

CEBI cc PC ①

I think it would be advisable to hold a short meeting.



Prime Minister

Prime Minister

Are you content with Mr. Ridley's preferred course? Or prefer to hold a meeting? One possibility might be a

UK-MALAYSIAN AIR SERVICES

You asked for a report on why the dispute between British Airways and Malaysian Air Services (MAS) over a fifth weekly frequency for MAS between Kuala Lumpur and London has still not been resolved.

message to Dr. Mahathir. CDP 2/6

You agreed in principle with Dr Mahathir in Kuala Lumpur on 5 April that MAS should be allowed to operate a fifth frequency to London and that a similar right would be granted to BA if requested. The joint press release said:

"Details of the fifth frequency will be discussed between the two sides. It is expected that it will be between one and two years before the additional service is operational."

As a first step in settling the detail, BA met MAS in Kuala Lumpur on 20-21 May. MAS said that it wanted to operate its fifth frequency from June 1986 and to agree with BA arrangements for introducing further frequencies at a future date (quite beyond your agreement with Dr Mahathir). BA tabled a package fully consistent with the terms of your agreement with Dr Mahathir under which:

- (i) MAS would start its fifth frequency in November 1986;
- (ii) All capacity limitations on MAS services would be removed;
- (iii) BA would enjoy additional rights to carry traffic from Kuala Lumpur to other points on route;

June 86
No capacity
restrictions.

No revenue
share.

Rehir for BA

No 6th or 7th frequency



- (iv) There would be a commercial agreement between the two airlines under which MAS would pay BA a royalty of 5% of the difference between the earnings of the two airlines on London-Kuala Lumpur traffic in recognition of the fact that it would be uneconomic for BA to mount a fifth frequency for the time being.

BA estimate that this deal could be worth over £10m a year to MAS and that it would cost them about £2m a year. This is an extremely generous offer for MAS and one which should have formed the basis of early agreement. But MAS would not accept what BA had offered or discuss it further with BA. The Malaysian Government has asked for urgent official consultations. We have agreed to talks in Kuala Lumpur towards the end of July, the earliest date that the Malaysians could manage; we offered dates in London in early July. Indications from the Malaysians are that they interpret your agreement in principle with Dr Mahathir as meaning that MAS can start its fifth frequency when they wish and give nothing in return. They are likely to insist that all capacity limits should be removed; that any extra rights for BA should be separately negotiated in return for other concessions; that there should be no commercial agreement with BA; and that arrangements should be agreed for sixth and seventh frequencies.

I find this quite intolerable particularly as we have seen no movement from the Malaysians on the related issue of the discriminatory tax which is still biting very heavily on the revenues of many foreign carriers in Malaysia and in particular on BA and Cathay Pacific. The April joint press release stated:

"It was noted that the Board of Airline Representatives had made representations to the Government of Malaysia about concessions for a tax relief on air travel by Malaysian Airline System and that this matter, which calls for a formal reply, is being considered by the Malaysian Government."



There has been no substantive reply. As you instructed, we have been encouraging further multilateral representations at the airline level backed up by joint diplomatic representations. The Board of Airline Representatives has not been able to progress the matter any further although it is maintaining pressure on the Malaysian Government. Diplomatic representations have proved difficult to organise effectively because of the number of countries involved and the fact that each country's position is slightly different depending on the terms of its bilateral arrangements with Malaysia. But we now have a text which we hope will attract sufficient support to demonstrate to the Malaysians that their action is widely resented among the governments on which MAS depends for its landing rights.

The difficulty we now face is that the Malaysians are once again starting to use their familiar tactics of linking their demands on air service matters with the prospects of British companies obtaining major export contracts in Malaysia. I believe that no major contracts have been awarded to UK firms since your visit. There is some concern among businessmen that they may be shut out. Paul Channon will be in Malaysia on 3 July, and may well be pressed by the Malaysians on our position.

