

## Reassessing Thatcher's foreign policy:

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DOI:

[10.1177/13691481231190502](https://doi.org/10.1177/13691481231190502)

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*Document Version*

Publisher's PDF, also known as Version of record

*Citation for published version (Harvard):*

Wei, R, Burnham, P & Kerr, P 2023, 'Reassessing Thatcher's foreign policy: The Sino-British Declaration 1984', *British Journal of Politics and International Relations*. <https://doi.org/10.1177/13691481231190502>

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# Reassessing Thatcher's foreign policy: The Sino-British Declaration 1984

The British Journal of Politics and  
International Relations

1–16

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DOI: 10.1177/13691481231190502

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## Abstract

This article presents a ‘primacy of domestic politics’ interpretation of the Thatcher government’s main objectives in the negotiations of the early 1980s, which secured the return of Hong Kong to China in 1997. In the immediate aftermath of the Falklands conflict, sovereignty issues were uppermost in public discourse and the government’s decision to cede sovereignty over Hong Kong seems inconsistent with other elements of Thatcher’s foreign policy. However, when placed in the context of domestic economic objectives it is clear that the liberalisation and deregulation agenda would be undermined by a lack of investor confidence in sterling overseas should business confidence be disrupted in Hong Kong with a potentially disastrous diversification out of sterling. The 1984 Joint Declaration secured special status for Hong Kong enshrining the independence of the currency and the Hong Kong banking system thereby averting a sterling crisis which would have had major implications for the City of London and Thatcher’s domestic policies.

## Keywords

British politics, foreign policy, Hong Kong, political economy, sterling, UK–China relations

## Introduction

In one of his lesser-known academic contributions, Jim Bulpitt (1988) suggests a novel conceptualisation of foreign policy. Rather than accepting the assumptions of the realist tradition (in either its classical or neorealist guise) with its balance of power concerns and ‘system-level’ analysis, Bulpitt makes a somewhat unacknowledged contribution to the ‘primacy of domestic politics’ school whose diverse members include Kehr (1977), Appleman-Williams (1959), Kolko (1969), Skocpol (1979), Van der Pijl (1984, 2022) and on some readings Lenin (1968). Bulpitt does not simply wish to suggest that the distinction between the ‘domestic’ and the ‘foreign’ has increasingly become blurred or that they

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are interdependent arenas or that the autonomy of traditional foreign policy institutions has been reduced. His claim is much more radical and centres on the argument that in an 'open polity' such as Britain, the external environment and foreign policy are 'analytically integral parts of domestic politics and domestic political management: they cannot be treated as something apart from the mainstream, as mere afterthoughts' (Bulpitt, 1988: 183). In this reading, foreign policies and domestic political management must both be designed, 'to reduce, as far as possible, the adverse impact of external forces' (Bulpitt, 1988: 184). In other words, foreign policy analysis shifts to the question, how did a particular administration seek to manage the impact of external forces on their domestic political management, 'such that their general interests were either positively promoted or not adversely affected' (Bulpitt, 1988: 181). Bulpitt (1988: 202) recognises that looking at the methods by which politicians in office manage the impact of external forces on domestic politics is both a neglected and difficult area of study, but, nevertheless, is one which 'deserves more attention from British academics than it has hitherto received'. This article takes up Bulpitt's challenge by looking in detail at a rather under-researched foreign policy area under Thatcher's administration, the return of Hong Kong to China agreed at the signing of the Sino-British Joint Declaration in Beijing in December 1984.

The Declaration stipulated that on 1 July 1997, Hong Kong would cease to be governed by the United Kingdom and would revert back fully to China, although its status as a Special Administrative Region granted Hong Kong the continuation of its capitalist economic system and position as an international financial centre. The article draws on declassified primary documents made available by the UK National Archives, which are housed at Churchill College, Cambridge, under the auspices of the Margaret Thatcher Foundation.

The existing literature on the negotiations - with the exception of the valuable historical analysis of Mark (2017, 2023), Hau (2021) and Hurst (2022) - is heavily descriptive and predominantly biographical in nature and suggests that Thatcher's negotiations were largely a failure and that the return of sovereignty to China (with no role for continued UK administration) was akin to a national humiliation. By contrast, this article argues that the outcome achieved by the Conservative government was in large part successful. Although sovereignty and continued UK administration over the region were conceded, Thatcher's negotiation maintained investor confidence in Hong Kong and averted a potentially disastrous financial crisis which would have had major consequences for the Conservative government's sterling policy and its domestic programme of financial liberalisation and deregulation. At the start of the negotiations in 1982, Hong Kong was already a significant international financial centre with over 200 foreign banks operating in and out of the territory having achieved a leading position in 'loan syndication' particularly for the rest of Asia (TNA: PREM19/792 f206, 12 September 1982). If the government failed to secure the capitalist basis of the region, this would affect the solvency of the banking system, prompt a major shift out of HK dollars and result in a foreign exchange crisis for which the United Kingdom alone would be ultimately liable. Any agreement therefore based on Hong Kong as a Special Administrative Region, which did not guarantee the independence of the currency and the banking system, would threaten the stability of the international financial system and deal a serious blow to sterling and the domestic programmes of the government which were based on removing the very controls that would paradoxically become necessary to reimpose in a crisis. Despite some public angst over the 'loss of sovereignty' the principal conclusion of this article is that the Conservative government succeeded in gaining the much more important prize of

aligning foreign and domestic policy objectives providing a basis for the growth of the City of London and a flourishing financial centre in Hong Kong. In terms of Bulpitt's framework, Thatcher pursued a strategy that managed to reduce the adverse impact of external forces while providing an effective external support system to bolster the key elements of her domestic economic strategy on which rested the Conservatives' wider statecraft objectives.

