The Cost of Merger Delay in Restructuring Industries

By
Robert B. Ekelund Jr., Ph.D., and
Mark Thornton, Ph.D.¹

The number and size of mergers in the 1990s have risen sharply, due partly to restructuring in formerly regulated industries and partly to the creation of new markets and economies of scale by communication technologies such as the Internet and cellular telephone. Most research suggests that these mergers have produced significant benefits for consumers.

This study asks whether government officials, particularly those in the antitrust field, are moving fast enough to accommodate the needs of the rapidly restructuring formerly regulated industries. Overlapping jurisdictions and growing attention to delays in getting regulatory approval for proposed mergers make this a ripe subject for investigation.

Our study concludes that:

- Delay in approving mergers in restructuring (formerly regulated) industries is endemic to the process of merger examination. The proximate reasons for such delays are the existence of multiple and overlapping jurisdictions of regulatory control and the private interests of rivals, regulators, and elected officials.

Regulatory delays to mergers in restructuring industries cost over $12 billion in 1996.

¹Robert B. Ekelund Jr., Ph.D., is the Lowder Eminent Scholar in the Department of Economics at Auburn University. Mark Thornton, Ph.D., is the O.P. Alford III Chair of the Ludwig von Mises Institute at Auburn University.
Delays for merger review in restructuring industries take an average of 186 days, roughly twice the time from announcement to completion of mergers in unregulated industries.

Delays may be more common in restructured industries because rivals and potential rivals of merging companies have experience and expertise in using regulation to achieve competitive advantages, thus lowering the incremental cost of this kind of behavior.

Merger delay creates direct costs (out-of-pocket expenditures by the merging companies to have mergers approved by regulators) and indirect costs (postponement or loss of efficiency-improving changes in organization and practices).

By measuring the premium paid by acquiring companies for the stock of target companies, a premium attributable to regulation-induced delay, we estimate the additional regulatory delay to mergers in restructuring industries cost over $12 billion in 1996.

In view of the significant delays and costs engendered by the current merger review process, we suggest several reforms. Adjusting the reporting threshold for inflation or by changes in the stock market indexes would ease the burden on small firms. Eliminating merger review authority for federal, state, and local regulatory agencies other than the Federal Trade Commission and Department of Justice would speed the review process significantly, as would requiring that all merger review be completed within 30 days. Congressional hearings should be held annually on the problem of merger delays to draw attention to their costs and to the interest-group politics that often lay behind such delays.

Our study proceeds as follows. In Part 1, we conduct an empirical test to determine whether average merger delays in regulated industries are greater than in unregulated industries for a random sample of mergers in the 1990s. We further isolate mergers in the telecommunications industry to see if delays are even longer in this industry.

Part 2 details the mechanisms and methods of merger delays. In addition to the antitrust hurdles ordinary mergers must overcome, regulated and restructuring industries must undergo further scrutiny by numerous and overlapping jurisdictions, often facing rigorous opposition by rivals with vast experience using political means to achieve competitive advantages.

In Part 3 we ask who benefits from such delays. Public interest aims are, in our opinion, an often-convenient veneer under which hide the private interests of rivals, bureaucrats, and elected officials. The efficiency of mergers is defended in Part 4 and, in consequence of that efficiency, the economic costs of merger delays are identified in Part 5.

In Part 6, we recommend some possible reforms that might mitigate the costs of merger delay and in a final section, we summarize our findings and conclusions. An appendix describes two major recent mergers, one not yet completed, in the telecommunications industry.
Measuring Merger Delay

Anecdotal evidence, some of which is presented later in this paper, suggests that mergers within regulated industries, particularly those undergoing restructuring due to deregulation, take longer to complete than mergers in unregulated areas of the economy. In order to test whether mergers are systematically delayed in regulated industries in general and in the communications industry in particular, we conducted four regressions on merger data.

A naive theory was developed in order to test the fundamental question of whether merger delays are longer in regulated industries than in unregulated industries. Our model specification is as follows:

\[ T = \beta_0 + \beta_1 DREG + \beta_2 DCOMM + \beta_3 SCR + \beta_4 DEAL + \epsilon \]

where:

- \( T \) measures the time (in days) from the announcement to completion of the merger;
- \( DREG \) is a dummy variable that is set equal to 1 for all mergers between regulated firms;
- \( DCOMM \) is set equal to 1 for all communications industry mergers;
- \( SCR \) is the 50-firm concentration ratio for the industry in 1992;
- \( DEAL \) is the monetary size of the merger in millions of dollars;
- \( \beta_i \) are the estimated coefficients; and
- \( \epsilon \) is the econometric disturbance term.

This simple least-squares regression allows us to estimate the additional delay, if any, of mergers in regulated industries (including communications). The specification also allows us to determine whether or not communications mergers, in particular, are subject to more or less delay than regulated mergers more generally.

The completion times for the three types of mergers—unregulated, regulated, and communications—are determined as follows. Let \( bX \) be the value of \( \beta_3 \) and \( \beta_4 \) multiplied by their respective sample means. The completion time of an unregulated industry merger is \( \beta_0 + bX \). For regulated industry, non-communications mergers the average \( T \) is \( \beta_0 + \beta_1 + bX \). Thus, the difference between regulated and unregulated industry mergers is the coefficient \( \beta_1 \). For communications mergers, the average completion time is \( \beta_0 + \beta_1 + \beta_2 + bX \), so that the
difference between communications mergers and unregulated industry mergers is $\beta_1 + \beta_2$. The difference between communications mergers and regulated mergers is $\beta_2$.

If statistically significant, the coefficient $\beta_2$ would reveal whether communications mergers are either systematically longer or shorter than mergers in regulated industries. If communications mergers take longer than regulated firm mergers generally, then the $\beta_2$ will be positive. If shorter, the $\beta_2$ will be negative. If $\beta_2$ is not statistically significant (i.e., $\beta_2 = 0$), then there is no difference between communications mergers and regulated mergers generally.

Mergers in more concentrated industries are likely to be subject to more scrutiny, so we include a measure of concentration in the regression. $\beta_3$ indicates the effect in days of a one-percentage-point increase in the concentration ratio. Larger mergers may attract more antitrust attention, so we include the size of the merger in dollars ($DEAL$) as a regressor. If size matters in merger review, we should expect to see a positive and significant sign on the coefficient of $DEAL(\beta_4)$.

We collected a random sample of 553 mergers with values exceeding $150 million that occurred between January 1990 and December 1998. Mergers with privately held companies are eliminated from our sample because they do not face the same form of merger review. All mergers are also constrained to be completed—that is, to have had announcement and completion dates recorded—over the time period of the sample (1990-1998). This constraint biases our sample to mergers with shorter delays, since many of the mega-mergers of recent years are still undergoing review and could not be included in our sample.

Mergerstat Review provides data on merger completion time and industry type. The 50-firm Concentration Ratios ($SCR$) are from Census data. They are based on seller’s four-digit Standard Industrial Classification (SIC) code. We use the 50-firm ratio because SIC code concentration ratios do not account for geographic markets. Thus, a four-firm ratio might appear small for telecommunications, when in fact every local market may be a monopoly. If the largest 50 firms dominate the market, then it is fairly safe to assume that the industry is concentrated even across geographic markets.

The total test sample constituted 553 mergers between 1990 and 1998. Of these 553 mergers, 378 were originated and completed in regulated industries (including mergers in communications, broadcasting, electric, gas, and water utilities, banking, and finance). Communications mergers number 83 of the 378 mergers in regulated industries. The remaining 175 mergers were in unregulated industries, including food processing, apparel, chemicals, paints, coatings, toiletries, and cosmetics.

---

2Our data source in all instances was Mergerstat Review. (Houlihan Lokey Howard & Zukin, Los Angeles, California; http://www.hlhz.com and www.mergerstat.com.)