I think that we have two options. The first is to concede to all Malaysian demands on air services. This may remove one of the alleged impediments to our exporters for the time being; whether it will produce orders is another matter and I am quite sure that the Malaysians will be back again soon for further frequencies at which time they will employ exactly the same tactics. The second option is to take a tougher line with the Malaysians on air services and make it clear that we are prepared to negotiate an arrangement on the fifth frequency but only within the terms of your agreement with Dr Mahathir. We would expect the negotiations to have some regard for BA's interests. At the



same time, we could perhaps also convey the message to the Malaysians that we are looking for some positive sign of goodwill on their part, particularly as regards removal of the discriminatory tax and the placing of export contracts.

I strongly prefer the latter course. Seen from here, it looks as if we are giving valuable concessions to the Malaysians without any concessions on their side. But as the issues are important and concern your discussions with Dr Mahathir, you may feel differently, or prefer to hold a meeting about our tactics.

Copies of this minute go to Geoffrey Howe, Nigel Lawson, Norman Tebbit, and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'N.R.' with a flourish.

NICHOLAS RIDLEY

20 June 1985

Malaysia: Relations ¹⁹⁷⁹





DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

C D Powell Esq
Private Secretary
10 Downing Street
LONDON SW1

20 June 1985

~~DITF~~. Agree to use
this?
2) if so. ER please
reply.

CDP
25/6.

Dear Charles,

UK-MALAYSIA AIR SERVICES

My Secretary of State wrote to the Prime Minister earlier today about our problems with the Malaysians on the terms on which MAS would operate a fifth weekly frequency from Kuala Lumpur to London.

At the same time, I have received your letter of 7 June enclosing one which the Prime Minister had received from Sir Arnold Hall of Hawker Siddeley, and a letter of 6 June from Tim Flesher enclosing one from Teddy Taylor MP, both about our air services problem with Malaysia. Depending on the view that the Prime Minister takes on the minute from my Secretary of State, we suggest that she might reply to Sir Arnold Hall and Teddy Taylor along the lines of the attached drafts.

I am sending copies of this letter and of the draft replies to Peter Ricketts in the Foreign and Commonwealth Office and to John Mogg in the Department of Trade and Industry.

Yours,
Richard.

R A ALLAN
Private Secretary

DRAFT LETTER

Sir Arnold Hall FRS F.Eng
Chairman
Hawker Siddeley Group Plc
18 St James's Square
LONDON
SW1Y 2LJ

Thank you for your letter of 6 June expressing anxiety about developments since Dr Mahathir and I agreed in principle that MAS should be allowed to operate a fifth frequency to London.

As you will remember, the joint press release issued at the time of my meeting with Dr Mahathir pointed out that details of the fifth frequency would be discussed between the two sides and it was expected that it would be between one and two years before the additional service was operational.

As a first step in the detailed discussions, BA met MAS as you know in Kuala Lumpur last month. BA put some detailed proposals to MAS within the framework of my agreement with Dr Mahathir. I hope that these will provide a basis for an agreement during the discussions between governments which I understand the Malaysians are proposing and which I hope will take place in July.

EM.

03

RESTRICTED



10 DOWNING STREET

From the Private Secretary

14 June 1985

BT

The Prime Minister has noted that the dispute between British Airways and Malaysian Air Systems over a fifth frequency has still not been resolved, despite the agreement in principle reached between Dr. Mahathir and her in April. She would like a very early report on why this is so.

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

Charles Powell

Richard Allan, Esq.,
Department of Transport.

RESTRICTED

BT



From the Minister for Trade

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

CP/C

*Prime Minister
CDD
13/6*

Rt Hon Nicholas Ridley MP
Secretary of State for
Transport
Department of Transport
2 Marsham Street
LONDON
SW1P 3EB

13 June 1985

Dear Mickey,

*Please let me know
why this has not
been solved
yet*

As you know, during the Prime Minister's visit to Malaysia in April, her discussions with Dr Mahathir seemed to have cleared the way for a settlement of the air services dispute which was threatening our wider trading interests there. It is somewhat disappointing to learn that the recent talks between British Airways and Malaysian Air Systems have not resolved the problem. Several businessmen, including representatives of British Aerospace, Biwater Shellabear, BREL and Hawker Siddeley, have reported veiled threats against British suppliers until the dispute has been satisfactorily resolved.

Given the Prime Minister's lead I very much hope that the matter will soon be amicably settled and that we shall thus avoid a repetition of the difficult trading relations which preceded the Prime Minister's visit.

