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AN ANALYSIS OF SOUTH CAROLINA'S INCENTIVES TO THE BOEING COMPANY

Amanda S. Kuker[*]

INTRODUCTION

In 2009, South Carolina passed House Bill 3130.[1] This bill amends various existing South Carolina Code sections and provides certain benefits, including tax exemptions and economic development bonds to taxpayers who create 3,800 full-time jobs and invest a minimum of $750 million within the state.[2] Although the bill does not mention a specific corporation by name, the legislation and the political movements that occurred around the time of its drafting strongly suggest that it was drafted to incentivize the dominant U.S. aircraft manufacturer, The Boeing Company ("Boeing"), to expand its presence in South Carolina.[3] Subsidies, such as those found in House Bill 3130, are nothing new to the aircraft industry.[4] In fact, both Boeing and its European rival, Airbus SAS ("Airbus"), have enjoyed the benefits of similar subsidies in the past.[5] Many of these subsidies, however, have come under intense scrutiny by the World Trade Organization ("WTO").

The WTO was established in 1995 as an international organization that oversees and facilitates international trade.[6] One hundred and fifty-three nations, which together account for over 97%

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[1] H.B. 3130, 118th Gen. Assemb. (S.C. 2009).

[2] *Id.*

[3] *See generally id.*

[4] Appellate Body Report, *European Communities – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R (May 18, 2011) [hereinafter *European Communities – Measures Affecting Trade in Large Civil Aircraft*].

[5] *Id.*

[6] *The WTO in Brief: What is the WTO?*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm (last visited Aug. 28, 2011).

of international trade, are members of the WTO.[7] As a member nation, a country participates in the negotiation of and agrees to be bound by WTO treaties, which are then ratified in the member nation's parliament.[8] When disagreements occur between members concerning the interpretation of WTO treaties, the WTO provides a dispute settlement venue with a "neutral procedure based on an agreed legal foundation."[9] More specifically, the dispute settlement body of the WTO "serves to clarify the provisions of the covered agreements 'in accordance with customary rules of interpretation of public international law'" as codified in Article 31 and 32 of the Vienna Convention on the Law of Treaties.[10]

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[7] *The WTO in Brief: The Organization*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr02_e.htm (last visited Aug. 28, 2011).

[8] *Understanding the WTO: Who We Are*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm (last visited Aug. 28, 2011).

[9] *Id.*

[10] Panel Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 7.1, WT/DS353/R (Mar. 31, 2011) [hereinafter *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*]; Vienna Convention art. 31, 32, May 23, 1969, 1155 U.N.T.S. 331 ("Article 31 General rule of interpretation. 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. 3. There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties. 4. A special meaning shall be given to a term if it is established that the parties so intended. Article 32 Supplementary means of interpretation. Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.").

For the past seven years, the WTO has attempted to parse through complex litigation between Boeing and Airbus.[11] Each company filed an individual case against the other challenging the legality of subsidies that its rival received.[12] Many of the subsidies challenged in these cases are similar to the incentives provided by South Carolina, which raises the following question: do the incentives provided by South Carolina violate WTO treaty law?

This paper examines the South Carolina incentive package under the WTO's Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The first section provides a brief overview of the background information pertinent to this paper's discussion including a chronology of the aircraft industry and overview of the historical, political, and economic context in which the Airbus-Boeing dispute arose. Section II lays out a concise synopsis of the SCM Agreement, the core governing law. In Section III, the substantive analysis of the South Carolina incentives begins. This section opens with a description of each of the incentives provided for in House Bill 3130. Then, the laws of the SCM Agreement are applied to South Carolina's House Bill 3130. The fourth and final section not only summarizes the findings outlined in the above sections, but also expounds on tangential issues, such as the enforceability of the WTO's rulings on the Airbus and Boeing cases and the atypical development of the aircraft manufacturing industry.

I. A BRIEF HISTORY OF THE AIRCRAFT INDUSTRY

An intense rivalry exists between Airbus and Boeing. While these two main players presently dominate the aircraft industry, this has not always been the case. The early aircraft industry in both the United States and Europe was highly fragmented.[13] Boeing stepped out in front of its competitors at the height of World War II, when it proved uniquely qualified to satisfy the increasing demand for specialized military aircraft. This success eventually crossed over into the civil sector in the 1950s, when Boeing unveiled its 707 jetliner.[14]

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[11] *See generally European Communities – Measures Affecting Trade in Large Civil Aircraft*, *supra* note 4.

[12] *Id.*

[13] Robert Carbaugh & John Olienyk, *Boeing-Airbus Subsidy Dispute: An Economic and Trade Perspective,* 2 GLOBAL ECON. Q. 261, 263 (2001).

[14] *Id.* at 262.

Airbus was formed in 1970 as a Franco-German joint venture, created to combat the United States' dominance of the aircraft industry.[15] To kick-start its growth, Airbus received direct production subsidies and government loans that covered up to 80% of its development costs,[16] paid below market interest rates, and occasionally benefited from debt forgiveness.[17] Needless to say, Airbus gradually usurped a significant proportion of the formerly United States-dominated aircraft production market.[18] By the 1990s, Airbus accounted for 30% of all new plane orders, steadily encroaching on Boeing's 60% market share.[19]

According to United States trade officials, the Airbus subsidies breached existing international trade agreements.[20] More specifically, United States trade officials alleged that the European subsidies provided Airbus with a distinct competitive advantage: Airbus could price its aircrafts at least 10% below cost.[21] The United States further argued that Airbus would most likely never have survived its initial years, let alone managed significant growth within the industry, but for the generous subsidies Airbus received from European governments.[22] This tension marks the beginning of the Airbus-Boeing Dispute, a case that will spend years in front of the WTO.

A. THE AIRBUS-BOEING DISPUTE

A key factor fueling the Airbus-Boeing Dispute is the duopolistic structure of the aircraft industry. Airbus and Boeing are essentially the only two large civil aircraft producers in the aircraft industry. Thus, competition for market share has become a zero-sum game.[23] In other

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[15] *Boeing v. Airbus: The WTO Dispute that Neither Can Win*, DEUTSCHE BANK RESEARCH, 4 (Feb. 1, 2007), http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000205714.pdf. [hereinafter *Boeing v. Airbus*].

[16] Carbaugh, *supra* note 13, at 272.

[17] *Id.*

[18] *Id.* at 262.

[19] *Id.*

[20] *Id.* at 272.

[21] *Id.*

[22] *Id.*

[23] Annemarie Michaela Spadafore, Excess Baggage: Weighing the Contribution of Political and Corporate Interests in the WTO Cases over Commercial Aircraft Subsidies 71, (2008) (unpublished Ph.D. dissertation, Miami University) (on file with Miami University).

words, whenever a new large civil aircraft product is released, Boeing and Airbus compete directly against each other for customers.[24] Each sale closed by one company is a sale lost by the other. The effect of a lost sale is exaggerated by the industry's customer purchase trends. The market's core customers, large airlines and leasing companies,[25] tend to enter into multi-billion dollar, long-term contracts that require multiple aircraft deliveries from the same producer over the course of numerous years.[26] For example, in 2005, Boeing closed a deal with Qantas Airlines for forty-five aircraft plus twenty options and fifty purchase rights.[27] Entering large contracts such as these benefits an airline company because it increases aircraft familiarity among the company's pilots.[28] However, for the aircraft manufacturer, this behavior significantly increases the detriment of a lost sale.

Whether Airbus or Boeing wins a sale frequently boils down to one factor: price.[29] A hot topic in the Airbus-Boeing Dispute, price is often the distinguishing factor between Airbus's and Boeing's contract bids,[30] especially considering that nearly every aircraft model produced by one company has a direct and nearly identical competitor product from the other company.[31] In such a market environment, subsidies become especially controversial because subsidies allow the recipient company to either increase its non-operating cash flow or transfer its decreased marginal unit cost through to its customers by lowering prices.[32] Furthermore, because each company possesses such a large market share, each pricing decision affects the market price for large civil aircrafts.[33] Therefore, subsidies help companies win both sales and market share.

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[24] Executive Summary of the First Written Submission by the European Communities, *United States – Measures Affecting Trade in Large Civil Aircraft*, 6, WT/-DS316 (Feb. 19, 2007), *available at* http://trade.ec.europa.eu /doclib/docs/2007/march/tradoc_133819.pdf [hereinafter Executive summary].

[25] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1689.

[26] *Id.* ¶ 7.1685.

[27] *Id.* ¶ 7.1788.

[28] Spadafore, *supra* note 23, at 71.

[29] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1694.

[30] Spadafore, *supra* note 23, at 71.

[31] *Boeing v. Airbus*, *supra* note 15, at 3.

[32] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶7.1699.

[33] *Id.* ¶ 7.1688 (explaining the European Communities' claim "that most airlines that operate LCA are Boeing customers, and provides the following

The Airbus-Boeing Dispute began in 2004 when the United States terminated the then governing Bilateral EU-US Agreement of Trade in Large Civil Aircraft (informally known as the 1992 Agreement) and filed a case against the European Communities challenging the European Communities' subsidies to Airbus ("the Airbus case"). [34] In turn, the European Communities immediately followed suit and filed a similar case against the United States challenging the United States' subsidies to Boeing ("the Boeing case").[35] The two cases have been in front of the WTO for the past seven years.