3 Concentration Ratios in Manufacturing (1992) and Economic Census Establishment and Size (1992).
Several factors made it desirable to offer four alternative tests of our model. Use of data constrained to having the merger originate and be completed over the test period may overrepresent mergers of shorter duration. Since some mergers originating in 1997 and 1998 might not yet be complete, we found it desirable to partition the sample into two separate periods. The first sample (Model 1) contains mergers over the entire period of our sample (1990 through 1998), whereas in the second (Model 2), we use a sample of mergers conducted only between 1990 and 1996.

Five outliers—mergers taking longer than 500 days to complete—were discovered with a histogram of the data points. Since these outliers may have an untoward influence on results, we eliminated these observations in the third and fourth of our regressions. Our sample characteristics and restrictions then yield four distinct models as shown in Table 1.

<table>
<thead>
<tr>
<th>Model</th>
<th>Observations</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>553</td>
<td>Dates (1990 through 1998); T &gt; 0;</td>
</tr>
<tr>
<td>(2)</td>
<td>547</td>
<td>Dates (1990 through 1998); T &gt; 0; T &lt; 500</td>
</tr>
<tr>
<td>(3)</td>
<td>332</td>
<td>Dates (1990 through 1996); T &gt; 0;</td>
</tr>
<tr>
<td>(4)</td>
<td>326</td>
<td>Dates (1990 through 1996); T &gt; 0; T &lt; 500</td>
</tr>
</tbody>
</table>

Factors not accounted for in our simple model are assumed to affect the dependent variable in a random fashion, and this white noise is captured by the random disturbance term of the least squares regression (e). If there are factors left out of the specification that systematically influence the dependent variable, then our model suffers from specification error, in this case, an omitted variables problem. Other specification errors such as endogenous explanatory variables, errors in measurement, and an incorrect functional form, can each cause least-squares estimates to be biased, inconsistent, and inefficient.

To check for the presence of such specification errors, the RESET test is performed for each version of the model. RESET is a rather general test of specification error, and detects all of the specification problems listed above. Note that the null hypothesis for RESET is "no specification error," so the desire is to accept the null at lower significance levels. The RESET F-statistic for each model is well below its critical value, providing strong evidence that the models do not suffer from the specification errors listed above. This result is encouraging since it indicates that while the model is quite simple in specification, it does not suffer from specification error.
Our statistical results for the four models are reported in Table 2. Importantly, all variables of interest are of the expected signs and significance levels in all four models. White’s test indicated the presence of heteroskedasticity, so White’s standard errors are used to compute the t-statistics in the table.

<table>
<thead>
<tr>
<th>TABLE 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>\textbf{REGRESSION RESULTS—TIME TO MERGE}</td>
</tr>
<tr>
<td>(White’s t-statistics in parentheses)</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textbf{Variable} &amp; \textbf{MODEL 1} &amp; \textbf{MODEL 2} &amp; \textbf{MODEL 3} &amp; \textbf{MODEL 4}</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>Constant &amp; 58.51 &amp; 70.98 &amp; -2.77 &amp; 27.81</td>
</tr>
<tr>
<td>&amp; (2.81)* &amp; (4.05)* &amp; (0.06)* &amp; (0.84)*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textit{DREG + DCOMM} \text{\textit{DREGCOMM}} &amp; 83.19 &amp; 73.73 &amp; 115.08 &amp; 98.30</td>
</tr>
<tr>
<td>&amp; (8.06)* &amp; (7.86)* &amp; (7.16)* &amp; (7.24)*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textit{DCOMM} &amp; -15.99 &amp; -6.09 &amp; -30.44 &amp; -12.60</td>
</tr>
<tr>
<td>&amp; (-1.23) &amp; (-0.50) &amp; (-1.51) &amp; (-0.71)</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textit{SCR50} &amp; 0.40 &amp; 0.25 &amp; 1.08 &amp; 0.73</td>
</tr>
<tr>
<td>&amp; (1.66)* &amp; (1.25) &amp; (2.09)* &amp; (1.92)*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textit{DEAL} &amp; 0.00 &amp; 0.00 &amp; 0.01 &amp; 0.01</td>
</tr>
<tr>
<td>&amp; (2.85)* &amp; (3.12)* &amp; (2.80)* &amp; (3.05)*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\textit{Adj. R}^2 &amp; 0.10 &amp; 0.11 &amp; 0.15 &amp; 0.18</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\text{F-statistic} &amp; 16.00* &amp; 18.29* &amp; 15.92* &amp; 18.96*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\text{White F-statistic} &amp; 2.94* &amp; 4.71* &amp; 2.40* &amp; 2.48*</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>\text{RESET F-statistic} &amp; 0.69 &amp; 0.46 &amp; 0.12 &amp; 0.83</td>
</tr>
<tr>
<td>\hline</td>
</tr>
<tr>
<td>Observations &amp; 553 &amp; 547 &amp; 332 &amp; 326</td>
</tr>
<tr>
<td>\hline</td>
</tr>
</tbody>
</table>

\*Statistically significant at the 1 percent level  
\textbf{b}Statistically significant at the 5 percent level  
\textbf{c}Statistically significant at the 10 percent level

As expected, completing a merger in a more concentrated industry takes longer, \textit{ceteris paribus}. However, the coefficient on the 50-firm concentration ratio is significant at the 5 percent level in only one model (model 3), suggesting that a one point increase in the concentration ratio leads to only one day longer to approval.

The value of mergers (\textit{DEAL}) is significant, highly so, but the coefficient indicates that it takes nearly \$1 billion in additional value to increase delay by only about 10 days in two of the
specifications (models 3 and 4, those restricted to the period 1990 through 1996 mergers). This means that antitrust authorities may use size to choose which mergers to scrutinize, but the size of merging firms does not add very much to the length of time required for regulatory approval.

The coefficients on the variable DREG are significant at the 5 percent level or better in all four models. This result clearly signifies that, holding concentration and the size of the deal constant, mergers in all regulated industries including those in communications, take between 73 and 115 days longer on average than those in unregulated industries.\(^4\) Note that the mean value of \(T\) for mergers between unregulated firms is 94.21 days. While the DCOMM coefficient is negative, it is not significantly different from zero in any of the four models. This result indicates that communications mergers are neither shorter nor longer than mergers in other regulated industries.

The results of all four specifications are highly suggestive. On average, mergers in regulated industries take about 92 days longer than mergers of comparable value in unregulated industries. This is 92 days in addition to an average delay for unregulated industries of 94 days, for a total average delay of some 186 days. Naturally, this is only an average. Many such mergers take a good deal more time than our average suggests.\(^5\)

This simple model explains about 20 percent of the variation in “time to merge” (ADJ R\(^2\) = 0.18 in Model 4). Naturally many other factors have an impact (presumed to be random across mergers in the sample) on the “time to merge.”\(^6\) As Long, Schramm, and Tollison argue in their study of antitrust determinants, economic factors influence only about 40 percent of the variance in antitrust activity measures, with much of the activity explained outside the model.\(^7\) Stockholder approval takes time, but there is no reason to believe, a priori, that this source of delay differs between regulated and unregulated firms.

These tests, which we regard as first approximations, only tell us from a formal empirical perspective what one would surmise from media accounts of the travails of restructuring industries. We will argue below that major factors include competitors particularly well-equipped to use the regulatory system to attain competitive advantages and political influence.

---

\(^4\)These differences reflect variation in the estimated coefficients across models, not confidence intervals.

\(^5\)It is of course possible that some types of mergers in communications receive quick approval (radio, cable) while others, such as mergers between local Bells and inter-industry mergers (e.g., telephone and cable) may take much longer. Some anecdotal evidence on recent experience with communications mergers is discussed in an appendix to this study.

\(^6\)There are additional reasons to expect a low R-square value. A low value is expected with the use of highly microanalytic panel data (indeed, under most circumstances a high value would be suspect). See Henri Theil, Principles of Econometrics (New York, NY: John Wiley and Sons, 1971).