The article is structured in four parts. In the first part, we develop the theoretical framework and review existing approaches to Thatcher's foreign policy drawing out the key themes from the very sparse literature on UK–China negotiations over Hong Kong. Part II discusses in detail UK policy towards Hong Kong from 1979 to 1983 based on the analysis of declassified archival materials found in the Thatcher Archive and Part III places the negotiations in the context of the government's precarious management of sterling. Part IV looks in depth at the 1984 Agreement and the conclusion returns to some of the earlier theoretical discussions highlighting three main contributions of the study.

### *Part I: Foreign policy and the existing literature on the Sino-British Declaration 1984*

Given the vast existing literature on Thatcher and Thatcherism, it is somewhat surprising to find that there is relatively little written on foreign policy under the Conservative governments 1979–1990 (for an overview see Byrd, 1988). In a rare study of Thatcher's foreign policy, Paul Sharp (1997: xv) argues that her claim to be an international statesperson rested on three foundations: 'her relationship with Ronald Reagan and the strong support she gave to his Cold War policies; the successful war to recover the Falklands Islands; and her opposition to the European Community's plans for further integration'. For Sharp (1997: xvii), Thatcher managed to combine economic liberalism with political nationalism with the result that:

instead of seeking to transform the British state into a modest and practical vehicle for managing the common affairs of the bourgeoisie, Thatcher tried to restore it as a liberal great power, committed to a few vital international principles and its own, independently defined, national interests.

Sharp's three dominant foreign policy themes are echoed in most of the existing literature. Jessop et al. (1988: 181) argue that Thatcherism was 'too attached to the traditional Atlanticism of British foreign policy, with its preference for a special relationship with the US'. Gamble (1988: 106) too emphasises that Thatcher gave priority to the US alliance: 'the close political relationship between Thatcher and Reagan helped underline the continuing importance of the Anglo-American relationship in the political and economic management of the world system'. Euro-scepticism and a passionate belief in the special relationship with the United States are themes also stressed by Charles Powell (2019), who notes that Thatcher, 'believed we should win, not just endure, the cold war and that we should promote, not just defend, the superiority of liberal democracy over communism'.

The vast majority of the existing literature on Thatcher's negotiations with the Chinese government over the future of Hong Kong is written by former advisors and civil servants (Cradock, 1994; Patten, 2022; Renwick, 2013; an insightful exception is Mark, 2017). Three broad themes emerge from a review of these largely descriptive accounts of the negotiations. First, there is widespread acceptance that, as Buckley (1997: 110) puts it, Thatcher's negotiations were:

not a success . . . she failed to persuade the Chinese leaders that there ought to be role for Britain in Hong Kong during the post-1997 era and was obliged to admit in her later memoirs that Deng Xiaoping had proved obdurate.

Patten (2022: xxiv–xxv) goes further to suggest that the principal ‘embarrassment for Britain was moral’ because Hong Kong citizens, unlike those of other former colonies, were not to be given independence. The second dominant theme is a focus in the literature on the importance of ‘sovereignty’ as a key principle for Thatcher. This is aptly conveyed by Kavanagh (1990: 267–268), who notes that ‘in foreign affairs, Mrs Thatcher has proved to be something of a ‘little Englander’ . . . with a deep commitment to national sovereignty’. In respect of Hong Kong, he recognises but does not explain the apparent conundrum that this ‘determination to retain British sovereignty’ in foreign affairs ‘has to be set against Britain’s negotiated return of Hong Kong to China’ (Kavanagh, 1990: 268). Third, the existing literature emphasises that despite her skill in putting forward the British case, Thatcher could not match the negotiating prowess of the Chinese and, in particular, Deng Xiaoping. Accounts of former advisors point to divisions in the Foreign Office with Thatcher on occasion suffering rebuke from Foreign Office mandarins and ‘given her own lack of any real leverage’ seeking independent advice from such diverse figures as Alan Walters and the Prime Minister of Singapore, Lee Kuan Yew (Renwick, 2013: 88). By contrast, the Chinese negotiators are portrayed as highly organised and determined to recover Hong Kong, with a large share of the credit given to Deng for the successful conclusion of the Joint Declaration.

In addition to these largely biographical accounts, a small but highly influential literature has recently emerged centred around the work of the international historian Chi-Kwan Mark (2017, 2023). Drawing on a range of archive material, Mark clearly identifies sovereignty and confidence as the key themes of the negotiations and suggests that the UK government was guided by the ‘project of “educating” China in Hong Kong’s capitalism’ (Mark, 2017: 168). This theme is also developed by Hurst (2022: 1390) who concludes that Thatcher’s key concern focused largely on Hong Kong’s economy. Our analysis builds on Mark (2017, 2023) and Hurst (2022) to suggest that the confidence issue was not only about demonstrating to the Chinese government, ‘how Hong Kong’s capitalist system worked’ (Mark, 2017: 169), it was also fundamentally related to Thatcher’s own domestic economic strategy and the necessity of averting a sterling crisis. We will refer back to these themes in the conclusion and will now present the theoretical framework which informs the analysis developing Kehr and Bulpitt’s observations on foreign policy.