In each case, each party argues that the opponent nation's aircraft manufacturing subsidies have enabled the subsidized company to lower its costs, use the cost savings to lower the price of aircrafts, win sales, and unfairly increase its market share.[36] In its case against the European Communities, the United States challenged seventy-one subsidies provided to Airbus by various European Communities, including France, Germany, Spain, and the United Kingdom.[37] The challenged subsidies include launch aid, "grants and government-provided goods and services to develop, expand, and upgrade Airbus manufacturing sites," preferential loan terms, forgiveness of debt, and equity infusions, among others.[38] The European Communities' case against the United States challenges subsidies Boeing received from NASA, the Department of Defense, and the states of Washington, Kansas, and Illinois.[39]

II. THE GOVERNING LAW: AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

Since subsidies significantly affect market share in the aircraft industry, both Boeing and Airbus desire some level of subsidy

figures: of 764 airlines that operate Airbus and/or Boeing aircraft, 645 operate Boeing LCA, 507 operate only Boeing LCA, 119 operate only Airbus LCA.").

34 Spadafore, *supra* note 23, at 33.

35 *Id.*

36 *Background Fact Sheet: WTO disputes US/EU Large Civil Aircraft*, WORLD TRADE ORGANIZATION (Jan. 31, 2011), http://trade.ec.europa.eu/doclib/docs/2010/september/tradoc_146486.pdf [hereinafter *Background Fact Sheet*].

37 *DS316 WTO Panel Subsidy Findings – Win/Loss Analysis* (2010), THE BOEING COMPANY, http://www.boeing.com/aboutus/govt_ops/docs/wto/Win_and_Loss_Analysis.pdf (last visited Aug. 2, 2011); Executive Summary, *supra* note 24, at 1.

38 Executive Summary, *supra* note 24 at 1.

39 *Background Fact Sheet*, *supra* note 36, at 1.

regulation. The body of law that governs subsidy disputes can be found in the SCM Agreement. This agreement provides guidelines for determining whether government funding in any industry is an actionable or prohibited subsidy and how an actionable or prohibited subsidy should be remedied.

The first step in the WTO's analysis is to determine whether government funding qualifies as a subsidy.[40] Under the SCM Agreement, a subsidy is defined broadly as a "'financial contribution' that confers a 'benefit' on its recipient."[41] Thus, a subsidy exists if its funding satisfies two criteria: (i) it must be a financial contribution to the recipient, and (ii) it must confer a benefit on the recipient.[42] In a prior WTO case, *US – Softwood Lumber IV*, the WTO appellate body clarified that the "evaluation of the existence of a financial contribution involves consideration of the *nature of the transaction* through which something of economic value is transferred by a government" and that "[a] wide range of transactions falls within the meaning of 'financial contribution.'"[43] Furthermore, funding is deemed to confer a benefit on a recipient when it is provided "on terms that are more advantageous than those [terms] that would have been available to the recipient on

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[40] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, art. 1, 1867 U.N.T.S. 14 [hereinafter SCM Agreement].

[41] Executive Summary, *supra* note 24, at 9 (citing SCM Agreement, *supra* note 40, art. 1.1 (stating "1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if: (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as 'government'), i.e. where: (i) a government practice involves a direct transfer of funds (e.g. grants, loans and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); (iii) a government provides goods or services other than general infrastructure, or purchases goods; (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) a benefit is thereby conferred.")).

[42] SCM Agreement, *supra* note 40, art. 1(B)(2)(a)(ii).

[43] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.29 (emphasis added) (citing Appellate Body Report, *US – Softwood Lumber IV*, ¶ 52, WT/DS257/AB/RW (Dec. 5, 2005)).

the market."[44] Insight into the interpretation of this benefit requirement is explained in WTO appellate precedent:

> [T]he word 'benefit,' as used in Article 1.1(b), implies some kind of *comparison*. This must be so, for there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred,' because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on *terms more favourable* than those available to the recipient in the market.[45]

Precedent also demonstrates, however, that generally "the financial contribution clearly confers a benefit, in as much as [the taxpayer] need not pay certain taxes that would otherwise be due." [46]

This broad definition covers a number of contributions, including the following contributions, which were challenged by the European Communities in its WTO case against the United States: "direct and potential direct transfers of funds . . . ; government revenue otherwise due that is foregone or not collected . . . ; and provision of goods or services other than general infrastructure . . . ." [47] Not all funding satisfying the above criteria violates the SCM Agreement. Rather, a subsidy is permitted under the SCM Agreement so long as the subsidy in question is neither prohibited nor specific.[48]

A subsidy is prohibited if it falls under one of the forms listed in Article 3.1 of the SCM Agreement.[49] Prohibited subsidies include

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[44] *Id.* ¶ 7.114.

[45] *Id.* ¶ 7.30 (emphasis added) (citing Appellate Body Report, *Canada – Aircraft*, ¶ 157, WT/DS70/AB/RW (July 21, 2000)).

[46] *Id.* ¶ 7.169 (citing Panel Report, *US – FSC,* ¶ 7.103, WT/DS108/R (Oct. 8, 1999)).

[47] *Id.* ¶ 7.26.

[48] *European Communities – Measures Affecting Trade in Large Civil Aircraft, supra* note 4; SCM Agreement, *supra* note 40, art. 1.2 (stating "A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.").

[49] Executive Summary, *supra* note 24, at 10.

"subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" and "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."[50] To determine whether a subsidy is prohibited in law, or de jure, the panel must focus solely on the text of the legislative authority.[51] If a subsidy is prohibited in fact, or de facto, the panel may consider circumstantial evidence.[52] WTO precedent provides that de facto export contingency requires three criteria: (i) a subsidy must be granted, (ii) which is tied to (iii) the actual or anticipated exportation or export earnings.[53] According to the appellate body, "tied to" implies a "relationship of 'conditionality or dependence'" and may be rephrased as "contingent upon."[54]

Actionable but not prohibited subsidies fall under Article 2 of the SCM Agreement. Generally, a subsidy is specific if its application is explicitly limited to "an enterprise or industry or group of enterprises or industries."[55] According to prior WTO rulings, specificity analysis is unique to each case:

> At some point that is not made precise in the text of the [SCM Agreement], and which may modulate according to the particular circumstances of a given case, a subsidy would cease to be specific because it is *sufficiently broadly available* throughout an economy as not to benefit a *particular limited group of producers of certain products*. The plain words of Article 2.1 indicate that specificity is a general concept, and the breadth or narrowness of specificity is not susceptible to rigid quantitative definition.

[50] SCM Agreement, *supra* note 40, art. 3.1.

[51] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.1518.

[52] *Id.*

[53] SCM Agreement, *supra* note 40, art. 3.1(a) n.4; *Accord U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.1519 (citing Appellate Body Report, *Canada – Aircraft*, ¶ 169, WT/DS70/AB/RW (July 21, 2000)).

[54] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.1520.

[55] SCM Agreement, *supra* note 40, art. 2.1.

> Whether a subsidy is specific can only be assessed on a case-by-case basis.[56]

However, Article 2 outlines factors that may be considered to determine whether a subsidy is specific. Factors to consider in determining specificity include the "use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy."[57] A subsidy that sets out objective criteria or conditions governing eligibility is not specific.[58]

A specific subsidy is also actionable if it results in "adverse effects" to the challenging party.[59] The SCM Agreement provides that "[N]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members."[60] The term "adverse effects" is to be understood within the meaning of Articles 5(a) and 5(c) of the SCM Agreement as *present*[61] "injury to the domestic industry of another member" and "serious prejudice to the interest of another member."[62] Under Section 6.3 of the SCM Agreement, "serious prejudice" occurs if the subsidy can be linked to one or more of the following effects:

(i) displacement or impediment of imports into the subsidizing member's market,

(ii) displacement or impediment of exports of another member into third country markets,

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56 *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.31 (emphasis added) (citing Panel Report, *US – Subsidies on Upland Cotton*, ¶ 7.1142, WT/DS267/R (Sept. 8, 2004)).

57 SCM Agreement, *supra* note 40, art. 2.1(c).

58 *Id.* art. 2.1(b).

59 Executive Summary, *supra* note 24, at 2.

60 SCM Agreement, *supra* note 40, art. 5.

61 *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1654 ("Article 5 Adverse Effects: No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994; (c) serious prejudice to the interests of another Member.").

62 SCM Agreement, *supra* note 40, art. 5(a), 5(c).

(iii) significant price undercutting as compared to another member in the same market or the generation of significant price suppression, price depression or lost sales in the same market, or

(iv) an increase of world market share for a particular product of the subsidized member after a subsidy is received compared to the subsidized member's average market share during the previous 3 years.[63]

The panel in the Boeing case interpreted Article 6.3 to "require the establishment of a causal link between the subsidies in question and the particular form of serious prejudice."[64] However, because the Article does not include the word "cause," the panel reasoned that there is a "certain degree of discretion in selecting an appropriate methodology for determining whether the "effect" of a subsidy is any of the phenomena set forth in Articles 6.3(a) through (d)" that the panel may use in reaching its decisions.[65] Accordingly, the panel made the following proposal:

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[63] *Id.* art. 6.1-6.2 ("Article 6, Serious Prejudice: 6.1 Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of: (a) the total ad valorem subsidization of a product exceeding 5 per cent; (b) subsidies to cover operating losses sustained by an industry; (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; (d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.").