I will be visiting Malaysia in the early part of July for trade discussions and to promote British firms' interests, in particular project business. If agreement has not been reached by then I would be happy to help in any way possible.

I am copying this letter to members of EX.

[Handwritten signature]
PAUL CHANNON *[Handwritten signature]*

manuscript

PA/BF Hwy

Sir A. HALL

14/6

SRW

14/6

18/6

7 June 1985

I enclose a copy of a letter to the Prime Minister from Sir Arnold Hall of Hawker Siddeley about continuing problems over the fifth frequency into London for Malaysian Airlines.

I should be grateful for a draft reply. I am copying this letter to John Mogg in the Department of Trade and Industry and Peter Ricketts in the Foreign and Commonwealth Office.

(C. D. POWELL)

Henry Derwent, Esq.

Department of Transport

dg

CF?

Sir Arnold Hall F.R.S., F.Eng.

Chairman

Hawker Siddeley Group PLC

18 St. James's Square,

London, SW1Y 4LJ

Tel: 01-930 6177

6th June, 1985.

The Rt. Hon. Margaret Thatcher, F.R.S.,
Prime Minister,
10, Downing Street,
London, S.W.1.

ack 7/6

Dear Prime Minister.

Though I am concerned about troubling you again on the Malaysian issue, (which was referred to in your letter to me dated the 7th May), I think perhaps I should do so, in view of events since your visit to Kuala Lumpur, and because it seems that a decision on the locomotive contract is imminent, but our position is again threatened by difficulties on the issue of the 5th frequency into London for Malaysian Airlines.

But first, may I thank you for what it has now been possible to arrange on our behalf for this contract. We have, I believe, the best commercial bid in the competition, and this is backed by a highly competitive Government finance offer.

The issue of the 5th frequency into London for Malaysian Airlines clouds the scene, despite what you arranged during your visit. I am enclosing copies of two statements on this issue, one being a joint statement between British Airways and Malaysian Airlines, and the other a statement by British Airways. If you will ask one of your staff to look them over, I think he will find that the situation that has developed can be summarised as follows.

In your meeting with the Malaysian Prime Minister, you arranged that Malaysian Airlines should, in due time, have an additional London flight. However, the view apparently being taken on this is, "Yes, - an additional flight - but no more seats to be sold, in a week, than are sold with the existing number of flights.". The relevant parts of the statement are sidelined in the copies.

This produces a situation in which Malaysian Airlines buy another aeroplane, operate another service with it, but have the same earning capacity as before, so that they are using 20% more capital - to say nothing of the additional

overhead - to stay where they are. I cannot believe this was the intention of the arrangement you made with the Malaysian Prime Minister, or that it is likely to have been his understanding of it.

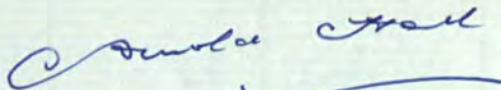
It is the case that the statement goes on to say that the seat limitation might be removed under a package proposal, which includes a number of other issues, suggested by British Airways. However, no arrangements seem to have been made to progress this.

The Malaysians, for their part, seem to have complicated the issue further by bringing in a new proposal - perhaps as a counter - to the effect that they should be allowed an immediate increase in the seats they can sell on their existing services. I doubt if this can have been the intention. The sensible thing would be that they are allowed more seats to offer when the additional landing frequency is started, so that their new capital equipment can be revenue earning.

To me it does not make business sense to seek to separate the issue of an additional frequency, and the issue of how many seats can be offered for sale. I do not think it unreasonable that the Malaysians should see it this way, and can understand why at least some of them regard the position taken as being directed to frustrating the agreement you made with their Prime Minister. As for their side raising new issues on the existing services, that does not help either.

I cannot see any reason why it should not be possible to bring these discussions to a quick and clear conclusion, a course very desirable to those of us who have in play important commercial business issues, the resolution of which have been so long threatened politically by this otherwise unrelated situation. Might it be possible to suggest to both sides that they sit down together, and do not get up until the matter is settled in conformity with what must have been the underlying intention of your arrangement with Dr. Mahathir?

Yours sincerely,



A.A. HALL.

Encs.