Foreign policy, as the external-facing political and economic affairs of the government, is relatively simply to describe but raises a number of difficult, and well-documented, conceptual problems (see Morin and Paquin, 2018; Smith et al., 2016). In particular, how can we theorise the making of foreign policy in the context of the other imperatives and institutional components of government, and second, what is the relation between domestic and foreign policy?

Although the disciplinary split between political science and international relations would suggest that foreign policy can be analysed in isolation from domestic policy, the rise of the ‘primacy of domestic politics’ school, and its contemporary manifestation as Foreign Policy Analysis (FPA), question that assumption (Kaarbo, 2015; Kehr, 1977; Skocpol, 1979). Eckart Kehr’s pathbreaking work in the 1920s pointed to the inadequacies of the realist ‘primacy of foreign policy’ approach. In a scathing critique of the

orthodoxy, he posed the question of whether foreign policy, which is usually seen as a 'realm of autonomous and objective political norms, in which social and internal political conflicts have no place', should instead be seen as 'an intimate reflection of internal political and social organization' (Kehr, 1977: 22). The fundamental issue for Kehr (1977: 23) was not simply whether 'domestic political considerations sometimes cause foreign policy to deviate from its predetermined course in minor details', but rather the extent to which foreign policy was 'determined all along the line by the social structure'. In this view, foreign policy, while contending with the external environment, is guided to the greatest extent by domestic concerns. For Kehr (1977: 30), the foreign policy of the Bismarckian Reich was to be understood in terms of the 'class division of the German people into bourgeoisie and proletariat [which] had a direct causal relationship with the implementation of an anti-English world policy and the development of the German battle fleet'. In this reading, bourgeois-nationalist interests were passionate in advocating an undying enmity against England and as a consequence the 'foreign policy demanded by the ruling strata was opposite to the one demanded by the group subjected to its rule' (Kehr, 1977: 31). In short, Kehr (1977: 31) argues that it is 'technically impossible to isolate foreign policy from all other aspects of life' and erroneous to consider it purely a matter of the Foreign Office and interstate diplomacy. Ruling parties proceed from the objectives of their domestic and economic policies and foreign policy is 'a means to their domestic ends' (Kehr, 1977: 24). Kehr's focus on the 'domestic-external linkage' is shared by writers in the contemporary tradition of FPA which is usefully summarised by Kubalkova (2001: 17) as an analysis of 'a complex, multilayered process, consisting of the objectives that governments pursue in their relations with other governments and their choice of means to attain these objectives'. As Juliet Kaarbo (2015: 5) emphasises, 'attention to domestic politics or decision-making is an essential characteristic of FPA research', which has drawn productively on Putnam's (1988) 'two-level game' model and Mintz's (2004) 'poliheuristic' approach looking at how leaders make decisions. While Kaarbo (2015: 5) perceptively sees FPA as a 'sub-field or area of research' rather than a distinctive theory of politics, it has nevertheless tended to endorse a focus on the 'subjective understandings of leaders as funnels for other international and domestic factors' and prioritise rational choice and psychological forms of explanation including the study of emotions (Smith, 2021). Poliheuristic choice theory, for example, seeks to integrate elements of the cognitive psychology approach to decision making with rational choice calculations (Mintz, 2004: 4). Although contemporary work on FPA has made significant contributions to understanding the domestic/external divide it has been criticised for being overly 'actor-centred' and 'actor-specific' in its analysis (Rapport, 2016) and for unpacking the state to the 'point that the concept of the state disappears' (Alden and Aran, 2017: 87). The strength of the Kehr/Bulpitt version of the 'primacy of domestic politics' approach, we would argue, is that it is rooted in historical analysis of the contradictory forces facing the state drawing on a clearly articulated theory of statecraft. In addition, it is noteworthy for specifying the *primacy* of domestic politics rather than simply including 'domestic factors' as part of a multilayered explanation.

Statecraft for Bulpitt is broadly defined as the 'politics of state or polity management' and is concerned with 'gaining and maintaining office . . . [and] achieving a minimal level of governing competence' (Bulpitt, 1995: 520). It consists of three main elements: a set of governing objectives, a governing code – a set of principles underlying policies understood as policy-related behaviour, and a set of political support mechanisms (including political argument hegemony – essentially how to beat your opponents). A crude



understanding of statecraft would reduce it simply to the strategies involved in winning elections – and some of Bulpitt's analysis does indeed support this interpretation. However, on closer inspection it is clear that achieving a minimal level of governing competence involves not only the articulation of a governing code but also relative success in pursuing the policies that form the code. Policies are not therefore as irrelevant as a crude interpretation of statecraft would imply. This is indeed recognised by Bulpitt (1996: 226) when he notes that a 'positive role will be played by the rules underlying the policy preferences of the governing strategy'. Relative success in policymaking supports the achievement of a minimal level of governing competence, which in turn facilitates polity management, part of which is the winning of elections.