[64] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1656; *See also,* Panel Report, *US –Subsidies on Upland Cotton*, ¶ 7.1341, WT/DS267/R (Sept. 8, 2004); Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil*), ¶ 372, WT/DS267/AB/RW (June 2, 2008) (supporting this conclusion with the ordinary meaning of the language in the Article as well as Article 5) ("Although Article 6.3 does not use the word 'cause', the Panel considers that the sub-paragraphs of Article 6.3 require the establishment of a causal link between the subsidies in question and the particular form of serious prejudice. This interpretation of Article 6.3 accords with the ordinary meaning of the terms 'arise' and 'effect', and finds contextual support in Article 5(c) and Part V of the SCM Agreement. Article 5(c) provides that no Member should *cause* serious prejudice to the interests of another Member through the use of any subsidy.").

[65] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.1656 (citing Appellate Body Report, *US – Upland Cotton*, ¶ 436 WT/DS267/AB/RW (June 2, 2008)) (discussing the approach to causation and non-attribution taken by the compliance panel in that

> The panel proposes to adopt a counterfactual approach to determining whether the 'effects' of the subsidies at issue in this dispute are displacement or impedance, significant lost sales or significant price suppression . . . first by examining the effects of the subsidies on Boeing's LCA commercial behaviour (i.e. Boeing's prices and product offerings) and secondly by examining the effects of the subsidies, through their effects on Boeing's commercial behaviour, on Airbus' prices and sales in the specific product markets.[66]

As part of this analysis, the panel will also consider "non-attribution" factors to "ensure that the effects of other factors on prices do not dilute the causal link between the subsidies and the price suppression."[67] In summary, the panel looks for a "genuine and substantial relationship of cause and effect between the subsidy in question and the displacement or impedance, significant lost sales, or significant price suppression."[68] "Serious prejudice" is analyzed using a two prong test: (i) does the evidence suggest that the effect of the subsidy falls into one of the situations identified in Article 6.3(a) through (c),[69] and (ii) did the specific subsidy cause these effects?[70]

Notwithstanding the above, Article 8 provides for the exception of certain specific subsidies. Subsidies for research up to 75% of

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dispute (in the context of a claim of significant price suppression)) ("[A] panel has a certain degree of discretion in selecting an appropriate methodology for determining whether the 'effect' of a subsidy is significant price suppression.").

[66] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1659.

[67] *Id.* ¶ 7.1660 (citing Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil),* ¶ 375, WT/DS267AB/RW (June 2, 2008)).

[68] *Id.* ¶ 7.1662.

[69] SCM Agreement, *supra* note 40, art. 6.3 ("Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply: (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member; (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market; (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market.").

[70] *European Communities – Measures Affecting Trade in Large Civil Aircraft*, *supra* note 4.

industrial costs or 50% of precompetitive development activity, as well as subsidies aiding disadvantaged regions of the member's territory, will be deemed non-actionable notwithstanding evidence to the contrary under Articles 3 through 7.[71] A subsidy is also non-actionable if the government or other granting authority "establishes objective conditions governing the eligibility for, and the amount of, a subsidy . . . provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to."[72]

III. BOEING IN SOUTH CAROLINA

Despite the ongoing Airbus-Boeing Dispute currently before the WTO, both parties are continuing operations, which includes accepting new subsidies. One of the most recent subsidies to Boeing came from the State of South Carolina in House Bill 3130 ("H.B. 3130").[73]

A. THE SOUTH CAROLINA INCENTIVES PACKAGE

House Bill 3130 amends South Carolina Code Section 12-6-2320, Section 12-36-2120, and Sections 11-41-20 through 90. [74] This 2009 bill provides certain benefits for up to ten years to taxpayers who meet two requirements. First, the taxpayer must invest at least $750 million in real or personal property in a single county in South Carolina. Second, the taxpayer must create at least 3,800 new and full-time jobs within seven years.[75] In return, the taxpayer receives income and sales tax exemptions as well as economic development bonds.[76]

House Bill 3130 amended Section 12-6-2320 to expand the definition of allowable arrangement for income tax reductions with taxpayers.[77] Prior to the bill, South Carolina could enter into agreements with taxpayers under Section 12-6-2320(B)(3)(a) for up to ten years if the taxpayer was:

> [P]lanning a new facility in this State or an expansion of an existing facility and the new or expanded facility result[ed] in a total investment of at least ten million dollars and the creation of at least two

[71] SCM Agreement, *supra* note 40, art. 8.
[72] *Id.* art. 2.1 (b).
[73] H.B. 3130, 118th Gen. Assemb. (S.C. 2009).
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*

> hundred new full-time jobs, with an average cash compensation level for the new jobs of more than three times the per capita income of this State at the time the jobs [were] filled which must [have been] within five years.[78]

The amendment altered this section by adding Paragraph 3(a)(ii), which provides for an alternative set of conditions under which the State may enter into an agreement with a taxpayer if "the taxpayer is planning a new facility in this State and invests at least seven hundred fifty million dollars in real or personal property or both in a single county in this State and creates at least three thousand eight hundred full-time new jobs" within seven years.[79] The main changes in the amendment are the increase in required investment from $10 million to $750 million and the increase in required job creation from 200 to 3,800. These changes reflect the State's anticipation of a significant arrangement with a large corporation.

House Bill 3130 also amends Section 12-36-2120 by adding new paragraphs that expand the current sales tax exemptions for aircraft fuel, computer equipment, and construction materials.[80] The sales tax exemptions for aircraft fuel are covered in Paragraph 9(e) and (f).[81] This paragraph removes the sales tax from:

> coal, or coke or other fuel sold to manufacturers, electric power companies, and transportation companies for . . . (e) the generation of motive power for test flights of aircraft by the manufacturer of the aircraft [and] (f) the transportation of an aircraft prior to its completion from one facility of the manufacturer of the aircraft to another facility of the manufacturer of the aircraft, not including the transportation of major component parts for construction or assembly, or the transportation of personnel.[82]

Under new Paragraph 65(b) of Section 12-36-2120, the sales tax exemption is expanded to broadly cover "computer equipment" used at

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[78] S.C. CODE ANN. § 16-6-2320 (2008).
[79] S.C. CODE ANN. § 12-6-2320(B)(3) (2010).
[80] H.B. 3130, 118th Gen. Assemb. (S.C. 2009).
[81] S.C. CODE ANN. § 12-36-2190(9)(e)-(f).
[82] *Id.*

Boeing's expanded North Charleston plant.[83] "Computer equipment" is defined in Section (65)(c) as follows:

> original or replacement servers, routers, switches, power units, network devices, hard drives, processors, memory modules, motherboards, racks, other computer hardware and components, cabling, cooling apparatus, and related or ancillary equipment, machinery, and components, the primary purpose of which is to store, retrieve, aggregate, search, organize, process, analyze, or transfer data or any combination of these, or to support related computer engineering or computer science research.[84]

Lastly, construction materials are exempted in amended Section 12-36-2120(67).[85] House Bill 3130 amended this section to include in the existing exemption for construction materials an exemption for "construction materials used in the construction of a new or expanded single manufacturing facility."[86]

Each of the tax incentives is linked to a claw-back provision.[87] Under these provisions, the State is allowed to "assess any tax due as a result of the taxpayer's failure to meet the requirements."[88] These provisions protect the State in the chance that Boeing does not meet and maintain the investment or employment levels required by the code amendments.

House Bill 3130 also amends numerous sections of the State General Obligation Economic Development Bond Act, which permits the issuance of economic development bonds under certain circumstances.[89] More specifically, these economic development bonds, more formally known as "state general obligation development

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[83] *Id.* § 12-36-2120(65)(b).

[84] *Id.*

[85] *Id.* § 12-36-2120(67).

[86] *Id.*

[87] THE ECONOMIC IMPACT OF BOEING IN SOUTH CAROLINA, MILEY & ASSOCIATES, INC. 11 (2010), *available at* http://scfuture.org/wp-content/uploads/2010/05/Economic-Impact-of-Boeing.pdf.

[88] *See generally* H.B. 3130, 118th Gen. Assemb. (S.C. 2009); S.C. CODE ANN. § 12-6-2320(B)(4) (2010); *See also* S.C. CODE ANN. §§ 12-36-2120(9), (65)(e), (67) (2010).

[89] S.C. CODE ANN. § 11-41-40 (2010).

bonds," are limited in application to "financing for infrastructure,"[90] which includes:

> land acquisition, site preparation, road and highway improvements, rail spur construction, water service, wastewater treatment, employee training which may include equipment used for such purpose, environmental mitigation, training and research facilities and the necessary equipment therefore, *buildings and renovations to buildings whether new or existing (i) associated with an economic development project as defined in Section 11-41-30(2) that includes air carrier hub terminal facilities as defined in Section 55-11-500(a), or (ii) located on land that is owned by the State or an agency, instrumentality, or political subdivision thereof*.[91]

A total of $270 million was approved to incentivize Boeing to expand its plant in South Carolina.[92] Of this amount, $220 million were approved as general obligation bonds.[93] Typically, the amount of general obligation debt[94] that the State of South Carolina may incur is limited annually to a certain percentage of the general revenues of the state for the previous year.[95] However, there is no numerical ceiling on the amount of general obligation debt that may be authorized by a two-thirds vote of the members of each House of the General Assembly,[96] so long as the debt is incurred for a public purpose.[97] Further support for this unlimited indebtedness may be found in Article 5 of the South Carolina Constitution:

> [i]f general obligation debt be authorized by (a) two-thirds of the members of each House of the General Assembly; or (b) by a majority vote of the qualified electors of the State voting in a referendum called by the General Assembly there shall be no conditions or restrictions limiting the incurring of such

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[90] *Id.*

[91] *Id.* § 11-41-30(3)(a)-(j) (emphasis added).

