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THE GOVERNMENT'S WAR ON MERGERS
The Fatal Conceit of Antitrust Policy

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Executive Summary

Antitrust is thought by some to be the bulwark of free enterprise. Without the vigilance of the Justice Department and the Federal Trade Commission, so the argument goes, giant corporations would ruthlessly destroy their smaller rivals and soon raise prices and profits at consumers' expense.

But antitrust has a dark side. Opposition to mergers, though in theory based on worries that competition may be impaired, often in practice comes not from consumers whose interests antitrust is supposed to defend, but from competitors faced with the prospect of a larger, more aggressive rival. Because they respond to the demands of competitors, labor unions, and other well-organized groups having a stake in stopping mergers that promise to increase economic efficiency, the antitrust authorities all too often succeed, not in keeping prices from rising, but in keeping them from falling.

The politicization of antitrust is not just a matter of historical curiosity. Politics stalks many of the high-profile cases brought by President Clinton's trustbusters, including Primestar's planned purchase of a key satellite slot as well as the mergers proposed between Staples and Office Depot, WorldCom and MCI, and Lockheed Martin and Northrop Grumman.

When the antitrust authorities intervene to reshape markets at the behest of competitors, private decisions about how best to organize production are displaced by government decisions. Innovative firms are penalized, scale economies are lost, and competition is thwarted, not enhanced.

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Introduction

The stock market boom of the 1990s has triggered a new wave of mergers in the U.S. economy. Driven by expectations of continued technological progress and economic growth, rising share prices have helped provide the wherewithal for alert corporate executives to take advantage of profit opportunities created by the existence of undervalued assets.

The forces unleashed by the integration of the world's economies are as far-reaching as they are robust. In response, leading American firms in the automobile, telecommunications, defense weapons systems, pharmaceuticals, and financial services industries, among others, have moved aggressively to consolidate their resources and to diversify their operations in order to compete more effectively in the rapidly changing global economy of the late 20th century.

Whether measured by numbers of proposed transactions or values of combined assets, this latest merger wave dwarfs the three or four that have gone before it since the epic trust-building era at the turn of the century.[1] A record 3,700 pre-merger notification forms were submitted to federal antitrust agencies in fiscal year 1997-–up from 1,500 in FY 1991-–and midway through FY 1998, the pace was 25 percent ahead of the previous year.[2] About 3,500 of the 3,700 merger transactions announced in FY 1997 were worth more than $15 million each-–and 128 of them were valued at more than $1 billion each.[3]

At the same time, antitrust law enforcement has exhibited renewed vigor under President Clinton's appointees to leadership positions at the Justice Department's Antitrust Division and the Federal Trade Commission, who seem to be wary of (if not openly hostile to) the self-correcting forces of unfettered markets.[4]

Supported by cadres of government lawyers and economists, who have poured old "big is bad" antitrust-doctrine wine into new bottles by coining catchy terms for apparently novel threats to competition, the antitrust agencies have lately intervened actively to micromanage (and in some cases to block outright) a number of high-profile mergers in industries that, by all commonsense definitions of the word, are highly competitive. No longer content simply to oppose a merger on the grounds that it might tend to create a monopoly, the antitrust authorities now worry about "unilateral competitive effects" and a host of other exotic-sounding sources of consumer injury.[5]

Indeed, the textbook concept of "monopoly"--a single business entity producing a product having no close substitutes--seems to have passed quietly into antitrust history. Instead, somewhat beleaguered by the pace of economic events,[6] the antitrust agencies now contend with so-called franchise firms, alleged monopolies such as Microsoft Corp., Intel Corp., and Coca-Cola Co., characterized by strong brand names and huge market shares that, "unlike classic monopolists, . . . use their size not to jack up prices but to spread their costs, hold down prices and keep competitors on the ropes."[7]

The fruits of revived antitrust activism, which its partisans applaud as signaling a return to the happy days of hard-nosed law enforcement that existed before the Reagan administration willfully neglected its duty of protecting consumers against abuses of market power,[8] raise serious questions about the purposes and effects of antitrust policy. Although the conventional wisdom is that antitrust helps preserve free markets, a rehearsal of the facts in a number of merger cases recently before the Antitrust Division and the FTC suggests that the federal trustbusters frequently have trouble distinguishing competition from monopolizing.

