Subsidies and Unfair Competition in Global Commercial Aviation: How to Respond

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Executive Summary

Commercial air passenger service is a mixed industry with privately owned companies competing against state-owned enterprises (SOEs) and partially state-owned firms throughout much of the world. Because World Trade Organization (WTO) rules and those of other trade agreements do not at this time cover international air passenger service, a system of bilateral “Open Skies” agreements has developed in order to open markets to international competition, reduce government interference in international aviation, and facilitate efficient resolution of disputes over rates, landing rights, and standard fair practices for commercial aviation. In recent years, however, heavily subsidized SOEs in the Persian Gulf states Qatar and the United Arab Emirates (UAE) have posed a major challenge to the maintenance of a stable Open Skies regime. Using tens of billions of dollars in government-provided capital not available to their overseas competitors, these SOEs have taken significant market share from established airlines in, for example, the United States, Europe, Australia, and India. Subsidized SOE air carriers in China—which has no Open Skies agreements with the world’s major industrialized nations except Australia—are beginning to raise many of the same concerns.

In 2018 the United States and the two Gulf sheikdoms concluded separate bilateral agreements intended to begin addressing this problem. Both accords mandated greater transparency in accounting by Qatari and UAE-owned air carriers so that unfair, market-distorting government subsidies would be more visible, and each agreement also included concessions from the sheikdoms about a related irritant: the proliferation of third-country stopover destinations on otherwise direct Gulf carrier routes to and from the United States. As major US carriers battle to reverse losses of market share due to increased international competition, the continued expansion of Middle Eastern airlines in transatlantic routes is a growing problem.
These accords are too new for any confident prediction to be made about how effective they will ultimately be in restoring open and fair competition to international commercial aviation. The United States—and its allies in Europe and Asia, many of whose established airlines have also been hurt by subsidized SOE competition from the Persian Gulf—should remain highly vigilant until relevant data can be collected and analyzed. In 2018 Qatar Airways purchased a large stake in the small Italian carrier Meridiana, restocked its aging fleet, rebranded the company Air Italy, and began opening new international routes between Italy and the United States—which suggests an intention to evade the spirit of the U.S.-Qatari agreement. Developments in 2019 only reinforced the suspicion that Qatar is using large subsidies to Air Italy to evade the commitments in the 2018 MOU. In the future, if the results prove disappointing, expanded use of the WTO or other trade agreements may be worth considering as a further tool to help address the problem of SOEs in general, not just those affecting the airline industry. A new 2019 EU rule points the way for possible international cooperation using precedents for prohibiting subsidization by SOEs. In the meantime, however, the United States and its allies should vigorously pursue the guarantees of financial transparency and equal opportunity to compete accorded to their domestic air carriers by the open skies system—and give cautious but serious consideration to the pursuit of additional Open Skies agreements with China, which currently operates outside the system’s framework of rules.

**Background**

Commercial aviation, especially in the international arena, has long been an outlier in a world increasingly characterized by open competition and lightly regulated markets. The early years of the airline industry were dominated by national champion carriers, frequently owned by national governments. The experience of the two twentieth-century world wars resulted in tight control over the use of air space, and the need to plan for emergency mobilizations provided major national governments a strong incentive to keep air fleets—even those privately owned—in strictly domestic hands.

Broader competition emerged after World War II, as widening prosperity and technological advances in the jet era led to greater demand and lower costs for air travel. In the 1970s and 1980s the United States, then by far the world’s largest market for air travel, deregulated its airline industry. As the European Union grew and became more market oriented, and the former Soviet bloc disintegrated and abandoned fully centralized command economies, new privately owned airlines emerged to challenge the old system of national champion carriers and meet increasing demand.

Yet as the world’s largest economies integrated and developed an elaborate system of open trade under the umbrella of what became the World Trade Organization (WTO), major elements of the older model for commercial aviation persisted. This was due in part to issues of air-space sovereignty and a continuing felt need to preserve national fleets. Commercial aviation, like most service industries, has never been included in the WTO system of disciplines for cross-border trade, and most countries still require majority
domestic ownership of commercial passenger service providers.¹ As a result, the international air market is now a mixed one, with many state-owned enterprises (SOEs) competing against mixed public-private and fully private entities.²

Figure 1 provides data on the huge increase in passenger traffic in recent decades. Traffic has grown by well over 200 percent since 2004.