[92] Project Gemini Agreement, Boeing Company-South Carolina, Jan. 1, 2010, 3 (on file with author) [hereinafter Project Gemini Agreement].

[93] *Id.*

[94] This excludes highway bonds, state institution bonds, tax anticipation notes, and bond anticipation notes.

[95] *See generally* S.C. CODE ANN. § 11-41-20 (2010).

[96] *Id.* § 11-41-20 (5).

[97] S.C. Const. art. X, §13(3).

> indebtedness except (i) those restrictions and limitations imposed in the authorization to incur such indebtedness, and (ii) the provisions of subsection (3) hereof [requiring a public purpose]. [98]

Pursuant to Section 13(5) of Article X of the Constitution, House Bill 3130 amended South Carolina Code Section 11-41-50(B)[99] to allow for economic development bonds up to an aggregate principal of $170 million.[100] The remainder of the economic bonds were authorized as follows: $40 million of general obligation bonds, subject to the maximum annual debt limit, reallocated from a previous project pursuant to Section 11-41-50(A),[101] (ii) an additional $10 million

[98] *Id.* § 13(5).

[99] S.C. CODE ANN. § 11-41-50(B) (2010) ("In addition to and exclusive of the economic development bonds provided for and issued pursuant to subsection (A) of this section, the General Assembly provides that pursuant to Section 13(5), Article X of the Constitution of this State, 1895, (i) additional economic development bonds may be issued under this chapter in an aggregate principal amount that does not exceed one hundred seventy million dollars, and (ii) in addition to the authorization contained in the preceding clause, additional economic development bonds may be issued provided that the aggregate principal amount of economic development bonds then outstanding under clauses (i) and (ii), together with the economic development bonds to be issued pursuant to this clause (ii), does not at any time exceed the principal amount specified in clause (i). From the proceeds of the economic development bonds authorized pursuant to this subsection, no more than a total of one hundred seventy million dollars of proceeds may be used for any one project regardless of available capacity.").

[100] *Id.* ("(i) additional economic development bonds may be issued under this chapter in an aggregate principal amount that does not exceed one hundred seventy million dollars, and (ii) in addition to the authorization contained in the preceding clause, additional economic development bonds may be issued provided that the aggregate principal amount of economic development bonds then outstanding under clauses (i) and (ii), together with the economic development bonds to be issued pursuant to this clause (ii), does not at any time exceed the principal amount specified in clause (i).").

[101] Letter from Joe Taylor, Secretary of the Department of Commerce, to the South Carolina State Budget and Control Board, (Jan. 8, 2010) (on file with author); S.C. CODE ANN. § 11-41-50(A) (2010) ("Pursuant to Section 13(6)(c), Article X of the Constitution of this State, 1895, the General Assembly provides that economic development bonds may be issued pursuant to this subsection at such times as the maximum annual debt service on all general obligation bonds of the State, including economic development bonds outstanding and being issued, but excluding research university infrastructure bonds pursuant to Chapter 51 of this title, highway bonds, state institution bonds, tax anticipation notes, and bond anticipation notes, will not exceed five

authorized under the same Section,[102] and (iii) $50 million authorized as Air Carrier Bonds under the Air Carrier Hub Terminal Facilities Act codified in Section 55-11-520(A), in return for which Boeing committed itself to operate the air carrier hub facility.[103]

In addition to the state provided benefits, Boeing also receives local incentives. One of the more significant incentives provided by Charleston County is the Fee-In-Lieu-of-Tax ("FILOT")[104] codified in Chapter 44 of Title 12 of the South Carolina Code. FILOT is an incentive mechanism that reduces property taxes for new or expanding businesses.[105] Boeing's investment is locked in to an assessment rate of 4%, a rate significantly lower than the standard industrial property assessment rate of 10.5%.[106] At this rate, Boeing will pay taxes at a fixed millage rate of 269.8 mills over the thirty year term.[107]

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and one-half percent of the general revenues of the State for the fiscal year next preceding, excluding revenues which are authorized to be pledged for state highway bonds and state institution bonds. The State at any time may not issue general obligation bonds, excluding economic development bonds issued pursuant to this chapter, research university infrastructure bonds issued pursuant to Chapter 51 of this title, highway bonds, state institution bonds, tax anticipation notes, and bond anticipation notes, if at the time of issuance the maximum annual debt service on all such general obligation bonds, outstanding and being issued exceeds five percent of the general revenues of the State for the fiscal year next preceding, excluding revenues which are authorized to be pledged for state highway bonds and state institution bonds.").

[102] Letter from Joe Taylor, *supra* note 101, at 2.

[103] Project Gemini Agreement, *supra* note 92, at 3; S.C. CODE ANN. § 55-11-520(A) (2010) ("Pursuant to the provisions of subsection 6(c), Section 13, Article 10 of the Constitution of this State, in order to provide funds to pay a portion of the costs of (1) acquiring land, (2) constructing, enlarging, improving, extending, renovating, and equipping suitable air carrier hub terminal facilities to be located in this State, (3) purchasing equipment, ground support equipment, machinery, special tools, maintenance, boarding facilities, and any and all additional necessary real or personal property for the operation of air carrier hub terminal facilities, and (4) if petitioned by a special purpose district or other political subdivision of the State, to pay a portion or all of the costs described in Section 55-11-510, not exceeding fifty million dollars of general obligation bonds of this State, to be outstanding at any time may be issued in the manner provided in this article and by law.").

[104] Project Gemini Agreement, *supra* note 92, at 3, 13.

[105] *Id.* at 3.

[106] S.C. CODE ANN. § 12-44-50 (2010); Project Gemini Agreement, *supra* note 92, at 3.

[107] *Charleston County Financial Incentives for The Boeing Company Final Assembly Project*, CHARLESTON COUNTY GOVERNMENT ONLINE (2010), http://www.charlestoncounty.org/departments/council/Boeing

Charleston County also offered Boeing Special Source Revenue Credits (SSRC) under South Carolina Code Section 4-29-68.[108] As a result, for the first fifteen years of the FILOT program, a 50% credit will be applied.[109] In other words, 50% of the revenue from the FILOT payments is returned to Boeing during the first fifteen years, essentially reducing Boeing's assessment rate to 2%.[110] Charleston County estimates that the FILOT program will raise $138.6 million over the course of thirty years, representing 74% of Boeing's payments.[111] The remaining 26%, or $49.8 million, is returned to Boeing.[112]

In addition to the FILOT, Boeing also received a Multi-County Industrial Park designation under South Carolina Code Section 4-1-175. As a result of this designation, Boeing was qualified to receive the SSRC. This designation also allowed Boeing to use job tax credits to offset state corporate income taxes and qualified it for a Set-Aside and Utility Credit Grant, which included $5 million for site preparation costs, $150,000 for a traffic study, and $100,000 for public infrastructure.[113]

B. Legality of the Incentives under the World Trade Organization's SCM Agreement

The question of whether South Carolina's incentives are illegal subsidies under the WTO should be answered in light of the most recent WTO panel ruling on the Boeing case, the European Communities' case against the United States filed as part of the Airbus-Boeing dispute. Accordingly, the following analysis will mirror the analytical process implemented by the panel and apply the terms of the SCM Agreement in accord with their application in the Boeing case.

FinancialIncentives1-12-10.pdf [hereinafter *Charleston County Financial Incentives*].

108 *Id.*

109 THE ECONOMIC IMPACT OF BOEING IN SOUTH CAROLINA, *supra* note 87, at 13.

110 *Charleston County Financial Incentives*, *supra* note 107.

111 *Id.*

112 *Id.*

113 *Id.*

1. WHETHER A SUBSIDY EXISTS WITHIN THE MEANING OF ARTICLE 1 OF THE SCM AGREEMENT

In analyzing the legality of South Carolina's incentive package under the SCM Agreement, the first determination must be whether each incentive individually qualifies as a subsidy as defined in Article 1 of the SCM Agreement. As discussed in depth above, a subsidy is defined as a financial contribution in the form of either foregone government revenue otherwise due, or a direct transfer of funds, in each case that confer a benefit on the recipient.[114]

The South Carolina tax exemptions would most likely qualify as a subsidy because the tax rate reductions provide a financial contribution that confers a benefit on the recipient. The reduction in tax rate is clearly not a direct transfer of funds; however, the sales tax rate reductions for certain applications of aircraft fuel, computer equipment, and construction materials provided to Boeing may constitute foregone government revenue otherwise due. The panel's previous interpretation of these requirements suggests that the tax rate provided in the incentives package should be contrasted against the general "tax rules applied by the Member in question."[115] If a member state has a general rule of taxation, the analysis is a *but-for* test: government revenue is otherwise due where the company would have to pay a certain amount of money to the government *but for* the incentives.[116] Where a general rate of taxation is difficult to define, the panel has acknowledged that it looks to "the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the foregoing of revenue which is 'otherwise due.'"[117]

There is a general rate of taxation in South Carolina. In South Carolina, the sales and use tax is set state- and industry-wide at 6%, with an additional 1% in certain local governments.[118] However, the legislation has carved out certain exclusions for manufacturers. South Carolina Regulation 117-302, *Manufacturers, Processors, Compounders, Miners and Quarries*, points to several exclusions in

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[114] SCM Agreement, *supra* note 40, art. 1.1.

[115] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.116.

[116] *Id.* ¶ 7.118.

[117] *Id.* ¶ 7.119.

