taken note of the fact that all the options in the latest draft of the Basic Law concerning the election of the future legislature include an element of direct elections.

Introduction of Direct Elections

The government has concluded that the introduction of a number of directly elected members into the Legislative Council before 1997 would be a logical and desirable further step in the development of Hong Kong's system of representative government. It would be welcomed by the community and would be conducive to the maintenance of stability.

The government has further concluded that it would not be right to make this major constitutional change in 1988, given that opinions in the community on this point are so divided. The argument that the Legislative Council should continue for one more term with its present forms of membership, rather than undergo a second restructuring in three years, is strong. At the same time, there are good reasons for leaving sufficient time before 1997 for the new form of election to become firmly established. The government has therefore decided to introduce directly elected members into the Legislative Council in 1991.

The government considers that direct elections should be on the basis of single-seat geographical constituencies. It does not believe that indirectly elected members representing geographical constituencies should in these circumstances be retained. It is difficult to see any advantage in having two parallel systems of geographical representation in the Legislative Council, directly and through District Boards. To have both would substantially increase the size of the Legislative Council and upset its overall balance. The Government has therefore decided to introduce ten directly

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elected seats in 1991, in place of the ten currently filled by indirect elections from the District Boards. The future of the remaining two electoral college seats - those elected by members of the Municipal Councils - is discussed in Chapter V of this White Paper.

Detailed arrangements for the conduct of direct elections, including the drawing up of constituencies, will be devised over the next two or three years. The public will have the opportunity to comment on them.

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CHAPTER VIII

THE WAY FORWARD

The public response to the 1987 Green Paper showed that there is a strong demand among the community for the system of representative government to be developed further. The forms of representation developed over the years have proved to be effective and to have firm popular support. The three-tier structure of government received strong endorsement in the 1987 review and there is a clear wish among the people of Hong Kong to retain and strengthen this system. At the same time there is clear concern that future development should take the form of a prudent and gradual evolution, to ensure stability between now and 1997 and a smooth transfer of government in 1997.

The decisions announced in this White Paper reflect all these considerations, and take full account of all the views expressed during the course of the review. A continuing, steady evolution of Hong Kong's system of representative government is clearly in the best interests of the community, both to meet the developing needs of our society and to maintain confidence in our future. Such a process plainly has broad support within the community.

The White Paper charts the course of further development of representative government between now and 1991. The framework of government after 1997 will be incorporated in the Basic Law which will be promulgated in 1990. Further development will be necessary between 1991 and 1997 to ensure that there is continuity and a smooth transition in 1997. Decisions will need to be taken during that period to enable Hong Kong's system of government to evolve in a way that is compatible both with the framework set out in the Basic Law and with the aspirations of the Hong Kong community. These decisions will require further public consultation though not necessarily in the form of a review such as that just concluded.

The system of government in Hong Kong is unique, and has

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developed in the way that it has because of the unique circumstances of the territory. The system of government for the future Hong Kong Special Administrative Region, which was set out in broad outline in the Sino-British Joint Declaration and which will be elaborated in more detail in the Basic law, will also be unique. Hong Kong after 1997 will continue to require a structure of government tailored to its own special circumstances. The overriding aim of the Government is that Hong Kong's system of representative government in the years between now and 1997 should be able to evolve gradually from the present system to ensure a smooth transition in 1997. This should be done in a manner that commands the full confidence of the people of Hong Kong and ensures that government is both effective and responsive.



MO 6/19/1L

MINISTRY OF DEFENCE

MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-930 7022

3/1

CH/EXCHEQUER	
REC.	08 JAN 1988
ACTION	CST
COPIES TO	

7th January 1988


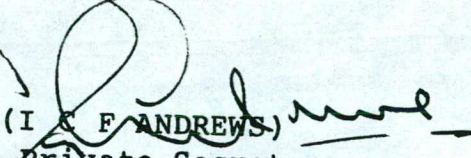
Dear Jill,

HONG KONG DCA: RENEGOTIATION

Before his departure for India, my Secretary of State had seen the replies from the Prime Minister and the Foreign and Commonwealth Secretary to his minute of 21 December on the subject of the negotiations with the Hong Kong Government (HKG) over the Defence Costs Agreement (DCA). He had noted their reactions to his proposal for a change in apportionment in Hong Kong's favour, subject to the constraint that the Defence Budget should not be expected to bear a shift of more than about 5% of the total costs of the garrison between 1988 and 1997 without any compensation from the HKG.

He had been prepared to instruct the MOD's negotiators accordingly. But in his letter of 6th January, the Chief Secretary expressed his concern that the HKG might reject any concession and hold out for something more. Whilst it is apparently common ground between Ministers that a concession of about 5% on the apportionment would be acceptable if it resulted in a settlement, it is clear that discussions need to take place between officials of our two Departments, as suggested by the Chief Secretary, before negotiations with the HKG can be resumed. Whilst my Secretary of State is anxious that there should now be genuine negotiations, with both sides having some room for manoeuvre, he would, I am sure, wish these discussions to take place as soon as possible in the hope that the Chief Secretary's concerns can be resolved. Officials here stand ready for an early meeting.

I am sending copies of this letter to the Private Secretaries to other members of OD(K) and to Trevor Woolley (Cabinet Office).



 (I. C. F. ANDREWS)
 Private Secretary

Jill Rutter
HM Treasury

FROM: MISS M O'MARA

DATE: 8 JANUARY 1988

CHANCELLOR OF THE EXCHEQUER

cc Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Mountfield
 Mr Peretz

*Chy agree we should telephone
 No 10 to say that we are content?*

HONG KONG: REPRESENTATIVE GOVERNMENT

The Foreign Secretary sent the Prime Minister on 6 January a draft of the key chapters in the Hong Kong Government's White Paper on representative government which cover direct elections to the Legislative Council and the way in which the Hong Kong Government proposes to proceed. This is not an issue of direct interest to the Treasury but we see no reason to raise any objection to the proposal and no difficulties with the text of the draft White Paper.

Background

2. While the public reponse to the Hong Kong Government's Green Paper showed a clear preference in favour of direct elections to the Legislative Council, opinions on timing have been divided. Some favour introduction at the earliest opportunity in 1988; others feel to move so quickly would endanger stability and continuity.

Proposals

3. The Hong Kong Government sets a premium on the maintenance of stability and therefore proposes direct elections should not be introduced ^{until} 1991. This still leaves sufficient time for the new form of election to become firmly established before Hong Kong is restored to China in 1997. Direct elections would take the form of 10 directly elected seats in geographically based single seat constituencies, rather than in a single territory-wide constituency. These would replace the 10 seats currently filled by indirect elections from the District Boards. The Chinese have agreed privately to the introduction of direct elections in 1991 and to provision being made for this when the Basic Law is promulgated in 1990.

Conclusion

X | 4. As the draft White Paper points out, stability is essential to maintain overseas business confidence in Hong Kong. We would therefore support the Hong Kong Government's wish to proceed steadily, introducing direct elections in 1991. If you agree, your office might like to telephone No 10 to indicate you are content.

MOM

MISS M O'MARA

pmf



10 DOWNING STREET
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	11 JAN 1988
ACTION	MISS O'MARA
COPIES TO	SIR P. MIDDLETON
	SIR G. LITTLE
	MR ANSON
	MR MOUNTFIELD

11 January 1988

From the Private Secretary

Dear Tony,

HONG KONG: REPRESENTATIVE GOVERNMENT

The Prime Minister has considered the Foreign Secretary's minute of 6 January about the White Paper on Representative Government in Hong Kong due to be published in February. She is content with the decisions regarding direct elections set out in the draft and with the way in which the Foreign Secretary proposes to handle this.

I am copying this letter to the Private Secretaries to members of OD(K) and to Sir Robin Butler (Cabinet Office).

Yours sincerely,
Charles Powell

CHARLES POWELL

A. C. Galsworthy, Esq., C.M.G.,
Foreign and Commonwealth Office.

SECRET

Chapter I

Introduction

Background

On 27 May 1987 the Government published a Green Paper entitled "The 1987 Review of Developments in Representative Government". Hong Kong's system of representative government has been developing since the 1970s. It was last reviewed in 1984, when elections to governmental institutions were still confined to the regional and district levels of government. As a result of that review, the Government decided to extend the electoral process to the central level. Accordingly, the Legislative Council was significantly reorganized in 1985 with the introduction of 24 indirectly elected Members. The Government also announced in 1984 its decision to review the development of the whole system of representative government again in 1987. That review began with the publication of the Green Paper.

General Objectives

2. Hong Kong has evolved over the years a system of government which differs from those elsewhere in the world. This has reflected the special circumstances of Hong Kong, including its status as a non-sovereign

territory; its small area with a large, rapidly growing and increasingly educated population; its fast pace of economic and social development; and its position as a major business and financial centre. These factors have required the Government to develop the system of administration to meet the growing needs and expectations of society, while maintaining political stability, economic prosperity and effective administration.

3. This requirement continues to shape the Government's thinking on the system of government. The system has to evolve as Hong Kong society develops, so as to ensure that the Government continues to have the support of the community. At the same time, the need to maintain stability and prosperity under an effective administration remains as strong as ever.

4. These considerations point towards the value of developing a more representative system, so as to improve the responsiveness of the Government to society's needs. It should also be recognized that Hong Kong's stability and prosperity owe much to the pursuit of consistent policies and prudent development. This points to the need to evolve gradually from the unique system that has served Hong Kong well until now, and not to force the pace of

reform to an extent that might introduce instability and uncertainty into the administration of the territory. In this connexion, it is particularly important that the people of Hong Kong should have confidence in the system of government during the period leading up to the restoration of Hong Kong to China in 1997, and in continuity after 1997 when Hong Kong will be a Special Administrative Region of the People's Republic of China.

5. The Government's objectives with regard to the system of representative government in Hong Kong are therefore as follows:

- (a) that it should continue to evolve to suit Hong Kong's circumstances;
- (b) that its development should be prudent and gradual;
- (c) that any reforms should have the widest possible support so as to command the confidence of the community as a whole; and
- (d) that the system in place before 1997 should permit a smooth transition in 1997 and a high degree of continuity thereafter.

The Green Paper

6. The Green Paper of May 1987 sought the views of the community on whether the system of representative government should be further developed in 1988 and, if so, in what manner. The main issues addressed in the Green Paper were:

- (a) the composition and functions of the District Boards and Municipal Councils and possible ways of improving the links between them;
- (b) the composition of the Legislative Council and the methods of selecting its Members, including whether and, if so, when an element of direct elections should be introduced;
- (c) whether the Governor should continue to be the President of the Legislative Council; and
- (d) practical aspects of elections to the District Boards, the Municipal Councils and the Legislative Council.