![FIGURE 1]
Number of commercial airline passengers in millions

To accommodate and facilitate the growing industry and the enormous increase in both international passenger and cargo traffic, especially after deregulation began in the 1970s, a complex series of bilateral and sometimes regional Open Skies agreements began to proliferate. With origins dating back to the Chicago Convention of 1944, the same year that the Bretton Woods agreement created the foundations for the postwar liberal trading system, these Open Skies texts were (and remain) agreed-upon sets of rules by which mutually beneficial rights for establishing air services between signatories can be

¹ Certain service-sector industries—like finance—have indeed been covered by important recent regional accords like the Trans-Pacific Partnership (TPP). TPP also included specific disciplines for express air delivery services but continued to exclude coverage of commercial passenger aviation altogether. See Chapter 10 of the TPP text at https://ustr.gov/sites/default/files/TPP-Final-Text-Cross-Border-Trade-in-Services.pdf
² About one-half of the countries with which the United States has Open Skies agreements have publicly-owned air carriers. See transcript of May 21, 2018, Hudson Institute event, “Are Gulf State Airlines Taking Unfair Advantage of Open Skies Agreements?” https://www.hudson.org/research/14362-full-transcript-are-gulf-state-airlines-taking-unfair-advantage-of-open-skies-agreements
secured. They also allow for flexibility in setting schedules, rates, and capacity (passenger and cargo alike), and for non-discriminatory treatment of carriers from each side. Importantly, they require that: “Each Party shall allow a fair and equal opportunity for the designated airlines to compete” on generally accepted commercial grounds where regulation and access to support services are concerned.

The United States has Open Skies agreements with more than 120 partners, negotiated by the Departments of Transportation and State. They are executive agreements not subject to approval by Congress, which otherwise has constitutional authority over international trade. They provide legal certainty for the terms of commerce, including for air cargo services, while avoiding tedious negotiations over each and every change in route structures or numbers of landing slots for each airport pair served. Such agreements are of enormous benefit to both the airlines and their passengers. Brookings Institution economists Clifford Winston and Jia Yan estimate passenger benefits alone of $4 billion per year from Open Skies agreements.4

Distortions in Commercial Aviation Markets and Impacts on US Carriers

In recent decades the biggest threat to the generally open, market-oriented international air services markets has come from the new and dynamic Middle Eastern airlines: Emirates Airline, Etihad Airways, and Qatar Airways (the “Middle East three” or ME3). Founded in 1985, Emirates is the world’s largest airline by capacity, although by no means the largest in terms of revenue. Etihad built its passenger traffic to 14 million per year by 2014, growing by 24 percent in 2014 alone. Each ME3 carrier is building enormous new fleets of the most modern, largely widebody aircraft for competitive use in their central hubs on the Persian Gulf. These hubs are within eight hours flying time from 80 percent of the world’s population. By 2017 Emirates and Etihad had 228 Boeing aircraft in their fleets and orders for another 300 on the books. By 2019, Emirates also had 110 Airbus A380 planes, which carry up to 500 passengers, in their fleet and another 13 on order. Etihad has 66 Airbus airliners in their fleet and another 62 on order. The government of Dubai—at a cost of approximately $32 billion—is building out what it claims will be the world’s largest passenger airport to handle more than 200 million passengers per year.

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passengers per year and service 100 Airbus A380s simultaneously. These investments are designed to continue building traffic from large and lucrative markets like the United States, Europe, and Asia. In 2006 Emirates flew to only one U.S. hub but had expanded that number to thirteen by 2016.

