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FOR PRIME MINISTER'S PARTY:
 MEETING WITH DR MAHATHIR, 6 AUGUST: BRIEFING ON DEFENCE PACKAGE
 AND AIR SERVICES

1. THE DEFENCE PACKAGE IS LIKELY TO BE THE MAIN SUBJECT FOR DISCUSSION WITH DR MAHATHIR. THE PRIME MINISTER WILL WISH TO ASSURE HIM OF HER FULL SUPPORT FOR IT. HE IS LOOKING FOR CONCESSIONS ON AID AND MAYBE ALSO ON AIR SERVICES. ON AID, WE CANNOT ACCEPT ANY LINKAGE BETWEEN AID AND DEFENCE SALES AND THE PRIME MINISTER MAY WISH TO MAKE CLEAR THAT OUR LATEST OFFER IS AS FAR AS WE CAN GO. IF DR MAHATHIR RAISES AIR SERVICES, THE PRIME MINISTER MAY WISH TO ENCOURAGE HIM TO PERSUADE MAS TO CONTINUE TO TALK TO BRITISH AIRWAYS, BUT ON A BROADER RANGE OF COMMERCIAL OPTIONS.

DEFENCE PACKAGE

2. THE PRIME MINISTER IS FAMILIAR WITH THE BACKGROUND TO THE DEFENCE PACKAGE. ON 23 MARCH THE DEFENCE SECRETARY SIGNED A PROTOCOL WITH THE MALAYSIAN MINISTER OF DEFENCE FOR THE SUPPLY OF DEFENCE EQUIPMENT INCLUDING TORNADO AIRCRAFT, RAPIER MISSILES, RADARS, HOWITZERS AND SUBMARINES. PAYMENT WOULD BE IN CASH, USING THE PROCEEDS OF CRUDE OIL SALES BY PETRONAS, THE MALAYSIAN STATE OIL CORPORATION. (A BRIDGING FINANCE FACILITY, REQUIRING ECGD COVER OF POUNDS 200-300 MILLION WILL BE NEEDED. ECGD CAN PROVIDE IT). AT MALAYSIAN REQUEST THE PROTOCOL INCLUDED A REFERENCE TO AID (UNSPECIFIED) IN SUPPORT OF NON-MILITARY PROJECTS TO 20 PER CENT OF THE VALUE OF THE DEFENCE EQUIPMENT (I.E. POUNDS 200 MILLION ACCORDING TO THE APPROXIMATE VALUATION OF POUNDS 1 BILLION ORIGINALLY PLACED ON THE EQUIPMENT COVERED BY THE PROTOCOL; POUNDS 300 MILLION ACCORDING TO LATER ESTIMATES BY THE INDUSTRY OF POUNDS 1.5 BILLION). LINKING AID TO DEFENCE SALES CONTRACTS WOULD SUBJECT MINISTERS TO SEVERE CRITICISM IN PARLIAMENT AND IN THE OECD. ON 20 JUNE, FOLLOWING AN INTER-MINISTERIAL MEETING MR YOUNGER WROTE TO THE MALAYSIAN FINANCE MINISTER (DAIM) RULING OUT LINKAGE. AT THE SAME TIME OUR HIGH COMMISSIONER SENT A SEPARATE LETTER OFFERING POUNDS 200 MILLION IN THE FORM OF POUNDS 70 MILLION ATP GRANT AND POUNDS 130 MILLION ASSOCIATED EXPORT CREDIT COVER SUPPORT FOR ELIGIBLE CIVIL PROJECTS. THE MALAYSIANS EXPRESSED DISAPPOINTMENT THAT THE POUNDS 200 MILLION WOULD NOT ALL BE IN THE FORM OF ATP GRANT AND INDICATED THAT DR MAHATHIR WOULD NEED FURTHER CONCESSIONS TO SELL THE PACKAGE TO HIS CABINET. OUR HIGH COMMISSIONER WROTE AGAIN TO DAIM ON 27 JULY (IN TERMS AGREED BY THE PRIME MINISTER AND COLLEAGUES) STATING THAT WE WOULD BE PREPARED TO CONSIDER SYMPATHETICALLY THE POSSIBILITY OF PROVIDING FURTHER SUPPORT IF

PROGRESS WERE MADE IN USING THE POUNDS 200 MILLION AND THE MALAYSIAN GOVERNMENT PUT FORWARD FURTHER ELIGIBLE PROJECTS. SPRECKLEY TOLD DAIM ON INSTRUCTIONS THAT THIS OFFER REPRESENTED A MAJOR EFFORT ON OUR PART TO MEET MALAYSIAN WISHES AND THAT IT WAS AS FAR AS WE COULD GO. WHAT INDICATIONS WE HAVE SUGGEST THAT THE MALAYSIANS WILL ACCEPT THIS. UNLESS SPREAD OVER A VERY LONG PERIOD HIGHER FIGURES COULD CREATE ATP BUDGET PROBLEMS, CROWDING OUT SUPPORT FOR PROJECTS ELSEWHERE AND REQUIRE AN INCREASE IN THE ECGD COUNTRY LIMIT WHICH WOULD BE DIFFICULT TO AGREE.