7. The Green Paper discussed a number of issues affecting the three tiers of the present system of government. It put forward a range of options, and set out the arguments for and against each of them. It did not make recommendations. The object was to encourage the widest possible public response.

The Survey Office

8. A Survey Office was set up to collect public opinion on the Green Paper. It operated outside the ordinary machinery of government and without interference from the Administration. Two independent monitors were appointed to oversee its work. Its task was to collect and collate, but not to assess, the views expressed by the public. Its terms of reference and those of the monitors are at Appendix A. The Survey Office received submissions from the public from 27 May to 30 September 1987. It submitted its report on the public response on 29 October 1987, and the monitors submitted their separate report on the following day. Both reports were tabled in the Legislative Council and published on 4 November. The monitors concluded in their report that the Survey Office had carried out its duties properly, accurately and impartially, and in line with its terms of reference.

Public Response

9. The Green Paper succeeded in eliciting widespread public response. During the four months of the public consultation period, the Survey Office received 131,589 written submissions. In addition, 168 public opinion surveys were conducted and there were 21 signature campaigns. This response was unprecedented. In comparison, the 1984 Green Paper on the future development of representative government attracted 364 submissions; and the assessment in late 1984 of the acceptability of the draft agreement on the future of Hong Kong attracted 2,494.

10. The Legislative Council held debates on the contents of the Green Paper and on the reports of the Survey Office and the monitors. Both Municipal Councils and all 19 District Boards discussed the issues raised in the Green Paper. These discussions and other comments on the Green Paper exercise were covered extensively by the media.

The White Paper

11. In drafting this White Paper, the Government has taken full account of all the views expressed by the public during the period of the review. It has also kept in mind the special circumstances of Hong

Kong as summarized above; the provisions of the Sino-British Joint Declaration on the Question of Hong Kong; and the progress made by the Chinese Government in drafting the Basic Law for the future Hong Kong Special Administrative Region. The following chapters set out the Government's decisions on the next steps in the development of representative government.

Chapter II

The Present System of Representative Government

12. The present system of representative government has evolved gradually over the years. It consists of three separate but inter-connected tiers - at district, regional and central level.

13. Each tier has its own role. At district level, the 19 District Boards are advisory bodies concerned with local matters affecting the daily lives of the residents of their districts. At the regional level, the Urban and Regional Councils (the two "Municipal Councils") are statutory, financially autonomous bodies with executive responsibility for providing public health, cultural and recreation services in their regions. At the central level, the Legislative Council enacts laws, debates policy issues and controls public expenditure. The Administration is accountable to the Council for the implementation of Government policy and the expenditure of public funds.

14. The District Boards consist mainly of members directly elected by constituencies with about 25,000 residents for each member. About one third of their

members are appointed by the Government. District Board members keep in close touch with public opinion in their districts through contacts with local residents and local organizations such as Area Committees and Mutual Aid Committees.

15. The Municipal Councils also include directly elected members. Constituencies are much larger than those for District Boards, with about 210,000 residents for each elected Council member. Half the members of the Urban Council are directly elected, and the other half appointed. The Regional Council's composition is more complicated. One-third (twelve members) are directly elected. Nine are indirectly elected, one from each District Board in the region. The Chairman and two Vice-Chairmen of the Heung Yee Kuk are ex-officio members, providing a direct link with the indigenous residents of the New Territories. The remaining twelve members of the Regional Council are appointed by the Governor.

16. Until 1985 the Legislative Council was composed entirely of Appointed Members, including a substantial number of Government officials. In that year the numbers of Official and Appointed Members were reduced to ten and 22 respectively and, for the first time, 24 Elected Members were introduced. Twelve of

these Members are elected from "functional" constituencies based on major professional and occupational groups. The other twelve are elected on a geographical basis by an electoral college comprising all members of the Municipal Councils and District Boards.

17. The three-tier structure has proved itself to be well suited to Hong Kong's requirements. The public response to the Green Paper was strongly in favour of retaining it. The Government intends to plan the further development of representative government on the basis of this structure, and with the following points in mind:

- (a) The responsibilities of each of the three tiers of government should be clear, and their roles should not overlap.
- (b) The three tiers should co-operate effectively, and be linked in such a way that the views and concerns at each level of government are adequately represented at the next higher level.

- (c) The methods of choosing the membership of each tier of government should be such that the Board or Council will be in close touch both with the views of the general public and of those sectors whose concerns are particularly relevant to its work.

Chapter III

Direct Elections to the Legislative Council

Public Response to the Green Paper

18. Of all the questions raised in the Green Paper, the subject of direct elections to the Legislative Council produced by far the greatest public response. The Survey Office received 124,228 submissions on the matter from individuals and groups of individuals, representing the views of 137,217 people in all. More than half of the submissions from individuals came in the form of a variety of pre-printed standard letters. It also received 605 submissions from associations and other bodies. 164 public opinion surveys of various sorts addressed the issue, and 21 signature campaigns collected over 200,000 signatures. The Legislative Council debated the subject and the Municipal Councils and all District Boards discussed it.

19. The bulk of the views expressed favoured introducing directly elected Members into the Legislative Council. Even allowing for the fact that many people did not express any views, it is

plain that there is a strong trend in public opinion in favour of developing the present system to include a directly elected element at the central level of government and doing so well before 1997.

20. On the question of whether a directly elected element should be introduced in 1988 opinion was, however, sharply divided. Those who favoured introduction in 1988 argued that direct elections were important for the development of more open, accountable and representative government and should therefore be introduced as early as possible. Those against argued that introduction in 1988 was too soon either because it could endanger stability and continuity, coming within three years of the last major reorganization, or because the system of elections to be used after 1997 had not yet been established in the Basic Law due to be promulgated in 1990.

21. Among submissions to the Survey Office from individuals, groups and associations, more were against than in favour of the introduction of direct elections in 1988. The two public opinion surveys commissioned by the Survey Office produced a similar result. Other public opinion surveys and signature campaigns were generally in favour of direct elections in 1988. Opinions among Legislative Councillors, Municipal Councillors and District Board members differed widely.

22. Taken as a whole, the public response to the Green Paper showed that there is wide support among the people of Hong Kong for the principle of introducing directly elected Members into the Legislative Council, but that the community is divided over the timing of this move.

23. Opinions on how direct elections might be organized were few and also divided. Those who commented were on balance in favour of having several constituencies rather than a single territory-wide constituency. They also showed a slight preference for having direct elections in addition to, rather than instead of, the present system of indirect elections by an electoral college.

Stability and Transition

24. Stable government has always been crucial to Hong Kong. It will remain crucial in the years leading up to 1997 and beyond. Stability is essential for confidence in the government and in the future of the territory, as well as for overseas business confidence in Hong Kong. This important point has always been well recognized by the community.

25. The maintenance of stability requires that the development of Hong Kong's system of representative

government should continue to be evolutionary rather than revolutionary; that each step should be carefully considered; and that changes should command wide support and confidence in the community.

26. Such evolution must also be compatible with a smooth transfer of government in 1997. There will be inevitable changes at that time. The interests of the community will be best served if there is also a high degree of continuity and the form of government is one with which the people of Hong Kong are already familiar. In considering the development of Hong Kong's system of representative government before 1997, account must therefore be taken of the relevant stipulations of the Sino-British Joint Declaration and the deliberations of the Basic Law Drafting Committee over how those provisions should be implemented after 1997. In this connexion, the Government has taken note of the fact that all the options in the latest draft of the Basic Law concerning the election of the future legislature include an element of direct elections.

Introduction of Direct Elections

27. Having taken account of all the factors considered above, the Government has concluded that the introduction of a number of directly elected Members into the Legislative Council before 1997 would be a logical and desirable further step in the development

of Hong Kong's system of representative government. It would be welcomed by the community and would be conducive to the maintenance of stability.

28. On the question of timing, the Government has concluded that it would not be right to make such a major constitutional change in 1988, given that opinions in the community on this issue are so clearly divided. The argument that the Legislative Council should continue for one more term with its present forms of membership, rather than undergo a second restructuring in three years, is strong. However, there are also good reasons for leaving sufficient time before 1997 for the new form of election to become firmly established. The Government has therefore decided to introduce a number of directly elected Members into the Legislative Council in 1991.

29. The Government believes that direct elections are best carried out on the basis of single-seat geographical constituencies. This raises the question of what happens to the present geographically-based electoral college seats. It is difficult to see any advantage in having two parallel systems of geographical representation in the Legislative Council, operating both directly and through District Boards. That would mean having Members elected on a geographical basis by both direct and indirect methods. In addition, having two types of

geographically elected Members would involve substantially increasing the size of the Legislative Council and upsetting its overall balance. The Government has therefore decided that, in 1991, there should be ten directly elected seats, one from each of ten district-based constituencies, and that these should take the place of the ten seats currently filled by indirect elections from the District Boards. The future of the remaining two electoral college seats - those elected by members of the Municipal Councils - is discussed in Chapter V of this White Paper.

30. Detailed arrangements for the conduct of direct elections, including the drawing up of constituencies, will be devised over the next two or three years.

Chapter IV

Composition of the Legislative Council

31. As well as the question of direct elections, the Green Paper put forward a number of options for changes in 1988 to the numbers of Official, Appointed and Elected Members of the Council.

Public Response

32. These issues stimulated comments in over 42,300 submissions to the Survey Office, 108 public opinion surveys and one signature campaign. The general view was that there should be no major changes in the composition of the Legislative Council in 1988, but there were varying degrees of support for adjustments to the number of seats in one or more of the existing categories of membership.

33. There was a substantial majority of views in favour of retaining the present number of Official Members, i.e. ten. Many people thought that a reduction would hamper efficiency.

34. Most submissions from individuals did not favour changing the number of Appointed Members in

1988. Many stressed the value of the wide range of experience that this group brought to the Council. However, another body of opinion, including most of the submissions from groups and associations, was in favour of reducing the number of Appointed Members.

35. In general the public response supported the concept of the functional constituency system and an increase in the number of Members elected in this way. There was a large response from groups and associations seeking representation, either for themselves or for bodies to which they are affiliated, as functional constituencies.

36. Many District Board members favoured an increase in the number of Members elected by the electoral college. A clear majority of submissions to the Survey Office, however, opposed changing either the number of electoral college constituencies or the number of Members elected by each constituency.

37. The Green Paper raised, as an issue for discussion in the longer term, a suggestion that a proportion of the members of the legislature might in future be elected by a new, broadly-based electoral college. Few submissions commented on this concept,

but the public opinion surveys commissioned by the Survey Office showed that there was some interest in the community in considering the idea further.