The growth of the ME3 and the airports and other infrastructure that support them, according to forensic accounting work prepared for the Partnership for Open and Fair Skies (the “Partnership,” whose members are United, Delta, and American Airlines as well as several pilot and flight attendant associations, and the airline division of the Teamsters), has been made possible in large part by substantial government subsidies from the oil kingdoms of Qatar and the UAE. Total cash or in-kind subsidies of around $48 billion through 2015—along with about $4 billion in indirect benefits like below-market-rate jet fuel—have allowed the ME3 to achieve a ten-fold increase in daily passenger seats since 2001. In the US-Dubai market, ME3 passenger seats on a daily basis increased by 435 percent since 2008, but total bookings remained basically flat. The result was a loss of market share for the three largest US carriers, United, American, and Delta. As we will see in the next section, European carriers were even harder hit by the new competition. It is worth noting too that the ME3 do not pay income taxes, which in a market-oriented world is another form of subsidy. In the United States, airline firms pay both income taxes and a substantial share of the cost of any expanded or modernized public infrastructure.

United, American, Delta, and their European counterparts (the continent’s “big three” carriers Lufthansa, AirFrance/KLM, and British Airways parent IAG) remain the world’s largest airlines by revenue and continue to operate the world’s largest fleets by number of aircraft. The two major US express air cargo firms, UPS and FedEx, rank in the top three in the world while Emirates has grown into the number two slot.

Table 1 illustrates the loss of passenger market share by US carriers for traffic between the United States and the Middle East from 2005 to 2017. The bump in share observed for 2010–2012 is likely due to recovery from an overall slowdown in international passenger demand during and after the great recession.

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8 Tang, “International Air Service Controversies,” 3.
10 Gerchick, “Rise of the Aerostate.”
11 See WATS.
The United States also lost overall international market share in passenger traffic during the same period. US carriers sold 54 percent of all international seats to and from the United States in 2007, and 58 percent in the post-recession year 2012, but only 48 percent in 2017. As we shall see in the next section, competition from SOEs in China and other nations also contributed to loss of market share by US carriers.

Additionally, ME3 airlines contributed to lost business for US carriers in the growing US-India market, according to data compiled by the Partnership. Gulf airlines have exploited government subsidized service—and government-funded upgrades to their already geographically convenient hubs—to grow their market share for US-India passenger travel from 8 percent in 2008 to 46 percent in 2016. US carriers simultaneously lost around one-third of their passengers between the United States and India.

The situation is arguably even worse for the European airline industry. The ME3 have substantially expanded flights and capacity to Europe and Asia over the last two decades. Moreover, they have started to capture traffic between Europe and the United States to Asia by offering connections to each destination through European hubs like Heathrow and Malpensa (Milan) airports. In 1998 the European big three ranked first, second, and third in terms of passenger seats available between the Europe/Middle East zone and Asia. But by 2016 Emirates alone offered more seats than the big three combined, and Qatar and Etihad ranked second and third. Between 2008 and 2016 the big three lost one-third of their market share between Europe and Asia, while the ME3 more than doubled its share. In 2016 the ME3 captured 29 percent of this market compared to 25 percent for

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13 Partnership for Open and Fair Skies, “Presentation,” www.openandfairskies.com/subsidies
the big three.\textsuperscript{14} Figure 2 shows the growth in bookings between Europe and Asia from 2008 to 2018. The big three lost 8.5 percent in bookings during this period while the ME3 grew by more than 200 percent.

**Figure 2: Growth in Bookings Between Europe and Asia Relative to 2008**

![Graph showing growth in bookings between Europe and Asia from 2008 to 2018](image)

Source: Partnership for Open and Fair Skies; Marketing Information Data Tapes (MIDT). Europe defined as the 28 members of the European Union plus Switzerland, Norway, and Iceland.

European carriers have been affected more than those in the United States by competition from the Middle East. Other established carriers, like Qantas, have also seen a drastic drop in their business as the ME3 expands to Asia. Figure 3 shows the rapid expansion in capacity by the Gulf airlines over the last two decades relative to competitors from major regions around the world. (In the following section of this paper we will see that the ME3 is now more aggressively targeting the United States.)