As a result, the antitrust laws have far too often been brought to bear in attacking innovative, risk-taking firms that have succeeded in developing previously unknown products and in establishing wholly new industries. The temporary market dominance those pioneers work hard to achieve by using resources efficiently and serving consumers well--and work hard to maintain by fending off the competitive challenges of late-coming rivals--is greeted not with acknowledgment of the value they have created, but with hostile charges of unlawful monopolization.

By chilling incentives to innovate and by forcing sellers to worry that their prices might be too low or too high, thus making it more difficult to keep them in line with costs, the antitrust laws both reduce the welfare of consumers and handicap American firms as they strive to compete on a global scale.

Despite the intensely competitive environments spawned by the globalization of markets, antitrust law enforcers persist in taking a static view of the world. "They accept the data of the momentary situation as if there were no past or future to it and think that they have understood what there is to understand."[9] A firm that dominates its industry today will continue to dominate it, so the argument goes, unless government takes corrective action.

Mergers, contracts freely entered into by buyers and sellers, and all "the well-known moves and countermoves" within industries consisting of a few large firms are not seen as an attempt "to deal with a situation that is sure to change presently[,] . . . to keep on their feet, on ground that is slipping away from under them."[10] Instead, they are seen as anti-competitive practices aimed "at nothing but high prices and restrictions of output."[11]

Business practices that seem to raise antitrust concerns are best understood, not as strategic behavior to exploit a market in which a few large firms temporarily hold a commanding lead, but as responses to ever-present threats to dislodge the market leader. Evaluated in that light, antitrust law enforcement becomes, at best, ill-informed meddling and, at worst, heavy-handed interference with the freedom of private property owners to allocate scarce resources to their highest valued uses. Private decisions about how best to organize the production of goods that satisfy consumers' wants are displaced by government decisions.

Using their authority to enjoin mergers or to condition approval on the divestiture of specific assets or the erection of "firewalls" between certain operating units, the antitrust authorities determine how the ownership of productive resources will be distributed among firms and which product lines firms will be allowed to offer. Using their authority to prohibit "unfair" methods of competition, the antitrust authorities determine what features products will be allowed to embody and what prices their sellers will be allowed to charge.

Worried for much of this century that market power might result in prices that are too high, antitrust increasingly summons images of the Gilded Age to insist that firms will ruthlessly exploit economies of scale to dominate their markets by charging prices that are too low.[12] Like the great muckraker Henry Demarest Lloyd--and Karl Marx--law enforcers nowadays seem to believe that competition leads inexorably to monopoly.[13]

Supporters of antitrust deny that it is simply another form of regulation.[14] But it took the Department of Justice nearly 25 pages of text merely to summarize the prohibitions and disclosure and nondisclosure requirements imposed on NewCo, a joint venture between MCI Communications Corp. and British Telecom.[15] It is likewise hard to see how attempting to coerce Microsoft into offering its core product (Windows 98) without what it thinks to be an important application (Internet Explorer) or, alternatively, packaging a competitor's Web browser with its operating system, is anything other than intrusive government regulation operating in disguise.[16]

What is more important, while the stated purpose of the antitrust laws is to protect consumers against the abuses of monopoly, in practice they are frequently used to protect the rivals of successful firms against the harsh forces of the competitive marketplace. A law that declares mergers to be illegal where they would lessen competition or tend to create a monopoly is also a law that rivals of the merging firms can call upon to block the creation of a more effective competitor.[17] Protestations to the contrary, strategic use of antitrust processes to protect competitors rather than to preserve competition has transformed the laws into another form of economic regulation, vulnerable to capture by politically powerful special-interest groups.