3. THIS PROBLEM HAS HELD UP NEGOTIATION OF AN MOU ON THE DEFENCE PACKAGE PROPER. DR MAHATHIR NOW ACCEPTS IT CANNOT BE SIGNED ON 6 AUGUST AND HAS SUGGESTED SIGNATURE DURING HIS VISIT TO THE UK IN LATE SEPTEMBER. WE HAVE REPLIED THAT IT IS TOO EARLY TO DECIDE ON TIMING OR SIGNATORIES. OUR PREFERENCE IS FOR SIGNATURE BY DEFENCE MINISTERS AND TO AVOID TYING OURSELVES TO ARTIFICIAL DEADLINES.

AIR SERVICES

4. THE BRIEFING WE HAVE ALREADY PROVIDED CONTAINS BACKGROUND ON

AIR SERVICES. THE MALAYSIANS HAVE SINCE HINTED THAT WITHOUT AGREEMENT ON SIXTH AND SEVENTH WEEKLY FREQUENCIES TO LONDON FOR MAS (INSTEAD OF THE PRESENT FREQUENCY OF FIVE FLIGHTS PER WEEK) MAJOR CONTRACTS IN THE DEFENCE PACKAGE MAY BE LOST. DR MAHATHIR HAS TOLD OUR HIGH COMMISSIONER THAT HE HOPED THE PRIME MINISTER WOULD PRESS BA TO BE MORE FORTHCOMING IN THEIR NEGOTIATIONS WITH MAS. THE PRIME MINISTER WILL NOT WISH TO RAISE THIS SUBJECT HERSELF, BUT IF DR MAHATHIR DOES SO, SHE MAY WISH IN ADDITION TO DRAW ON THE FOLLOWING WHICH IS MORE FORTHCOMING THAN THE LINE IN THE ORIGINAL BRIEFING AND IS BASED ON SUBSEQUENT DISCUSSION WITH BRITISH AIRWAYS. THE PRIME MINISTER MAY ALSO WISH TO BE AWARE THAT THE BRITISH AIRPORTS AUTHORITY'S PROPOSALS FOR RUNNING MALAYSIAN AIRPORTS NOW LOOK LIKELY TO BE ACCEPTED.

5. THERE SHOULD BE NO LINKAGE WITH THE DEFENCE PACKAGE: AIR SERVICES MUST BE CONSIDERED ON THEIR OWN MERITS. WE HOPE THAT A WAY FORWARD CAN BE FOUND WHICH WILL ALLOW MAS TO OPERATE ADDITIONAL SERVICES TO LONDON. OF COURSE BRITISH AIRWAYS ARE NOW A PRIVATE COMPANY. BUT WE UNDERSTAND THAT THEY WOULD BE PREPARED TO LOOK AT A RANGE OF COMMERCIAL OPTIONS AND OTHER IDEAS FOR DEVELOPING THE UK/MALAYSIAN MARKET. DR MAHATHIR MIGHT THEREFORE ENCOURAGE MAS TO CONTINUE THEIR DIALOGUE WITH BA ON THIS BROADER BASIS. THE PRIME MINISTER MAY WISH TO AVOID BEING DRAWN FURTHER. MAS HAVE REPEATEDLY FAILED TO PRODUCE FIGURES TO JUSTIFY AN INCREASE IN SERVICES. BA'S IDEA IS THAT THE TALKS COULD BE BROADENED OUT TO COVER ARRANGEMENTS WHICH WOULD BENEFIT BOTH AIRLINES, NOT JUST MAS. BA HAVE NOT TOLD US WHAT IDEAS THEY HAVE IN MIND. BALANCING BENEFITS ARE COMMONLY SOME SORT OF COMPENSATION PAYMENT, EXTRA PASSENGER RIGHTS OR DEVELOPMENT OF TOURISM. BUT THESE ARE FOR THE AIRLINES, NOT GOVERNMENTS, TO DISCUSS.

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MALAYSIA: POLITICAL AND ECONOMIC ROUND-UP
SUMMARY

1. AS A RESULT OF FIRM ACTION BY DR MAHATHIR THE POLITICAL SCENE IS CALM AND PUBLIC CRITICISM HAS BEEN SILENCED. HE IS FULLY IN CONTROL. HIGH COMMODITY PRICES HAVE CONTRIBUTED TO AN ECONOMIC RECOVERY AND A HIGH RATE OF GROWTH. MALAYSIA'S INTERNATIONAL INTERESTS REMAIN LIMITED AND THE MAJOR EVENT ON THE HORIZON IS THE COMMONWEALTH HEADS OF GOVERNMENT MEETING NEXT YEAR.

