



Foreign and Commonwealth Office

London SW1A 2AH

3 April 1985

*Dear Charles,*Civil Aviation: Malaysia

Kuala Lumpur telno 214, reporting Mr Gillmore's meeting with Dr Mahathir, shows that the Malaysians have no inclination to seek in advance of the Prime Minister's visit a compromise solution to the Air Services dispute along the lines agreed with the Prime Minister last week.

Air Services will therefore inevitably be a major item in Dr Mahathir's agenda for talks with the Prime Minister. There are a number of possible outcomes which can be listed in descending order of desirability:

- (a) Dr Mahathir agrees to drop the tax measure; we agree to a fifth service to begin in 1987; public announcement that agreement has been reached, details to be worked out by officials, including possibility of a 1986 start;
- (b) Dr Mahathir agrees privately that the tax measure will be reconsidered in due course; we confirm willingness to introduce a fifth frequency in 1987 once measure has been removed; public announcement that matter has been discussed constructively and officials will follow up;
- (c) Dr Mahathir refused to offer any commitment over tax measure; we say we shall have to consider further steps (unspecified); public announcement that there has been no agreement but discussions will continue;
- (d) Dr Mahathir obdurate and demands our agreement to fifth frequency; we riposte by threatening to call for consultations, perhaps in company with other airlines concerned, and mention possibility of terminating Air Services Agreement; public announcement that no agreement has been reached.

There is still a possibility, as Mr Gillmore says, that (a) may be achievable. Dr Mahathir may have it in mind to keep any concession up his sleeve until the last minute during his actual discussion with the Prime Minister. This would be consistent both with his character and perhaps a wish to take personal credit for a diplomatic success. We should certainly continue to work for such an outcome.

/Nevertheless



Nevertheless, we may have to accept that, realistically, the best we are likely to achieve is (b). Such an outcome would be reasonably consistent with the hints we have received of what the Malaysians could accept provided they did not have to announce publicly that they had made any concessions. If this line were agreed, the next step would be for us to reopen Air Service talks between the two Governments to see what further progress could be made; but it would have to be on a strict understanding that the starting of a fifth frequency would be dependent on the prior removal of the tax measure and that agreement on the one would be conditioned upon a firm commitment about the other. Dr Mahathir's clear agreement on this point would be essential.

If we were unable to achieve either of the first two outcomes above, that at (c) would probably represent the only other outcome which would allow the remainder of the visit to continue relatively unaffected and which would avoid damaging repercussions to our bilateral relationship. The object would be essentially to achieve a breathing space with the possibility, which could be mentioned, that the Prime Minister would be prepared to continue discussing the subject with Dr Mahathir during his private visit here later in the month (18-20 April). This offer might be sufficient to convince Dr Mahathir that, while firm on the details, we were still prepared to try and find an amicable solution; but we would not, I think, be able to hold out the possibility of reopening talks at official level until more common ground between our two positions had been found.

Outcome (d) would clearly imply an open confrontation and almost certainly the souring of the atmosphere for all further talks during the visit. We should also have to accept that the consequences could well involve damage to our commercial interests over a wide range and possibly the reimposition by Dr Mahathir in some form of his "Buy British Last" policy. There would certainly be a strong chance of such a reaction to any threat on our part to terminate the Air Services Agreement; calling for consultations under the Agreement in order to study the effects of the Malaysian tax measure might be less provocative in his view. The repercussions would still be likely to be severe so far as our relations with Malaysia were concerned and there would also be inevitable and adverse effects on the visit.

I am sending copies of this to Richard Allen (Department of Transport) and Richard Hatfield (Cabinet Office).

Yes we
 (P F Ricketts)
Private Secretary

Peter Ricketts

C D Powell Esq
 10 Downing Street

①



10 DOWNING STREET

Prime Minister

Malaysian Air Services

The only point for you to decide is:

Is a decision by the Malaysians to suspend implementation of the tax measure and a promise to revoke it in their next budget enough to let us offer the fifth frequency in two years time?

Officials from all 1/2 us sub departments think it is. Agree? C.D.P.