Instead of investing resources to improve their products, cut their costs, or expand their sales, firms increasingly turn to Washington for relief from aggressive rivals. Netscape Communications Corp. lobbies the antitrust agencies to stop Microsoft from bundling a Web browser with its computer operating system; Pepsi sues Coke, complaining of practices that make it difficult for Pepsi to hold on to the accounts of customers who sell soft drinks at the fountain; and GTE Corp. files a lawsuit to block the merger of WorldCom and MCI on the ground that access to the Internet will be impaired.

That is not how competition is supposed to work. In a freely functioning marketplace, firms "injure" their rivals by taking sales away from them. Market forces then demand a counterresponse by the bruised competitor, which by adding more features to its product, lowering its price, or both, can strive to regain the business lost to its hard-nosed rival. Consumers gain when markets are left alone to operate in that way. But when firms choose instead to complain to the antitrust authorities, hoping that government will intervene to provide protection from the harsh realities of the competitive marketplace, consumers lose. Protecting competitors does not preserve competition; protectionism is the antithesis of competition.

If the Justice Department and the FTC cannot be relied upon to apply the antitrust laws in ways that promote consumers' interests and if, in fact, they routinely protect competitors at consumers' expense, then the laws themselves have no intellectual justification. Unfettered competition offers consumers much better protection from "monopoly" than the ill-informed--and frequently politically inspired--meddling of the antitrust agencies.

The Confused Economics of Merger Policy

Public policy toward mergers raises all of the economic issues that are central to evaluating the purposes and effects of the antitrust laws. Will the combination of two formerly independent firms create a new business entity with such a large share of the relevant market that prices and profits can be expected to increase at consumers' expense? Or will the merged firm instead be able to take advantage of cost-saving opportunities, thereby expanding output, lowering price, and enhancing consumer welfare?

The antitrust authorities' answers to those questions in turn hinge, first, on the definition of the relevant market within which the competitive effects of the merger will be evaluated; second, on judgments about the sources and magnitudes of possible merger-related cost savings; and, third, on the existence of barriers to the entry of new rivals that would permit the merged firm profitably to raise price above competitive levels.

Merger law enforcement is based on an "incipiency" doctrine which holds that preventive measures against monopoly are superior to corrective measures. The government's legal authority to enjoin mergers was established by the Clayton Act of 1914, Section 7 of which declared in part

> that no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation also engaged in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly in any line of commerce.

Section 7 was conspicuously silent on means other than stock purchases by which one firm could acquire an ownership interest in another. Apparently, merger transactions involving the purchase of physical assets did not offend the Clayton Act, even if equity shares were also acquired.[18] Courts also held that an acquiring firm could not be compelled to divest the physical assets it had purchased even if a stock acquisition was subsequently found to be illegal.[19] That glaring loophole rendered Section 7 virtually impotent.[20]

Congress reinvigorated the enforcement of Section 7 by passing the Celler-Kefauver Act in 1950. That amendment explicitly prohibited the acquisition of another firm's physical assets if the effect was to substantially lessen competition or tend to create a monopoly. The Clayton Act's asset loophole was thereby closed and the government has rarely lost a merger case since.

Merger law enforcement was strengthened further by passage of the Hart-Scott-Rodino Premerger Notification Act of 1976, which requires the parties to mergers exceeding stated thresholds to announce their intentions to the Antitrust Division and the FTC simultaneously, and to hold the proposed transaction in abeyance until the government grants clearance to proceed.[21] Decisions to grant such clearance or to oppose the merger on antitrust grounds are supposed to be governed by the Department of Justice's Merger Guidelines, first promulgated in 1968 and revised on a number of occasions since.[22]

Until very recently, the analytical model established by that document involved defining the relevant antitrust market-–the "line of commerce" and the "section of the country"--within which the competitive effects of a proposed merger would be evaluated. Once such a market was established, the guidelines spelled out market concentration criteria (based initially on market shares and, later, on values of the Herfindahl-Hirschman Index)[23] that would determine whether the combination of two previously independent firms would, in the antitrust agency's judgment, pose a threat to competition.