\textsuperscript{14} See Partnership for Open and Fair Skies, “Restoring Open Skies: Addressing Subsidized Competition from State-Owned Airlines in Qatar and the UAE,” Washington, 2018. Europe is defined as the 28 members of the European Union plus Switzerland, Norway and Iceland.
Gulf state-owned carriers are not the only SOEs leveraging heavy (and so far largely undisclosed) government subsidies to rapidly expand their share of the global passenger aviation market, of course. China’s airlines have built dramatic new capacity to meet the local and international travel needs of its growing economy and middle class. Measured by number of passengers flown (using 2016 data), China Southern and China Eastern airlines now rank sixth and seventh in the world and measured by total miles flown both are among the world’s top ten. China Southern and a third Chinese SOE, Air China, also now rank among the world’s top ten carriers by passenger-distance measures, indicating their entry into especially valuable long-haul international markets. China is very likely

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15 See WATS.
to become the world’s largest air transport market in the near future.\textsuperscript{16} And US carriers have already begun to lose market share on China-US routes. They now account for just 38 percent of passenger traffic on these routes, as Table 2 illustrates.

\textbf{Table 2: US Airlines Market Share in US-China Routes, 2005-17}

\begin{figure}[h]
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\includegraphics[width=0.5\textwidth]{table2.png}
\caption{US Airlines Market Share in US-China Routes, 2005-17}
\end{figure}

China’s three largest airlines have grown their passenger numbers by 70 percent since 2010. They increased the capacity of their flights between the United States and China to 61 percent of total two-way capacity in the same time frame. Chinese airlines are even starting to take business from the ME3. “It is natural to expect China’s carriers to eclipse those from the Gulf,” says Will Horton of CAPA, an industry consultancy.\textsuperscript{17} There is evidence of two types of subsidy helping propel this rapid growth. Tight capacity limits on many intra-China routes drive up prices and profits. And direct subsidies from local Chinese government agencies to build service to and from foreign destinations—and second-tier domestic cities like Chengdu, Xian, or Harbin—are common. One study has calculated that direct subsidies account for half the profits earned by China’s four mainland-based international carriers.\textsuperscript{18}

As noted at the outset, the United States does not have a full Open Skies agreement with China and is embroiled in a series of increasingly consequential, broader trade disputes

\textsuperscript{16} See Jon Ostrower, “China to Overtake the US as World’s Largest Air Travel Market,” \textit{CNN Money}, October 27, 2017.
\textsuperscript{17} “Chinese Carriers Are the New Disrupters in Air Travel,” \textit{The Economist}, April 5, 2018.
with the Middle Kingdom. This makes any potential agreement to liberalize air travel highly unlikely in the near-term future.¹⁹

Responses to Subsidized Competition by State-Owned Enterprises: Two Steps Forward and One Step Back

The United States has taken the lead in challenging subsidized competition from the ME3, utilizing the Open Skies agreements with Qatar and the United Arab Emirates. Article 11 of the US-UAE text states clearly that “Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete.”²⁰ A white paper commissioned by the Partnership for Open and Fair Skies substantiates claims of massive government subsidies to the ME3 carriers over the last two decades, cumulatively totaling more than $50 billion.²¹ The acquisition of the world’s largest fleets of new, long-distance, widebody aircraft and the construction of massive new airports (Qatar’s Hamad airport is five times the size of Chicago’s O’Hare) are among the results of direct and indirect subsidies. In a highly competitive global marketplace, with a business model characterized by very thin, single-digit profit margins, government support of such scale bends the balance heavily in favor of the ME3. Both the top three US carriers and their labor unions support the charge of unfair competition.²²

The Trump administration took up the case for challenging the ME3 in a September 14, 2017, interagency meeting led by the White House and the Departments of State and Transportation.²³ A decision was taken to use Article 15 of the Open Skies agreements to “take action to address the unfair behavior of the Gulf carriers” and to “seek disciplines on subsidies, transparency, and state-owned enterprises.” The administration also sought to secure specific commitments from the UAE and Qatar to freeze the opening of new services involving passengers picked up in third countries on flights between the United States and the Gulf states. (These are known as “fifth freedom” rights in the Open Skies system.)