As part of this general framework, Bulpitt (1988: 181) suggests that a productive new agenda for political science would be the study of how external forces impact on domestic politics to enhance a governing code and ultimately party statecraft. Foreign policy therefore does not only have domestic consequences. Rather it can be devised in such a way as to play a major role in supporting the government's domestic policy programme as a key element of statecraft. Unlike Kehr he does not seek an explanation in the broader social structure but rather in the domestic policy making of the ruling party which he emphasises is also distinct from abstract realist notions of the 'national interest'. Furthermore this framework allows us to integrate the politicisation/depolicitisation literature (Burnham, 2001) into the study of foreign policy suggesting that a 'domesticist' emphasis will favour a depoliticised foreign policy whereas an 'externalist' orientation will favour a politicised foreign policy orientation.

As the United Kingdom moved from a relatively closed postwar economy characterised by currency controls and close government involvement in the domestic economy to a more open international environment, Bulpitt, (1988: 202, 1996: 227) suggests that from the 1980s, governments sought to actively manage the impact of external forces on domestic politics through a *domesticist* orientation of foreign policy which prioritised the achievement of domestic policy objectives. This framework, drawing on Bulpitt (1988), now yields the question which guides the rest of the analysis: in what ways and for what reasons, did successive Thatcher governments seek to manage the impact of external forces on domestic politics such that their general interests were either positively promoted or not adversely affected?

We will suggest that this framework produces an original understanding of Thatcher's negotiation of the return of Hong Kong. Contrary to many existing accounts we will argue that the government had no illusions about the sovereignty issue and fully expected to lose administrative control. The aim of the negotiations was to achieve a settlement which did not disrupt sterling and which did not therefore threaten the basis of the Conservative government's domestic economic reforms.

## Part II: *Handing back Hong Kong – sovereignty and confidence*

Cradock (1994), Renwick (2013) and Mark (2017, 2023) provide a good narrative overview of the background to the return of Hong Kong to China. Hong Kong had been a colony of the United Kingdom since 1898 during the Qing Empire. The process of Hong Kong's colonisation occurred in three stages. Hong Kong Island and the Kowloon Peninsula were ceded to the United Kingdom in perpetuity by Treaties in 1842 (Treaty of Nanking) and 1860 (Treaty of Peking) and the New Territories were leased to the United Kingdom for 99 years in 1898 (Convention for the Extension of Hong Kong) to expire in 1997 when the governor's right to administer the New Territories was to cease under the

terms of the Order in Council of 1898 (TNA: PREM19/789 f97, 26 July 1982). It is important to recognise that, despite the legality of the agreements, successive Chinese governments had consistently regarded the Treaties as unequal (that is, forced upon a weak China in the nineteenth century) and had long taken the view that the whole of Hong Kong was in essence a Chinese territory (TNA: PREM19/789 f97, 26 July 1982). This position was well understood by the Conservative government when negotiations began in 1979, with 18 years left to run under the terms of the 1898 Treaty. Two events in particular made it clear to the government that China would not be willing to negotiate over sovereignty or continued British administration. First, during the visit of Premier Hua Guofeng to the United Kingdom in 1979 it was emphasised that the Chinese Government viewed the UK's approach towards Hong Kong as 'unnecessary and inappropriate'. Deng Xiaoping had clarified that 'China regarded Hong Kong as Chinese territory' with no continuing role for the United Kingdom (TNA: PREM19/789 f209, 9 October 1979). However, when pressed by Thatcher he had conceded that 'the Chinese would take account of the special circumstances of Hong Kong and would not harm the interests of the investors' (TNA: PREM19/789 f209, 9 October 1979). From the start Thatcher was under no illusion that the Chinese Government considered the future of Hong Kong as a matter for their own decision. This was emphasised with increasing force during Thatcher's state visit to China in 1982. Thatcher recalls in her memoirs:

By the time I visited the Far East in September 1982 Britain's standing in the world, and my own, had been transformed as a result of victory in the Falklands. But one issue on which this was, if anything, a drawback was in talking to the Chinese over Hong Kong. The Chinese leaders were out to demonstrate that the Falklands was no precedent for dealing with the Colony. I was well aware of that myself, both from the military and the legal viewpoints. (Thatcher, 1995: 259)

The People's Republic of China refused to recognise the Treaty of Nanking, signed in 1842, by which the island of Hong Kong had been acquired by Britain (Thatcher, 1995: 259). During her first meeting on 22 September 1982, the Chinese Premier Zhao Ziyang made it very clear that China would not compromise on sovereignty and that China intended to recover sovereignty over the whole of Hong Kong in 1997 and no later. Thatcher and Deng Xiaoping met the next day and Thatcher records that Mr Deng unlocked the way to a solution to Hong Kong. Deng Xiaoping had accepted that two different economic systems could coexist in China, by the creation of special economic zones. He also claimed that China was not prepared to discuss sovereignty and that with or without an agreement the Chinese Government would formally announce its decision to recover Hong Kong in 1 or 2 years' time (Thatcher, 1995: 261).

In private it was clear that sovereignty (or any form of continued British administration) was non-negotiable. However in the context of the Falklands war and with opinion polls suggesting that the public wanted a continuation of British administration (TNA: PREM19/789 f13, 6 September 1982), the Thatcher government's public pronouncements continued to focus on sovereignty while behind the scenes the government's real objective focused on stabilising sterling and securing the capitalist basis of Hong Kong as a key centre of banking and finance. The importance of securing an agreement on special status for Hong Kong as an international financial centre was brought home to Thatcher, when on route to Beijing she commented to journalists that countries should not 'abrogate treaties' (Howe, 1995: 365). Geoffrey Howe (1995: 365) recalls that the 'effect on confidence of this public confrontation was marked and rapid', with a 12% fall in the value of



the HK dollar and a 25% fall in the Hong Kong stock market. The effect on confidence was brief but a salutary lesson to the United Kingdom that it was crucial to arrive at a negotiated settlement with China and not risk a conclusion in which China imposed a unilateral outcome.