Official and Appointed Members

38. It would be in line with the evolution of representative government gradually to reduce the proportion, if not the number, of Appointed Members, including appointed Official Members, in the Legislative Council. The appointment system will in any case have to cease by 1997, because of the stipulation in the Sino-British Joint Declaration that the legislature of the Hong Kong Special Administrative Region will be constituted by elections. Nevertheless there is a strong argument against moving too quickly in this direction. The introduction of 24 Elected Members in 1985, out of a total membership of 56, marked a significant change in the overall composition of the Council. The effect of any further changes would need to be carefully measured.

39. The ten Official Members - three ex-officio and seven appointed - are responsible for introducing Government business into the Legislative Council, explaining Government policy and answering other Members' questions on the administration of Hong Kong. They will continue to be required to fulfil these

functions until the relevant longer-term constitutional issues have been settled. The number of Official Members was reduced in 1985 from 18 to ten. As a result, Official Members now have to handle some matters in the Council for which they have no direct responsibility. This system is not ideal: it would clearly be better to have the official directly responsible for each item of business present in the Council to handle it. However, this would mean either appointing more Official Members, or finding alternative ways of enabling a wider range of officials to participate in the Council's proceedings. The response to the Green Paper shows that most people are not in favour of increasing the number of Official Members. Alternatives might be to arrange for different groups of officials to attend each meeting or to have officials attend meetings as non-members. An ever-changing team of Official Members would, however, run the risk of radically altering the relationship between the Council and the Administration or damaging the cohesion of the Council.

Elected Members

40. As set out in Chapter III of this White Paper, ten directly elected members will be introduced into the Legislative Council in 1991. They will replace the

ten members currently elected by the geographical (District Board) constituencies of the electoral college. The remaining two seats under the present electoral college arrangement are filled by the special constituencies of the Urban and Regional Councils. There are strong reasons for continuing to have elected representatives of the two Municipal Councils on the Legislative Council. They form a key part of the system of links between the three tiers of representative government (as described in paragraph 6(b) of Chapter II). Consequently, although the present electoral college will be abolished in 1991, the Government has decided to retain two special constituencies so that each of the Municipal Councils may continue to elect a Member to the Legislative Council.

41. So far as the functional constituency system is concerned, there is a good case for limited expansion in 1988. The system has worked well since its introduction in 1985. The public response to the Green Paper showed that there is wide support for developing it further. The Green Paper suggested the following guidelines by which to consider whether a group or groups should become a functional constituency:

- (a) functional constituencies should be substantial and of importance in the community;

SECRET 高度機密

- 23 -

- (b) any new constituency should be clearly defined to avoid difficulties over who qualifies for inclusion and how the electorate is prescribed;
- (c) constituencies should not be based on ideology, dogma or religion;
- (d) particular groups or bodies should not be represented in more than one functional constituency.

When these guidelines are applied to the many claims made for functional constituency representation, they suggest that the range of sectors represented by the present nine constituencies (see Footnote) is about right but that there is a case for enlarging particular constituencies to include more groups with related interests. Consequently the Government has concluded that there should be a small increase in the number of seats elected through functional constituencies.

Footnote : The present nine constituencies are : Commercial; Industrial; Financial; Labour; Social Services; Medical; Teaching; Legal; and Engineering, Architectural, Surveying and Planning.

SECRET 高度機密

Conclusions

42. In the light of all these considerations, the Government has decided that the composition of the Legislative Council from 1988 should be as follows:

- (a) There will continue to be ten Official Members, as at present. In order to ensure that official representation in the Council is as effective as possible, the Governor may from time to time appoint different officials to the Council according to the business to be conducted during the session and the policy expertise required. Each appointment will be for a continuous period of reasonable length.
- (b) The number of Appointed Members will be reduced from 22 to 20.
- (c) The number of Members elected by functional constituencies will be increased from twelve to 14. One additional Member will be elected from an enlarged Financial constituency (to be renamed the "Finance and Accountancy" constituency) and will represent members

of the accountancy profession. The other will be elected from an enlarged Medical constituency (to be renamed the "Medical and Health Care" constituency) which will have two divisions: one consisting of doctors and dentists and the other of nurses, midwives, pharmacists and five paramedical professions. Each division will elect one Member to the Legislative Council. Details of how these two new constituencies will be organized are given at Appendix B.

(d) The number of Members elected by the electoral college will remain unchanged.

43. The composition of the Legislative Council in 1988 will therefore be as follows:

Official Members	10
Appointed Members	20
Members elected by	
functional constituencies	14
Members elected by	
the electoral college	<u>12</u>
	<u>56</u>

44. For 1991, the effect of the decisions announced in this White Paper will be:

- (a) to introduce ten Members directly elected from geographical constituencies;
- (b) to abolish the present geographically-based electoral college system of election, but retain two special constituencies for the Urban and Regional Councils each to elect one Member to the Legislative Council.

Chapter V

The District Boards and the Municipal Councils

45. The Green Paper presented options for changes in the role and composition of the District Boards; the relationship between urban District Boards and the Urban Council; and the size and committee structure of the Urban Council.

Role and Composition of District Boards

46. The Survey Office reported that most submissions on this subject were not in favour of changing the role of District Boards. Many argued that this would involve major constitutional change. Some felt that it could confuse the relationship between the three tiers of government and complicate the implementation of territory-wide policies. Most Legislative and Municipal Councillors who spoke publicly on the matter shared these views, although many also felt that the District Boards' advisory function should be enhanced. District Board members themselves were divided in their views. Public opinion surveys however showed a measure of public support for giving District Boards powers to take decisions and direct government action on certain district matters.

47. Opinion on the question of the composition of District Boards was generally against change in 1988, although there was some support for reducing the number of appointed members.

48. District Boards have proved themselves to be a valuable part of the system of representative government in Hong Kong. There is no demand for fundamental changes to their present role or composition. There is however clear support for developing their advisory role. The Government has decided to do this by requiring Government departments to consult the Boards about all district matters. Where the advice of the Boards cannot be accepted, or if proposals on which the Boards have given advice subsequently undergo significant change, the departments concerned will be required to explain their reasons to the Boards. Furthermore, departments will, as far as possible, consult District Boards on their annual programme of work in the district, rather than piecemeal on individual projects, in order to give the Boards a broad picture within which to advise on priorities.

49. The Government also intends to increase gradually the resources provided to District Boards for local environmental projects and community activities, taking care to avoid an overlap between the work of the Boards and the Municipal Councils.

50. The composition of the District Boards will not be changed significantly in 1988. The overall ratio of elected to appointed members will remain approximately 2 : 1, but account will be taken of the special circumstances in different districts.

Relationship between the Urban Council and District Boards

51. Most submissions to the Survey Office on this subject favoured improving the present relationship between the Urban Council and urban District Boards. Many of these wanted to see more opportunities for District Board members to participate directly in the work of the Urban Council and its Select Committees. Many also wanted to expand the membership of the Council to include an elected representative of each urban District Board. They argued that this would help strengthen the links between the Council and the Boards. This option was supported by a great many District Board members. Members of the Urban Council

however opposed it: they favoured the retention of the present system whereby they are ex-officio members of urban District Boards.

52. There is no question but that the Urban Council works well under the present arrangements. It provides a high standard of municipal services and plays a key role in the cultural and recreational life of the community.

53. The present arrangements do not, however, provide for the District Boards to participate directly in the work of the Council, for which there is firm public support. This could be remedied if the link between the Urban Council and the Boards were to be provided by Board members sitting on the Council, rather than by Council members sitting on the Boards. Such a link would then obviate the need for members of the Urban Council to sit on urban District Boards.

54. Looking at the three-tier structure of representative government as a whole, such a development would have the added merit of rationalizing the links between the tiers by having each tier represented at the next higher level, i.e. District Board members sitting on the Urban Council (as they do already on the Regional Council) and both Municipal Councils in turn being represented in the Legislative Council.

55. The Government has therefore decided that, when the next Municipal Council elections take place in March 1989, each of the ten District Boards in the urban area should elect a representative to sit on the Urban Council. Urban Councillors will at the same time cease to be ex-officio members of the urban District Boards. The Government also believes it is right to amend the legislation concerning cross-membership between the Urban Council and urban District Boards, to bring it into line with that presently in force in the Regional Council area. Thus, the Government proposes to remove the requirement for a member of the Urban Council to resign from the Council if he is elected to an urban District Board, and vice versa. Some of these proposals were announced in December 1987, before the publication of this White Paper, in order to enable Urban Councillors wishing to continue as District Board members beyond March 1989 to stand for election in the District Board elections on 10 March 1988.

Role and Composition of the Municipal Councils

56. There was less public interest in the other issues in the Green Paper affecting the Municipal Councils. Some submissions commented in favour of retaining two separate Councils. There was general support for the present arrangements regarding the

composition and work of the Regional Council. Most comments on the committee structure of the Urban Council did not favour change, and there was little support for the idea of sub-regional committees.

57. As a result of the changes set out in paragraph 55 above, the size of the Urban Council will be increased from 30 to 40 members in 1989, including 15 appointed and 15 directly elected members as at present and ten new members from the District Boards. It will be for the Council itself to consider whether any changes to its committee structure will be necessary in the light of this.

58. There will be no change in 1989 to the role or composition of the Regional Council.

Chapter VI

The Presidency of the Legislative Council

59. The Green Paper raised the question of whether the Governor should continue to be the President of the Legislative Council. Nearly 95,000 submissions to the Survey Office, 110 public opinion surveys and two signature campaigns commented on the issue. There was a clear majority in favour of the Governor remaining as President of the Legislative Council, at least for the time being. At the same time, there was some support for the suggestion that the Governor might appoint another person to preside over specific meetings or parts of meetings.

60. In the light of this response there will be no change to the Presidency of the Legislative Council in the immediate future. The Governor will continue to be President. When he cannot attend the Council a Member appointed by him, or the senior Official Member present, will preside in his place.

Chapter VII

Practical Aspects of Elections

61. The Green Paper invited comments on various practical aspects of elections to the District Boards, the Municipal Councils and the Legislative Council, including:

- (a) the sequence and timing of elections;
- (b) the terms of office of elected members;
- (c) the age of entitlement to vote;
- (d) the age of eligibility for candidature;
- (e) the voting systems used in elections;
and
- (f) certain other electoral arrangements.

Sequence and Timing of Elections and Terms of Office

62. The Green Paper raised the question of whether the sequence of elections should be altered so that

elections to the District Boards are followed by elections to the Municipal Councils and then by elections to the Legislative Council. Submissions to the Survey Office were evenly divided on this. Most District Board members who spoke on the issue did, however, advocate such a change, and some public opinion surveys recorded significant support for it.

63. The Green Paper also raised for discussion the possibility of staggering the terms of office of different groups of Legislative Councillors so that, while all terms would be of equal length, they would begin in different years. There was little public response on this point. The balance of it was against such a change.