[118] *Compare* S.C. CODE ANN. § 12-36-910 (2010) (providing a 5% rate), *and* S.C. CODE ANN. § 12-36-1110 (2010) (adding an additional 1% to the general rate, "penny tax"), *with U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.709.

Code Section 12-36-120 and exemptions in Code Section 12-36-2120.[119] Section 12-36-120 excludes from the state sales statutes the sale of "tangible personal property to a manufacturer or compounder as an ingredient or component part of the tangible personal property or products manufactured or compounded for sale" and "tangible personal property used directly[120] in manufacturing, compounding, or processing tangible personal property into products for sale."[121] Furthermore, Section 12-36-2120, discussed in depth above, provides specific sales tax exemptions, into which exemptions in subsections (9)(e) and (f), (65) and (67) were inserted as part of the Boeing deal.[122]

Because the tax rate exemptions provide an exceptional rate that requires Boeing to pay less in taxes, the tax exemptions likely qualify as a financial contribution. South Carolina Regulation 117-302, "[m]anufacturers . . . *enjoy* several exclusions and exemptions from the sales and use taxes," suggests that these exemptions are at a preferential or exceptional rate.[123]

The exceptional treatment of the incentives such as aircraft fuel, computers, and construction materials in Code Section 12-36-2120 is

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[119] S.C. CODE ANN. REGS. 117-302 (2011).

[120] *Id.* at 117-302.1 ("[B]y 'used directly' is meant that the materials or products so used come in direct contact with and contribute to bring about some chemical or physical change in the ingredient or component properties during the period in which the fabricating, converting or processing takes place. It is not necessary that such materials or products be used up or entirely consumed, provided there is a compliance with the requirements set forth herein. These exclusions apply to: (a) odorants purchased by gas companies and used in compounding gas for sale.(b) chemicals, such as soda, ash, alum, chlorine, etc., used in treating water for sale by municipalities and others engaged in the business of processing or compounding water for sale.(c) refrigerants used by manufacturers to produce ice for sale.(d) acetylene, oxygen, and other gases sold to manufacturers or compounders which enter into and become an ingredient or component part of the tangible personal property or products which he manufactures or compounds for sale, or which are used directly in fabricating, converting, or processing the materials or products being manufactured or compounded for sale.(e) plates attached by the manufacturer to his product for identification purposes and which become a part of the product. These exclusions do not apply to sales of acetylene, oxygen, and other gases for use by repairman, welders, dentists, junk dealers, and others are subject to the sales or use tax, whichever applies.").

[121] S.C. CODE ANN. § 12-36-120(2)-(3) (2010).

[122] *See id.* § 12-36-120; S.C. CODE ANN. § 12-36-2120(9), (65) (2010).

[123] S.C. CODE ANN. REGS. 117-302 (2011) (emphasis added); *Cf. U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.126.

further highlighted by the language in South Carolina Regulation 117-302, which specifically differentiates between "exclusions" and "exemptions."[124] Whereas the broader "exclusions" in Section 12-3-120 fall outside the sales tax statute's applicability, the "exemptions" fall within the statute, but are released from the obligation. The nature of exemptions themselves implies that if the exemptions were repealed, the items exempted from sales tax would otherwise fall under the general rule of taxation and the revenue from tax on those items would be realized by the State as increased revenue.

Likewise, the FILOT agreement between Boeing and the County of Charleston and the related SSRC would also qualify as subsidies because the property tax fee, which Boeing has agreed to pay in lieu of certain local property taxes, and which is further reduced by the SSRC, constitutes a financial contribution that confers a benefit. Under Section 12-43-220(a), "[a]ll real and personal property owned by or leased to manufacturers and utilities and used by the manufacturer or utility in the conduct of the business must be taxed on an assessment equal to ten and one-half percent of the fair market value of the property."[125] However, under the FILOT agreement, Boeing is locked in at a 4% assessment rate.[126] This assessment rate is further reduced by the SSRC, pursuant to which 50% of the FILOT payments are credited to Boeing for the first fifteen years.[127] Thus, Boeing's assessment rate for property taxes in Charleston is 2% for the first fifteen years and 4% for years fifteen through thirty. In saving up to 8.5% in property taxes, Boeing is receiving a preferential fee in lieu of the standard taxation rate of 10.5% in return for its investment in Charleston.

Furthermore, the terminology of the Fee Agreement between Boeing and Charleston County confirms the conclusion that the FILOT

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[124] S.C. CODE ANN. REGS. 117-302 (2011) ("The exclusions can be found in Code Section 12-36-120 and includes containers, ingredients and component parts, and items used directly in manufacturing, compounding or processing tangible personal property for sale. The exemptions can be found in Code Section 12-36-2120 and include exemptions for coal, coke, fuel, electricity, and machines.").

[125] S.C. CODE ANN. § 12-43-220(a)(1) (2010), *amended effective* Jan. 1, 2011.

[126] *Fee Agreement, by and between Charleston County, South Carolina and The Boeing Company*, CHARLESTON COUNTY GOVERNMENT ONLINE, § 5.2 (Dec. 1, 2009), http://www.charlestoncounty.org/departments /council/BoeingFeeAgreementWithChasCounty.pdf.

[127] *Id.* § 1.1(b)(9)(c).

is an exceptional rate compared to the general rate of taxation. In Section 2.2 of the Fee Agreement, Charleston County and Boeing agree that Boeing shall be exempt from *ad valorem* property taxes in the state and in return, Boeing is obligated to pay a fee at a lower rate.[128] The agreement itself compares the preferential rate to the rate agreed to in the FILOT agreement, referring in multiple sections to "property taxes *that would be due* with respect to such property, *if it were taxable*" and "*if it were otherwise subject to* ad valorem *taxes*."[129] Furthermore, the parties to the agreement acknowledge in Section 5.4 that the agreement is intended "to afford Boeing the benefits . . . in consideration of Boeing's decision to locate the Project within the County," further evidencing the financial contribution being afforded to Boeing by the FILOT agreement.[130]

The Economic Development Bonds are also a subsidy under Article 1.1(a)(1)(i) of the SCM Agreement. Neither Washington, Illinois, nor Kansas provided general obligation bonds to Boeing similar to those provided by South Carolina. However, the analysis implemented by the panel regarding Kansas Development Finance Authority Bonds (KDFA bonds) provides valuable insight into how the SCM Agreement would apply to general obligation bonds. Kansas legislation provided up to $500 million in bonds to Boeing as "an eligible business for an eligible project" so long as Boeing (i) paid at least $600 million in average gross compensation, (ii) paid at least $50,000 average annual compensation per employee, (iii) invested at least $1 billion in real or tangible personable property in Kansas, and (iv) operated in the manufacturing sector during the three taxable years immediately preceding application for benefits.[131] An eligible business must repay these funds with interest, but payments are made from an account in which the income taxes withheld from the eligible business's employees are deposited.[132] The panel determined the bonds were a subsidy in the form of a direct transfer of funds.[133] Because, in this case, the eligible business owns its own bonds, the business

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[128] *Id.* § 2.2, 5.1(a). South Carolina does not collect property taxes at the state level. Instead, property taxes are collected by individual counties.

[129] *Id*. § 5.1(a)-(b) (emphasis added).

[130] *Id.* § 5.4.

[131] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶¶ 7.822-7.823 (citing KAN. STAT. ANN. § 74-50,136 (2004)).

[132] *Id.* ¶ 7.824.

[133] *Id.* ¶ 7.832.

essentially receives a direct grant from Kansas in the amount of the interest due on the bonds.[134]

Just as the net effect of the KDFA bond issuances was a grant, the net effect of the development bonds is also a direct transfer of funds in the form of a grant.[135] Although Boeing will pay rent for the property (which is owned by the state), Boeing is under no obligation to repay the development bonds.[136] Furthermore, Boeing pays no tax upon receipt of the bonds, and the interest on the bonds is paid by the State.[137] Essentially, Boeing received an infrastructure-related grant in the amount of the economic development. Therefore, the general obligation bonds from South Carolina constitute a financial contribution in the form of a direct transfer of funds.

The development bonds also confer a benefit on Boeing. With respect to direct transfers of funds, a benefit is conferred when the company "received a financial contribution more favourable than that available on the market."[138] The panel found that the financial contribution from the KDFA bonds was more favorable than market terms because the bonds required neither loan repayment nor interest payments.[139] According to the panel, "on the marketplace, any such transfer of funds would be accompanied by a requirement that the sum be repaid with interest."[140] Furthermore, precedent provides that "financial contributions in the form of grants confer a benefit."[141]

According to the panel's reasoning in the Boeing case ruling, where a tax measure "constitutes a financial contribution, a benefit is conferred."[142] Thus, in qualifying as either government revenue otherwise due but foregone or a direct transfer of funds, and in conferring a benefit, the South Carolina sales tax exemptions, FILOT agreement, and general obligation bond incentives more than likely all qualify as subsidies under Article 1 of the SCM Agreement.

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[134] *Id.* ¶ 7.827.

[135] *See id.* ¶ 7.827.

[136] *See generally* State General Obligation Economic Development Act, S.C. CODE ANN. § 11-41-10 to -180 (2010).

[137] *Id.*

[138] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.834 (citing Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW (July 21, 2000)).

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] *Id.* ¶ 7.171.