PART 2

How Are Mergers Delayed?

Mergers are delayed through a variety of regulatory hurdles that companies must overcome. All mergers between public companies must comply with the provisions of the Hart-Scott-Rodino Pre-merger Notification Act (HSR). This delay allows federal antitrust authorities to scrutinize mergers for possible anti-competitive aspects. Firms in regulated industries also have to pass inspection by other federal regulatory authorities and by state regulatory and antitrust authorities. These additional obstacles increase the length of delays.

The primary source of delay for all mergers in the United States is federal antitrust laws. The Sherman Antitrust Act of 1890, the first antimonopoly law passed by Congress, provided that “every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal . . . .” Believing the Sherman Act was ineffective in preventing monopoly, Congress passed the Clayton Act in 1914 and, along with it, the Federal Trade Commission Act creating a five-person commission (the Federal Trade Commission, or FTC) to prosecute “unfair” competitive practices.

The Clayton Act sought to limit a firm’s acquisition of the stock of another firm “where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly” (emphasis added). The so-called incipiency doctrine focuses on conditions that might tend to create monopoly—not to have actually created market power.

The Clayton Act, many believed, left a large loophole since it was silent on the legality of mergers through acquisition of physical assets. The Celler-Kefauver Act closed that “loophole” in 1950. Further restrictions on the freedom to merge were imposed by the Hart-Scott-Rodino Premerger Notification Act of 1976 (HSR). This Act requires merging parties to announce their intentions simultaneously to the Antitrust Division of the Department of Justice (DOJ) and to the Federal Trade Commission (FTC) and to refrain from actual merger until given approval.

Antitrust has undergone a century-long evolution from reactive moves against isolated cases of suspected monopoly abuse to a proactive policy that scrutinizes all corporate activity. State and municipal governments have taken to using merger reviews to address consumer complaints regarding tree trimming, payphone charges, and the choice of channels available on cable television. The result has been a proliferation of costly and time-consuming rules and procedures.
One clear example is the numerous criteria established in 1976 for HSR premerger notification. The law originally required that firms must notify the DOJ and FTC of an impending merger if the acquiring firm has assets of more than $100 million or annual sales of $10 million and if the firm being acquired has assets of at least $10 million in assets or annual sales.\(^8\) There is a 30-day review timetable (15 days for a cash tender offer) and a second request may be issued for an additional 20 days (10 for cash) of review, during which time the agency with jurisdiction can ask for additional information.

The nominal dollar amounts imposed by HSR have not been adjusted for inflation since the law was adopted in 1976. Prices as measured by CPI and the GDP-deflator have increased by approximately 200 percent since that year, so simply failing to adjust the threshold for inflation has greatly increased the number of mergers that are subject to review. The increased caseload could add to the length of delay for each merger and to the cost of bureaucracy.

In addition to the FTC and DOJ, several other federal bureaucracies are involved in the review of merger and acquisition agreements. In addition to traditional antitrust concerns, these agencies have their own sets of rules and guidelines which they apply against proposed mergers. Since these agencies review mergers involving firms over which they have regulatory authority, the cost of this review falls most often on firms in "restructuring" industries.

It would be difficult to believe that these additional layers of review could speed up the approval process, and not difficult to imagine that they result in greater delay and cost. Case studies and anecdotes clearly show that the additional layers of review contribute to the delays identified in Part 1.

Mergers must also be approved by state antitrust and, in some instances, local regulatory authorities. The state attorneys general may require review of merger agreements, and state-level regulatory authorities such as the state public service commission will likely review mergers involving public utilities such as telephone, cable, gas, electricity, and water companies.

According to two experts, James Rill and William Kovacic, antitrust enforcement by state attorneys general has changed dramatically since 1960, when it was practically non-existent. According to Kovacic:

Since the 1980s, we have seen the emergence of the states as a third significant focal point of enforcement activity, along with the Federal Trade Commission and the Department of Justice, to the point where they stand side-by-side with U.S. Assistant Attorney General Joel Klein.\(^9\)

\(^8\) HSR applies if the acquiring firm is trying to gain control of more than $15 million (or 15 percent) of the target's assets or stock.

Regulatory delays abound in all areas of industry restructuring. For example, delays have become endemic in the movement to change the competitive landscape in electrical utilities. The incredibly complex overlapping state and federal jurisdiction amounts to a special and burdensome tax on competitive market forces in industries where deregulation is seeking to unleash exactly those agents of change.

At the federal level alone (if the merger involves interstate commerce), the Federal Energy Regulatory Commission (FERC), the DOJ, the FTC, and the Securities Exchange Commission (if the merger deal is subject to the Public Utility Holding Company Act of 1935) all have jurisdiction. FERC has adopted merger review guidelines based on the Merger Guidelines issued by the DOJ and FTC in 1992 (discussed above). These tightly ordered applications of general merger guidelines suggest, as FERC promulgated in 1996, “that the agency will not approve a merger unless the potential anticompetitive effects of a proposed merger are remedied or the parties commit to future remedies.” The burden of devising such “remedies” rests with the merging utilities.

Costly delays or divestiture or other “compensating” requirements often create merger terminations even though the net benefits to consumers would have been positive.

State regulatory approvals must also be obtained by merging utilities under their jurisdictions. At least 47 states engage in such review. State utility commissions and, in many instances, state attorneys general, play explicit roles in the merger review process under state antitrust laws. California regulators, for example, play an active role in scrutinizing mergers. The proposed merger of Southern California Edison and San Diego Gas & Electric touched off state hearings beginning in 1989. After a two-and-one-half-year delay, the merger was disapproved on the basis that it would have anti-competitive effects. The Union Electric/CIPSCO, Inc. merger review process lasted from August 1995 through December 1997, more than two years from start to finish.

Costly delays or divestiture or other “compensating” requirements often create merger terminations even though the net benefits to consumers would have been positive. In September 1995 an agreement to merge was completed by the Baltimore Gas & Electric Company and the Potomac Electric Power Company. FERC approved the merger with rate cap conditions, but the Maryland Public Utilities Commission’s approval was conditioned on unrealistic demands. According to Strasser and Gotts, the Maryland commission “required that the two companies

---

10 In their survey on utility consolidation, Strasser and Gotts document the tangle and contradictions when both federal and state agencies review electric utility mergers (Sarah E. Strasser and Ilene Knable Gotts, “Utility Consolidation in the Face of Deregulation: Much Ado About Nothing, or the Tempest,” Practicing Law Institute, Corporate Law and Practice Course Handbook Series, 1998). Every one of these cases involves competitive challenges to mergers designed to create economic efficiency and consumer benefit.

11 Ibid., page 395.

12 State attorneys general may seek injunctive relief (including divestiture) and damages under Clayton Act provisions.
transfer most of the savings anticipated to be generated by the combination to consumers in the form of rate cuts amounting to $56 million... per annum, in addition to absorbing the costs associated with several purchased-power contracts, which amounted to another $25 million per year... The District of Columbia Public Utilities Commission also conditioned its approval on severe rate cuts plus a “contribution” from the utilities of $5 million to a District economic development fund. The deal fell through on December 22, 1997, after a delay of more than two-and-one-quarter years.

When a merger depends on the approval of multiple regulatory bodies at the local level, costs may be staggering. The AT&T/TCI merger, for example, received Federal Communications Commission (FCC) approval in March 1999. The former “Ma Bell” sought to provide integrated local, long-distance, video, and Internet services in Western markets by the acquisition of Tele-Communications Inc., a cable firm. A month before the FCC’s approval of the deal, DOJ had given it the green light, without conditions. But even after clearing those two federal hurdles, AT&T still had about 1,000 approvals to obtain from local regulators. As of February 1999, there were 28 municipal holdouts (including large markets in Los Angeles, Oakland, and Seattle), and AT&T was considering just going ahead with the merger and taking any legal and financial consequences.

