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PM/85/22PRIME MINISTERAir Services to South-East Asia

1. I shall not be able to come to your meeting tomorrow on the above subject as I am accompanying The Queen on Her State Visit to Portugal. I have asked Tim Renton to come in my place; you might find it useful to have my comments in advance on Nicholas Ridley's minute of 22 March, particularly on Malaysia.

2. As Nicholas says, we have been trying hard to persuade British Airways to reach an amicable solution with MAS. During direct negotiations between the airlines considerable progress was made, and it looked as if agreement might be reached for MAS to have their fifth service, but starting in 1987. But the Malaysian Finance Ministry's decision on the discriminatory tax point referred to by Nicholas Ridley (about which the governments of the other major airlines serving Malaysia feel equally strongly) makes it impossible for BA to reach a commercial agreement. The British High Commissioner in Kuala Lumpur has accordingly been instructed to raise the matter with the Malaysian Government and to try to persuade them to end this discrimination so that the whole dispute can be settled before your visit. Mr Gillmore may be able to make the point directly to Dr Mahathir himself if the latter agrees to see him: he has asked to see the Minister of Finance as well. We should press ahead vigorously with efforts to settle all this before your visit. But at the same time, we need to plan on the assumption that the problem is not settled before you go.



3. We have accordingly considered whether the High Commissioner should in advance of your visit formally offer a fifth service to begin two years after the removal of the tax measure. Such an offer would have the advantage of presenting our position in a constructive light without yielding the point of principle on the discriminatory Malaysian tax measure. We should not take a final decision on this until we learn the outcome of Mr Gillmore's initial approach. But my view at this stage is that it would be tactically better to keep this offer in reserve for you yourself to make, if necessary, to Dr Mahathir - who wishes, we suspect, to reserve the final steps in a settlement to his personal meeting with you. If this is right, you will need to have a card in your hand.

4. If the issue cannot be settled before you go, we must expect ^{him} to raise it with you in strong terms. But I do not believe that he would wish to see the overall success of the visit jeopardised. We ourselves have on repeated occasions stressed our view to the Malaysians that this issue should not be allowed to spill over and affect our relations generally. The Malaysian Foreign Minister assured me during a conversation with him in Dublin last November that this was no part of Malaysian intentions.

5. If it becomes clear that the issue cannot be resolved during your meeting with Mahatir and that there is a clear risk of this souring the atmosphere for the whole visit, you will need to have a means of defusing the situation. I suggest that in that case, you propose an immediate meeting of senior officials with instructions to take the matter up urgently and resolve it. If the blockage concerns the tax issue, then you might propose that a senior Malaysian Ministry of Finance official join the talks.

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6. I am copying this minute to Norman Tebbit and to Nicholas Ridley.

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

GEOFFREY HOWE

Foreign and Commonwealth Office
25 March, 1985

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