2. WHETHER THE SOUTH CAROLINA SUBSIDIES ARE SPECIFIC WITHIN THE MEANING OF ARTICLE 2 OF THE SCM AGREEMENT?

However, not all subsidies violate the SCM Agreement; it only prohibits specific subsidies. As discussed above, Article 2 provides that a subsidy is specific if the "granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to 'certain enterprises'" in either the text of the granting legislation or in other statements and expressions of intent by the granting authority.[143] In the recent Boeing case, the panel focused on the term "explicitly," interpreting it to mean that the "limitation must 'distinctly express all that is meant; leaving nothing merely implied or suggested.'"[144] While the panel clarified that the limitation must be "'unambiguous' and 'clear,'" it also acknowledged that "there is some tipping point, which varies on a case-by-case basis, at which access to the subsidy in issue is no longer considered limited to 'certain enterprises' but rather is 'sufficiently broadly available' throughout an economy so as to be non-specific."[145] A subsidy is not specific, however, if the granting authority outlines objective standards that automatically determine whether a taxpayer is eligible for the subsidy, and if so, how much the subsidy would be.[146]

In analyzing the specificity of the Washington incentives, the panel began with a de jure inspection of Washington House Bill 2294, the granting authority.[147] This de jure inspection, according to the panel in the Boeing case ruling, analyzes the incentives in light of the respective code as a whole, rather than relying solely on the language of the amending legislation.[148] Thus, the specificity analysis of the South Carolina incentives will likewise begin with a de jure inspection, during which the limitation placed on the incentives' applicability will be considered in light of the entire code section in which the incentives are found.

With respect to the sales and use tax exemptions for fuel provided by House Bill 3130, the language of the amended law creates de jure specificity. The language of Sections 12-36-2120(9)(e) and (f)

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143 *Id.* ¶ 7.190.

144 *Id.* ¶ 7.190.

145 *Id.* ¶¶ 7.190 - 91 (citing Panel Report, *US –Subsidies on Upland Cotton*, WT/DS267/R (Sept. 8, 2004)).

146 SCM Agreement, *supra* note 40, art. 2.1(b).

147 *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.194.

148 *Id.* ¶ 7.199.

explicitly limits the tax measures to the aerospace industry.[149] For example, Section (9)(e) expands the sales tax exemption for coal, coke or other fuel sold to manufacturers to cover "the generation of motive power for transportation of *aircraft by the manufacturer of the aircraft*."[150] Likewise, Section (9)(f) provides a similar exemption for "the transportation of an aircraft prior to its completion from one facility of the *manufacturer of the aircraft* to another facility of the manufacturer of the aircraft."[151] The applicability of each of the above sections is limited to the "manufacturer of the aircraft,"[152] which, like similar limitations in Washington House Bill 2294, qualifies the incentives as "expressly and unambiguously limited to enterprises manufacturing commercial airplanes."[153] According to the panel in the Boeing case decision, a subsidy will be considered as limited to certain enterprises if it is limited to a certain industry.[154] Such a limitation may come about by a reference to "the types of products [the industry] produces."[155] Therefore, because the sales tax exemptions for fuel are limited to the aerospace industry, the sales tax exemption incentives will likely be considered de jure specific under the SCM Agreement.

A de jure analysis of the remaining sales tax exemptions for computer equipment and construction materials leads to a different conclusion. The sections providing these exemptions contain more general language and refer only to manufacturing facilities.[156] Neither section suggests a limited application to the aerospace industry nor does either limit the applicability to certain enterprises.[157] Therefore, these two sections will not likely be considered de jure specific within the meaning of Article 2.1 of the SCM Agreement.

While all three of these sections appear in Section 12-36-2120, which contains subsidies relating to various industries including mining, quarrying, and farming,[158] the panel noted in its analysis of the similar tax incentives of Washington House Bill 2294 that any preferential rate provided to other industries, whether in the same code

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[149] S.C. CODE ANN. § 12-36-2120(9)(e), (f) (2010).
[150] *Id.* § 12-36-2120(9)(e) (emphasis added).
[151] *Id.* § 12-36-2120(9)(f) (emphasis added).
[152] *Id.*
[153] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.196.
[154] *Id.* S.C. CODE ANN. §§ 12-36-2120(65), (67) (2010).
[155] *Id.*
[156] *See* S.C. CODE ANN. §§ 12-36-2120(65), (67) (2010).
[157] *Id.*
[158] *Id.* § 12-36-2120.

section or elsewhere, constitutes possible "separate specific subsidies to the industries concerned."[159] Consequently, unless evidence was provided demonstrating "that reductions to separate industries are part of a wider, generally available and explicit programme of tax reductions," the sales tax exemption for fuel, but not the other two exemptions or the income tax reduction, is de jure specific.[160]

In fact, the remaining sales tax exemptions for computer hardware and construction materials most likely qualify as non-specific under Article 2.1(b), which provides that subsidies with objective eligibility conditions are non-specific. The notes to this article of the SCM Agreement define objective criteria or conditions as being "neutral . . . not favor[ing] certain enterprises over others, and . . . economic in nature and horizontal in application, such as number of employees or size of enterprise."[161] These "conditions must be clearly spelled out in law" and strictly applied.[162] South Carolina has arguably passed this threshold. The language of both exemptions limits the incentives' application to use by a manufacturing facility, where "(i) the taxpayer invests at least seven hundred fifty million dollars in real or personal property or both comprising or located at the facility over a seven-year period; and (ii) the taxpayer creates at least three thousand eight hundred full-time new jobs at the facility during that seven-year period."[163] South Carolina's legislation lays out criteria for eligibility that is arguably objective, namely the minimum requirement of $750 million capital investment and creation of 3,800 new full-time jobs. Pending notification to the state, eligibility is automatic.[164] Furthermore, the state expressly retains the right to collect any tax due if the taxpayer fails to meet the mandatory, minimum requirements.[165] However, the eligibility requirements arguably fail the objectivity test in that the investment and job creation requirements are so demanding that they essentially exclude all but a certain few large enterprises like Boeing. Nevertheless, cut-off standards are inherent in any eligibility requirement and the line must be drawn somewhere.

However, despite passing the de jure specificity test under Article 2.1(a) and qualifying as de jure non-specific under Article 2.1(b), the

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[159] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.204.

[160] *Id.* ¶ 7.205.

[161] SCM Agreement, *supra* note 40, art. 2.1(b) n.2.

[162] *Id.* art. 2.1(b).

[163] S.C. CODE ANN. § 12-36-2120(9)(f) (2010).

[164] *Id.*

[165] *See, e.g., id.*

exemptions may still be found de facto specific under Article 2.1(c) of the SCM Agreement. According to the panel in the Boeing case, even if a subsidy is de jure non-specific under Article 2.1(b), the subsidy may nevertheless "be found de facto specific under Article 2.1(c) of the SCM Agreement."[166] Article 2.1(c) provides catch-all factors that may be considered when a subsidy appears specific despite having qualified as non-specific pursuant to Article 2.1(a) and (b).[167] As noted above, these factors include the "use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of the subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy."[168]

The income tax reduction and the computer hardware and construction materials sales tax exemptions are most likely de facto specific within the meaning of Article 2.1(c). Although other manufacturing companies, such as BMW Manufacturing Company (which currently operates a plant in South Carolina), possess the financial means to surpass the investment and job creation thresholds if they were to expand operations in the state, Boeing is the predominant user of these subsidies. In fact, circumstances suggest that these tax exemptions were enacted with Boeing in mind. More specifically, these exemptions were passed in the same amending legislation as the Boeing-related general obligation bonds, for which former Secretary of the Department of Commerce, Joe Taylor, advocated in his January 8, 2010 letter to the South Carolina State Budget and Control Board "for the benefit of The Boeing Company."[169] The timing of the amending legislation's passage, which adds exemptions explicitly related to the

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166 *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.339 (citing Response of the United States to Question 145, *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 128, WT/DS353 (March 22, 2007)).

167 SCM Agreement, *supra* note 40, art. 2.1(c) ("If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.").

168 SCM Agreement, *supra* note 40, art. 2.1(c).

169 Letter from Joe Taylor, *supra* note 101.

aerospace industry, also coincided with negotiations between Boeing and the State of South Carolina, strongly suggesting a relationship between the two actions. In the alternative, it is highly likely the panel would find that Boeing makes either the predominate or a disproportionally large use of these sales tax exemptions "consider[ing] the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as the length of time during which the subsidy programme has been in operation."[170] Although the legislation is relatively new, the subsidy's high investment and job creation requirements exclude the majority of taxpayers and narrows the pool of eligible taxpayers to a much smaller group of large enterprises, such as Boeing. If other enterprises are unable to achieve the investment and job creation threshold, a disproportionately large amount of the subsidy would be devoted to Boeing. Thus, the potential that House Bill 3130 violates the restrictions in Article 2.1 against the "use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises [and] the granting of disproportionately large amounts of subsidy to certain enterprises,"[171] is quite high.

The FILOT tax reductions from Charleston County are likewise also de facto specific. The granting authority, South Carolina Code Section 12-44-40, is broadly drafted so as not to explicitly limit its application to a certain enterprise, which protects the incentive from de jure specificity. However, when combined with the related SSRC, Boeing receives a disproportionately large amount of subsidization. Not only does Boeing benefit from a lower assessment rate and a low fixed millage rate, but it is also rebated 50% of its payments for the first fifteen years, a subsidy valued at $53 million.[172]

The economic development bonds are likely de facto specific for similar reasons. While the amending legislation does not explicitly refer to Boeing, the aerospace industry, or even the manufacturing sector, the subsidy is also predominantly used by Boeing. Section 11-41-50(B) allows for "additional economic development bonds . . . in an aggregate principal amount that does not exceed one hundred seventy million dollars."[173] Boeing received the maximum $170 million allowable under this Section. Therefore, Boeing has received a

[170] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.752.

