

Prime Minister

We must make a decision before 18th of the month

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cc BT

## CIVIL AVIATION: MALAYSIA AND SINGAPORE

I thought it might be helpful to you if I let you have a note on our current problems with Malaysia and Singapore on civil aviation in advance of your visit next month. You will, of course, be receiving a brief through the Foreign and Commonwealth Office. You are likely to be under some pressure from Dr Mahathir in Malaysia and to a lesser extent from Lee Kuan Yew in Singapore to make substantial concessions on air services. The circumstances and the political overtones of the two cases are in fact different. While I am doubtful whether either will be ready for resolution during your visit, I believe that you have a tenable position on each.

The Malaysian Government is seeking an additional weekly service to London for MAS, giving them five services in total. BA, the British carrier on the route, operate four services a week. Our air services arrangements with Malaysia provide for fair and equal opportunities as between both carriers to compete for traffic on the route; so long as the two airlines agree on the basis on which a fifth frequency could operate at a future date there should have been no substantial problem in meeting with Malaysians on their request. In fact, BA and MAS have made good progress in identifying a way forward.

But last October, the Malaysians amended their tax law to discriminate in favour of passengers travelling on MAS services and against travellers on foreign carriers including BA and Cathay Pacific. This is a blatant breach of the fair and equal opportunity principle and it is estimated

that it could cost BA about £4m per annum. We cannot conclude an agreement with the Malaysians while this tax discrimination remains. If we can secure unequivocal Malaysian political commitment to a rapid removal of the tax measure, you could in turn offer the prospect that MAS could have their fifth frequency, although the precise details and timing would have to be worked out in negotiation by officials. I am sure that we must press strongly on Dr Mahathir that the solution to their problem rests at least initially in their own hands.

*Why?*

Singapore Airlines are pressing for a new service of three frequencies a week to Manchester in addition to their daily service to Heathrow. A number of our North West MPs have taken this up with me in the context of airports policy and are insisting on it as part of the price for accepting development at Stansted. But the cost to BA would be a loss of profit of over £7m a year.

All this has added a particularly difficult political dimension to the basic air services arguments. You have agreed to see Ian Gow and me about the airport issues next week, and we shall be discussing them at E(A) on 3 April. Whatever concession we need to make to Singapore will have greatest effect if it is made at about the time of our airports policy White Paper in May or June, and I believe that it is very important to carry our North West supporters if we can.

The next step is to have discussions at official level on the detail of the SIA case; the Singapore Civil Aviation Authority has just written in support of SIA and I saw the Singapore High Commissioner yesterday. I have told the High Commissioner that we would be pleased to begin negotiations between officials as soon as these can be arranged. I made it clear that the talks will take time and that we will want

to secure countervailing benefits for British carriers in line with the principle of fair and equal opportunity in our air services arrangements. I have asked BA to urgently consider the areas on which we might negotiate. I have suggested to the High Commissioner that continuing press campaigns would not be helpful. He accepted these points. These negotiations will not be easy but we will certainly enter into them in a spirit of wanting to find solutions.

If Lee Kuan Yew raises the matter with you, it will be helpful if you could stress the need for officials to meet as soon as practicable to examine the technical details and the broader questions of reciprocity of benefits for British carriers.

I am sending a copy of this minute to Geoffrey Howe and to Norman Tebbit.

*R. A. Allen.*  
*(Private Secretary)*

NICHOLAS RIDLEY

22 March 1985

*(approved by the Secretary of State  
and signed in his absence.)*

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PRIME MINISTER'S VISIT TO ASIA, 4-13 APRIL 1985

Briefs of Officials

014: UK/Malaysia and UK/Singapore Air Services

Malaysia

1. British Airways and Malaysian Air System each operate four services a week between the UK and Malaysia under an Air Services Agreement dated 24 May 1973 which is amplified by a Memorandum of Understanding containing more detailed provisions dated 26 March 1982. Under these arrangements both sides are entitled to operate additional services when a joint seat load factor of more than 67% has been achieved over a previous period of six months.
2. The Malaysians claim that they have achieved a 67% seat factor but we dispute that. The underlying statistics are not seriously in dispute. The problem arises because the agreed arrangements provide for the Malaysians to count 'a reasonable amount' of through passengers between London and Australia not breaking their journey in Kuala Lumpur other than to change planes (if that). This imprecise phrase (originally part of an airline agreement) lies at the root of the trouble. The Malaysians argue that 25% is perfectly reasonable; we do not and cannot agree. BA and QANTAS between them already have less than 60% of London/Australia passengers, the remainder being carried on the connecting services of intermediate carriers like MAS. There is no shortage of healthy competition from carriers based in Singapore, the Philippines, Indonesia, Hong Kong, Thailand, not to mention several of our European neighbours. If they were all entitled to increase their capacity to London when a quarter of their passengers were simply travelling between London and Australia, the share of traffic available to BA and QANTAS would shrink still further, and the day when a second British carrier could be licensed to compete on the Australian route (one of BCal's ambitions) would recede still further into the distance.

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3. The Malaysians have a long history of bringing political pressures to bear in support of their air services negotiators. They made a major advance in 1979 when we needed their support within the Commonwealth for our handling of the Rhodesia question. They made a further advance in 1980-82 when they bought new Boeing 747s with Rolls Royce engines which had been ordered by BA, and used this deal to extract a promise of sympathetic consideration for their requests to have additional capacity in order to make economical use of the larger new aircraft. The negotiations took place in March 1982 at a time when we were trying to persuade the Malaysians to abandon their 'buy British last' policy, so again we may have been more generous than was strictly justified on aviation grounds. At all events the Malaysians went away satisfied at the time, though now they are claiming that even then we did not honour our undertaking to give their request for additional capacity 'sympathetic consideration'.