These examples may be multiplied across virtually all power and communications mergers of the 1990s. The overall picture is not pretty. Congress has initiated a process of deregulation or restructuring in industries formerly characterized as public utilities. However, while these former public utilities are now free to compete with one another, they are still constricted and regulated by state and federal antitrust and regulatory authorities. We believe this web of overlapping regulatory review delays mergers and imposes a large efficiency cost on the economy.

---

13Strasser and Gotts, supra note 10, page 403.
PART 3

Who Benefits from Merger Delays?

Enforcement of antitrust laws is the main cause of regulatory delays in mergers, yet antitrust doctrine faces a basic contradiction. Even the casual observer cannot help but notice that most antitrust enforcement actions tend to have the effect of raising prices, stymieing competitive moves, and limiting competitive pressures on rival firms.

Robert Bork, a leading scholar of antitrust economics, found that antitrust policy was anti-competitive in the bulk of its application.14 Alan Greenspan, chairman of the Federal Reserve System, called antitrust enforcement "economic irrationality and ignorance."15 In addition, the critique of antitrust laws by the modern Austrian school of economics shows that all long-term monopolies are the creation of government and that monopolies cannot endure in a truly free market. Therefore, antitrust law is unnecessary to "protect" competition unless enforcement is aimed at government itself.16

Investigation into the classic cases of "trust busting" has found that many cases were largely unfounded and unsuccessful.17 Firms were merging, industries were consolidating, and greater market power could be calculated, but this behavior was associated with lower prices, better products, improved distribution and service, along with the development of major efficiencies and technological advances.18

The firms involved in the cases examined were not restraining trade, foreclosing competition, accomplishing reciprocity, engaging in predatory practices. Nor, for that matter, were they generally abusing consumers or competitors. In fact, the more likely inference from all the cases is that the mergers would have intensified competitive pressures, realized certain economies, and would have increased consumer welfare.19


17 Burton Folsom Jr., The Myth of the Robber Barons (Young America's Foundation, 1996).


Antitrust policy has near-unanimous support among antitrust attorneys and antitrust economists, but even its most enthusiastic supporters would have to admit that in practice antitrust policy has been far from perfect.20 What, then, explains this contradiction—what Judge Robert Bork called "a policy at war with itself"? McChesney and Shughart explain the need for a rational explanation of the antitrust paradox:

Explanations of regulatory failures that rely on error or ignorance explain nothing at all. No debate can be joined on the basis of any nonscientific "explanation." Thus, the profession's continued belief that antitrust has a happy future, dismissing a century of failures as mere mistakes, is frustrating.21

Public choice theory provides the missing answer. Public choice theory explains that public policy is based on individual self-interest and that policies originate and are driven by interest-group politics.22 Once established, the interests of the antitrust bureaucracy—including the legislative, executive, and judicial branches of government—also influence antitrust policy.23

If antitrust law enforcement is based on interest-group politics, then merger delay might also constitute a rent-seeking process whereby rival firms seek to foil the competitive moves of merger partners and antitrust bureaucrats seek to promote their interests and the interests of some of their constituents rather than those of the general public.24 This would buttress our view that every day a merger is delayed by regulations poses an economic cost on consumers and workers.

The historical record shows that antitrust policy originated, not as a public-interest policy designed to enhance competition and protect the consumer, but to subvert competition and protect inefficient incumbent suppliers. This was true of the Sherman Antitrust Act of 1890,25


24 Federal antitrust officials tend to be appointees of the President, while state-level antitrust officials are elected or appointed, or are career civil employees.

state-level antitrust laws passed before Sherman, and the Clayton Act of 1914. The purpose of those who enacted antitrust law was not to protect competition. It was to stifle competition and protect politically influential companies from competition.

Rivals of merger partners are most often the ones that try to stop competitive mergers by lodging complaints.

Antitrust law enforcement is also politically motivated. Rivals of merger partners are most often the ones that try to stop competitive mergers by lodging complaints. It could be that rivals are acting on behalf of the general interests of society, but this is not what careful study of stock market prices reveals. If mergers create monopoly power and increase market price, then rivals are helped as well because they can raise price and increase output. Conversely, rivals are harmed when mergers are competitive. Evidence from earlier mergers demonstrates that when the DOJ and FTC announced challenges to competitive mergers, the stock prices of their rivals increased, demonstrating that the proposed mergers were competitive. While researchers were not able to rule out the possibility that some anti-competitive mergers might have been deterred, their results clearly indicate the perverse pattern that government merger policy has “protected rival producers from facing increased competition due to efficient mergers.”

Richard Posner has characterized antitrust enforcement as a form of pork-barrel politics. Indeed, evidence on FTC behavior supports a pork-barrel-type relationship between the Commission and Congress that grew even stronger during the “reform” decade of the 1970s when Hart-Scott-Rodino was passed. Further tests confirmed that the FTC uses political as well as economic variables when deciding to challenge a merger and that “the process is driven by the desires of politicians to stop mergers” and that “greater political pressure does cause the FTC to challenge more mergers.”

26 Donald J. Boudreaux, Thomas J. DiLorenzo, and Steven Parker, “Antitrust before the Sherman” in Shughart and McChesney, supra note 21, pages 255-270.


The historical record suggests that Congress, the DOJ, and the FTC are supplying public policy in a manner that expands their power or budgets, rather than promotes the public interest and economic efficiency. Public choice theory also explains political behavior at the state and local levels. According to Kovacic, "It's clear that the National Association of Attorneys General is panting for new legal terrain to plough, and the members can't wait to collect the harvest . . . the harvest could be of dollars, or it could be of votes."32 One former Attorney General even admitted, "much of these new lawsuits where several states join together—is about politics." A former economist with the Justice Department admitted that this has nothing to do with economic efficiency or justice—"they are just trying to get a free ride from all the publicity. It is shameless."

The mechanisms leading to delay are even more debilitating and costly in recently deregulated industries that are undergoing restructuring. Because a regulatory structure has been in place—often for 50 years or more—incumbent firms often have major regulatory divisions that provide the legal wherewithal and access to regulators and elected officials that lowers the costs of lodging complaints against mergers by their competitors. Delay is also more costly in restructuring industries because decades of regulation have increased the benefits of strategic competitive moves such as mergers.

Regulatory authorities—often new to their role as antitrust regulators—are all too eager to create procedures and rules for rent-seeking challenges to mergers. As a current commissioner on the Federal Communications Commission recently argued:

The FCC . . . seems intent on becoming the federal government's third antitrust agency. The commission eschews its explicit merger review authority, instead using its licensing authority to review mergers in a discriminatory manner, scrutinizing some mergers intensely and turning a blind eye to others. In fact, the FCC has no written rules about how to review mergers. It makes them up as it goes along.34

The politics of antitrust enforcement appears to have intensified in recent years. The Microsoft case is illustrative. Traditionally, the Department of Justice and Federal Trade Commission have colluded to divide their enforcement territories so that the DOJ gets one set of industries to "protect" and the FTC's turf consists of the other half of the economy. After the FTC twice failed to make a case against Microsoft, the DOJ was prodded by Senator Orrin Hatch of Utah, the ranking Republican member of the Senate Judiciary Committee, to

33 Ibid., pages 17-18.
"investigate" Microsoft. Hatch is no doubt influenced by the fact that Utah is home to Novell Corporation, the maker of WordPerfect, the major word processing software competing with Microsoft's Word.35

Antitrust policy was created to protect interest groups from competition and has been used for the private benefit of politicians, bureaucrats, and the interest groups they represent.

The view that antitrust law is a policy to protect the public interest and promote competition is losing force.36 Antitrust policy was created to protect interest groups from competition and has been used for the private benefit of politicians, bureaucrats, and the interest groups they represent. Public choice theory therefore provides us with a private-interest explanation for the woeful century-long record of antitrust policy. We can expect therefore that the policy of merger review and delay is also not in the public interest, but rather is simply another part of the rent-seeking process.