[171] SCM Agreement, *supra* note 40, art. 2.1(c).

[172] *The Economic Impact of Boeing in South Carolina*, *supra* note 87, at 13.

[173] H.B. 3130, 118th Gen. Assemb. (S.C. 2009).

disproportionally large amount of the subsidy, which may not be utilized to the benefit of any other corporation.

3. WHETHER THE SOUTH CAROLINA INCENTIVES ARE PROHIBITED SUBSIDIES WITHIN THE MEANING OF ARTICLE 3 OF THE SCM AGREEMENT?

To determine whether the South Carolina incentives are prohibited subsidies, the panel would have to decide whether the South Carolina incentives are contingent, either in law or in fact, on export performance.[174] The verbiage of the subsidy does not indicate a de jure export contingency or favoring of domestic goods, so the analysis will focus on de facto contingency. A subsidy is de facto export contingent where "the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings."[175] However, just because the recipient of a subsidy exports products does not automatically qualify the subsidy as export contingent.[176] In prior cases, de facto contingency was found where the repayment terms for financing of "high-technology projects in the Canadian regional aircraft sector" were tied directly to sales of the aircrafts.[177] In applying Article 3.1(a), the panel focused on the word "contingent."[178] The panel explained, de facto export contingency "must be inferred from the total configuration of facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any case."[179]

Under these standards, the South Carolina legislation is most likely not export contingent. In the current panel ruling, the business and occupation tax breaks from Washington, in conjunction with certain federal subsidies, were found to cause serious prejudice by means of "displacement and impedance of European Communities, exports from third country markets within the meaning of Article 6.3(b)

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[174] SCM Agreement, *supra* note 40, art. 3.1.

[175] *Id.* art. 3.1 n.4.

[176] *Id.*

[177] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶ 7.1517.

[178] *Id*. ¶ 7.1518.

[179] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, ¶ 167, WT/DS70/AB/RW (July 21, 2000).

of the SCM Agreement" with respect to the 100-200 and 300-400 seat product markets, "and significant price suppression and significant lost sales within the meaning of Article 6.3(c) in [those] product market[s]."[180] The European Communities challenged the Washington state business and occupation tax reductions as measures intended to decrease marginal costs per aircraft, alleging the reduced cost led to serious prejudice against Airbus.[181] The panel rephrased the issue as follows: "[W]hether the availability of . . . B&O tax subsidies enabled Boeing to compete on price in individual sales, and secure sales that it would not otherwise have made, and where it did not win those sales, led to Airbus securing those sales at lower prices than it would otherwise have obtained."[182] In reaching its conclusion, the panel referred to *US – Upland Cotton*, in which the panel called for an "integrated examination of the effects of any subsidies with a sufficient nexus to the subsidized product and the particular effects-related variable under consideration" under Articles 5(c) and 6.3(c).[183] The panel recognized that the business and occupation tax reductions, in combination with certain other federal subsidies, "enabled Boeing to lower its prices beyond the level that would otherwise have been economically justifiable, and that in some cases . . . it led to Airbus being able to secure the sale only at a reduced price."[184] The European Communities also argued, although the panel rejected this claim, that the Washington legislation was export contingent because it required Boeing to build a minimum of thirty-six aircrafts, which it argued was more than could be sold in the United States alone.[185] The European Communities, therefore, claimed that the subsidy is arguably contingent on Boeing exporting whatever number of planes it could not sell domestically. [186]

The economic requirements of capital investment and job creation used by South Carolina do not present the same ties to exportation.

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[180] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1833.

[181] *Id.* ¶ 7.1801 (citing First Written Submission by the European Communities, *United States – Measures Affecting Trade in Large Civil Aircraft*, ¶ 1233, WT/DS353 (July, 11 2007), *available at* http://trade.ec.europa .eu/doclib/docs/2007/september/tradoc_136101.pdf).

[182] *Id.* ¶ 7.1814.

[183] *Id.* ¶ 7.1804 (citing Panel Report, *US –Subsidies on Upland Cotton*, ¶ 7.1192, WT/DS267/R (Sept. 8, 2004)).

[184] *Id.* ¶ 7.1818.

[185] *Id.* ¶ 7.1475.

[186] H.B. 3130, 118th Gen. Assemb. (S.C. 2009); S*ee also* H.B. 2944, 58th Leg., Reg. Sess. (Wash. 2004).

First, the magnitude of South Carolina's incentives does not cause the same price suppression concerns as the combined Washington and federal subsidies. The panel estimated the combined value of the Washington B&O and federal subsidies at $2,213,800,000, of which amount $2.2 billion is attributable to the federal subsidies.[187] By contrast, the entire South Carolina incentive package has been estimated at $470 million.[188] This is only a 21% share of the Washington and federal subsidies.[189] Although the cost of development may discount slightly, it is unlikely that this amount will significantly suppress the cost of aircraft. Furthermore, there is also no minimum aircraft requirement and the investment requirements do not indirectly support exports. As mentioned above, "the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy." [190] Therefore, although Boeing does export aircraft, this fact is also not determinative of export contingency. Considering these facts, South Carolina's incentives do not appear tied to actual or anticipated exportation or export earnings and are therefore not prohibited.

4. WHETHER SOUTH CAROLINA CAUSES, THROUGH THE USE OF THE SUBSIDIES, ADVERSE EFFECTS WITHIN THE MEANING OF ARTICLE 5(C) OF THE SCM AGREEMENT?

The next step in the panel's analysis would be an evaluation of whether any specific subsidy caused adverse effects to the challenging member state. In past WTO cases, including the Boeing case, price undercutting has been proven "through a comparison of prices of the subsidized product with prices of a similar non-subsidized product supplied to the same market."[191] This comparison is made "at the same level of trade and at comparable times" or, if impossible, through a

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[187] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1811.

[188] *The Economic Impact of Boeing in South Carolina*, *supra* note 87, at 12. This amount includes all subsidies. The panel, on the other hand, looked only at certain subsidies for its calculation. Thus, the percentage calculation below is based off a numerator likely much larger than the panel would consider.

[189] Calculations were as follows: $470,025,000/2,213,800,000 = .2123 or 21%.

[190] SCM Agreement, *supra* note 40, art. 3.1.

[191] *Id.* art. 6.5.

comparison of export unit prices.[192] Under the second prong, the panel decides whether these effects were caused by the specific subsidies.

In the Boeing decision, the panel examined "whether Washington's B&O tax breaks positioned Boeing to (i) compete on price in individual sales, and secure sales that it would not otherwise have made," or (ii) "where it did not win those sales, led to Airbus securing those sales at lower prices than it would otherwise have obtained."[193] Such a situation could occur because the B&O tax subsidies serve to either decrease the marginal unit cost or increase Boeing's non-operating cash flow.[194] Whether the panel looks at the marginal unit cost or the non-operating cash flow depends on the nature of the subsidy: "[W]e consider it axiomatic that the nature of the United States subsidies at issue—in terms of their structure, design and operation—is relevant in assessing whether or not they have price suppressing effects."[195] Subsidies that are directly related to the production or sale of an aircraft require an analysis of the marginal unit cost, whereas subsidies that do not directly relate to the production or sale of an aircraft require an analysis of the non-operating cash flow.[196]

The majority of the South Carolina subsidies would fall into the latter category with the exception of the South Carolina tax measures, which closely mirror the Washington B&O incentives and would likely meet the same fate as the B&O tax measures. The panel labeled it an "inescapable" conclusion that "in law the effects of the subsidies on Airbus' prices and sales constitute significant lost sales and significant price suppression, within the meaning of Article 6.3(c) of the SCM Agreement, as well as displacement and impedance of exports from third country markets, within the meaning of Article 6.3(b)" at least with regard to Boeing's 100-200 and 300-400 seat single-aisle products, although insufficient evidence was produced to validate a similar decision regarding 787 aircrafts.[197] Both parties agreed that the B&O tax measures, considered together with certain federal subsidies, "lead to an increase in revenues after the transaction (the sale of an LCA)," meaning "both subsidies are directly tied to sales of individual

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[192] *Id.*

[193] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), supra* note 10, ¶¶ 7.1814, 7.1823-26.

[194] *Id.*

[195] *Id.* ¶ 7.1695 (citing Panel Report, *US –Subsidies on Upland Cotton*, ¶ 7.1289, WT/DS267/R (Sept. 8, 2004)).

[196] *Id.* ¶¶ 7.1823-26.

[197] *Id.* ¶¶ 7.1822-26.

LCA."[198] More specifically, the panel acknowledged that "the subsidies lower taxes that Boeing pays and thereby increase Boeing's after-tax profits."[199] Considering these facts, the panel determined that the B&O tax measures, along with certain federal subsidies, set Boeing up in a more favorable position than it could otherwise have achieved.[200] First, these subsidies "enabled Boeing to lower its prices beyond the level that would otherwise have been economically justifiable, and . . . secur[e] sales that it would not otherwise have made."[201] These subsidies also, in certain cases, "led to Airbus being able to secure the sale only at a reduced price." As a result, the subsidies ultimately "served to entrench Boeing as the incumbent supplier, thereby putting it at an important switching cost advantage over Airbus in future sales of aircraft of the same family to that same customer."[202] The panel would likely find the South Carolina incentives that are similarly structured to the Washington incentives, including any income tax reductions or sales tax exemptions, likewise cause adverse effects to the interests of the European Communities for the same reasons.