Market concentration has been the linchpin of merger analysis. It serves as a rough-and-ready indicator of the likelihood either that the newly combined firm will acquire market power-–allowing it unilaterally to raise prices above competitive levels[24]-–or that collusion among the firms remaining in the market will become profitable. Offsetting factors, such as production-cost savings and the absence of barriers to entry, might make post-merger price increases unprofitable. At least on paper, those offsetting factors have been given greater weight in subsequent versions of the Merger Guidelines, but market definition and market structure remain at the heart of the antitrust agencies' analytical model of mergers.[25]

Despite the apparent precision with which pre- and post-merger market shares and market concentration are computed, the process of defining the relevant antitrust market determines how high the resulting numbers will be. Narrowly drawn market boundaries, which include only a few products, increase the probability that a proposed merger between any two sellers in that market will be challenged. And, not surprisingly, given the bureaucratic incentives of the antitrust authorities to produce tangible evidence of their law enforcement activities,[26] a bias toward defining markets narrowly has inevitably ruled the process.

The more narrowly antitrust markets are defined, the more merger cases there are to work on, the more opportunities there are for government attorneys to gain the experience that will be rewarded when they subsequently take jobs in private law firms, and the larger and more secure are the antitrust bureaus. The more active are the antitrust agencies, the more clients the private antitrust bar gets to defend and the greater is the demand for economists to serve as expert witnesses in antitrust proceedings.

Definition of the relevant market is a conceptually straightforward process of identifying the products and firms to which buyers could reasonably turn if confronted with an increase in the price charged by the prospective merger partners.[27] Yet, instead of being used as a way of summarizing and organizing the information appropriate for predicting the likely competitive effects of a merger, market definitions have been nothing short of Byzantine.

In mounting a challenge to Nestlé's proposed acquisition of Stouffer, for instance, the Federal Trade Commission defined the relevant market to include only "high-priced, nonethnic, frozen entrees."[28] Other examples, drawn from the transactions reviewed under various incarnations of the Merger Guidelines, include markets consisting of "bagged dry-mix concrete in the Washington-Baltimore area"; "beer production and distribution within the State of Kentucky"; "direct contract front-loaded trash removal in Dallas"; "home and office staplers"; "traditional department stores in Milwaukee"; and "noncarbonated, ready to serve, naturally or artificially flavored fruit drinks, fruit punches, or fruit ades which contain 50 percent or less fruit juice and are customarily sold under refrigeration to the consumer."[29]

Not so long ago, McCormick & Company's proposed acquisition of the Spice Islands brand was abandoned when the FTC voted unanimously to oppose the transaction on the grounds that it would substantially lessen competition, possibly leading to higher prices in the "gourmet spice market."[30]

The extent to which serious economic analysis can be brought to bear in defining relevant antitrust markets is constrained by the willingness of judges to understand and embrace it. In Brown Shoe,[31] the first major merger case brought after the Celler-Kefauver Act strengthened the language of Section 7, the Supreme Court enumerated a half-dozen or so factors it would rely upon in determining the boundaries of relevant antitrust markets. The Brown Shoe Company's acquisition of G. R. Kinney was unlawful, the Court declared, not because it created a shoe retailer with a national market share of 2 percent, but because competition was impaired in 270 cities ("submarkets") where Brown and Kinney both operated retail shoe stores.[32] The majority opinion went on to say that whether "well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes" could be

> determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.[33]

One of the unfortunate legacies of Brown Shoe was the excuse it gave antitrust officials to look no further than the casual statements of the managers, employees, or customers of the firms involved in a merger transaction for evidence of the appropriate boundaries of competition. "The parlance of businessmen ('the Chicago drugstore market,' 'the high-fashion shoe market')" became a substitute for formal modeling of the market forces that might thwart any attempt by the merger partners to raise price.[34]

Brown Shoe's "practical indicia" subsequently led to the condemnation of mergers between firms operating in markets variously defined as the business of commercial banking in the city of Philadelphia and three contiguous counties,[35] the manufacture of insulated aluminum wire (but not insulated copper wire),[36] the production of metal cans and glass jars (but not plastic containers),[37] grocery retailing in the Los Angeles area,[38] and beer brewing in the state of Wisconsin (or, alternatively, the three-state area consisting of Wisconsin, Illinois, and Michigan).[39]

Economists have developed a variety of sophisticated empirical techniques for identifying the boundaries of markets relevant for assessing the competitive effects of mergers. In one way or another, all of those techniques grapple with the fundamental problem of measuring the extent to which consumers and producers will respond to a hypothetical post-merger increase in price. Elasticities of demand and supply are crucial to predicting the magnitude of the reduction in sales the merger partners can anticipate as consumers switch their purchases to existing rivals and as new competitors enter the market to take advantage of profit opportunities.