Subsequent negotiations with the two Gulf states resulted in 2018 agreements touted by the US side as major steps forward on the problem of subsidies. The Qatar agreement was announced on January 30 at the US State Department, with Defense Secretary Jim Mattis present, presumably to underscore the ongoing interest of defense planners in the importance of maintaining a vibrant and substantial commercial airline fleet for any

future national defense or natural disaster contingencies. Such high-level participation also signaled the administration’s determination to ensure a level playing field and preserve good paying jobs, which are characteristic of the airline industry in the United States. Under the Qatar agreement, Qatar Airways promised to practice greater transparency in record keeping and reporting (in order to make any subsidies or favorable treatment more apparent) and to forgo any new fifth freedom passenger flights involving the United States. The two carriers covered by the UAE agreement pledged to “open up their accounting books by publishing annual statements ‘consistent with international accounting standards.’” There was no formal agreement to freeze fifth freedom routes with the UAE, but a side letter stating that the UAE carriers had “no current plans” to add more of these flights was also released, and US carriers and the State Department understand this side letter as a binding commitment.

The European Commission, spurred by its dominant members Germany and France, has also in recent years become concerned about “unfair” competition from Persian Gulf airlines. Four other EU members supported a formal Commission initiative. The Partnership for Open and Fair Skies’ “white paper” was cited in support of the EC decision to investigate competition from the ME3. It is worth noting that the Europeans also cited potential unfair competition from Chinese, Turkish, and Brazilian state-owned airlines in mandating their review. In 2019 the EU adopted a new regulation allowing the Commission to conduct investigations of the ME3, for up to one year, upon presentation of evidence that they are causing harm to European carriers. After such an investigation, the Commission must prove actual injury, which presents a tough hurdle. One commentator was pessimistic about this measure’s possible impact: “The effectiveness of this new regulation is a head-scratcher. It’s quite loosely cobbled together and doesn’t really contain enough bite to make a tangible difference. It seems as if it’s just another empty-handed understanding, just like what was seen in the U.S.”

It is unclear whether the transparency components of the bilateral agreements negotiated by the United States, along with enhanced scrutiny from the EU, will produce significant reductions in subsidies from the Qatari and UAE governments to their national champion air carriers. It is simply too soon after these accords were finalized for new financial data to have been generated and scrutinized. There has been no apparent cancellation of orders for new widebody aircraft or any slowdown in airport construction that might be attributable to withdrawal of some level of subsidy or indirect support.

Evidence has already emerged, however, to suggest that Qatar and its national champion carrier may be inclined to creatively evade aspects of their new bilateral commitments. In late 2017, Qatar took a 49 percent, controlling interest in the second-tier and failing

Italian airline Meridiana. At the time of purchase the small regional carrier had shrunk to a fleet of just eleven aging aircraft. Qatar Airways’ chief executive immediately announced that twenty new 737 MAX planes on order by his firm would supplement the Meridiana fleet. A strategy of growing the airline “to improve connectivity in Italy, other European destinations and to the United States would follow.” With Italy’s national champion Alitalia in bankruptcy, Qatar aims to build its stake in Meridiana, which it quickly rebranded as Air Italy, to become Italy’s “real” national carrier. To expand internationally, as many as thirty Boeing 787 Dreamliners and/or Airbus A330 widebody aircraft are planned to be “transferred” to Air Italy’s fleet from Qatar Airways’ existing order book. The financial terms of this aircraft “transfer” are unclear, but no sale prices have been given. And these transactions come at a time when Qatar Airways is already reporting large operational losses: $700 million in the 2016-17 fiscal year, and an expected “very large loss” in 2018.

There is, however, more recent evidence that at least $30 million of the initial Qatar Airways injection into the holding company for Air Italy has been forgiven by the Middle Eastern airline company. Additionally, Qatar Airways received a $491 million cash injection from the government of Qatar in 2018 partially to offset its operating loss that year and to facilitate the continued aid to Air Italy. Finally, Qatar Airways guaranteed a $30 million loan, carrying a 2.5 percent interest rate, to Air Italy from HSBC. Another $28.8 million loan from the parent holding company to Air Italy carried the same coupon rate. Such favorable loan terms could never have been approved for a startup just emerging from bankruptcy without backing from a larger and more stable firm. The Aga Khan Foundation, the new entity’s majority owner, has provided no fresh cash or loans to assist it, and all major operating leaders of Air Italy came from Qatar, indicating fairly clearly that the latter is in firm control.