---

35 Shughart and McChesney, supra note 21, page 343-344.

PART 4

Are Mergers Efficient?

In order that merger delay be costly for society—with extra delay in regulated industries even more costly—mergers must be “efficient,” not just profitable. Thus, a central economic question raised by merger activity in the 1990s is less whether antitrust laws work than whether mergers efficiently reduce cost, increase consumer welfare, and raise stockholder value. Or do mergers reduce output, raise price, and enrich the stockholders at the expense of consumers and employees? The answer is not obvious, but a “consensus opinion” can be established by reviewing the theory and historical evidence.

We would predict that mergers are efficient due to the trends that fueled the 1990s merger boom. Major factors were the expansion of free trade into ever-widening world markets following the collapse of communism, adoption of free trade agreements, and spread of market institutions around the world. In the U.S., the deregulation of domestic public utilities has unleashed hundreds of billions of dollars in capital and created new national markets where only strictly regulated regional markets previously existed. The development of new technologies such as the Internet has occurred side-by-side with these other developments, ceaselessly creating profit opportunities and opportunities for social gains. In each case, mergers are part of an institutional response to new economic realities.

More than a quarter century ago the economist Harold Demsetz offered an efficiency hypothesis for a positive relationship between market concentration and profitability. While antitrust policy would use this relationship to prevent mergers, Demsetz explained that the greater profitability could be due to the relative efficiency of large firms over small firms. Denying mergers therefore could harm economic efficiency in the name of maintaining price competition. He proposed a straightforward empirical test of the collusion hypothesis: if high concentration supports collusion, then empirical evidence should find that the profits of both large and small firms are similarly affected by concentration. Alternatively, if only the profits of large firms rise with concentration, then larger firms are more efficient and antitrust policy is harmful.

---

37 Mergers often displace workers whether the merger is efficient or monopolistic. However, this is usually a short-run cost to the individual worker and a necessary part of the resource allocation mechanism of the market economy and not a social cost.

Empirical tests in a number of subsequent studies have supported the efficiency hypothesis. In addition, several alternative econometric techniques have been used in inter-industry structural tests of efficiency. Dickson, for example, provides broad support for efficiency using several tests within an aggregate industry framework.  

Naturally, questions of such import rarely develop a unanimous consensus through statistics alone. While a clear econometric explanation of the effects of merger remains at some distance, a host of new techniques have been developed for answering such questions.  

If markets are unfettered by government regulation and other artificial barriers to entry, the potential of new firms entering the market can serve as a credible deterrent to firms that would otherwise exploit their market power.

A theory of contestable markets has been developed by William Baumol and others showing that bigness and concentration (and hence mergers) are not necessarily harmful to consumers and market efficiency. High-cost "fringe" firms serve to limit the market power of larger low-cost firms, because such fringe firms can and do expand through time. Even in the absence of fringe firms, if markets are unfettered by government regulation and other artificial barriers to entry, the potential of new firms entering the market can serve as a credible deterrent to firms that would otherwise exploit their market power.

---


40 Would a finding that the Demsetz condition holds be incompatible with post-merger concentration and increased market power? Both collusion and efficiency would be possible in this scenario. Some think so. Stephen Martin noted that "a positive concentration-profitability relationship for large firms and an insignificant concentration-profitability for small firms is perfectly consistent with the exercise of market power by large firms" ("Market Power and/or Efficiency?" *The Review of Economics and Statistics*, May 1988, page 331). For details of this view also see Martin, *Advanced Industrial Economics* (Oxford: Blackwell, 1993), page 490 et passim. Martin assails Demsetz's econometric tests as inconclusive and inconsistent with the concentration-collusion-market power interpretation of inter-industry statistics (using concentration ratios and other measures of market power). There is little support for the market power hypothesis, vis-à-vis concentration due to the Telecommunications Act of 1996 in radio markets, and the case for efficiency is much stronger. (See Robert B. Ekelund Jr., George S. Ford, and Thomas Koutsk, "Market Power in Radio Markets: An Empirical Analysis of Local and National Concentration," *Journal of Law and Economics*, forthcoming.)


Avenues to obtain economies of scale are available that do not require mergers, such as increasing the size of a firm through internal growth. No doubt these avenues are pursued more often by more firms than is the merger route. But mergers are proposed when business management determines that alternatives to a merger would be less efficient, take too long, or pose a higher risk of failure. Requiring firms to grow internally rather than through mergers is likely to be particularly inefficient in industries such as electricity and communications, where the amount of available capital is substantial but currently misallocated. In other cases, mergers allow content producers to team up with access providers in ways that bring together skills and comparative advantages that each firm alone lacks.

The tools of economic reorganization, including mergers and acquisitions, are particularly valuable in restructured markets such as airlines, banking, radio, telephone, television, natural gas, and electric power. Competitive forces dictate that these deregulated firms seek new efficiencies in the use of capital and labor and that they restructure their companies to fit the realities of market competition. Empirical evidence suggests that deregulation and this restructuring have been beneficial for customers and stockholders.\textsuperscript{43} Mergers and acquisitions are a vital part of this process of restructuring.

While evidence mounts that most mergers are efficient, there is also evidence that preventing mergers causes inefficiency and unemployment. Due to the political environment and institutional incentives, government agencies face less severe penalties if they prevent something from taking place even though it would have been beneficial (a Type 1 error, or “error of commission”) than if they fail to stop something harmful from occurring (a Type 2 error, or “error of omission”).\textsuperscript{44} Consequently, they tend to commit many more Type 1 errors than Type 2 errors. In the case of antitrust law enforcement, this means many mergers are prevented or delayed for no more reason than the risk adversity of the regulators.

Studies have shown that the level of antitrust enforcement is related to the level of unemployment, with higher levels of enforcement causing higher unemployment rates.\textsuperscript{45} Mergers may cause some lost jobs in the short run, but the net effect is to increase productivity and therefore the number and quality of jobs in the long run. Delaying or prohibiting mergers causes the misallocation of capital and delay of technological advances, which can prevent job creation from taking place.


\textsuperscript{44} Aaron Wildavsky, Searching for Safety (Transaction Publishers, 1988), pages 199-201.

The fact that most mergers are efficient and competitive and that antitrust policy is, on balance, ineffective and anti-competitive, is the emerging consensus of many objective observers. Nobel prize-winning economist, F.A. Hayek, for example, argued successfully that “bigness” is a normal and efficient (and self-correcting) feature of many industries and that under the right conditions concentration is to be preferred to less-concentrated industry structures or to government remedies to monopoly.46

Antitrust authorities themselves now recognize the dominance of the efficiency rationale for mergers. The Department of Justice and Federal Trade Commission’s Horizontal Merger Guidelines (published in 1992) clearly recognize efficiency as a principal incentive of mergers. They note, for example, that:

The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers. . . . Cognizable efficiencies include, but are not limited to, achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations of the merging firms. The Agency may also consider claimed efficiencies resulting from reduction in general selling, administrative, and overhead expenses.47

While it is unclear to what extent the Guidelines determine antitrust policy enforcement, it is known that the DOJ and FTC use the Herfindahl-Hirschman Index (HHI) of market concentration (summed squares of individual market shares of all participants) as a guide or framework for merger analysis. In effect, they weigh potential problems of competitiveness (high HHIs) against probable enhancement of economic efficiency to determine whether a merger will be allowed to go by unchallenged.

There are, finally, four additional reasons that would suggest that mergers are especially important for competition and efficiency in restructuring industries where regulation is being replaced with competition:

• First, these very industries are where the lion’s share of contemporary mergers are taking place. The market is clearly signaling that mergers are an efficiency-enhancing way to restructure quickly and with low risk.


