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Foreign and Commonwealth Office

London SW1A 2AH

29 March 1985

Prime Minister
Agree here
beginns?
CDP
30/3

Dear Charles,

Malaysia: Prime Minister's Visit: Air Services Dispute

You will have seen FCO telno 165 to Kuala Lumpur, which we sent in response to your letter of 26 March.

We have now received Mr Gillmore's account of his meeting with the Malaysian Finance Minister (Kuala Lumpur telno 195). Daim took the line that the Malaysians were prepared to lift the tax measure we object to, but he did not see how he could do so before the next Budget in October. This, as Mr Gillmore says, is not a sufficient basis on which to strike a deal over the Malaysian request for a fifth service. Mr Gillmore asks for instructions before he sees Mahathir on Tuesday.

I enclose a self-explanatory draft telegram, cleared with officials in DTp, which suggests a way in which we might still be able to reach a mutually satisfactory basis for a settlement of this difficult item before the Prime Minister's visit. I should be grateful for your comments in time for us to send instructions to Mr Gillmore not later than Monday afternoon.

We have also received Mr Gillmore's comments on the handling of the linkage between the air services dispute and commercial contracts (para 2(c) of FCO telno 165). I enclose a further self-explanatory telegram cleared with DTI and MOD officials dealing with this point, and would be grateful for comments on that also by Monday afternoon.

I am copying this to Richard Allen (Dept of Transport), Callum McCarthy (DTI) and Richard Mottram (MOD).

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
10 Downing Street

** His Tel No 196*

*PS Copies of KL
Tels 195 & 196 enclosed.*

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OUT TELEGRAM

	Classification and Caveats CONFIDENTIAL	Precedence/Deskby IMMEDIATE
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ZCZC	1	ZCZC
GRS	2	GRS
CLASS	3	CONFIDENTIAL
CAVEATS	4	
DESKBY	5	
FM FCO	6	FM FCO
PRE/ADD	7	TO IMMEDIATE KUALA LUMPUR
TEL NO	8	TELEGRAM NUMBER
	9	YOUR TELNO 195: AIR SERVICES DISPUTE
	10	1. The degree of commitment we are prepared to offer on a fifth
	11	service will of course depend on the degree of commitment the
	12	Malaysian Government can offer on the tax measure. But there may
	13	be an intermediate position between the sort of deal outlined
	14	in para 2(a) and (b) of my telno 165, and the position outlined
	15	in para 6 of TUR. This is that the Malaysians publicly suspend
	16	the implementation of the tax measure in the immediate future
	17	(this might be by way of a moratorium pending further study of
	18	the effect of the measure), and give a private undertaking to
	19	the Prime Minister to revoke it in the next budget. We could
	20	then agree to allow MAS a fifth service from a date which would
	21	in effect be two years after the suspension of the tax measure,
///	22	subject to a form of words which would give us a let out if
//	23	suspension proved not to be permanent or to have the desired
/	24	effect in restoring BA to a position of fair and equal
	25	competition. It might be possible to take much of the sting out,

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File number	Dept	Distribution
Drafted by (Block capitals)		
Telephone number		
Authorised for despatch		
Comcen reference	Time of despatch	

OUT TELEGRAM (CONT)

	Classification and Caveats CONFIDENTIAL		Page 2
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 or not to restore fair and equal competition. It might be possible to take much of the sting out of this latter point, so far as the Malaysians were concerned, by referring publicly only to the need for the details on timing etc to be worked out in discussions by officials under the terms of the ASA.
 2. When you see Mahathir on 2 April, and assuming that he does not, as a result of Daim's talk with him (para 5 of TUR), open with some conciliatory gesture on this subject, you should begin by taking the line in para 2(a) and (b) of my telno 165. If Mahathir shows himself ready to concede the tax issue, but voices the same inhibitions about action before October, you should initially counter with the argument you used with Daim (para 4 of TUR). But you have discretion to make the suggestion in para 1 above, provided Mahathir is genuinely interested in seeking a solution and seems willing immediately to suspend operation of the tax measure.