In March 1983, Thatcher sent a private letter to Zhao Ziyang stating that:

provided that agreement could be reached between the British and Chinese Government on administrative arrangements for Hong Kong which would guarantee the future prosperity and stability of Hong Kong, and would be acceptable to the British Parliament and to the people of Hong Kong as well as to the Chinese Government, I would be prepared to recommend to Parliament that sovereignty over the whole of Hong Kong should revert to China. (Thatcher, 1995: 489)

In private the billionaire banker Lord Rothschild advised Thatcher that at the present time the most important factor for Hong Kong's financial stability was confidence, and how international investors' confidence could be secured through Chinese diplomatic guarantees: 'Hong Kong's future financial viability can only be assessed within a context of acceptance of eventual Chinese sovereignty over Hong Kong, not from market trends that were caused by initial disappointment in unrealistic expectations that precluded Chinese sovereignty' (TNA: PREM19/1059 f235, 1 December 1983). This message had also been relayed to Thatcher in the strongest possible terms by the Foreign and Commonwealth Office prior to her state visit in 1982. It was crucial, the FCO argued, that any final agreement did not destabilise the economic fortunes of Hong Kong since the United Kingdom remained liable for resolving any crisis situation and of course any destabilisation could have serious consequences for Thatcher's domestic policy programmes particularly those involving the liberalisation of finance. The UK's governance of Hong Kong had produced a somewhat peculiar institutional framework concerning currency and banking. Although in practice the HK government ran its financial affairs independently of the UK government, the Foreign and Commonwealth Office (TNA: PREM19/792 f206, 12 September 1982) was clear that, 'in the last resort HMG would be regarded as responsible for Hong Kong since it is a colony over which, formally speaking, they have plenary powers of control, both executive and legislative'. Hong Kong had no separate central bank or exchange controls and although it ran an Exchange Fund to regulate the value of the HK dollar, external debt carried HMG's guarantee, 'because of the United Kingdom's responsibility for external affairs' (TNA: PREM19/792 f206, 12 September 1982). At the start of the negotiations in 1982, Hong Kong was already a significant international financial centre with over 200 foreign banks operating in and out of the territory having achieved a leading position in 'loan syndication', particularly for the rest of Asia (TNA: PREM19/792 f206, 12 September 1982). In an assessment of the consequences of failing to maintain market and investor confidence, the FCO noted that if Thatcher failed to secure the capitalist basis of the region, this would affect the solvency of the banking system, prompt a major shift out of HK dollars and result in a foreign exchange crisis for which the United Kingdom would be ultimately liable (TNA: PREM19/792 f206, 12 September 1982). In addition, since Hong Kong was not a member of the International Monetary Fund (IMF) or the World Bank, stabilisation would have to come from Her Majesty's Government (HMG), which would also be responsible for all of Hong Kong's obligations and debts accruing from its

membership of the Asian Development Bank (amounting in 1982 to approximately US\$180 million). Finally, Hong Kong had commitments with the Export Credit Guarantee Department totalling some US\$3 billion, which if called upon to cover would, ‘have major consequences for the UK Exchequer’ (TNA: PREM19/792 f206, 12 September 1982). The Foreign and Commonwealth Office’s conclusion was clear: any agreement based on Hong Kong as a Special Administrative Region which did not guarantee the independence of the currency and the banking system would threaten the stability of the international financial system and deal a serious blow to sterling and the domestic programmes of the Thatcher government, which were based on removing the very controls that would paradoxically need to be reinstated in a crisis. The importance of securing a joint agreement on the basis of maintaining investor and market trader confidence can only be fully understood in the context of the difficulties facing the government’s management of sterling between 1979 and 1984.

### *Part III: The plight of sterling and Thatcher’s domestic programme of financial liberalisation and deregulation*

The Conservative government’s domestic attempt to deregulate and liberalise the operations of the City of London was designed, in part, to reinvigorate the financial circuit of accumulation in Britain – as Crafts puts it, ‘as a radical response to the poor performance of the United Kingdom economy during the 1970s’ (Crafts, 2018: 121). The abolition of exchange controls, the ‘Big Bang’ at the Stock Exchange and the Conservatives’ general sterling policy all, ‘in effect transferred important aspects of domestic policy to the international market economy for determination’ (Bulpitt, 1988: 198). As Bulpitt (1988: 198) further clarifies:

the more the Treasury, Downing Street and the Bank of England relied, as they did after 1982, on a combination of interest rates and the exchange rate to regulate the economy, the more they relied on foreign ‘confidence’ in the British economy to assist them in managing that economy.

The dilemma for the government was that introducing greater competition in financial markets at home could easily be undermined by a lack of investor confidence in sterling overseas should business confidence be disrupted in markets such as Hong Kong with a potentially disastrous diversification out of sterling. As Schenk (2010: 350) notes, since 1945 Hong Kong had been crucial to the stabilisation of sterling – with Hong Kong voluntarily holding £660 million of sterling assets by the mid-1970s. By 1984, Hong Kong was the third largest financial centre in the world with the fourth largest gold market after London, Zurich and New York (Macintyre, 1985: 204). By the time of the Joint Declaration, over 70% of all banks in Hong Kong were foreign banks, with locally owned banks expanding their international operations (Macintyre, 1985: 204). Recent, archive based, research on the UK’s liberalisation and deregulation programme points to an even closer link between Thatcher’s domestic strategy and the increasing need to maintain overseas investor confidence in sterling.