• Second, the premise of deregulation is that, over time, government regulation had instilled massive inefficiencies in regulated markets such as airlines, banking, and communications. This means that changes in the size and scope of firms in those industries are necessary.\textsuperscript{48} Under the old model of utility regulation, government regulators had neither the authority nor the knowledge to make those changes. Viewed from the premises of deregulation then, mergers are a necessary and logical component of restructuring.

• Third, the high rate of technological advance taking place in these historically regulated industries continuously works to undermine existing market power by threatening to make possible the sudden entrance of lower-cost or superior service providers.

• Finally, the restructured industries are now competing with each other. Technological breakthroughs and economies of scale are enabling power companies to operate telephone networks; cable companies can offer telephone services; banks, insurance companies, and stockbrokers can all compete in each other’s businesses. Bigness now creates the power to enter entirely new markets where competition was once thought inefficient or prohibited by regulation.

The evidence is compelling that most mergers are efficient and beneficial to workers, consumers, and investors. The alternative to allowing markets to determine which mergers will or won’t succeed is to place one’s faith in antitrust laws, laws that historically have been counterproductive and used for political ends rather than the public interest. Allowing mergers to take place quickly and with minimal expense is especially important for restructuring industries if the benefits of deregulation are to be realized.

PART 5

The Cost of Merger Delay

Since most mergers are economically efficient, regulations that cause merger delay impose unnecessary costs on society. Because delays are longer in regulated industries, where the need for and benefits of mergers are greatest, the social costs of merger delay in these industries are likely to be considerable. Here we present an estimate of those costs for a representative year of the 1990s.

The cost of delay is in some cases so burdensome that it destroys the merger itself.

The direct costs of regulatory delay include complying with HSR rules. Even under the relatively benign antitrust policies of the Reagan administration, filing meant copying thousands of pages of documents and filing out countless forms, with such tasks often carried out by highly paid legal operatives. In the new and relatively aggressive antitrust era, the costs of filing premerger notification are even more extensive. This investment produces nothing of value to the economy.

Another direct cost is spending on lobbying regulators and elected officials. Firms such as Microsoft spend millions of dollars a year on lobbying, money that would be better spent on software development. In May 1998, Microsoft had 88 lobbyists registered with Congress and “that does not include pollsters, public relations experts, litigators, or informal advisors.”49 Lockheed, which attempted to take over Northrop Grumman, failed to make the necessary investment in the lobbying process, apparently in the naïve belief that the merits of the planned merger would be sufficient to win political approval. Its merger plans were eventually denied after rival Raytheon provided large amounts of negative information to government officials. The costs of lobbying increase with the length of the delay and diminish rather than enhance productivity and wealth creation.

Indirect costs of regulatory delay are less visible but probably many times larger. Both the initial delay caused by HSR and the additional delay caused by federal and state bureaucracies give competitors the opportunity to scuttle proposed mergers through regulatory means and to respond with competitive bids and mergers of their own. Therefore, not only are mergers delayed, but the delay allows competitors to increase the price of acquisition and decrease the benefits of mergers.

The cost of delay is in some cases so burdensome that it destroys the merger itself. Many merger proposals wither on the vine as firms wait for merger approval while their competitors take alternative products to market. As a result, unknown numbers of proposals for mergers and other strategic moves are withdrawn or canceled before any regulatory decision is finally made.

The power to delay can be substantial enough to prevent companies from attempting or even contemplating mergers and acquisitions.

Another indirect cost is higher consumer prices and less choice in markets currently dominated by one or a small number of regional companies. Mergers and acquisitions create new firms big enough to compete nationally with small and less efficient local businesses and regional monopolies. AT&T's acquisition of cable networks, for example, is allowing it to compete with Baby Bells around the country for local telephone and Internet service.

Still another indirect cost of regulatory delay is the uncertainty and stress experienced by employees of the merging firms. Uncertainty about the future can prevent or postpone decisions on everything from major consumer purchases to education, career, and even marriage plans. One can imagine how difficult it is to focus on current tasks and build a sense of team unity when the strategies, management, and even name of the firm are kept in play month after month.

Even if the government's antitrust authorities produce benefits by preventing those mergers that would harm consumers over time, the cost of delaying all mergers and acquisitions is likely to outweigh those benefits. While the general population perceives government regulation and the delay it generates as a protection from "greedy corporations," evidence suggests that the largely invisible losses caused by regulatory interference outweigh the benefits.

How, then, do we put a price tag on the cost of regulatory delay? An interesting and provocative approach is suggested by the recent work of Professor Mark Sirower of New York University. Sirower's main thesis, which we find to be unpersuasive, is that mergers are motivated by egoistic desires of corporate leaders and permitted by agency problems in corporate America. Corporate executives, according to Sirower, are lured into making mergers on the often-unfulfilled promises of synergy between the acquiring and target companies. While the Sirower study suffers from several theoretical, methodological, and empirical problems, its author provides several penetrating insights linking economic losses to merger delay that are consistent with our findings.

First, Sirower notes that in terms of the profitability of mergers, time is of the essence. "The element of time is absolutely crucial in acquisitions, for two reasons. First, from a planning perspective, if acquirers do not begin to realize RPIs [Required Performance Improvements] immediately, they grow quickly with time to an amount that is unachievable. Second, and even more important, time kills the acquirer, because the acquirer has sent notice to its competitors that it expects to be a better competitor. The longer that synergies do not materialize, the more likely it is that competitors will respond before the company realizes any gains— one more way

---

to fall into the synergy trap.”

Delay therefore causes losses internally for the firm as the opportunity cost of capital grows, and delay causes lost opportunities as competitors are alerted to new competitive threats. “The transition to the post-acquisition integration phase must be done quickly and decisively.”

Second, Sirower develops a direct link between antitrust law and the cost of delayed mergers. He notes that the waiting time for merger clearance under HSR with cash tender offers is only one-half that of other mergers. “This can serve to minimize the chance of competing bidders entering the game, potentially leading to a contested process.” He found no independent difference in the premium paid in tender offers versus mergers, and there was no effect of tender offers on the ultimate performance of mergers. However, he did find that “contested acquisitions . . . resulted in higher premiums than uncontested acquisitions, and contested tender offers resulted in higher premiums than uncontested tender offers.”

This is important because in Sirower’s study, higher premiums paid by acquiring firms are the leading indicator of an unprofitable merger and the best measure of how unprofitable a merger would be. Thus, he links merger delay caused by antitrust laws with the lower profitability of mergers and acquisitions. His result confirms previous studies which indicate that the “publicness” of mergers and acquisitions increases the potential of multiple bidders, higher premiums, and lower returns. For example, he writes: “I found the presence of multiple bidders to have a negative effect on acquiring firm performance.”

Third, Sirower found that the stock price of the acquiring company fell after the merger was announced and stayed low during delay, and that subsequent stock price increases were dampened. His data set consisted of only 168 mergers, and these were the largest mergers during the 1980s. Our own empirical finding that merger delay was greater in mergers involving bigger companies suggests that Sirower’s database unintentionally over-represents those mergers most likely to suffer the effects of regulatory delay caused by antitrust and other types of regulation. His finding that these mergers tend to be inefficient is not generalizable to all mergers, most of which are smaller and therefore escape scrutiny by regulators and the delay that

---

51 Ibid., page 65. RPIs are “the actual performance requirements that managers face on a day-to-day basis following an acquisition just to break even.” (Ibid., page 15.)

52 Ibid., page 76.

53 Ibid., page 133.

54 Ibid., page 133. “Premiums,” notes Sirower, “translate into specific required performance improvements for the new firm to meet” (page 52).

55 Ibid., page 27.

56 Ibid., page 100.
results. In short, Sirower’s findings confirm that regulation is the major negative factor in the returns on and desirability of mergers in regulated markets.

Sirower argues that the loss due to delay is the result of managerial incompetence, but our analysis shows that the delay and subsequent loss are more plausibly due to actions by regulators and rivals. Sirower’s explanation, with its assumption that the vast majority of the captains of industry are making huge systematic mistakes, is scientifically unappealing, but his detailed empirical analysis provides a foundation to conduct an indirect estimate of the costs of regulatory delay.