4. Since the dispute commenced, British firms seeking major contracts in Malaysia, particularly in the transport sector, have reported that they will not get any business until the dispute is resolved in favour of MAS. British Steel certainly lost an £8m contract for steel rails to Poland despite the fact that they were the lowest bidder. Dr Mahathir has publicly denied any such policy, but reports continue to reach us that it is being applied.

5. Another factor in all this is Malaysia's deep seated jealousy of Singapore. SIA operate daily flights to London, and also make no secret of the fact that they carry passengers between London and Australia. But London/Singapore traffic is also more than double the traffic between London and Malaysia.

6. [redacted] we have encouraged BA to enter into discussions with MAS about a fifth frequency on terms consistent with the Air Services Agreement. Abandoning the old approach based on achieved traffic patterns, the airlines have made quite good progress towards agreeing how the market might expand in future, based on cooperation to stimulate both business travel and  
/tourism

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tourism in both directions. These forecasts might justify a fifth service for MAS in about 1987, but their whole basis has been undermined by the adoption of discriminatory tax arrangements in Malaysia.

7. The Malaysian Government announced last October that in future the tax concession available to Malaysian residents on annual leave journeys would be available only to passengers travelling on MAS. This is a flagrant breach of the commitment to fair and equal opportunity which is fundamental to all Air Services Agreements, and it is already costing BA £4m per annum in lost revenue. Cathay Pacific are even harder hit on Kuala Lumpur-Hong Kong services where they are losing up to £8m per annum. Both airlines reckon that the tax concession affects about 30% of their available market.

8. Reasoned protests have been made through the Board of Airline Representatives in Kuala Lumpur, and discussion between BA and MAS continued without interruption on the assumption that the tax measure would be withdrawn; but on the contrary the Malaysian Finance Minister confirmed his intention to maintain it on 18 February.

9. As a result BA have understandably not been disposed to move from their discussion of forecasts to any question of when additional frequencies might be justified. Nor could such discussions now be held at official level. The Malaysian action has both breached the agreement and distorted the market on which forecasts were being based. Until fair competition is restored there is no basis for further discussions about additional frequencies.

10. Indeed if the Malaysians do not themselves take action to deal with the taxation issue we will have to call for consultations with them to discuss the effect on the market, and to decide what action to take in defence of our rights under the agreement.

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11. British Airways and Singapore Airlines each operate seven services a week between the UK and Singapore under an Air Services Agreement dated 12 January 1971. Both airlines are entitled to mount whatever services they consider appropriate, but there has been an informal understanding that neither side will operate more than a daily service without prior approval.

12. SIA are currently interested in operating three services a week via intermediate points in the Gulf and Europe to Manchester, in addition to their daily services to London. They first expressed interest in serving Manchester in 1983 when we agreed that 'as and when SIA wants to operate to Manchester the application will be approved provided that any SIA service to Manchester is in substitution for an SIA service to London. The same constraint was applied to any services which BA might wish to operate from Manchester to Singapore. Consequently when SIA applied for these services in September last they were turned down. It is only this month (letter dated 13 March 1985) that SIA's application, widely canvassed in the Press, has actually been formally supported by the Singapore authorities. There will have to be consultations about it.

13. In strict air services terms Singapore have no case for additional services. They first operated a daily B747 service between London and Singapore in 1976, though at that time their services called at three or even four intermediate stops. Since then with increasing traffic and improved technology they have progressively reduced the number of intermediate stops, so that this summer for the first time they will be operating daily direct non-stop services south-bound from London to Singapore. In the opposite direction one stop is still necessary (in the Gulf) on essentially technical grounds. Moreover the new 'Big Top' jumbos have about 10% more seats than the earlier aircraft. In consequence SIA's available capacity for services between London and Singapore will have increased by more than the 67% traffic growth which they say has taken place since 1976.

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14. We do not begrudge either SIA or the passenger the improvements in service which have resulted, but it is much more doubtful whether SIA really have a case for additional services.

15. An important consideration however is the lobby of North West MPs who have opposed the development of London's airports on the grounds that growth should be funnelled to the regional airports, particularly Manchester. There is no way that Manchester could handle a sufficient proportion of London's traffic to seriously affect the need for development in the London area, but it may well prove necessary to make some concessions to the Manchester lobby in order to gain their support. Despite the likely cost to BA, SIA's services to Manchester may have to be part of that package, but it is a concession which, if it has to be made, should be made as near as possible to the time of publication of the White Paper on Airports Policy in order to have the maximum political effect on the Manchester lobby. We therefore need to play our consultations with Singapore long enough to delay any decision until close to the date of publication of the proposed White Paper.

FOREIGN AND COMMONWEALTH OFFICE  
MARCH 1985

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10 DOWNING STREET

*From the Private Secretary*

25 March 1985

Civil Aviation: Malaysia and Singapore

The Prime Minister was grateful for your Secretary of State's minute of 22 March about current problems with Malaysia and Singapore on civil aviation.

The Prime Minister has commented that we must make a drive to settle these problems before she goes to Malaysia and Singapore (which is on 4 April). The Prime Minister would like to discuss this with your Secretary of State as soon as possible and a meeting has been arranged for 1800 hours tomorrow.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office) and to Callum McCarthy (Department of Trade and Industry).

(C.D. Powell)

Richard Allen, Esq.,  
Department of Transport

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