HOWE
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OUT TELEGRAM

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GRS	2	GRS	
CLASS	3	CONFIDENTIAL	
CAVEATS	4		
DESKBY	5		
FM FCO	6	FM FCO	
PRE/ADD	7	TO IMMEDIATE KUALA LUMPUR	
TEL NO	8	TELEGRAM NUMBER	
	9	YOUR TELNO 196: PM'S VISIT, AIR SERVICES AND COMMERCIAL	
	10	CONTRACTS	
	11	1. We accept the force of the arguments in para 1 of TUR.	
	12	2. The best course might be, when you deploy with Dr Mahathir	
	13	the point in para 2(c) of our telno 165, not to mention any	
	14	specific project at the outset. If Mahathir responds by asking	
	15	whether we have any particular contract in mind, you could	
	16	respond by running through the list in para 2 of your TUR though	
	17	in terms of priority we would put your (b) at the end of the list.	
	18	DTI (next word underlined pace the argument in para 4 of TUR)	
	19	would like mention also made of the Biwater Rural Project, which	
	20	in fact is the first project which the Prime Minister is being	
	21	advised in her briefs to raise.	
///	22	3. It would presumably still be useful to mention Taylor	
//	23	Woodrow, if only as a prospect to be pursued in the longer term.	
/	24	HOWE	
	25	NNNN	
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TO IMMEDIATE FCO

TELEGRAM NUMBER 195 OF 28 MARCH

YOUR TELNO 165: AIR SERVICES DISPUTE

1. I SAW THE FINANCE MINISTER THIS EVENING AND SPOKE TO HIM AS INSTRUCTED IN PARA 3 OF YOUR TUR. I WAS PARTICULARLY GRATEFUL FOR THE DISCRETION TO INFORM DAIM OF THE PRIME MINISTER'S CONCERN AND TELL HIM THAT I WOULD BE SEEING DR MAHATHIR ON TUESDAY AND EXPECTED TO SPEAK ON THE DIRECT INSTRUCTIONS OF THE PRIME MINISTER.

2. DAIM SAID:

(A) THAT MANY FOREIGN GOVERNMENTS HAD REMONSTRATED OVER THE TAX ISSUE BUT THAT HE HAD NOT BEEN ABLE TO GET FROM ANY A CLEAR STATEMENT OF THE LIKELY IMPLICATIONS OF THE TAX MEASURE FOR FOREIGN AIRLINES' EARNINGS. THE FIGURES THAT I HAD BEEN ABLE TO GIVE HIM WERE, HE PRESUMED, ESTIMATES BUT THEY WERE HELPFUL SEMI COLON

(B) THAT THE SPECIFIC LEGISLATION DID NOT INSIST THAT FOR TAX EXEMPTION PURPOSES ALL PASSENGERS SHOULD FLY ON MAS, MERELY THAT THEIR TICKETS SHOULD BE BOOKED THROUGH MAS.

3. ON (A) I SAID THAT THE FIGURES I HAD GIVEN HIM (YOUR TELNO 125 PARAGRAPH 2) WERE OF COURSE ESTIMATES. BUT BRITISH AIRWAYS' TRAFFIC FIGURES FOR NOVEMBER, DECEMBER AND JANUARY WERE NOT AND THEY SHOWED A DRAMATIC DROP IN TRAFFIC. ON (B) I SAID THAT WHATEVER THE SPECIFIC LANGUAGE OF THE LEGISLATION THE EFFECT WAS NONETHELESS CLEAR IF PASSENGERS HAD TO BUY THEIR TICKETS THROUGH MAS THE VAST MAJORITY WOULD BE BOOKED ON MAS FLIGHTS AND FOR THE OTHERS, MAS WOULD REAP THE BENEFIT IN CASH FLOW AND COMMISSION. FURTHERMORE, SINCE THE MEASURE CONCERNED INCOME TAX FOR INDIVIDUALS I KNEW FOR A FACT THAT PEOPLE ENJOYING THE BENEFITS OF ANNUAL JOURNEYS PAID FOR BY THEIR COMPANIES WERE PLAYING SAFE AND BOOKING ON MAS TO ENSURE THAT THEY GOT THE TAX BREAK.