Sirower’s empirical finding—that the premium paid by an acquiring company for the target company’s stock is directly related to the loss experienced by the acquiring company—provides the basis for calculating the loss due to regulatory delay. The longer the delay, the higher the premium, and the greater the loss.

Using 1996 for our calculations, we find that the average premium paid for mergers in regulated industries was indeed larger than the premium paid for mergers in unregulated industries. The average premium in regulated industries was 35.68 percent and the average premium for all mergers was 26.2 percent, so there was a 9.48 percentage point difference in premiums paid.67

The total value of mergers in regulated industries that were closed or completed was $53.4 billion, and the total value offered in new announcements in 1996 was $200.1 billion, indicating an increasing trend in merger value activity. Using the value of mergers actually closed in 1996, and assuming the difference in premiums was due entirely to regulation-induced delays, the estimated cost due to the additional regulatory delay in regulated industries was $5.06 billion. Using the dollar value offered in new merger announcements (this figure includes mergers that will subsequently be canceled), the estimated cost due to additional regulatory delay in regulated industries is $18.97 billion.

The first figure is backward-looking because it includes merger activity that was announced in 1994-1996. It also represents a lower limit of the estimated cost of regulatory delay because it ignores canceled transactions, many of which represent lost opportunities due to regulation. The second figure is a forward-looking estimate because it is calculated on the basis of mergers announced in 1996 that will be completed in 1996-1998. This figure probably represents an upward limit on the additional cost of regulatory delay in regulated industries because it includes transactions destined to be canceled. While canceled transactions are largely the result of regulation and delay, they are not entirely so. If we average these two estimates, the cost of additional merger delay in 1996 was over $12 billion.

---

67As does Sirower, we measure the premium as the percentage change in the price of the target firm from five days prior to takeover news to five days after the news, adjusted for the movement in the S&P 500 Index during that time. This calculation actually underestimates the difference in premiums between regulated and unregulated firms.
These estimates are exploratory, but they do capture the lost opportunities and the value of those opportunities to acquiring companies and their shareholders due to regulatory delay. Certainly the cost of merger delay due to regulation also affects consumers and the economy more generally, but these costs can be considered to be capitalized into the stock market values of the companies that lose those opportunities or are delayed from implementing those profit opportunities. Profit opportunities, consumer satisfaction, and stock market values go hand-in-hand.

Because they produce no useful goods or services, the direct costs of regulatory delay are a pure dead-weight loss to society.

To briefly summarize, we know the direct costs of regulatory delay—in the form of compliance costs, lobbying, public relations, etc.—are substantial. Because they produce no useful goods or services, those expenditures are a pure deadweight loss to society. The indirect costs of regulatory delay—lost products, innovations, and efficiencies that would have come about had mergers been completed rather than crippled by premature publicity or canceled due to the threat or cost of regulatory interference—are much greater, but those costs are largely invisible.

The premiums paid by acquiring firms for the stock of target companies give us a window through which to see the social cost of regulatory delays of mergers. Regulatory delay is the chief cause of higher premiums, and higher premiums are the leading indicator of a merger failing to produce the efficiencies anticipated by the merger partners. In 1996, we estimate the value of higher premiums paid for regulated firms to have been $12 billion.
Reform Recommendations

Our findings suggest the need for policy reform. The ideal policy would be to eliminate premerger review altogether, thereby eliminating delay and the many opportunities for rent-seeking mischief created by antitrust laws. This would increase economic prosperity and raise the standard of living. Since this change is politically unlikely in the near future, delays might be reduced by the following, more moderate, policy suggestions:

1. Adjust the HSR criteria for inflation to free small firms from the burden of filing the notification and having to lobby for permission to proceed. Adjusting the reporting threshold by changes in the stock market indexes, rather than inflation, would have an even greater beneficial impact. Computer power unavailable in 1976 should make federal review of proposed mergers possible in as little as 24 to 48 hours.

2. Raise to 50 percent of national market share the concentration level that triggers premerger review of multi-billion dollar mergers.

3. Eliminate merger review authority for federal, state, and local regulatory bureaucracies other than the FTC and DOJ and reduce or eliminate the regulatory or licensing hoops through which these mergers must jump.

4. Establish clear and objective guidelines for merger review so that proposals can be written to meet those guidelines in advance of regulatory review.

5. Establish a firm deadline for merger review that is less than 30 days. If review by more than one agency is required, the reviews should occur concurrently in order to be completed within the time period allowed.

6. Hold annual Congressional hearings on the problem of merger delay to draw attention to their costs and to the interest-group politics that often lay behind such delays.

---

58 Even if a few small firms were able to create pockets of monopoly power, that power would surely have a limited effect on the economy and could be easily dissipated. We are not arguing that small companies cannot have monopoly power, only that on net this is a clear area of policy reform.
PART 7

Summary and Conclusion

The merger boom of the 1990s unleashed a new era of “trust-busting” that includes high-profile antitrust cases, such as Microsoft, but also intensive premerger reviews by the traditional antitrust agencies, the Federal Trade Commission and the Department of Justice, federal agencies (e.g., the Federal Communications Commission and Federal Energy Regulatory Commission), state attorneys general, state regulators, and regulatory bodies at local levels.

Evidence suggests that merger activity is an efficient and necessary aspect of the market process that promotes competition, improves product quality, and lowers price. We find this response to be undesirable and counterproductive. Growing evidence suggests that merger activity is an efficient and necessary aspect of the market process that promotes competition, improves product quality, and lowers price. These benefits flow from economies of scale and scope, widened markets, changing technology, and managerial and labor consolidations. The role of mergers in restructuring formerly regulated industries appears to be more important than in industries characterized, historically, as competitive.

The essential motive for antitrust policy and enforcement has historically been to prevent or delay moves that put politically influential competitors at a disadvantage. Premerger review requirements produce a politicized labyrinth that delays an increasing percentage of all mergers and virtually all mergers relating to economic restructuring through deregulation. Rivals in restructuring industries have lower costs for engaging in activities that delay and sabotage competitive mergers due to their legal, legislative, and lobbying expertise.

Mergers have been delayed far beyond the original limits established in HSR of 1976. We find, empirically, that mergers in regulated industries in the 1990s are delayed nearly twice the length of mergers in unregulated industries, for an average total delay of some 184 days. On average, large mergers in regulated industries—such as communications, where so much activity is taking place—face the longest delays and the highest opportunity costs. Case studies of mergers in the communications industries (see Appendix) vividly illustrate the cost of delay.

Premerger notification and review cause delay that imposes a variety of economic costs. These costs include all the direct costs of review and the time costs of review, as well as the indirect costs of foregone economies, efficiencies, and product-service innovations that mergers otherwise bring. Our rough calculation of these costs is $12 billion in 1996. We find that the social cost of merger delay is growing over time. If these calculations hold for other years of the 1990s, merger delays are a highly significant drag on an economy undergoing massive and critical industrial restructuring for growth in the twenty-first century.

- 28 -
Congress, the administration, governors, and state legislatures all should act quickly to rein in bureaucracies that are plainly acting against the public interest. Raising the thresholds for premerger notification and review is the easiest policy change to implement, but it is far from the only reform that is necessary. Public hearings would help uncover the private interests that drive merger delay, making it easier for elected and appointed officials to act responsibly and block the tactics of delay.

More research on issues relating to delay remains to be done. Ours is but a first look at the cost of delay issue and is only a first approximation. A research program on merger delay cost, such as that mounted in the 1960s on delay of new drug approvals by the Food and Drug Administration, would reveal with greater precision the degree of delay attributable to regulators versus other factors, and how private interests trump public interests. More careful study is needed of the effects of merger delay on stock prices, as well as the effects on consumer prices, innovation, and perhaps international trade.