The move to a floating exchange rate under Heath in 1972 had encouraged an ever-growing volume of speculative activity in which capital flows responded not only to economic fundamentals but also to the ‘volatile and irrational judgements of currency traders and asset holders’ (Helleiner, 1995: 123). Heavy borrowing in international financial markets culminated in the infamous 1976 IMF loan under which the United Kingdom

secured US\$5.3 billion (Helleiner, 1995: 125; Rogers, 2012; Wass, 2008). Although the exploitation of North Sea oil produced a stabilisation of the sterling exchange rate from 1977 to 1981 (sterling appreciated from US\$1.60/£1 in 1977 to US\$2.44/£1 in 1981), the ‘petrocurrency effect’ was short-lived and from 1981 the pound began a 4-year decline against the dollar closing near to US\$1/£1 in 1984 (Schenk, 2010: 399). Both Howe and Lawson were convinced that only pro-market neoliberal policies could produce the ‘virtuous circle effect’ in which the ‘weak got weaker and the strong got stronger’ (Helleiner, 1995: 124). The deregulation of New York securities markets in 1975 had prompted British investors to shift their activity to New York (Helleiner, 1995: 151) and this lesson had not been lost on the incoming Conservative government who responded to this ‘competitive deregulation’ dynamic by abolishing the UK’s 40-year old system of exchange controls in October 1979. The move was hailed by Lawson as one of ‘critical importance’ in helping to establish credibility and was met with rejoicing in the City (Capie, 2010: 770–771). Fears that the removal would result in a wholesale flight of sterling into foreign assets proved unfounded but the move certainly made direct controls on the money supply less effective and increased the vulnerability of sterling in the hands of overseas traders (Capie, 2010: 769). Recent work by Jack Copley (2019) suggests that Thatcher’s exchange control liberalisation was in part motivated by a desire to exert downwards pressure on sterling to alleviate the strain on British exports. Thatcher, however, could not make public this aspect of the strategy since according to Chris Rogers (2012: 203, quoted in Copley 2019: 415) any *overt* action by the government to manage the floating rate would ‘have the potential to provoke a diversification out of the pound’. The precarious position of sterling following the introduction of the floating rate system, the impact of oil prices exacerbating global imbalances and the competitive deregulation dynamic introduced by the United States in 1975 produced extreme exchange rate volatility for sterling in the period 1979–1984. During the summer of 1984 sterling began a steep decline against the dollar further reinforcing Lawson’s private preference to make the sterling exchange rate an intermediate policy target (Schenk, 2010: 403). Shoring up sterling now became an urgent policy objective since any perceived weakness could ‘start as a gentle trend but turn into crises’ (Smith, 1993: 49). Treasury research had indicated that in an open economy such as Britain, sterling played an important role as a ‘transmission mechanism’ for inflation. As Smith (1993: 49) outlines, this not only worked in textbook fashion with a falling exchange rate raising the price of imports, but Lawson had observed that in Britain, businesses operating in the home market often increased their prices to match those of imports. As Lawson later admitted in a Treasury and Civil Service Committee session, exchange rate volatility had now produced a situation where industry ‘comes to believe that sterling will decline against other currencies . . . and therefore makes its decisions accordingly deciding what cost increases it can afford based on an extrapolation of that trend’ (Lawson, quoted in Smith, 1993: 50). It is in this context of near-permanent sterling crisis management, exacerbated by the newly called Miners’ Strike, that the Sino-British Declaration of December 1984 must be placed (on the implications of the Miners’ Strike for sterling see Lawson, 1992: 160).

#### ***Part IV: The 1984 agreement: Returning Hong Kong to China***

As 1983 drew to a close, Deng Xiaoping recognised Thatcher’s claim that improving UK–China relations was mutually beneficial and suggested that a joint agreement would not damage British interests, but on the contrary by putting an end to the colonialist era Britain would enhance its reputation and the Thatcher government would be applauded

across the world (TNA: PREM19/1059 f366, 7 November 1983). Yao Guang now elaborated the Chinese government's position producing a 10-point draft, which served as a template for the final agreement (TNA: PREM19/1059 f294, 14 November 1983):