The heavy subsidization of this small but growing airline is of concern for two principal reasons: it is in breach of the 2018 MOU with the United States, and it threatens in the long run US carriers’ ability to compete in major parts of the normally lucrative transatlantic markets. US carriers have already seen their share of this market fall from 42 percent in 2005 to 34 percent in recent years. After righting their performance in the

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last three years, the three major US carriers are building new capacity in an effort to reclaim lost share in the transatlantic market.\(^33\)

Clearly, Air Italy’s goal is to expand as a competitor in transatlantic routes to Italy, and it appears to be doing so at highly subsidized rates. As noted above, Air Italy acquired a new fleet of long-haul equipment. Since 2018, and expanding this year, this new entity has been using the international hub of Milan to offer direct flights to New York, Miami, San Francisco, and Los Angeles, and has announced service to Chicago starting next year. Even offering new direct flights from Europe to the United States violates an understanding the US side asserted as part of the 2018 MOU.\(^34\) According to US officials, the parties to the MOU are barred from initiating new flights from third countries such as Italy.\(^35\) Additionally, the prices offered for these routes in a three-week test period last spring appear designed to win market share at the risk of losing money, a practice called dumping under WTO rules. Fares for the four cities served by Air Italy averaged 28 percent less than those of competitors (which include Emirates Airline in the New York–Milan route) and fully 60 percent less in the normally more profitable business-class submarket. In searches on the Air Italy website on June 10 and July 2, 2019, I found the following prices for round-trip economy fares:

<table>
<thead>
<tr>
<th>Route</th>
<th>Price</th>
</tr>
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<tbody>
<tr>
<td>San Francisco–Milan</td>
<td>$618</td>
</tr>
<tr>
<td>Los Angeles–Milan</td>
<td>$593</td>
</tr>
<tr>
<td>New York–Milan</td>
<td>$545</td>
</tr>
<tr>
<td>Miami–Milan</td>
<td>$661</td>
</tr>
</tbody>
</table>

Air Italy has announced its intention to eventually offer direct service to Rome. A one-stop (Milan) connection from Miami to Rome was priced at $383 for flights last spring and $440 for fall flights.

While the financial reporting for the Italian carrier is not transparent enough (another violation of the MOU) to estimate the actual cost for these flights, it is difficult to imagine that such prices allow for a market-based profit. Air Italy has announced plans to quadruple its flights by 2022 as it acquires new aircraft, escalating the pressures on US and European airlines, which have lost one-third of their market share to Asia partially as a result of competition from the subsidized Middle East carriers.\(^36\)

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\(^35\) See for example “Letter from Earl Carter to the Trump Administration asking them to Take Action Against Qatar for Violating Open skies,” https://fairskies.org/2019/04/letter-from-earl-carter-to-the-trump-administration-asking-them-to-take-action-against-qatar-for-violating-open-skies/

There will be some who will not lament displacement of US and European airlines from important international routes, especially price-hungry consumers in search of even lower fares (and narrower seats). But tens of thousands of US workers and suppliers will bear the brunt of subsidized competition from the deep pockets of the oil sheikdoms. Having a large domestic aircraft fleet is certainly important to meet US transportation needs in times of conflict or emergency, especially given the demise of the US commercial naval fleet and defense transport fleet. Trying to maintain a global trading system based on rules that ensure transparency, fair play, and reciprocity is also an important reason for pursuing Qatari violations of the spirit and letter of the 2018 MOU.

Qatari emir Sheik Tamim bin Hamad Al Thani visited President Trump and senior administration officials in Washington on July 9. Soon thereafter the president convened a meeting in the Oval Office with the heads of the major US airlines involved in the dispute along with the head of Qatar Airways, Akbar Al Baker. The aggressive Qatari executive allegedly put a list of signed contracts between Boeing and Qatar Airways on the table. In an example of his transactional approach to trade policy, Trump was evidently convinced to move slowly on exerting any additional pressure on the Middle East carrier to ratchet back its subsidies.37 This response represents a lost opportunity to address the issues arising from poor implementation of Qatari commitments in the MOU. The circumvention of this understanding represented by the Air Italy expansion should be at the center of future discussions.