4. DAIM THEN SAID THAT HE REALISED THIS HAD CAUSED A "DREADFUL PROBLEM". HE WANTED TO TELL ME WHAT HE HAD NOT TOLD OTHER MISSIONS HERE: THAT HE WOULD WITHDRAW THE MEASURE AND COULD GIVE ME A SPECIFIC ASSURANCE OF THIS. BUT HE WAS IN A POLITICAL FIX AND COULD SEE NO WAY THAT HE COULD DO THIS BEFORE THE NEXT BUDGET IN OCTOBER. I SAID THAT THIS WAS A LONG WAY OFF AND AIRLINES WOULD CONTINUE TO BE PENALISED FOR MANY MONTHS TO COME. I URGED HIM STRONGLY TO SEEK WAYS OF RESCINDING THE LEGISLATION EARLIER. REFERRING TO MY EARLIER QUESTION (VIZ THE INTERROGATIVE LANGUAGE IN PARAGRAPH 2 OF YOUR TELNO 125) I SAID THAT I COULD NOT SEE HOW THIS COULD OPEN THE WAY TO A SOLUTION OF THE OTHER ISSUE IN THE NEAR FUTURE.

5. DAIM SAID THAT HE WOULD BE TALKING TO THE PRIME MINISTER WITHIN THE NEXT 24 HOURS AND WOULD RAISE THE MATTER WITH HIM. BUT HE STILL DID NOT HOLD OUT HOPE OF BEING ABLE TO WITHDRAW THE TAX MEASURE EARLIER THAN AT THE NEXT BUDGET.

6. IN THE LIGHT OF THE FOREGOING YOU WILL WISH TO CONSIDER WHETHER TO GIVE ME FURTHER INSTRUCTIONS FOR MY MEETING WITH THE PRIME MINISTER. IF THE MALAYSIANS ARE ADAMANT THAT NOTHING CAN BE DONE

CONFIDENTIAL

178

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TO REMOVE THE TAX PROVISION UNTIL OCTOBER, I CANNOT SEE HOW WE FOR OUR PART CAN ANNOUNCE PUBLICLY THAT A RESOLUTION HAS BEEN FOUND TO THE 5TH FREQUENCY ISSUE. IF THE LATTER HAPPENED BEFORE THE FORMER, IT WOULD LOOK AS IF WE HAD GIVEN WAY ON ALL FRONTS. THUS, IF YOU DECIDE THAT WE HAVE NO OPTION BUT TO ACCEPT THE PRIVATE ASSURANCE OF A CHANGE ON THE TAX MEASURE IN OCTOBER IN EXCHANGE FOR AN ASSURANCE ABOUT THE 5TH FREQUENCY IN, SAY, OCTOBER 1987, THAT AGREEMENT WOULD HAVE TO REMAIN CONFIDENTIAL UNTIL THE MALAYSIANS WERE PREPARED TO MAKE A PUBLIC ANNOUNCEMENT ABOUT THE REMOVAL OF THE TAX MEASURE. THIS WOULD NOT SATISFY THE AIM OF BEING SEEN TO RESOLVE THE ISSUES DURING THE PRIME MINISTER'S VISIT.
7. PLEASE SEE MIFT FOR COMMENTS ON PARAGRAPH 2(C) OF YOUR TUR.

GILLMORE

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ME WILSON

COPIES TO:-
MR LIMDLEY DTP/IAA
MR LORD DTP/IAA
MR DUNNING DTI

29 MAR 1985