DETAIL
POLITICAL

2. THE POLITICAL CLIMATE IS CALM, ON THE SURFACE AT LEAST. FIRM ACTION BY THE AUTHORITIES LAST NOVEMBER TO STAMP OUT RACIAL TENSION HAS CONTINUING EFFECT. DR MAHATHIR HAS ALSO DEALT FIRMLY WITH THE OPPOSITION FROM WITHIN HIS OWN PARTY AND IN THE NATIONAL COALITION MOST RECENTLY, THE SUSPENSION OF SIX SUPREME COURT JUDGES HAS PUT A STOP TO WHAT HE SAW AS A THREAT COMING FROM THE JUDICIARY AND THE LEGAL PROFESSION. THE PRIME MINISTER'S HAND IS ON ALL THE IMPORTANT LEVERS, AND NOBODY CAN AT THE MOMENT PREVENT HIM FROM CONSOLIDATING LEGISLATIVE ACTION, AND BUILDING UP THE NEW UMNO.

3. LEADERS OF THE PARLIAMENTARY OPPOSITION REMAIN IN DETENTION AND THEIR FOLLOWERS ARE VERY NERVOUS ABOUT TAKING ANY STEPS WHICH MIGHT CREATE FURTHER TROUBLE. NEW UMNO APPEARS TO BE MAKING PROGRESS IN RECRUITING MEMBERS AND SETTING UP ITS ORGANISATION. THE CHINESE AND INDIAN ALLIES IN THE NATIONAL COALITION HAVE CONCLUDED THAT THEY HAVE NO CHOICE BUT TO FOLLOW THE PRIME MINISTER'S LEAD AND TO SUPPORT HIS APPEALS FOR NATIONAL UNITY. DR MAHATHIR'S OPPONENTS WITHIN THE MALAY POLITICAL COMMUNITY HAVE HAD TO ACCEPT THAT DIRECT CHALLENGE WILL GET THEM NOWHERE AND THEY ARE ALMOST ALL KEEPING THEIR HEADS DOWN, THOUGH THEY CONTINUE TO REJECT HIS AUTHORITY.

4. DR MAHATHIR'S SKILL IN USING THE WEAPONS HIS POSITION GIVES HIM, AND HIS VERY UN-MALAY WAY OF DEALING DIRECTLY AND FORCEFULLY WITH ANY MANIFESTATION OF OPPOSITION, MAKE HIM UNASSAILABLE AT THE MOMENT. HIS CRITICS AND OPPONENTS ARE REDUCED TO GRUMBLING IN PRIVATE, AND TO WISHFUL THINKING ABOUT THE POSSIBILITY THAT HE MIGHT MAKE SOME CONSILIATORY GESTURES. HOWEVER, COMPROMISE IS NOT DR MAHATHIR'S STYLE.

ECONOMIC

5. HE IS HELPED BY THE FACT THAT THE ECONOMIC SITUATION CONTINUES TO IMPROVE, LED BY SUSTAINED IMPROVEMENT IN COMMODITY PRICES. GROWTH OF OVER 7 % FOR THE YEAR IS NOW BEING SPOKEN OF AND THERE ARE MANY INDICATIONS OF RENEWED CONFIDENCE. THE CONSTRUCTION INDUSTRY, FOR EXAMPLE, WHICH HAD BEEN BECALMED FOR THE LAST COUPLE OF YEARS, IS NOW BEGINNING TO TAKE UP AGAIN AND THERE ARE SIGNS OF INCREASED FOREIGN INVESTMENT. DOMESTIC INVESTMENT IS STILL VERY SLUGGISH AND EVEN THOUGH CHINESE BUSINESSMEN ARE FINDING IT EASIER TO MAKE MONEY, A NUMBER OF THEM CONTINUE TO SEE THEIR EVENTUAL FUTURE OUTSIDE MALAYSIA.

INTERNATIONAL

6. IN RECENT MONTHS MALAYSIA HAS NOT PLAYED A PROMINENT PART ON THE INTERNATIONAL STAGE AND THIS SEEMS LIKELY TO CONTINUE, THOUGH SHE IS A CANDIDATE FOR THE SECURITY COUNCIL. SHE FOLLOWS OTHER ASEAN COUNTRIES, ESPECIALLY INDONESIA, OVER INDO-CHINA, WITHOUT TAKING ANY PROMINENT ROLE. WE HAVE HEARD LITTLE RECENTLY ABOUT TRADITIONAL MALAYSIAN HOBBY-HORSES LIKE THE ANTARCTIC, THOUGH CRITICISMS OF THE PROTECTIONIST TENDENCIES OF THE DEVELOPED WORLD STILL SURFACE FAIRLY REGULARLY. THE PRIME MINISTER'S DECISION TO INVITE THE COMMONWEALTH HEADS OF GOVERNMENT MEETING HERE IN 1989 HAS PRODUCED SOMETHING OF AN ABOUT-TURN IN ATTITUDES TO THE COMMONWEALTH. THE SUCCESSFUL ORGANISATION OF THIS EVENT IS BEGINNING TO PRE-OCCUPY THE GOVERNMENT.

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