The Daily Dish

Enforcement — The Other Half of Trade Agreements

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Eakinomics: Enforcement — The Other Half of Trade Agreements

The U.S. has now witnessed the full toolbox of the Trump Administration's approach to trade agreements — the use of tariffs to precipitate a "crisis," brinkmanship in negotiations, and agreements that are "better" even though they contain non-tariff barriers to trade, quotas, and tariffs (the best example is the re-negotiation of the North American Free Trade Agreement into the United States-Mexco-Canada Agreement). I will not spill further ink on the flaws of this strategy.
But I remain convinced that enforcing trade agreements is just as important as negotiating good ones. If agreements are not enforced effectively voters will distrust international trade (and they do) and they will not support maintaining and expanding international commerce. The U.S. has used a variety of mechanisms to enforce its agreements (see the AAF paper by Jacqueline Varas and me). As it turns out, the Trump Administration faces a critical test of its willingness to use these enforcement mechanisms in the coming months.

Recall that international air travel — that is, international trade in air transportation services — is governed by Open Skies agreements. These are 120 U.S. bilateral agreements designed to prevent government intervention in commercial airline travel. Under Open Skies, private airlines in all partner nations have the freedom to make their own decisions about airline routes, the number of flights, the types of aircrafts, and pricing. When it became apparent that the governments of Qatar and the United Arab Emirates (UAE) had given over $52 billion in subsidies to Qatar Airways, Etihad Airways, and Emirates, the State Department entered into negotiations to make sure the Open Skies agreements were effectively enforced. In particular, these subsidies permitted those airlines to run so-called "fifth freedom" flights at rates below their economic costs and to the detriment of fair competition; one goal was to eliminate such market distortions.

One year ago, Qatar Airways committed to greater financial transparency. The logic of this agreement was impeccable. If it was not possible to channel subsidies to the airlines, they would not be able to run unprofitable international routes, and pricing would be on a playing field level with international competitors. Any genuinely non-economic fifth freedom route would simply disappear. It appeared to be a big win for trade enforcement.

With a year of experience in the rear-view mirror, the picture is not quite so rosy. The financial reporting is not transparent enough to erase suspicions that the Qatar government continues to funnel billions in illegal subsidies to Qatar Airways. Instead of simply continuing to expand its fifth freedom transatlantic flights, however, Qatar Airways bought a 49 percent stake in the money-losing Air Italy, which turned around and launched flights to California and Chicago. For all practical purposes, Qatar Airways may simply be laundering its subsidies though control of Air Italy to produce the same end result: anti-competitive, government-subsidized international flights.

Given that the Trump Administration values "fair and reciprocal trade" as a key priority, it will be particularly interesting to observe how it pursues the enforcement of these agreements in early 2019.