First, China would resume the exercise of sovereignty over Hong Kong on 1 July 1997 and the intervening period was the transition time for a settlement of the Hong Kong question. Second, after the resumption of sovereignty a Hong Kong special administrative region (SAR) directly under the authority of the central people's government would be established in accordance with article 31 of the constitution of the People's Republic of China (PRC) and it would enjoy a high degree of autonomy. Third, the SAR would be vested with the power of legislation and independent judicial power, including that of final judgement. Laws, decrees and regulations currently in force would remain basically unchanged. Fourth, the SAR government would be composed of inhabitants of Hong Kong. The principal officials would be appointed by the central people's government of China on the basis of the results of elections or consultations held locally. Local British and other foreign nationals could be employed as advisers in organs at various levels in the SAR. Fifth, the current social and economic system would remain unchanged as would the existing lifestyle. The freedoms of speech, press, assembly, association, travel, change of domicile, correspondence and ownership of enterprise would be protected by law. Sixth, the SAR would remain a free port and a separate customs area. Seventh, it would maintain the status of an international financial centre, and foreign exchange, gold, securities and futures markets would remain open, there would be a free flow of capital, and the Hong Kong dollar would circulate and be freely convertible as usual. Eighth, the SAR would have independent finances. Ninth, the SAR could establish reciprocal economic relations with Britain. British economic interests would be taken care of using the name 'Hong Kong China', the SAR could maintain and develop economic and cultural relations and sign agreements with foreign countries, regions and relevant international organisations, and the SAR government could issue its own travel documents for entry into and out of Hong Kong. Tenth, public order could be maintained by the SAR government and finally these policies for the SAR would be stipulated by the national people's congress (NPC) as the basic law of the SAR and would remain unchanged for 30 years - subsequently amended to 50 years (TNA: PREM19/1059 f294, 14 November 1983).

Premier Zhao Ziyang wished to expedite the pace of discussion so as to lead to agreement at an early date – 'this would be beneficial to confidence in Hong Kong and thus to stability and prosperity there' (TNA: PREM19/1646 f272, 21 December 1983). He hoped that the British side would continue to view the talks in the context of the overall world situation and friendly Sino-British relations, since it was entirely possible now to reach agreement (TNA: PREM19/1646 f272, 21 December 1983).

Although the UK government would have preferred to slow down negotiations and opt for a definitive agreement in 1985, Thatcher decided to link final discussions to Geoffrey Howe's visit to Beijing in April 1984 (TNA: PREM19/1263 f97, 20 March 1984). In a telegram from Howe to Thatcher the Foreign Secretary outlined the details of the Chinese bottom line – 'if the British could not accept these terms during the visit then the offers the Chinese had made on Hong Kong's status would be withdrawn and negotiations would fail' (Thatcher MSS2: THCR 1/10/75 f3; copy in PREM19/1266, 28 July 1984). On 6 September 1984, British negotiators and Chinese negotiators had their last round of talks leading to the Joint Declaration.

The Sino-British Joint Declaration was signed by Thatcher and Zhao Ziyang in Beijing's Hall of the People after 4 months of negotiations on 19 December 1984 (Secretary of State for Foreign and Commonwealth Affairs, 1985). This established the

terms under which Hong Kong would revert to Chinese control and become an official Chinese territory. According to the 'one nation, two systems' concept, Hong Kong would keep its largely democratic political system and capitalist economic system for another 50 years after the handover (Walker, 2020). Subsequently, the Sino-British Joint Declaration was ratified on 27 May 1985 and was registered at the United Nations by both governments on the 12 June 1985 (Brooke-Holland, 2019: 7).

Thatcher delivered a speech on 19 December 1984 following the agreement and stressed that:

the joint declaration on the future of Hong Kong is a landmark in the life of the territory in the course of Anglo-Chinese relations; and in the history of international diplomacy. The agreement establishes a firm basis for confidence in Hong Kong up to 1997 and beyond, and for its continued stability, prosperity and growth. Moreover, the agreement provides the framework in which, as a special administrative region of the people's republic of China, Hong Kong will maintain its economic system and way of life for 50 years after the first of July 1997. (Thatcher MSS2, THCR 5/1/5/289 f3, 19 December 1984)

In terms of the image of the agreement on the world stage, Thatcher noted that the agreement had been widely praised by other governments, in international organisations and in financial and economic circles. Thatcher concluded:

the negotiation itself has brought our countries closer together. It has increased our mutual understanding, respect and trust. I am convinced that as we work together in the future we shall be laying the foundation for an even closer and deeper relationship. That is good for Britain; good for China; and good for the world. (Thatcher MSS2, THCR 5/1/5/289 f3, 19 December 1984)

Although the term, 'golden age' is usually reserved for UK–China relations under Cameron, the period following 1984 can in many ways be seen as the first true 'golden age'. In 1985, Thatcher welcomed Premier Zhao to Britain and in October 1986 the Queen became the first British sovereign to visit China (TNA: PREM19/1502 f41 (Zhao Ziyang), 19 December 1984). Thatcher took steps to promote China's offshore oil and gas fields working with British Petroleum and was prepared to do further work in the South China Sea. Britain was also in contact with China in efforts to develop the mining of coal. Thatcher also strongly supported the establishment of the joint venture company for the Guangdong nuclear power project. Zhou emphasised that the joint venture would be the largest between China and any foreign country since China's opening to the outside world, and that he hoped both sides would cooperate in making it successful. Thatcher welcomed the news that China intended to buy five Airbus 310s from British Aerospace, and strongly urged the Chinese government to buy the BAE 146 (TNA: PREM19/1502 f41 (Zhao Ziyang), 19 December 1984).

During the final meeting between Thatcher and Deng Xiaoping, Deng stated that the achievement of the leaders of China and Britain was historic, and that a failure to solve the question of Hong Kong would have undermined relations in the future for both countries. Deng viewed the policy of opening up to the outside world, and allowing for the continuation of capitalism in Hong Kong, to be beneficial to the strength of socialism in mainland China. Thatcher concurred with this sentiment, believing that the agreement would be honoured as it was clearly to China's benefit (TNA: PREM19/1512 f41 (Deng Xiaoping), 19 December 1984).