64. Submissions to the Survey Office and public opinion surveys indicated that a clear majority of the community did not favour changing the length of terms of office for elected members of District Boards, Municipal Councils and the Legislative Council. However most of the members of these bodies who spoke on the subject did wish to change from a three-year to a four-year term.

65. These issues are affected by the arrangements set out in Chapters IV and V of this White Paper, by which the District Boards will each elect a

representative to one of the Municipal Councils, and the Municipal Councils will each elect a Member to the Legislative Council. This system would clearly work best if elections to the successive tiers of government were to follow in sequence and if the terms of office at all three levels were of equal length.

66. The Government has therefore decided:

- (a) that elections to the District Boards, the Municipal Councils and the Legislative Council should be held in that order;
- (b) that all three sets of elections should be held within the space of twelve months; and
- (c) that the terms of office of different groups of Legislative Councillors should not be staggered.

67. The terms of office of Elected Members of the Legislative Council will continue to be three years for the time being. The latest draft of the Basic Law envisages a four-year term for the legislature of the Hong Kong Special Administrative Region. If the Basic Law does provide for this, the question of introducing such a change before 1997 will then be examined.

68. Some interim adjustments to the terms of office of the District Boards and the Municipal Councils are necessary to prepare for the new sequence of elections. Accordingly, the Municipal Councils' next term will last from April 1989 to March 1991. The term of the District Boards beginning in March 1991 will also be adjusted so that, in the next set of elections to be held after 1991, the District Board elections will take place in August or September, i.e. about six months before elections to the Municipal Councils and one year before those to the Legislative Council.

Ages of Entitlement to Vote and Eligibility for Office

69. There was much public interest in the issue of the voting age and a clear majority of opinion from all sources considered that it should remain at 21 years. Many people felt that more civic education was needed before people below that age would be ready for the vote. There was little interest in the age of eligibility for candidature. Most of those who commented believed that this too should remain at 21 years.

70. The Government has decided not to change either the voting age or the age of eligibility for office. It has, since the 1984 White Paper, stepped up

its encouragement of civic education both in schools and outside. In 1985 it set up a Committee for the Promotion of Civic Education, under the chairmanship of a Legislative Councillor. Community interest in civic affairs is developing and may be expected to develop further through these efforts.

Voting Systems for Legislative Council Elections

71. Consideration of alternative voting systems is a complex subject, on which there was a limited public response to the Green Paper. Those who did comment generally favoured the adoption of a "preferential elimination" voting system for both functional constituency and electoral college elections to the Legislative Council.

72. As explained in the Green Paper, this system has advantages over the "preferential addition" system used in the 1985 functional constituency elections, because it gives greater weight to higher preferences than to lower ones and does not carry the risk that the candidate with the fewest first preference votes might nevertheless win the election. It also has an advantage over the repeated ballot system used in the 1985 electoral college elections in that it involves only one round of voting. The "preferential elimination" system will therefore be adopted in the

1988 Legislative Council elections for both the functional constituencies and the electoral college. Details of the system are at Appendix C.

Other Electoral Arrangements

73. The Green Paper mentioned the Government's intention to increase election deposits and to introduce tighter controls on matters such as name-dropping, the filing of returns for election expenses and the supply to candidates of information about registered voters. Legislation on these points was enacted in December 1987.

74. The Green Paper invited views on the limits on election expenses, in particular that for candidates in Municipal Council elections. Most comment on this was in favour of retaining the present limit of \$35,000 for Municipal Council elections. The Government has decided that all limits on election expenses should be reviewed regularly, both immediately after each set of elections and again six months before the next set of elections, in order to ensure that they keep up with changing circumstances and with inflation. Accordingly, the limits for District Board elections were reviewed recently and those for the next Legislative Council and Municipal Council elections will be reviewed in March 1988 and September 1988 respectively.

Chapter VIII

The Way Forward

75. The public response to the 1987 Green Paper showed that there is a strong desire among the community for the system of representative government to be developed further. The forms of representation developed over the years have proved to be effective and to have firm popular support. The three-tier structure of government received strong endorsement in the 1987 review and there is a clear wish among the people of Hong Kong to retain and strengthen this system. At the same time there is substantial support for the view that future development should take the form of a prudent and gradual evolution, to ensure stability between now and 1997 and a smooth transfer of government in 1997.

76. The decisions announced in this White Paper reflect all these considerations, and take full account of all the views expressed during the course of the review. A continuing, steady evolution of Hong Kong's system of representative government is clearly in the best interests of the community, both to meet the developing needs of our society and to maintain confidence in our future. Such a process has broad support within the community.

SECRET 高度機密

- 41 -

77. The White Paper charts the course of further development of representative government between now and 1991. Continuing development will be necessary between 1991 and 1997 to ensure that the system evolves steadily to provide continuity and a smooth transition in 1997. The framework of government after 1997 will be incorporated in the Basic Law which is due to be promulgated in 1990. Decisions will therefore need to be taken during the period up to 1997 to enable Hong Kong's system of government to evolve in a way that is compatible both with the aspirations of the Hong Kong community and with the framework set out in the Basic Law. These decisions will require further public consultation, though not necessarily in the form of a review such as that just concluded.

78. The system of government in Hong Kong is unique, and has developed in the way that it has because of the unique circumstances of the territory. The system of government for the future Hong Kong Special Administrative Region, which was set out in broad outline in the Sino-British Joint Declaration and which will be elaborated in more detail in the Basic Law, will also have its own special features. Both before and after 1997 Hong Kong will continue to require a structure of government tailored to its own special circumstances.

The aim of the Government in the

SECRET 高度機密

period up to 1997 is that Hong Kong's system of representative government should be able to evolve gradually and progressively from the present system, in a manner that commands the full confidence of the people of Hong Kong, ensures that government remains both responsive and effective and provides for a smooth transfer of government in 1997 and a high degree of continuity thereafter.

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Handwritten initials

FROM: J M G TAYLOR
DATE: 12 January 1988

MISS O'MARA

cc PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Anson
Mr Mountfield
Mr Peretz

HONG KONG: REPRESENTATIVE GOVERNMENT

The Chancellor was grateful for your minute of 8 January. He agrees that we should support the Hong Kong Government's wish to proceed steadily, introducing direct elections in 1991. I have let No.10 know that we are content.

Handwritten signature

J M G TAYLOR



MO 6/19/1L

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REC.	18 JAN 1988
ACTION	CSI
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MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-930 7022

15 January 1988

1 See Robert

HONG KONG: REPRESENTATIVE GOVERNMENT

Mr Younger has seen the Foreign and Commonwealth Secretary's minute of 6th January about the White Paper on Representative Government in Hong Kong. He is content with the proposals set out in the minute.

I am sending copies of this letter to the Private Secretaries to other members of OD(K) and to Sir Robin Butler.

Younger

I C F Andrews

(I C F ANDREWS)
Private Secretary

Robert Culshaw Esq
Foreign and Commonwealth Office

CONFIDENTIAL

~~prep~~ papers pse
prep M

FROM: S A ROBSON
DATE: 15 January 1988

CHIEF SECRETARY

cc:
Chancellor
Economic Secretary
Sir Peter Middleton
Sir G Littler
Mr Anson
Mr Kemp
Mr H P Evans
Mr Turnbull
Mr Fox
Mr Call

HONG KONG DEFENCE COST AGREEMENT

This submission recommends you write to Mr Younger agreeing that, on certain conditions, the UK negotiating team should go to Hong Kong.

2 The UK has a defence cost agreement (DCA) with Hong Kong. Under the existing agreement Hong Kong pays 75 per cent of the cost of UK troops in Hong Kong. The DCA is currently being re-negotiated.

3 On 21 December Mr Younger wrote proposing the UK should amend its negotiating stance to allow Hong Kong's share to fall from 75 per cent to 70 per cent. In your letter of 6 January you said this was acceptable if it produced agreement with Hong Kong but you were concerned that Hong Kong would reject 70 per cent and demand more. You said that, before any concessions were made, a clearer view on this was needed. Officials should examine and report back.

4 I agreed with MOD that their Second Permanent Secretary should phone the Governor of Hong Kong. He should say that the UK might be willing to make a relatively small move in

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its position if Hong Kong were prepared to make a relatively large one (they presently say they will only pay 50 per cent of the costs). He was to ask the Governor if this sort of movement would be made by Hong Kong.

5 In the event the Governor asked this to be put in a telegram. I attach the exchange.
...

6 The Governor's response is not very encouraging. He reiterates Hong Kong's 50 per cent proposal, he says there will be no move in their position until they have seen our proposal and he says their "touchstone" is locally acceptability of a deal.

7 The issue is whether we should let the UK team go out on this basis. I have discussed this with MOD and FCO.

8 MOD's top officials think that a deal can be done in the area set out in Mr Younger's letter of 21 December. FCO officials are less sure.

9 The alternatives are:

(i) further exchange by telephone/telegram - this is unlikely to produce more clarity;

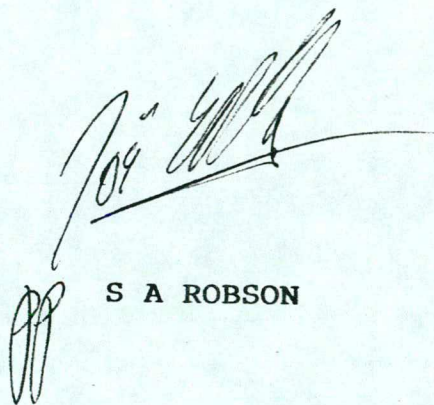
(ii) refusal to send our team for the time being. This is likely to lead the Governor to press hard on the Foreign Secretary and on No. 10.

10 In my view our best hope is to put as much steel as possible into our negotiators and their sponsors. To this end I have told the MOD's Second Permanent Secretary that, if the team does go, it would be on the basis that he thinks

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a deal can be done at 70 per cent and that the Defence Secretary endores his judgement. He is, as a result, an uncomfortable, but motivated, man.

11 I recommend you write to the Defence Secretary saying the team can go if he endorses the view of his own top
... officials. A draft is attached.



S A ROBSON

CONFIDENTIAL**DRAFT LETTER TO:**

The Rt Hon George Younger TD MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

HONG KONG DEFENCE COST AGREEMENT

Following my letter of 6 January, our officials have met and there has been an exchange of telegrams with the Governor of Hong Kong.

I have seen the telegram from the Governor. I do not find it particularly encouraging but I understand that, in the light of it, your senior officials think a deal is achievable in the area set out in your letter of 21 December. On the assumption ^{that} you share this view, I am content for the UK negotiating team to go to Hong Kong.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.

