Paper Trail: Working Papers and Recent Scholarship

Editors' Note: *In this edition, we review a study that is apparently the first to measure the deterrent effects of merger enforcement on the frequency of future mergers. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

—William H. Page and John R. Woodbury

Recent Papers

Jo Seldeslachts, Joseph A. Clougherty & Pedro Pita Barros,
Settle for Now but Block for Tomorrow: The Deterrence Effects of Merger Policy Tools
http://www.journals.uchicago.edu/doi/pdf/10.1086/596038

In this paper, economists Seldeslachts (Amsterdam), Clougherty (Berlin), and Barros (Lisbon) study the effects of merger enforcement actions on future mergers. Their statistical model confirms their theoretical prediction that the answer depends on the type of action: actions blocking mergers deter future mergers, while negotiated settlements do not. The study is apparently the first to measure the deterrent effects of merger enforcement on the frequency of future mergers. The authors provide an interesting discussion of their methodology, data, and results, and propose a tentative policy implication.

Previous studies of the deterrent effects of enforcement actions have generally focused on cartel prosecutions. The authors note, however, that a few studies examine whether merger enforcement affects the "composition" or form of future mergers. George Stigler, for example, found in 1966 that the Cellar-Kefauver amendments to Section 7 of the Clayton Act deterred horizontal mergers, but stimulated vertical and conglomerate mergers.[1] Others have found that the stock of rivals of merging firms traded at lower premiums after the adoption of premerger notification, suggesting that more effective enforcement deterred inefficient mergers. Still others have tried, not very successfully, to determine whether merger enforcement reduces or increases price/cost margins.

The authors suggest that their approach is an advance over previous work because it examines the effects of merger enforcement on the frequency of future mergers, not their form; it focuses on deterrent effects, not the direct effects of regulation on affected firms; it considers data from many countries over more than a decade rather than simply comparing conditions in countries with and without antitrust regimes or conditions before and after the adoption of an anti-merger regime; and it adopts a sophisticated "dynamic panel data" method of statistical analysis. The authors acknowledge, however, that something significant is lost by not examining the effect of enforcement on the composition of mergers. While they surmise that merger enforcement deters mainly anticompetitive mergers, their results do not prove this; they only tell us the effect of enforcement on the frequency of all mergers.

[1] George Stigler, *The Economic Effects of the Antitrust Laws*, 9 J.L. & Econ. 225 (1966).

The authors develop a model for analyzing the deterrent effects of enforcement tools. They are especially interested in the dramatic recent shift by agencies away from outright blocking of mergers and toward negotiated settlements. Mergers, the authors observe, can generate profits for the surviving firm from increased monopoly power, reduced costs, or both. Blocking the merger forecloses all profits; a negotiated settlement aims to minimize monopoly profits, but to preserve cost savings; and a clearance permits all profits. Thus, the authors infer, unsurprisingly, that blocking creates greater deterrence than a negotiated settlement, and a negotiated settlement creates greater deterrence than a clearance.

In the authors' model, firms determine the restrictiveness of a merger by various means, including the choice of merger targets and the structuring of the transaction. At one extreme, firms may aim for an outright monopoly; at the other extreme, they may try to eliminate any anticompetitive effects by fix-it-first divestitures. The agency, in turn, determines the levels of restrictiveness at which it will block, negotiate a settlement, or permit, but the lines between these levels are unclear to potential merging firms ex ante. Firms decide whether to propose a merger by taking account of the probable profit (given the restrictiveness of the merger), the likelihood of an enforcement response, and the direct costs of formulating the proposal. If the firms observe the enforcement agency shift away from blocking and toward the kinder and gentler negotiated settlement, they will be more likely to propose the merger. Firms update their estimates of the degrees of restrictiveness that will induce blockings or negotiated settlements based on their observations of the agency's enforcement actions. Thus, "a spike in blocked mergers leads to positive updating of the perceived probability of eliciting a block" and "a spike in negotiated settlements will lead to positive updating of the perceived probability of a settlement." (p. 615) In the former case, the spike should deter proposed mergers; in the latter case, the spike could deter or encourage mergers, depending upon whether the spike in settlements comes at the expense of blocks or clearances.

The authors examine 2-year averages of blockings, negotiated settlements, and "monitoring" (clearances subject to oversight) in 28 jurisdictions, including the United States, from 1992 to 2005. They find that the agencies as a group greatly increased the number of enforcement actions during the merger wave of the 1990s, in both absolute and relative terms. Thus, the rate of enforcement actions went from 1.5 percent to 5 percent of mergers over the studied period—either because the agencies were applying stricter standards or because there were narrowing reporting requirements to encompass mergers that are more likely to raise antitrust concerns. In addition, however, the data show that agencies disproportionately relied on settlements rather than blocking to resolve these concerns.

In estimating the effects of enforcement actions, the authors develop a sophisticated statistical model that controls for numerous factors that affect merger frequency: the merger wave of the 1990s, the increases in GDP and the stock market indexes, and changes in reporting thresholds and substantive merger standards. They report four regressions that instrument for different variables that might bias the results. They find that:

> [b]locked mergers have a statistically significant and negative impact on future merger behavior in all four regressions. The consistent strong impact of this variable suggests that spikes in the use of blocked mergers send a clear signal of toughness by antitrust authorities—a signal that significantly reduces future merger proclivities.

On average, a 10 percent increase in blockings results in a drop in mergers in the following year between 1 and 2 percent. The authors calculate, for example, that an increase in blockings of mergers in 2003 in the U.S. resulted in a 4.7 percent reduction in mergers in 2004; a sharp drop in blockings in the EU in 2003 led to a 13 percent increase in mergers. In contrast to the results for blockings, negotiated settlements appear to have no significant deterrent effect. The authors' results for both antitrust actions survive four different statistical tests for robustness.

The authors suggest that these results "imply that antitrust authorities should be cautious with regard to overusing negotiated settlements" (p. 630) because, even if they mitigate the anticompetitive effects of proposed mergers, they provide no deterrent effect on future mergers. As this highly qualified policy recommendation suggests, the authors stop short of recommending a major shift toward blocking mergers rather than reaching negotiated settlements. This caution is appropriate for two reasons. First, negotiated settlements are supposed to capture the cost savings from mergers while preventing their anticompetitive effects. If settlements were effective in accomplishing both of these tasks, a shift from negotiated settlements toward blockings would sacrifice cost savings that negotiated settlements might have permitted. (On the other hand, as the authors point out, prior studies have sharply questioned whether negotiated settlements actually prevent the anticompetitive effects of mergers.) Second, a spike in blocking may deter efficient mergers along with anticompetitive ones. The authors acknowledge that their results do not exclude this possibility. Until we know more about what kinds of mergers are actually deterred by blocks, it is inappropriate to treat all deterrence as an unalloyed social benefit. ●

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