## Conclusion

The principal aim of this article has been to show how a ‘primacy of domestic politics’ approach can be used to throw new light on aspects of Thatcher’s foreign policy. The Kehr/Bulpitt framework is not, of course, the only approach which can be used to understand more clearly the domestic/external linkage. For example, from the point of view of Chinese foreign policy, the concept of ‘one nation, two systems’ can, using Putnam’s (1988) framework, be seen as a highly effective compromise that squares the various circles that might otherwise have precluded agreement, enabling both states to achieve their core objectives and therefore secure ratification for the agreement. Similarly, from Mintz’s (2004) position it could be suggested that Thatcher made both a rational and a psychologically consistent decision to sacrifice any claim to sovereignty in order to protect her domestic economic agenda.<sup>1</sup> Utilising the Kehr/Bulpitt framework, we suggest, throws further light on the Sino-British Agreement 1984 showing how through a domesticist orientation of foreign policy the Conservative government managed the impact of external forces on its domestic political economy. Sidelining the issue of sovereignty (which by 1982 Thatcher knew was non-negotiable) the government structured its negotiations to convince the Chinese government of the importance of maintaining the capitalist economic basis of Hong Kong (Mark, 2017) consolidating its special status within China. This not only provided the United Kingdom with a privileged gateway to international finance and investment in Asia but more importantly supported the government’s financial liberalisation policies which were increasingly dependent on market confidence and credibility in sterling policy. The spectacular growth of Hong Kong in the decade after 1984 and the consolidation of the City of London as a leading financial centre following the 1986 ‘Big Bang’, highlight the significance of Thatcher’s achievement in underwriting investor confidence by building currency and banking independence into the Agreement.

The second conclusion recognises the role of the Sino-British Declaration in cementing Thatcher’s image as a strong international political leader. This draws on a more conventional Bulpittian understanding of the importance of foreign policy in helping achieve statecraft objectives. Although the Falklands conflict is often cited in this respect (see Bruni, 2018: 136; Lawson, 1992: 245) we argue the case for an elevation of the Sino-British Declaration in understanding Thatcher’s foreign policy given its strategic importance particularly for international business and financial interests. In addition, the negotiations offer an example of how ‘colonial issues’ could be tackled with a diplomatic approach rather than by violent or unilateral means. This theme was developed by the Secretary General of the United Nations who described the agreement as an example for other countries of the way in which difficult international problems could be successfully resolved (Thatcher MSS2, THCR 5/1/5/289 f3, 19 December 1984). The Declaration also extends our view of Thatcher’s global statesmanship beyond the usual narrative of ‘close friend of Ronald Reagan’ (Donaldson, 2018) to indicate that, however, close the UK–US ‘special relationship’, Thatcher was able to pursue a relatively independent line reaching trade and manufacturing deals with China (in strategic areas such as defence and nuclear power) many of which were directly contrary to US policy.

Finally, the article has wider implications for how UK–China relations are theorised and understood in respect of the ‘received wisdom’ on postwar UK governments and more recent literature on the ‘Golden Era’ under the Cameron government (Mark, 2023). While it is often acknowledged that foreign policy ‘remains a relatively unknown area of the three Thatcher governments’ (Byrd, 1988: 1), consideration of UK–China



relations is even less common. The opening of UK government archives enables research to be conducted in this area with the possibility of arriving at a more secure, theoretically informed and comprehensive understanding of UK–China engagement across postwar governments (also see Summers (2021) on the use of oral and ‘memoir’ history). In the existing literature on the so-called ‘Golden Era’ (for an overview see HM Treasury, 2017; Leoni, 2022) it is the Conservative–Liberal coalition from 2010 to 2015 which is seen to have prioritised ‘financial engagement’ with China as ‘a clear manifestation of the liberal spirit’ (Zhang, 2019: 209–213). The ‘Golden Era’ tagline, it has been suggested, was ‘created . . . to promote Chinese President Xi Jinping’s grandiose state visit to the United Kingdom in 2015’ (Turner, 2018) representing a clear break with the pattern of previous UK–China relations. However, by placing UK–China relations in a broader context, and with the help of detailed primary archival research, it becomes clear that the seeds of the first postwar ‘Golden Era’ in Sino–UK relations were sown 30 years earlier under the Thatcher government. The sale of UK arms to China, the role of the General Electric Company (GEC) in the development of the Guangdong Nuclear Power Station and other ventures including the sale of civil aircraft, food technology, telecommunications and railway and coal production initiatives spurred on the relationship which according to Thatcher, showed ‘the rest of the world how well Britain and China were co-operating and re-enforced the confidence created by the Hong Kong Agreement’ (TNA: PREM 19/1426 f27, 6 June 1985). The evolving relationship soon went beyond economic factors alone to include cultural and political elements with Thatcher pushing for the United Kingdom to be at the forefront of attempts to secure preferential terms for China in COCOM (the Coordinating Committee for Multilateral Export Controls set up by the Western bloc in 1950) – and for the eventual abolition of COCOM restrictions for China (TNA: PREM 19/1426 f27, 6 June 1985). In this respect, existing work on the Cameron government which sees Cameronism as a continuation of Thatcherism (Kerr et al., 2011) may draw further support for its arguments from the study of foreign policy.

## Funding

The author(s) received no financial support for the research, authorship, and/or publication of this article.

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## Note

1. The authors are indebted to one of the anonymous reviewers for this point.

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