In theory, markets are defined to identify those constraints.[40] In practice, market definition has become the principal issue in merger analysis. The fate of any merger transaction hinges almost entirely on how narrowly the relevant market is defined.

Antitrust partisans freely admit past errors in applying the laws, but remain faithful to the stated purposes of the Sherman, Clayton, and Federal Trade Commission acts. A review of the facts in a number of recent high-profile merger cases suggests that uncritical confidence in the abilities of those responsible for enforcing the antitrust laws to correct past errors is misplaced. As we shall see, driven by relevant market definitions that seem overly narrow, even ad hoc, the antitrust authorities still frequently get the economics of merger analysis wrong.

Staples-Office Depot

On March 10, 1997, the Federal Trade Commission announced that it would seek a preliminary injunction against the proposed merger of Staples and Office Depot, two of the nation's three major office-supply "superstore" chains. The FTC's challenge effectively killed the merger, whose fate was sealed three months later when a federal district court in Washington, D.C., granted the commission's request for a preliminary injunction.[41] As the record of merger law enforcement shows, all too frequently the commission construes the relevant market narrowly––in this instance, only office-supply superstores––thereby ensuring that the merger partners account for a large percentage of total sales. Accordingly, argues the commission, higher prices will inevitably follow the merger’s consummation.

In the view of the FTC’s leadership, Staples-Office Depot established three important precedents with respect to merger law enforcement under the most recent (1992) version of the Department of Justice’s Merger Guidelines-–namely, "the definition of the relevant market, . . . how to treat claims of efficiency in defense of a merger,"[42] and the salience of the distinction

> between anticompetitive mergers that make it more likely or more effective for firms to coordinate their actions, and anticompetitive mergers that make it profitable for the merging firms to reduce output and raise price unilaterally.[43]

Although "unilateral theories are now by far the most common,"[44] price fixing has a long history of per se illegality. Under the law, per se treatment means that the antitrust authorities do not have to show that firms accused of colluding actually succeed in reducing output and raising prices. The mere attempt to fix prices is sufficient to establish a violation. That standard reduces the government’s burden of proof considerably; but allowing a merger to be challenged on the supposition that the firms remaining post-merger <u>would</u> attempt to coordinate their actions is quite another matter.

Unilateral action is always easier to initiate than collective action. It is simpler therefore to make the case that a new firm with a large share of the market could profitably restrict output and raise price on its own than to assert that the firm would conspire with its remaining rivals to restrict output and raise price in unison.

The director of the FTC’s Bureau of Economics denies that Staples-Office Depot signals a return to reliance on the market-definition criteria announced in <u>Brown Shoe</u>.[45] That denial is unconvincing in light of the federal district judge’s appeal in that case to "practical indicia" for defining relevant antitrust submarkets.[46] The commission’s decision to analyze the merger’s competitive effects in the narrowly construed market consisting only of office-supply superstore chains was almost wholly based on evidence gleaned from internal company documents that could be interpreted as confirming "industry or public recognition of the submarket as a separate economic entity."[47] As summarized by one FTC official,

> the extensive documentary evidence from the merging firms' files . . . demonstrated that the two superstore chains charge lower prices in cities where they directly compete relative to prices in cities where the merging firms do not face each other head-to-head. The documents also showed that superstore competition is the main reason for this pricing policy.[48]

In accepting the commission's proposed market definition, the court relied heavily on business plans and other writings contained in the two companies' files referring to so-called price zones--one termed "competitive," where Staples and Office Depot both operated superstores and where, according to the FTC, office supply prices tended to be lower; the other termed "noncompetitive," where only one of the merging firms conducted business and where prices tended to be higher "without regard to whether other retailers nearby sold office supplies."[49]