JM

SECRET

156677
MDLIAN 2833

SECRET
FM HONG KONG
TO PRIORITY FCO
TELNO 0231
OF 170100Z JANUARY 88
INFO PRIORITY PEKING

BANK OF CHINA

WE HAVE BEEN CONSIDERING FOR SOME TIME WHETHER OR NOT TO INVOLVE THE BANK OF CHINA IN PROVIDING SERVICES TO THE EXCHANGE FUND IN EXCHANGE RATE INTERVENTION. WE FEEL THAT IT WOULD BE TO OUR ADVANTAGE IF THE BANK OF CHINA IS SEEN TO BE IN ACTION IN THE FOREIGN EXCHANGE MARKET IN A WAY SUPPORTIVE OF THE MAINTENANCE OF THE LINK, PARTICULARLY AT TIMES SUCH AS NOW WHEN SPECULATIVE PRESSURE IS SUBSTANTIAL.

DETAIL

2. THE EXCHANGE FUND ^{Intervenes} ~~INTERESTS~~ IN THE MONEY MARKET BY BUYING AND SELLING US DOLLARS AGAINST HONG KONG DOLLARS IN BOTH THE SPOT AND FUTURE MARKETS. SOME OF THIS INTERVENTION IS CARRIED OUT THROUGH LOCAL BANKS. WE HAVE HITHERTO BEEN USING ALMOST EXCLUSIVELY THE HONG KONG AND SHANGHAI BANKING CORPORATION (HSBC) FOR THIS, INVOLVING ONLY OCCASIONALLY OTHER MAJOR BANKS SUCH AS STANDARD CHARTERED AND THE HANG SENG BANK.
3. IN EARLY 1987 WE ALSO DEVELOPED A FORM OF INTERVENTION SPECIFICALLY TO TACKLE THE SITUATION WHEN THE HONG KONG DOLLAR IS STRONGER THAN US DOLLAR 7.80. THIS INVOLVES THE USE OF THE EXCHANGE FUND TO INDEMNIFY HSBC AGAINST ANY LOSS THAT MAY BE INCURRED WHEN THEY INTERVENE STRICTLY IN ACCORDANCE WITH OUR INSTRUCTIONS BUT ON THEIR OWN ACCOUNT. THE INDEMNITY ARRANGEMENT ALSO PROVIDES FOR THE PROFITS FROM SUCH INTERVENTION TO BE PAID TO THE EXCHANGE FUND AS AN INDEMNITY ~~ARRANGEMENT ALSO PROVIDES FOR THE PROFITS FROM SUCH INTERVENTION TO BE PAID TO THE EXCHANGE FUND AS AN INDEMNITY~~ FEE.
4. WE HAVE BECOME RATHER TOO DEPENDENT ON HSBC IN OUR EXCHANGE MARKET INTERVENTION. ALTHOUGH THEY HAVE SO FAR NOT EXPRESSED ANY CONCERN ABOUT THE DISTORTION SUCH ACTIVITY IS CAUSING TO THEIR BALANCE SHEET, THERE MAY COME A POINT WHEN THEY DO. WE THEREFORE CONSIDER SENSIBLE TO SPREAD THE BURDEN. WE HAVE CONSIDERED WHETHER STANDARD CHARTERED WOULD BE SUITABLE CANDIDATE FOR ENTERING INTO AN INDEMNITY

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MDLIAN 2833

AGREEMENT SIMILAR TO THAT WHICH WE HAVE WITH HSBC. BUT THEY WERE CONCERNED THAT THE AGGRESSIVE PURCHASES OF US DOLLARS BY THEM MIGHT BE MISINTERPRETED AS IMPRUDENT BEHAVIOR. THEY WERE NOT PREPARED TO TAKE THIS RISK.

5. THE NEXT OBVIOUS CANDIDATE IS THE BANK OF CHINA. THERE WOULD BE CLEAR BENEFITS IN THE BANK OF CHINA BEING INVOLVED IN OPERATIONS AIMED AT STABILIZING THE VALUE OF THE HONG KONG DOLLAR.

6. THERE IS A REMOTE POSSIBILITY THAT THE BANK OF CHINA MAY TRY TO EXACT A PRICE FOR AGREEING TO THIS. THEY MAY FOR EXAMPLE SEEK AN ASSURANCE THAT THEY WOULD BE INFORMED IN ADVANCE IF THE EXCHANGE RATE WAS EVER CHANGED, OR ASK THAT SOMEONE FROM THE BANK SHOULD BE MADE A MEMBER OF THE EXCHANGE FUND ADVISORY COMMITTEE. OUR RESPONSE WOULD BE THAT WE HAVE NO INTENTION OF CHANGING THE RATE, AS THE ENTERING INTO AN INDEMNITY AGREEMENT WITH THEM WOULD CONFIRM. ON MEMBERSHIP OF THE EXCHANGE FUND ADVISORY COMMITTEE, OUR ANSWER WOULD BE THAT THIS IS SOMETHING WE MIGHT BE PREPARED TO CONSIDER AT A LATER DATE AND THAT THEIR PRESENT WILLINGNESS TO GET INVOLVED IN MAINTAINING EXCHANGE RATE STABILITY IN HONG KONG, COULD BE A HELPFUL FACTOR TO TAKE INTO ACCOUNT WHEN IT CAME TO SUCH CONSIDERATION.

7. GRATEFUL FOR COMMENTS. IF YOU SEE NO OBJECTION, WE PROPOSE THAT (DEPUTY SECRETARY FOR MONETARY AFFAIRS) SHOULD APPROACH BANK OF CHINA'S GENERAL MANAGER IN HONG KONG (ZHANG XUEYAO) AND DISCUSS THE MATTER WITH HIM. IF THE NEGOTIATIONS DO NOT GO AS PLANNED IT WOULD NOT BE TOO DIFFICULT FOR US TO PUT THE MATTER ON HOLD.

WILSON

YYYY

DISTRIBUTION

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PS/PUS
MR GILLMORE
MR MCLAREN

ADDITIONAL 2

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MDLIAN 2833

MR D PERETZ, HMT

MR A LOEHNIS, B OF E

NNNN

PAGE 3
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CONFIDENTIAL



CC:
 Chancellor
 EST
 Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Kemp
 MR H P Evans
 Mr Turnbull
 Mr Fox
 Mr Call
 Mr Robson

Treasury Chambers, Parliament Street,

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

18 January 1988

Dear Secretary of State,

HONG KONG DEFENCE COST AGREEMENT

Following my letter of 6 January, our officials have met and there has been an exchange of telegrams with the Governor of Hong Kong.

I have seen the telegram from the Governor. I do not find it particularly encouraging but I understand that, in the light of it, your senior officials think a deal is achievable in the area set out in your letter of 21 December. On the assumption that you share this view, I am content for the UK negotiating team to go to Hong Kong.

I am copying this letter to the Prime Minister, to other members of OD(K) and to Sir Robin Butler.

Yours sincerely,

John Major

PP JOHN MAJOR

*(Approved by the Chief Secretary
 and signed in his absence).*



CH/EXCHEQUER	
REC.	19 JAN 1988
ACTION	Miss O'Mara
COPIES TO	EST Sir P Middleton Sir G Little Mr Anson Mr Mountfield

Foreign and Commonwealth Office

London SW1A 2AH

18 January 1988

Dear Charles

Hong Kong: Representative Government

Thank you for your letter of 11 January confirming that the Prime Minister is content with the Foreign Secretary's proposals on direct elections to the Legislative Council in Hong Kong. They are included in the enclosed complete draft text of the White Paper, which the Foreign Secretary's minute of 6 January said would be circulated in due course.

Apart from the decisions on direct elections, the draft embodies the following decisions on relatively minor residual matters:

(a) Composition of the Legislative Council

There will be no changes this year in the overall size of the council, which now comprises 57 members. There will continue to be ten official members. The number of appointed members will be reduced from 22 to 20. The number of members elected from functional constituencies will be increased from 12 to 14. There will continue to be 12 members elected on a geographical basis by the electoral college.

(b) The District Boards and Municipal Councils

(i) There will be no change in the role and composition of the District Boards. However, their advisory role will be developed by requiring government departments to consult the Boards on all district matters. The Boards will also be provided with additional resources.

(ii) Links between the District Boards in urban areas and the Urban Council will be strengthened. In March 1989, each of the ten Urban District Boards will elect a representative to sit on the Urban Council. As a result the size of the Urban Council will be increased from 30 to 40 members in 1989. Urban Councillors will then cease to be ex-officiomembers of the Urban District Boards. This will bring arrangements for District Board representation on the Urban Council in line with arrangements for the Regional Council.

/(iii)



(iii) There will be no change in the role and composition of the Regional Council.

(c) The Presidency of the Legislative Council

The Governor will continue to be the president of the Legislative Council for the immediate future.

(d) Practical aspects of elections

(i) The sequence of elections will be changed so that elections to the District Boards, the Municipal Councils and the Legislative Council are held in that order.

(ii) The age of entitlement to vote and of eligibility for office will remain at 21.

(iii) A preferential elimination system of voting (as described in the Green Paper) will be adopted in this year's Legislative Council elections.

(iv) The limits on election expenses will be reviewed regularly.

These relatively minor changes fully reflect the broad consensus of opinion which has emerged on these matters in the course of last year's public consultation exercise in Hong Kong. They are in line with our own strategy for the steady and gradual development of representative government in Hong Kong. The Foreign Secretary believes that it is right that the Hong Kong Government should proceed in this way.

I am copying this letter to the Private Secretaries of members of OD(K) and to Sir Robin Butler.

Done now

(R N Culshaw)
 (R N Culshaw)
 Private Secretary

C D Powell Esq
 PS/No 10 Downing Street

Prup

*Before to
Mr. J. J. ...
take to ...
whether ...
no \$HK.
Mr.*

From : D L C Peretz
Date : 21 January 1988

CHANCELLOR

cc Sir P Middleton
Sir G Littler
Miss O'Mara

HONG KONG : MONETARY CONTROL

*Note
sent copy of this page
to D Peretz & Sir G Littler
ACSA
22/1*

The Hong Kong authorities have been considering a possible technical change to the settlement system for Hong Kong dollar payments, designed to give them more effective control over short-term interest rates. The proposals in no way affect the arbitrage mechanism established in 1983 to underpin the exchange rate link. But as I think you know, the authorities have in practice had to bolster this mechanism by very substantial intervention. They are anxious to achieve more effective control over interest rates, so that interest rates can be used more actively alongside intervention to help maintain the link.

The present domestic monetary mechanism

2. At present the HK dollar clearing balances of other banks in Hong Kong are held at the Hong Kong and Shanghai Bank (HSBC), as is the HK dollar account of the official Exchange Fund (EF). This means that when the Exchange Fund sells foreign currency and buys HK dollars the operation does not create a money market shortage in domestic currency as the analogous operation would in the UK. The increase in the Exchange Fund's holding of Hong Kong dollars at the HSBC automatically offsets any reduction of holdings of HK dollars elsewhere in the banking system.