Conclusions: More Work and Vigilance Needed by United States and Allies

There are some who question the value to consumers—or to the US economy as a whole—of complaints about subsidization and unfair competition from state-owned airlines. Market purists argue that subsidized competition may be inefficient and ultimately self-defeating, but we should enjoy it while we can, since it tends to lower prices for airline customers and gives large traditional carriers additional incentives to improve service.38 In this view of things, the ME3 are taking market share simply because they currently offer a superior product at a lower cost. It is only political miscalculations and internal disagreements among the Gulf states and their carriers, according to one proponent of these arguments, that has clouded the ME3’s deserved success and prevented them from mounting a more effective, united response to their critics.39 Moreover, some US airlines—generally those with closer ties to the ME3 like Jet Blue and air cargo operators UPS and FedEx—are wary of pushing too hard on the subject of subsidies for fear that the clear and substantial broader gains derived from the Open Skies regime might thus be

jeopardized. (Though these US carriers, too, appear to be comfortable with the 2018 transparency agreements between the United States and the Gulf states.)

Nonetheless, it is hard to ignore the evidence for substantial government support and subsidies to the ME3 and the reality that market-oriented carriers in the United States, Europe, and elsewhere have lost market share at least partly as a result. The rise of China as an economic superpower in strategic competition with the West and its allies has also concentrated attention on the proliferation of subsidized SOEs, the commercial threat they pose to private firms, and the political threat Chinese economic ambitions pose to industrialized democracies in general. This threat clearly extends to commercial aviation, as political influence is especially important in an industry with a history of “national champion” airlines and close coordination with national security interests. Not only the United States and Europe, but also Australia, Japan, Hong Kong, Malaysia, and others are becoming ever more aware of the economic and political challenges posed by state-owned firms in China as well as the Gulf states.

Given these concerns, encouraged by populist pushback against job losses and other economic disruptions attributed to globalization, American and allied political leaders are likely to intensify their efforts to combat the worst effects of subsidized foreign enterprises. In a 2018 conference at Hudson Institute on Open Skies, former Congressional Budget Office director Douglas Holtz-Eakin responded to a question about a possible US-China Open Skies accord with an analogy to the Cold War: “We knitted together the Western Alliance against the threat of the Soviet Union, and we did it through trade and many other international agreements. We should do exactly the same thing with China.”

America’s two 2018 agreements with the Gulf states are a start in addressing wider concerns about the challenge posed by SOEs to the Open Skies regime. But especially in view of the new and aggressive Qatari initiative with Air Italy, enforcing the letter of these agreements will require sustained, collective political vigilance by leaders of the world’s major industrial economies. Given the broad impact of ME3 subsidies on Europe and other countries, it would be useful for the United States to work closely with its traditional allies on these issues. Constructive cooperation is already under way with respect to the newer threats from China. The United States, the EU, and Japan have an ongoing process to develop strategies to deal with Chinese violations of WTO rules on IPR, subsidies, and subsidized competition. In 2019 the EU explicitly targeted the ME3 for their subsidization of commercial aviation. This is a start and for US policymakers offers a promising avenue for international cooperation in pursuing the Middle Eastern SOEs.

42 “Chinese Carriers Are the New Disrupters in Air Travel.”
43 See: Hudson Institute transcript, “Are Gulf States Taking Unfair Advantage of Open Skies Agreements?”
Indeed, there is a growing perception that the market distortions and unfair competition resulting from subsidized SOEs might best be addressed in a broader, cross-industry context and with the kind of independent regulatory and dispute-resolution mechanisms employed by the WTO and various regional trade agreements. Multiparty trade pact rules do not generally cover service-sector industries like air transport, and efforts to extend such coverage to SOEs of any sort are fraught with controversy and likely to remain extremely difficult. The Trans-Pacific Partnership is a notable recent exception, however. Driven in part by concern over Chinese SOEs, the TPP (to which the U.S. is not a signatory at this time) explicitly covers services, including air express services. And if the specific threat to commercial aviation proves too difficult to solve through the Open Skies framework, recourse to the WTO and regional agreements may bear renewed and serious consideration. Nevertheless, for now, at least, the priority should remain firm and consistent enforcement of existing Open Skies agreements—and careful analysis of their ultimate effectiveness in counteracting the rise of subsidized competition from SOE air carriers.