The commission's staff economists, in consultation with an outside economic expert, Princeton professor Orley Ashenfelter, prepared econometric studies purporting to show that the prices of selected office supplies were indeed lower in cities served by two or three of the superstores than in cities served by only one of them. That conclusion remains a subject of considerable controversy, though.[50]

"Ordinarily in antitrust analysis, market power is measured by examining the characteristics of a given set of products or markets, defining differences between that set and actual or potential competitors, and then predicting that prices could be raised by a substantial amount" following the consummation of a merger.[51] In Staples, the court agreed with the commission's argument that the prospective merger partners already had raised prices in those cities where one of them faced no other superstore competition by 5 to 10 percent, according to one of the FTC's economic experts.[52]

On the basis of the "office supply superstore" market definition that the documentary and econometric evidence seemed to support, Staples and Office Depot combined would account for 75 percent of total sales and, by eliminating one of its only two competitors, the "merger would allow Staples to increase prices or otherwise maintain prices at an anticompetitive level."[53]

Reasoning that the evidence established that Staples and Office Depot competed only with each other (and with

Office Max, the nation’s third office supply superstore chain), the commission downplayed the importance of other conditions affecting local office supply prices, such as the sales of non-superstore office supply retailers.[54] Had independently owned office supply stores, mail order retailers of office supplies, and Wal-Mart, Sam’s Club, Best Buy, and other discount outlets been included in a broader antitrust market defined to encompass all office supply retailers, not just "superstores," Staples’ and Office Depot’s combined share would only have been 5 percent. Indeed, in this broader market, Wal-Mart alone has about the same revenue from office supply sales as the two superstores that wanted to merge.[55]

In addition to focusing only on "what could be learned by comparing price changes over time as more superstores enter a market,"[56] the court dismissed Staples’ and Office Depot’s claims of merger-related economic efficiencies. According to the court, the claimed cost savings were "in large part unverified, or at least the defendants failed to produce the necessary documentation for verification."[57] Even had the projected cost savings been documented to the court’s satisfaction, the FTC’s experts argued that most of the savings would not have been passed on to consumers in the form of lower prices anyway.[58]

In a last-minute attempt to appease the FTC, Staples and Office Depot agreed (on the basis of a recommendation by the FTC staff)[59] to sell 63 of their 1,149 superstores to their chief rival, Office Max, for the bargain-basement price of $1.7 million each.[60] Although the deal fell through when the commission nevertheless sought a court order enjoining the merger, Office Max seems to have been the chief beneficiary of the FTC’s action. The price of Office Max stock fell by 4.5 percent on the day Staples and Office Depot announced their merger plans; Office Max stock rose by 2 percent on the day the FTC announced its opposition to the transaction.[61] Those stock market reactions suggest that the merger would have led to lower office supply prices and tougher competition for Office Max and, moreover, that stopping the merger enabled Office Max to avoid that disadvantage.[62]

Staples-Office Depot illustrates the antitrust authorities’ propensity to define markets narrowly and to use the definitions to attack successful pioneering firms, including those operating in industries characterized by vigorous competition and low barriers to entry. Staples and Office Depot opened the nation’s first office supply superstores in 1986, launching an innovative way of doing business in what had been a low-volume, high-margin market dominated by small, independently owned retailers. By aggressively cutting the prices of office supplies and by selling everything from paper clips to personal computers, the superstores attracted the patronage of price-sensitive customers, especially small businesses and home offices, with such success that, within a decade, they had added more than 1,000 stores to their chains.

It is one of antitrust's bitter ironies that the new market Staples and Office Depot created (and which Office Max subsequently entered) became the central-–and, at bottom, the only–-issue in the FTC's decision to block the two pioneers' proposed merger.[63] In the wake of that antitrust fiasco, whose only winner seems to have been Office Max, office supply consumers might well ask what the benefits of merger law enforcement are supposed to be for them.