The proposal

3. The new proposal would mean moving to an arrangement where the Hong Kong banking system holds its clearing balances with the EF, rather than vice versa. There are two options, A and B. Option A would turn the EF into the settlement bank, holding all commercial banks' clearing accounts. But the favoured option, Option B, is more modest. Under this the HSBC would continue to

maintain clearing accounts for other banks. But it would in turn hold a balance with the EF equivalent to clearing balances held with it by the rest of the banking system; and the EF would not hold an account with the HSBC. Under this arrangement, intervention by the EF would create a domestic money market shortage, which it would then be able to relieve, later in the day, on terms of its own choosing - thus giving the Hong Kong authorities much the same kind of handle over short-term interest rates that the Bank of England has here.

4. The same mechanism would work in reverse at times of upward pressure on the HK dollar. Intervention would then create excess clearing balances at the HSBC and EF; and since these are not remunerated the result would be sharp downward pressure on domestic interest rates.

Discussion with the HSBC

5. The Hong Kong authorities have had some preliminary discussion of this idea with the HSBC, who welcomed it enthusiastically. This worried me at first, particularly since it was reported that the HSBC thought the change would in some way or other relieve them of their current "obligation" to play a major role in supporting the currency. But I have now had the opportunity to discuss all this with Joseph Yam (David Nendick's No. 2 in the monetary affairs department), when he visited the Bank of England last week. As a result, I am reassured. It seems that the HSBC's reaction was based on a misunderstanding of the effect the change will have (and a failure to understand the power the current system gives them to create money if they wish to do so). Nevertheless I understand they remain enthusiastic - possibly because they still do not understand the effects of the change.

Presentation and other problems

6. Despite the real advantages of the proposal, there could be substantial presentational difficulties both vis-a-vis the market and the Chinese. These are discussed in paragraphs 8-12 of the

? (don't underestimate them)

(see para 11 of Bank Note)

attached note by the Bank of England. Although the change could be presented as strengthening the exchange rate link, and locking the HSBC even more securely into Hong Kong, it could be interpreted as doing the reverse: undermining the credibility of the link, and opening the way for the HSBC to pursue its own commercial interests with less regard to the interests of the authorities. The subject has so far largely been dealt with at a technical level in Hong Kong, and in commenting to the Hong Kong authorities we need to make sure that Jacobs and the Governor are aware of these potential difficulties. I would hope that nevertheless, the idea, which has considerable technical merits, can be taken forward, but it will need careful handling and presentation.

Next Steps

7. We have it in mind, therefore, as the next step to send the attached commentary to Hong Kong.

8. If after weighing these points the Hong Kong authorities decide they do want to go ahead with the change, it will almost certainly be sensible to mention it first to the Chinese. That will clearly need very careful handling indeed. There have been previous discussions with the Chinese about the technical shortcomings of the Hong Kong domestic monetary arrangements, and while the Chinese appeared to understand these they also indicated they would be opposed to any change.

Intervention using the Bank of China

9. A PS on this separate but not totally unrelated matter. Telno. 0231 attached (just received) describes a more immediate proposal to seek to use the Bank of China as an intermediary in EF intervention, in the same way that the HSBC has been used up to now. I see no reason to object to this: if anything the reverse. Involving the Bank of China in this way should serve useful educational and diplomatic functions,

S E C R E T

as well as its immediate technical purpose; and if it leads to earlier Bank of China representation on the EF Advisory Committee that would be no bad thing.

DLCP

D L C PERETZ

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HONG KONG: ASSESSMENT OF PROPOSALS A and B

Background

1 We know, for reasons that have been rehearsed in earlier papers from the Bank and from Hong Kong, that the "link" does not operate with the automaticity claimed for it by theory, and that there is no practical means to correct that deficiency.

2 We understand that intervention has of late been necessary on an unprecedented scale and that the necessity publicly to raise the Exchange Fund's borrowing limit in order to fund the intervention has only been avoided by such devices as forward transactions and indemnities to banks intervening on the EF's behalf.

3 We therefore agree that it is desirable to develop capabilities within the field of monetary control that will make official influence over markets more effective. By so doing the link could be better supported, or alternative monetary goals more effectively pursued were the link ever to be abandoned.

The proposals

4 We have closely examined proposals A and B, and they were discussed at some length in meetings which Joseph Yam had during his two days in the Bank with Messrs Coleby, Elston, Latter and Peretz (HMT).

5 We are satisfied that either scheme offers a considerable improvement on present arrangements. We recognise that proposal B presents a lower profile than A, and, quite apart from technical considerations, is likely to be preferred both on political grounds and for its lower costs in terms of manpower and administration.

6 Under proposal B, the Exchange Fund's influence on monetary conditions would be more direct and effective. Whereas at present HSBC may be largely free to operate counter to the Exchange Fund (although HSBC acknowledges a moral obligation not

actively to do so, it may find itself passively doing so), proposal B would press HSBC into pulling in the same direction as, or at least not offsetting official operations. Each dollar of EF intervention in the foreign exchange or HK\$ interbank markets should therefore have greater and more durable leverage over the exchange rate or interest rates than at present.

7 Although proposal B is self-contained, it would not preclude - and could to some extent prepare the ground for - further evolution in monetary arrangements, eg in the direction of proposal A. But proposal A itself, as depicted in the Hong Kong text, would not be superior to B, in terms of influence on monetary conditions, unless it were modified to require either the panel banks to clear through their new EF accounts or HSBC to continue to adhere to the matching-balance rule of proposal B.

Presentation

8 By strengthening the EF's capability to influence monetary conditions, proposal B would contribute to reinforcing the link. Equally, however, were the link to be altered or abandoned, B would ensure that the authorities were not left bereft of any effective instruments with which, for example, to pursue an interest rate policy or to seek to control money supply. The Exchange Fund would be close to having the sort of influence over monetary conditions that monetary authorities in other places typically possess.

9 HSBC is reported to be favourably inclined towards B. This may seem surprising, since, although it would be no worse off than any other bank, it would lose the advantages that it currently enjoys. Thus,

- (i) it would be required to hold a 'clearing' balance (at the EF) which, if over 'target' would earn no interest, and if under would be charged penally; and
- (ii) depending on the way in which its initial EF balance was constituted, HSBC might be surrendering the seignorage derived from acting as clearing bank to the banking system.

10 The reported welcome from HSBC is not, however, inconsistent with its occasional calls in the past for the Government to develop more effective means of monetary control. These may be motivated by genuine public interest concerns. But at the present time HSBC may also be particularly alert to the fact that proposal B would relieve it of the moral obligation to operate in support of government monetary objectives (sometimes at variance with its own commercial instincts). This could in turn raise questions over HSBC's longer-term commitment to Hong Kong.

11 Thus, there could be difficulties in successfully presenting B both to the public and to the Chinese, although most points can be argued either way. To summarise:-

- (a) Would a better capability to influence interest rates be regarded as a buttress to the link (after all, other fixed-rate regimes are dependent to varying degrees on such capability)? - or
- (b) would it be regarded suspiciously, as a possible prelude to some departure from the link? - and
- (c) might not the implied admission of a need to bolster the link arouse hitherto non-existent concerns about the durability of the link, and hence actually damage confidence in it?
- (d) By singling out HSBC to hold a balance at the EF, would HSBC's commitment to Hong Kong be seen to be intensified? - or
- (e) might HSBC's moral commitment to Hong Kong seem to have been replaced by a more formal arrangement, which could even in future be generalised so that HSBC became merely one of many?

Conclusion

12 From the standpoint of monetary policy, proposal B is attractive. Particularly in view of the pressures on the link, there would be operational advantages in having B in place even

now. While the change could be presented as locking HSBC more tightly into the monetary system and as reinforcing the link, alternative interpretations are possible. Great care would therefore be needed in presenting any such move both to the Hong Kong public and to the Chinese, but we would hope that the momentum for change could nevertheless be maintained.

Bank of England
20 January 1988

Secret

GRS 450

SECRET

DEYOU/DEHOC ORIEL
FM HONG KONG
TO IMMEDIATE FCO
TELNO 331
OF 250830Z JANUARY 88
INFO PRIORITY PEKING

*Personal letter
write!*

cc PPS

Sir P Middleton
Sir G Lither
Miss O'Mara
Mr Lomas

Dep 26/1

STRICTLY PERSONAL FOR HUM, HKD, FROM GOVERNOR
PEKING : STRICTLY PERSONAL FOR AMBASSADOR/HEAD OF CHANCERY
MIPT : FAREWELL CALL BY LI CHU-WEN

1. THE ONE SIGNIFICANT MESSAGE THAT LI HAD FOR ME CONCERNED THE HKSB. LI LAUNCHED INTO THIS BY SAYING THAT THE UK WOULD CONTINUE TO PLAY AN IMPORTANT ROLE IN HONG KONG AFTER 1997. I REPLIED THAT THIS WOULD BE AS ONE OF THE MEMBERS OF THE INTERNATIONAL COMMUNITY: WE DID NOT SEEK ANY SPECIAL PRIVILEGES. LI SAID THAT THERE WERE, NEVERTHELESS, SOME OLD ESTABLISHED INTERESTS IN HONG KONG SUCH AS THE HKSB. HE HOPED THAT IT WOULD CONTINUE TO BE AN IMPORTANT PART OF HONG KONG AND THAT THE BANK'S INCREASINGLY INTERNATIONAL ROLE WOULD NOT CONFLICT WITH THIS. I SAID THAT THIS INTERNATIONAL ROLE DID NOT REDUCE THE BANK'S COMMITMENT TO HONG KONG EVEN THOUGH, LIKE OTHER PEOPLE, THEY WERE CONCERNED ABOUT 1997: THIS WAS A FACTOR OF WHICH WE HAD TO TAKE ACCOUNT.

2. LI CONTINUED BY SAYING THAT THE ACQUISITION BY THE HKSB OF SHARES IN THE MIDLAND BANK HAD AROUSED COMMENTS ABOUT THEIR POSSIBLE INTENTION TO WITHDRAW FROM HONG KONG. THIS HAD WORRIED PEOPLE IN PEKING. HE PERSONALLY DOUBTED IF THIS WAS THE HKSB'S INTENTION. TO WITHDRAW FROM HONG KONG COULD WELL BE DISADVANTAGEOUS FOR THEM.