The above analysis and conclusion would also likely apply to the South Carolina economic bonds, which Boeing is receiving explicitly "to support Boeing's 787 Program" in South Carolina.[203] Under the South Carolina incentive package, Boeing will receive $270 million in non-repayable bonds alone, of which slightly over $200 million will be spent on the construction of the 787 assembly facility.[204] Boeing will dedicate $10 million for the construction of roads and an additional $53.9 million for "site work and utilities."[205] The debt, including both principal and interest at a rate of 3.3%, will be repaid from South Carolina's general operating fund.[206] Because the facility is intended for work on the 787 product, these economic development bonds are tied to the production of a specific product. Furthermore, the subsidies from the state decrease the fixed cost of the 787 plant's initial production.

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[198] *Id.* ¶ 7.1806 (citing First Written Submission of the United States, *United States – Measures Affecting Trade in Large Civil Aircraft*, ¶¶ 751-52, WT/DS353 (July 13, 2007)).
[199] *Id.* ¶ 7.1807.
[200] *Id.* ¶ 7.1818.
[201] *Id.* ¶ 7.1818.
[202] *Id.* ¶ 7.1818.
[203] Project Gemini Agreement, *supra* note 92, at 1.
[204] *Id.* at 3.
[205] *Id.* at 13.
[206] *Id.*

However, in coming to this conclusion, the panel will have to consider the fact that Airbus does not produce a product that directly rivals the 787. The question then becomes whether it is possible to displace or threaten to displace the sale of an aircraft that is not yet in production. It is typical that a more advanced aircraft would surpass an older version in sales to at least some degree. Even if the South Carolina subsidies allowed Boeing to reduce the selling price of the new Dreamliner 787, the price reduction would not affect Airbus' aircraft sales. Most likely, potential buyers of the 787 would not consider Airbus's older-version aircrafts an alternative product because the machines lack the new technology available in the 787. If the panel were to determine that the production and sale of an aircraft for which a competitor has no direct rival displaces or impedes the import or export of a competitor's aircraft, the panel would abolish competitive advantage within the industry.

The second category of subsidies, comprising those that are not product specific, would be considered in relation to an increase in Boeing's non-operating cash flow. Of the South Carolina incentives, this would include the FILOT and the SSRCs. In the Boeing case, the parties and the panel agreed that "where a subsidy is not tied to production of a particular product, the subsidy may still affect the behaviour of the recipient of the subsidy in a manner that causes serious prejudice, depending upon the context in which it is used."[207] However, the panel found no significant adverse effects to the interests of the European Communities because the value of the remaining challenged subsidies—$550 million over the course of seventeen years—was *de minimis* and therefore irrelevant.[208] According to a study by the consulting group Miley & Associates, Inc., the FILOT initiative, which reduced Boeing's assessment rate to just 2% for fifteen years and 4% until year thirty, is worth $53 million.[209] This amount would most likely also be deemed *de minimis* and irrelevant. The South Carolina incentives present a lower total savings and a longer duration, which results in an even less significant average annual savings. Thus, the South Carolina incentives are likely not prohibited under the SCM Agreement.

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[207] *U.S. – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, *supra* note 10, ¶ 7.1828.

[208] *Id.* ¶ 7.1828.

[209] *The Economic Impact of Boeing in South Carolina*, *supra* note 87, at 13.

IV. CONCLUSION

Based on the information available and in light of the panel decision in the Boeing case, at least a portion of the South Carolina incentives would most likely be actionable under the SCM Agreement. An analysis of the incentives unveils the high likelihood that most, if not all of the incentives, including the tax breaks and general obligation bonds, are subsidies under the SCM Agreement because the incentives are financial contributions that confer a benefit on the recipient. Of these subsidies, the sales tax exemption for aircraft fuel is de jure specific, while the sales tax exemptions for computer hardware and construction materials are de jure non-specific under Article 2.1(b) but de facto specific under Article 2.1(c). Like the sales tax exemption for fuel, the general obligation bonds are de facto specific in that Boeing has received a predominant share of the available subsidy. The available evidence does not suggest that any of these subsidies are export contingent; therefore, none of the subsidies are likely prohibited. However, the effects of the South Carolina tax and bond subsidies do cause significant lost sales and significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement, as well as displacement and impedance of exports from third country markets within the meaning of Article 6.3(b) for the 787 aircraft model. In accordance with prior WTO rulings, the above result would command the panel to recommend, to the extent that the United States has acted inconsistently with the SCM Agreement, that the adverse effects be removed or the actionable subsidies be withdrawn as required by Article 4.7.

However, South Carolina's incentives will likely never come before the WTO panel. The current Airbus-Boeing dispute demonstrates the impracticality of WTO rulings. The current dispute has become the most expensive dispute in WTO history,[210] and there is still no promise of an end in sight.[211] Furthermore, the recent panel ruling resulted in a purported victory by both sides.[212] Even Airbus itself admits that it does not anticipate a solution to this dispute for a number of years.[213] In theory, the WTO panel's ruling should rectify

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[210] John W. Miller & Daniel Michaels, *Boeing Received Illegal Aid, WTO Says*, WALL ST. J., Sept. 16, 2010, http://online.wsj.com/article/SB10001424052748704652104575493594258438602.html.

[211] *Id.*

[212] Richard Wachman, *Airbus and Boeing both Claim Victory*, THE GUARDIAN (London), May 19, 2011, at 27.

[213] *Airbus Statement Regarding Today's WTO Panel Report in the U.S. Case Against the E.U.*, AIRBUS (Mar. 23, 2010), http://www.airbus.com

the unjust subsidies and their effects. However, the probability of such reaction is unlikely because the only repercussion of failing to do so is the imposition of trade sanctions by the injured country—a hefty decision that could spur retaliatory sanctions and other consequences potentially more harmful than the effects of the initial subsidy.[214] As a result, both sides continue to offer and accept arguably illegal subsidies, such as those from South Carolina, while simultaneously arguing before the WTO.

There is, however, some promise of reignited negotiations.[215] Even if the parties continue through the appeals process, it is almost certain that both will exit the WTO proceedings partially defeated.[216] At that point, both sides will most likely prefer to negotiate another agreement rather than either compensate each other for the illegal subsidies or enter into a trade war. While a bilateral treaty may have been preferable to both parties, such a solution is likely no longer an option. First, this option lost some of its viability when the panel released the following statement as part of its May 18, 2011 Appellate Body Report on the Airbus case, which cast serious doubt on the legal binding power of such bilateral treaties by emasculating the power of Article 4 of the 1992 Agreement: "Article 4 of the 1992 Agreement is not a relevant rule of international law applicable in the relations between parties, within the meaning of Article 31(3)(c) of the Vienna Convention."[217] More importantly, however, the industry is rapidly moving away from its duopolistic structure, which will render irrelevant a bilateral agreement that does not take into account the new market forces.

Economic forecasts suggest that the aircraft manufacturing market will double in size to a value of $3.2 trillion by 2029.[218] A number of emerging markets such as Russia, China, Japan, and Brazil are fighting for a share of the $1.7 trillion aircraft manufacturing market[219] and are

/presscentre/pressreleases/press-release-detail/detail/airbus-statement-regarding-todays-wto-panel-report-in-the-us-case-against-the-eu/.

[214] Miller & Michaels, *supra* note 210.

[215] *Id.*

[216] *Id.*

[217] Stephan Wittig, *The WTO Panel Report of Boeing Subsidies: A Critical Assessment*, 46 INTERECONOMICS 148, 152 (2011).

[218] *Id.* at 154.

[219] *Id.*; Jonathan Lynn, *U.S., E.U. Skirmish at Appeal over Airbus Subsidies*, REUTERS (Nov. 18, 2010), http://www.reuters.com/article/idUSTRE6AH40L20101118; Maennig & Wittig, *infra* note 221, at 187.

receiving bountiful government subsidies to ease their journeys.[220] Russian aircraft manufacturers came together in 2006 as the United Aviation Corporation.[221] China is contemplating a similar move and just reported that its Commercial Aircraft Corporation of China entered into a 100 plane contract for its first jetliner in November, 2010.[222] As one market observer notes, the results of the WTO case will provide a detailed instruction manual for "Airbus's and Boeing's next generation of rivals" on how to successfully receive government aid.[223] The entrance of new players in the aircraft manufacturing industry will certainly change the market environment significantly.

In summary, while South Carolina's House Bill 3130 appears to satisfy the requirements of the SCM Agreement at least in part, the European Communities would certainly have grounds for challenging the subsidies, although it's unlikely the European Communities would do so. More importantly, however, the aircraft industry is in the process of shifting out of a duopolistic structure. Airbus's and Boeing's actions regarding subsidies will likely set precedent for these new players, who, with the help of their own domestic subsidies, will have the chance to usurp a significant portion of the market share from these two dueling rivals.

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[220] Wittig, *supra* note 217, at 149.

[221] Wolfgang Maennig & Stephan Wittig, *WTO Dispute Settlement Proceedings: European Support for Airbus in the Spotlight*, 45 INTERECONOMICS 180, 187 (2010).

[222] *Id.*; Lynn, *supra* note 219.

[223] Madhu Unnikrishnan, *Who is the Real Winner in the WTO Subsidy Cases?*, 172 AVIATION WK. & SPACE TECH. 14 (2010), *available at* 2010 WLNR 14381960 (Westlaw).