We are convinced, however, that enough is known at this point to proceed with policy reforms that will shorten merger delays.
Appendix

Two Case Studies of Merger Delay in Telecommunications

Calculating with statistical accuracy the costs associated with merger delay is very difficult. Anecdotal evidence in the form of recent case studies of mergers and proposed mergers in telecommunications, however, is very revealing.

Predictably, competitors, regulatory agencies, and other interest groups got into the act when the Bell Atlantic/NYNEX merger was announced.

TheTelecommunications Act of 1996 enshrines the hope that integrated telecommunications services will evolve to serve consumers’ many needs, including local and long-distance telephone service, access to cable TV and Internet, and a growing variety of telecommunications services made possible by new technologies. As part of this restructuring, long-distance companies will enter local phone service areas (the local exchange carriers) and local Bell companies will enter long-distance markets. That is true of the two case studies we consider here: the Bell Atlantic/NYNEX merger (announced in April 1996 and completed in August 1997) and the proposed SBC/Ameritech merger (announced in May 1998 and not completed at the time this was written).

Bell Atlantic/NYNEX

The Bell Atlantic/NYNEX merger, encompassing telephone services over much of the East Coast, was announced in April 1996 and finally consummated in August 1997, a delay of 16 months. The motives of Bell Atlantic were clear and clearly promulgated: to enter the lucrative long-distance market. Together the two firms serve 40 million access lines in 19 states (and the District of Columbia), providing local telephone services to 25 percent of the nation. Further, 45 percent of all long-distance calls made in the United States originate in the area covered by the merged firm (Bell Atlantic, which also accounts for 35 percent of all U.S. international calls).

Few layoffs of the more than 140,000 combined employees of the two companies were proposed and few layoffs actually occurred. New investment in the first year was over $5 billion. The announced goal of Bell Atlantic is to capture 25 percent of the in-region long-distance market over a five-year period.

Predictably, competitors, regulatory agencies, and other interest groups got into the act when the merger was announced. The Federal Communications Commission imposed conditions regarding reporting requirements, computer interface standards to be established with competitors at the local level, charges to competitors (to be made at wholesale prices) for local access, and requirements relating to the accounting procedures of the merged firm. The
agreement also required the company to set up software systems allowing customers to easily switch services from one carrier to another. As Reed E. Hundt (then FCC chairman) said of the agreement, “If Bell Atlantic and NYNEX want to be the East Coast phone company, then they must open the whole East Coast to competition.”

What was the source of the 16-month delay? Overlapping jurisdictions—federal and state regulatory agencies withholding their approval—were the proximate cause. Underlying the regulatory delay, however, were interest-group pressures. Competitors such as AT&T, MCI, and other companies filed objections, principally concerning the terms at which they would be allowed into the local markets. Consumer groups also filed objections. Consumers Union opposed the merger, believing that the technical provisions proposed between the FCC and the companies were insufficient to permit new entrants into the giant’s merged markets. (Ultimately, the FCC, in approving the merger, noted that competitors could seek appropriate enforcement of the conditions from the Commission.)

Even after the merger was approved in August 1997, complaints continued, as did the doubts that competition would be a feature of East Coast telecom markets. Challenges to market entry by the merged firm continue in state regulatory jurisdictions. In January 1998, MCI filed a complaint with the FCC arguing that Bell Atlantic violated the terms of the merger agreement by requiring carriers to pay interconnection charges on the basis of historic network costs rather than using the “forward-looking” cost methods agreed to in the conditions established by the FCC. Additionally, the amount of the switching charge has become an issue.

The cost of this delay is difficult to gauge. However, a look at the stock price of Bell Atlantic is suggestive. While Bell Atlantic’s stock price has trended upward, it has been above the Dow Jones Industrial Average only since mid-1998, with volume rising after the consummation of the merger in August 1997. While many factors affect the stock of a particular company, this record is consistent with our theory that stock prices reflect the cost of delay. Slow growth in stock prices while the merger was being challenged reflects uncertainty that the merger would be approved and the competitive advantages being gained by rivals due to delay. The upward trend in stock prices after approval means investors believe the merger is efficient.

SBC/Ameritech

Formal merger negotiations between SBC and Ameritech began in May 1998. Informal discussions of the merger actually began a year earlier, in April 1997, when San Antonio-based SBC purchased Pacific Telesis in a stock swap of $16 billion. Later, in May 1998, SBC made a

---


massive stock-for-stock offer for Ameritech (offering a value of about $55.77 for each Ameritech share), contingent on approval from a host of regulatory agencies. This merger, still incomplete in June 1999, must be approved by two of the five Public Utility Commissions in Ameritech's service regions, local regulators, and the FCC. The DOJ will also review the transaction and some European countries will conduct their own reviews.

While the threat of anti-competitive practices may be a potential short-run problem, the merger would enable new telecommunications competition by permitting SBC to enter 30 markets beyond its traditional 13-state local regions. The merger, if completed, would provide integrated services of local, long-distance, Internet, and high-speed data services to a potential customer base of 180 million people in the top 50 markets in the United States. Company executives expect cost economies through heightened economies of scale and scope, elimination of duplicated expenditures, and cost control. Clearly, there would be synergies in a merged company. Local pain would be minimized since SBC is committed to retaining Ameritech's employment levels in the five-state region.

Since jockeying for politically determined competitive advantages has positive payoffs for these firms, new threats to the merger might be expected. MCI (now MCI WorldCom Inc.) filed a proposal in March 1998 to break up the Baby Bells. Filings in Illinois and Ohio attempt to put conditions on the merger—that consumers should have phone rates reduced if the merger takes place. A staff report from the Illinois Commerce Commission issued in early March 1999 strongly opposes the merger.61

Competitive rivals have even developed a "new" theory of anti-competitive behavior in order to stop or limit the terms of the merger. The so-called "Big Footprint" theory maintains that since the merged firm would be present in so many individual markets, the sheer geographic size of its holdings would provide it the ability and the incentive to deny access to new rivals. Thus, since the merged firm would control beginning and ending connections between, say, Houston and Chicago, it would have the incentive to limit or block competition in both cities.

The Big Footprint theory, untested in the courts, may not prevent the SBC/Ameritech merger, but it might elicit concessions from the merging companies.62 Moreover, this merger proposal occurs at the holding-company level and thus does not change regulatory oversight at the state level.


It is difficult, once again, to accurately assess the cost of these delays. Investors appear to believe the merger would be efficient. While many factors affect the price of stock, the value of SBC and Ameritech shares have trended upwards after the SBC announcement. Ameritech stock prices have risen well above the Dow Jones Industrial Average over the post-announcement period, suggesting particular benefits to the smaller firm from the merger. This means consumers, investors, and workers are bearing unnecessary costs each day that regulators, with the encouragement of rivals of SBC/Ameritech, delay the merger.

###

**About the Authors:**

Robert B. Ekelund Jr., Ph.D., is the Lowder Eminent Scholar in the Department of Economics at Auburn University. He received his B.B.A. and M.A. at St. Mary’s University and Ph.D. at Louisiana State University. Dr. Ekelund is the author of 21 books including a widely used basic text and recent works related to economic history, economic theory, and the economics of regulation (Sacred Trust: The Medieval Church as an Economic Firm (1996); Politicized Economics (1997); The Foundations of Regulatory Economics (1998); and Secret Origins of Modern Microeconomics (1999)). He has written more than 200 articles, papers, and monographs on economic theory and policy appearing in the American Economic Review, Quarterly Journal of Economics, the Journal of Political Economy, and the Journal of Law and Economics.

Mark Thornton, Ph.D., is the O.P. Alford III Chair of the Ludwig von Mises Institute at Auburn University. He received his B.S. in economics at St. Bonaventure and Ph.D. at Auburn University. Dr. Thornton is the former Assistant Superintendent of Banking (Alabama) and author of The Economics of Prohibition (1991) and numerous journal articles addressing regulation and antitrust.