3. I TOLD LI THAT, AS HE WOULD KNOW, HKSB HAD LONG SOUGHT TO EXPAND INTO EUROPE. I HAD DISCUSSED THIS MATTER WITH ZHOU NAN AND LI HOU ON MY LAST VISIT TO PEKING, AND HOPED THAT THEY HAD BEEN REASSURED BY WHAT I HAD SAID AND BY THE ASSURANCES GIVEN TO ME BY PURVES THAT THE ACQUISITION DID NOT REPRESENT THE FIRST STEP OUT OF HONG KONG BY THE HKSB. LI CONFIRMED THAT HE WAS AWARE

- 2 -

Secret

OF

OF THESE EXCHANGES IN PEKING. HE THEN SAID THAT HE APPRECIATED THE PROBLEM OF CONFIDENTIALITY. BUT, IF AT ALL POSSIBLE, WE SHOULD CONFIDE IN THE CHINESE IN ADVANCE OF PUBLIC ANNOUNCEMENTS OF THIS KIND. THIS WOULD HELP TO DISPEL ANY CONCERN OVER THE SORT OF SPECULATION THAT HAD BEEN EXPRESSED IN THE MEDIA. I EXPLAINED THAT WE HAD OURSELVES KNOWN ONLY AT THE LAST MINUTE BECAUSE THERE WAS NO OBLIGATION ON THE HKSB TO SEEK PRIOR APPROVAL AT THE LEVEL OF SHAREHOLDING. WE HAD TOLD THE CHINESE SOON AFTER WE FIRST HEARD. LI DID NOT PERSUE THE TOPIC AND WE PASSED TO OTHER MATTERS.

WILSON

LIMITED

HO) HKD

PS) LOST

PS) PLS

GLENFORTHUR

MR GILMORE

MR Mc' LAREN

Additional: -

MR LOENNS, BK OF ENGLAND

MR PEREZ, HM TREASURY



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PRIME MINISTER

1/2/88

HONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATION: FOURTH ROUND

1. Following the recent round of correspondence on the way ahead in negotiations with the Hong Kong Government (HKG) over future arrangements to cover defence costs after the end of March, my officials have spent the last week in Hong Kong. They took with them the concession which we had agreed, to adjust the present 75/25 cost sharing formula in favour of the HKG, to 70/30. They also had available - and presented as options - a variety of compensating offsets which would have allowed further apparent movement in favour of the HKG, even as far as 62.5/37.5, had they wished to adopt these for local presentational purposes. This would still have given us a 70/30 split in reality.

2. On their return last week, my officials reported that some encouraging progress was made initially in discussion with their counterparts along these lines. But, part way through the round the HKG side appeared to take a sharp step backwards, their attitude hardening in support of an arrangement the effect of which would be a straight 65/35 apportionment. On the final day, they tabled a proposal on these lines, described as the last firm offer to be made in this round of negotiations and which they have, as I understand, now reported to EXCO.

3. The Governor has also spoken on the telephone to the Second Permanent Secretary here, Sir John Belloch, in terms which closely reflect the written offer made in Hong Kong although he was careful to reserve his own position on any particular apportionment.



4. Thus there lie on the table the options put forward by my officials based on the negotiating position we agreed and also the proposal tabled subsequently by the HKG which, even with the most favourable gloss that could be placed upon it, represents a straight 65/35 apportionment. My officials would of course be quite willing to return to negotiations based on the line we have previously agreed and indeed the public position is that the Fourth Round has been adjourned whilst both sides report to their respective authorities. But the fact remains that, as things stand at present, the gap is still a wide one.

5. I am of course aware that the Governor anticipates difficulties in getting through his Executive and Legislative Councils any arrangements which in their eyes do not represent a significant improvement on the current DCA. At the same time, however, it must be said that this was specifically why we agreed that a concession should be offered. For my part, I can see no justification for conceding anything further to the HKG at the expense of the Defence Budget, given the strength of the Hong Kong economy and the opportunity contained within our proposals for suitable associated arrangements to meet their presentational needs. To move to a straight 65/35 formula would cost £50M over and above the cost of a 70/30 split. I am not prepared to make the cuts in my programme that such a concession would require.

6. What then is to be done? Notwithstanding the failure to agree on them so far, my officials believe that, given the will on both sides, there remains scope for options which would secure the apportionment of 70/30 we have agreed on the one hand, whilst at the same time providing a presentation that would be satisfactory in HK terms on the other. For example, it should be possible for the HKG to pay an additional sum in relation to the current agreement to offset a move to 65/35 under a new agreement. Failing that, there remains the provision in the present DCA that the existing arrangements and apportionment will continue for a period of five

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years if agreement on changes cannot be reached between the two sides. The Foreign and Commonwealth Secretary will no doubt wish to comment upon whether, given the powers and likely attitude of the Hong Kong legislature, this is in fact a practical alternative and I should be grateful for colleagues' views upon how we should proceed.

7. I am sending copies of this minute to Geoffrey Howe, Nigel Lawson, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew, Lord Glenarthur and Sir Robin Butler.

LY.

Ministry of Defence

1st February 1988

CONFIDENTIAL

papers p/c.
1/2/88.PM/88/006PRIME MINISTER

CH/EXCHEQUER	
REC.	01 FEB 1988
ACTION	CST
COPIES TO	

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Hong Kong Defence Agreement: Renegotiation

1. I have seen George Younger's minute to you of 1 February about the fourth round of negotiations with the Hong Kong Government over the defence costs agreement.
2. These have been difficult and frustrating negotiations. But I believe it is important to appreciate their full political dimension in Hong Kong. At the end of the day we have to secure an outcome which the Governor can commend and the Executive and Legislative Councils will accept. The alternatives of a breakdown or an imposed settlement would carry grave political and constitutional dangers.
3. The Governor has reported to me that he had the greatest difficulty in persuading Exco to support the final offer tabled by the Hong Kong negotiators. He is constrained by the advice of Exco and vitally dependent on the unofficial members of the Council to persuade their Legco colleagues to vote the necessary funds under a new agreement. He fears that an apportionment less favourable than the present Hong Kong offer would fail to receive support, with all the consequences of breakdown and a damaging public confrontation between Hong Kong and London.



4. The Defence Secretary referred to the provision in the present agreement for roll-over in the event of failure to reach agreement on changes. The interpretation of the relevant provision in the agreement is disputed by the Hong Kong Government; the agreement is not enforceable by law; as a political reality we could not impose this or any other outcome on Hong Kong; the Legislative Council would certainly refuse to vote the funds. To pursue this course would lead straight to constitutional crisis.

5. Instead I am sure we must concentrate on securing an agreed outcome which satisfactorily protects our interests and is capable of being sold in Hong Kong. I entirely understand the pressures on the defence budget, and very much sympathise with the difficulty of making further money available from within it. But equally we must take into account all the factors which affect political perceptions of the issue in Hong Kong:

- the newly assertive spirit of Legco, which has to be persuaded and certainly cannot be railroaded;
- the increasing costs which the Hong Kong Government will incur in expanding the local police;
- the fact that while this is happening the cost of the garrison will steadily decline;
- the Joint Declaration provision that after 1997 China will meet all the costs of its garrison in Hong Kong;
- the widespread suspicion that British commitment to Hong Kong is waning.

In the latter connection, I am particularly concerned that a crisis over the DCA might coincide with publication of the Hong Kong White Paper on representative government, when



a vociferous minority is bound to accuse HMG of pursuing our own interests at the expense of Hong Kong. The recent visit here of Mr Martin Lee demonstrated how unsettling the effect of such attacks can be, in Parliament and the media here, as well as in Hong Kong.

6. I agree with the Defence Secretary that there remains scope for the presentational aspects of an eventual package to be further explored. The idea of moving to a 65/35 apportionment against payment by the Hong Kong Government of an offsetting sum under the current agreement is certainly one option worth pursuing; although I do not know how feasible it would be in terms of Hong Kong budgetary practices or what amount could realistically be handled in that way. We must also recognise that however the package is presented, Hong Kong Councillors will be looking closely at the effective apportionment underlying it; and there is a limit to what can be achieved, particularly with a Hong Kong audience, by means of "creative accounting".

7. I nonetheless agree that our negotiators should be instructed to explore further all such avenues which might possibly assist presentation of the outcome to Legco. But I judge that something more may well be needed. I hope therefore that the negotiators can also be given scope to go a little beyond mere presentational adjustments if they judge this necessary to achieve a settlement, for example by flexibility over the exact size of the sum which we would seek to claw back to offset a 65/35 split in a new agreement.

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8. I am sending copies of this minute to the Chancellor of the Exchequer, the Secretaries of State for Defence, for the Home Office and for Trade, the Lord President, the Attorney General and Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
1 February 1988

CONFIDENTIAL

FROM : S A ROBSON
DATE : 2 FEBRUARY 1988

CHIEF SECRETARY

c.c. Chancellor
Sir P Middleton
Mr G Littler
Mr H P Evans
Mr Turnbull
Mr Fox
Mr Woodall
Mr Call

HONG KONG DEFENCE AGREEMENT : RENEGOTIATION

This submission recommends you respond quickly to Mr Younger's minute of 1 February to the Prime Minister endorsing his line. You should at the same time pour some cold water on Sir Geoffrey Howe's minute of the same date.

2. The current defence cost agreement (DCA) with Hong Kong expires in March and a new one is being negotiated. Under the present DCA, Hong Kong pays 75% of the cost of the garrison and the UK pays 25%.

3. The garrison is to be run down between now and 1997 when the Chinese take over. The UK went into the DCA negotiations seeking a new agreement under which the cost to us fell at least in line with the run down of the garrison. This meant that Hong Kong should pay at least 75% of the cost under the new agreement. There is a good case in principle for the Hong Kong share to rise. The settlement with China has meant the external threat to Hong Kong has diminished significantly and, as a result, the garrisons role has increasingly focused on internal security. It is reasonable for Hong Kong to carry the cost of its own internal security.

4. This principled approach was lost when the Prime Minister said (Powell's letter of 3 December to MOD) she "would not absolutely rule out some gesture to go a little way to meet the Hong Kong side if negotiations reach an impasse". At that time Hong Kong were saying they would pay no more than 50%.

There has been a strong suspicion in MOD that the FCO ensured that the Prime Minister's view quickly reached Hong Kong. The negotiations did quickly reach an apparent impasse - thanks to Hong Kong doing little more than say "no" to any proposal from our negotiators. Against this background Mr Younger wrote on 21 December proposing the UK go for a settlement under which Hong Kong carried only 70% of the cost. You wrote on 6 January saying that you were prepared to accept this if it resulted in a settlement but that you were concerned Hong Kong would reject the concession and hold out for more. You asked for an assessment of the likelihood of a settlement on the basis of a split of 70%-30%.

6. In my submission of 15 January I reported that senior MOD officials thought a settlement could be achieved on this basis. In the light of this you agreed the negotiators could go to Hong Kong.

7. Mr Younger's minute of 1 February reports that, initially, the negotiations made encouraging progress but Hong Kong then took a hard step back and dug in for a 65%-35% split. He says that, in his view, the UK should stick at a substantive 70%-30% split but we could look at devices which could result in an apparent split of 65%-35% while giving us 70%-30% in reality. The most obvious such device would be for Hong Kong to give us a lump sum of cash up front to offset the annual cost of a switch in their favour of 5% over the life of the DCA from 1988 to 1997.

8. Mr Younger also mentions the possibility of letting the existing DCA run forward. This DCA provides for the present 75%-25% split to run on for a further 5 years if a new agreement cannot be reached. This provision was put into the existing DCA at the insistence of Hong Kong.

9. Sir Geoffrey Howe's minute of 1 February is totally predictable. He makes a great deal of play with the desirability of avoiding a political fuss with Hong Kong and with the difficulties the Governor has in selling an agreement in Hong Kong. In this he

chooses to ignore the fact that Hong Kong also has an interest in avoiding the appearance of a political row with UK and that, certainly as seen by the UK negotiators, the Governor has been leading the Hong Kong hawks.

10. Sir Geoffrey seeks to rule out the idea of letting the present agreement roll on. He rightly says this is not enforceable by law. He chooses to ignore two points. First, why did Hong Kong insist on this provision in the existing DCA if it is as valueless as Sir Geoffrey implies? Second, the UK could deploy to advantage in the Hong Kong media that, when Hong Kong agreed the existing DCA, they clearly thought a continuation of 75%-25% beyond 1988 would be reasonable.

11. Sir Geoffrey goes on to say that he is prepared for the negotiators to explore the possibility of presentational devices but implies that some substantive shift by the UK is also needed.

12. The Treasury is in a difficult position in all this. Quite clearly, the more generous the settlement with Hong Kong, the more the upward pressure on the defence programme in PES 88. Mr Younger has already said he cannot afford a shift in Hong Kong's favour beyond 70%-30%; a move to 65%-35% would cost (in undiscounted terms) £50 million over the period to 1997.

13. At the same time we are dealing with Hong Kong through some rather weak MOD negotiators while the FCO are preaching appeasement from the sidelines (and probably telling Hong Kong about the UK negotiating position). The Prime Minister will no doubt be primarily motivated by a desire to avoid disruption to the so far successful transfer of Hong Kong to China.

14. This is not an easy position for you. The aim must be to avoid any move to Hong Kong beyond 70%-30%. I suggest you write in a way that encourages the Prime Minister to pause and stand back. I suggest making the following points :

- (a) the settlement with China created a sound reason in principle for Hong Kong paying more than 75%. As a result the agreed UK aim was to get Hong Kong to pay "at least" 75%;
- (b) in view of the political considerations the Prime Minister did not rule out "some small gesture" to avoid an impasse;
- (c) the UK then made a quite generous move from 75%-25% to 70%-30%;
- (d) as you suspected, Hong Kong's immediate reaction has been to reject this. This is the response to be expected from good negotiators - as Hong Kong have shown themselves to be. We should be equally robust and stick firmly to 70%-30%, although you would be willing to employ devices to ease the presentation in Hong Kong of such a settlement. Such devices would need to be agreed in advance between officials.
- (e) you are encouraged that MOD officials believe a settlement is available on this basis. You note that Sir Geoffrey says the Governor is "vitally dependent on the unofficial members of the Council". You understand that when MOD's 2nd Permanent Secretary went to Hong Kong in December these people felt that "a real movement in Hong Kong's favour was needed in the new DCA; but the fact of a movement was more important than the quantum";

(f) we do need to consider tactics carefully. We should put some pressure on Hong Kong but refusing to resume negotiations until they indicate a readiness to settle for a substantive 70%-30%.

15. A draft along these lines is attached. It is desirable that it should go today.

SAR

S A ROBSON

DRAFT MINUTE TO THE PRIME MINISTER

HONG KONG DEFENCE COSTS AGREEMENT : RENEGOTIATION

I have seen copies of George Younger's minute to you of 1 December and Geoffrey Howe's of the same date.

2. We started these negotiations with the aim of getting Hong Kong to pay at least 75% of the costs of the garrison over the period to 1997. We had a good case in principle, as George made clear in his minute of 1 December, for asking Hong Kong to pay a higher share than under the present agreement. The settlement with China had reduced the external threat to Hong Kong. As a result the role of the garrison is increasingly directed to internal security. It is entirely appropriate for Hong Kong to bear the cost of its own internal security. Hong Kong certainly could afford to meet the full costs of the garrison.

3. Such an approach had, of course, to be tempered by the political considerations. Your private secretary's letter of 3 December recorded that you "would not absolutely rule out some gesture to go a little way to meet the Hong Kong side if negotiations reach an impasse". In fact we have made quite a generous move towards Hong Kong by asking them to pay 70%, rather than at least 75%. This cost the UK £50 million.

4. Hong Kong's reaction is not surprising. They have responded like the good negotiators they undoubtedly are. They have tabled a counter proposal which is significantly more to their advantage, and they are seeking to put political pressure on us to make further concessions.

5. Geoffrey Howe commented that the Governor is "vitally dependent on the unofficial members of the Council" to secure the passage of a new agreement. I understand that, when MOD's

2nd Permanent Secretary visited Hong Kong in December, he had discussed with unofficial members and they told him that "a real movement in Hong Kong's favour was needed in the new DCA [by comparison with the present 75%] but the fact of movement was more important than the quantum". This suggests our move to 70% should be quite satisfactory. They also commented that "disaffected Legco members would seek any stick to beat HMG with (and that, failing the DCA, another would be found), and that in any event other issues would claim their attention in due course".

6. I am encouraged that, in the light of the latest negotiations, George's officials consider a settlement could be obtained on the basis of a split of 70%-30%. As George says, there is also the provision in the present DCA to roll forward the present 75%-25% split for another five years. Geoffrey appears to see little value in this provision but I do not find it easy to reconcile this with the insistence of the Hong Kong negotiators in 1980 to embody it in the DCA. We need to make more of it in the negotiations.

7. I agree with George that there is no justification for conceding anything more to Hong Kong than a split of 70%-30%. I would not rule out, subject to discussion between officials, devices of the sort he describes which could ease presentation in Hong Kong while retaining 70%-30% in substance. The tactics of the next stage of negotiations need to be considered carefully by officials. In my view negotiations should not be resumed until we have a clear indication from Hong Kong that they are willing to settle for a substantive split of 70%-30%.

8. I am copying to Geoffrey Howe, George Younger, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew, Lord Glenarthen and Sir Robin Butler.



FROM: CHIEF SECRETARY

DATE: 2 February 1988

PRIME MINISTER

cc:
 CHANCELLOR
 Sir P Middleton
 Sir G Littler
 Mr H P Evans
 Mr Turnbull
 Mr Fox
 Mr Robson
 Mr Woodall
 Mr Call

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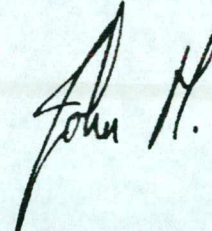
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8. I am copying to Geoffrey Howe, George Younger, Douglas Hurd, David Young, John Wakeham, Patrick Mayhew, Lord Glenarthur and Sir Robin Butler.


JOHN MAJOR

CONFIDENTIAL



10 DOWNING STREET
LONDON SW1A 2AA

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From the Private Secretary

2 February 1988

Dear Brian,

HONG KONG DEFENCE COSTS AGREEMENT

The Prime Minister has considered the Defence Secretary's minute of 1 February about the point reached in negotiations with the Hong Kong Government on future apportionment of defence costs. She has also seen the comments by the Foreign Secretary and the Chief Secretary.

The Prime Minister agrees that our aim should be to achieve in substance a 70/30 split, even if that requires us to accept devices which would allow the Hong Kong side to present it as 65/35. She would want our team to negotiate tenaciously for this result. They should not give the Hong Kong side any reason at all to think that we would be prepared to go further. Were a complete deadlock in practice to be reached, our negotiators would have to consult Ministers in London.

I am copying this letter to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor, the Home Secretary, the Trade and Industry Secretary, the Lord President, the Chief Secretary, the Attorney General and to Sir Robin Butler.

Yours sincerely,

(C. D. POWELL)

Brian Hawtin, Esq.,
Ministry of Defence.

CONFIDENTIAL

fpf



MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-930 7022
 XXXXXX 01-218 2111/3

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22nd February 1988

Dear Charles,

HONG KONG DEFENCE COSTS AGREEMENT: RENEGOTIATION

Following the exchange of correspondence between Ministers earlier this month which rests with your letter to me of 2nd February, officials from the Ministry of Defence, the Foreign and Commonwealth Office and the Treasury have met to consider the terms on which the MOD team might return to Hong Kong to resume the adjourned fourth round of negotiations on the future apportionment of defence costs. There has also been an exchange of telegrams between the FCO and the Governor. You will wish to know where matters now stand.

As a result of these exchanges, the Governor accepts that the Hong Kong Government team should now discuss how HMG's requirement for an effective 70/30 apportionment could be made acceptable in the Colony. In return, the MOD team will consider how their proposal for a 65/35 split could be presented as such in Hong Kong in a form which would be acceptable to our Ministers. The Defence Secretary believes that this would provide a satisfactory basis for the team to return to Hong Kong. There can, of course, be no absolute guarantee that the discussions will result in an acceptable agreement but the team will be negotiating within the remit agreed by Ministers for an effective 70/30 apportionment. The intention is that they will travel to Hong Kong tomorrow evening and that negotiations will resume on Thursday, 25th February.

I am sending copies of this letter to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Home Secretary, the Trade and Industry Secretary, the Lord President, the Chief Secretary, the Attorney General and to Sir Robin Butler.

Your sincerely
Brian Hawtin

(B R HAWTIN)
 Private Secretary

Charles Powell Esq
 10 Downing Street

CONFIDENTIAL

FROM : S A ROBSON
DATE : 24 FEBRUARY 1988

CHIEF SECRETARY

c.c. Chancellor
Mr Anson
Mr Mountfield
Mr Turnbull
Mr Fox
Mr Call

HONG KONG DEFENCE COSTS AGREEMENT : RENEGOTIATION

There is no need for you to respond to the letter of 22 February from Mr Younger's private secretary to Sir Geoffrey Howe's.

2. The letter simply records that, following the No 10 letter of 2 February (which came down helpfully close to your minute of the same date), officials had been negotiating via telegrams with the Governor of Hong Kong about the terms on which the negotiations can be resumed. After a good deal of twisting and turning by the Governor (and by the FCO) we have managed to work out an agenda which forces Hong Kong to focus on a substantive split of 70-30% - i.e. on the split we want. Without this there was every chance Hong Kong would have got to the table but to focus only on their 65-35% split.

3. So far, so good. The remaining problem is that we are now in the hands of some rather weak MOD negotiators who face a pretty sharp and tough Hong Kong team.

SAR

S A ROBSON

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