WorldCom-MCI

WorldCom, Inc., a little-known company headquartered in Jackson, Mississippi, shocked the global telecommunications industry in early 1998 when it announced a $37 billion offer to acquire MCI Communications Corp., one of the nation's leading long-distance telephone service providers. The proposed deal, nearly unanimously approved by both companies' stockholders at special meetings held on March 11, 1998,[64] followed the collapse of merger negotiations between MCI and British Telecommunications plc, a transaction that foundered on revelations that MCI had lost much more money in attempting to enter the local telephone service market than British Telecom initially thought.

Even before the WorldCom-MCI merger won formal shareholder approval, news reports suggested that the Justice Department's Antitrust Division had begun widening its probe into possible anti-competitive effects.[65] European regulators were also said to be scrutinizing the merger. The antitrust questions raised on both sides of the Atlantic were prompted by concerns that, if the transaction were approved, the two companies would control more than half of the high-capacity cables and computers forming the Internet's "backbone."

More specifically, concerns were voiced that the market power created by the merger would enable WorldCom-MCI, through its UUNet Technologies unit, to place rival Internet access providers at a disadvantage, either by degrading the quality of their connections at Internet traffic exchange points (connections governed by so-called peering agreements), raising the price of such access, or both.[66]

The economic theory underlying those antitrust concerns is the "essential facilities doctrine," the modern reincarnation of a charge leveled, in the Terminal Railroad case, at an association of railroads that early this century controlled all of the local terminal facilities and bridges spanning the Mississippi River at St. Louis, Missouri.[67] A careful analysis of the facts in that case shows, however, that the association did not deny competitors access, as indeed it could not: plenty of river crossings were located both north and south of St. Louis to which shippers that were not members of the association could turn without experiencing significant increases in cost.[68]

The association apparently did, however, charge higher prices to nonmembers on traffic that was not destined beyond the local St. Louis area. That was particularly true of coal bound for use in St. Louis itself, most of which was mined within 30 miles of the city (on the Illinois side of the Mississippi River).[69] The higher prices charged on local traffic could have been a form of price discrimination against "captive" shippers that could not easily reroute their freight to alternative river crossings. Although such price discrimination may be evidence of the association’s local (horizontal) market power, it had nothing to do with vertical integration per se.

Although the importance assigned to Terminal Railroad seems to rest on a number of misconceptions, the facts in the case are consistent with the theoretical proposition that, insofar as the value of an "essential facility" is derived from the demand for the services it is used to produce, the owner has no good reason to deny rivals access to it. Indeed, just the opposite is true: except for local traffic crossing the river westbound, "association members charged nonmembers the same price they charged themselves and denied access to no one."[70]

Although it is also true that economic theory identifies conditions under which the vertically integrated firm has an incentive to charge rivals higher prices for access to an "essential facility" than it charges its own affiliate, that price differential is imperative for capturing the efficiency benefits of vertical integration.[71] In the absence of what unintegrated rivals sometimes self-servingly call a "price squeeze," the vertically integrated firm cannot profitably expand the output of the final product that the essential facility is employed to produce, nor lower the final product's price. Under such conditions, forcing the vertically integrated firm to provide competitors equal access would destroy its incentives to integrate in the first place and, hence, cause the efficiency benefits of vertical integration to be lost.[72]

Although vertical integration provides substantial benefits to consumers even in the presence of a "price squeeze," the market environment in which WorldCom and MCI proposed to merge does not supply the conditions necessary for producing one. Although it may be true that the merging firms might control half of the Internet's backbone, the market for Internet access seems to be highly competitive: "there are nearly 40 backbone providers, 4,000 smaller Internet service providers and new entrants such as Qwest Communications International Inc. laying massive networks of their own."73 Consistent with the facts in Terminal Railroad, the existence of those alternative service providers means that WorldCom-MCI would be forced to charge rivals the same price for access they charge themselves.

If, on the other hand, the transaction produces significant cost savings, the merger partners may be able to reduce the prices they charge consumers for access to the Internet. That seems to be the case. MCI began advertising unlimited access charges of $14.95 per month (for customers who also use MCI's long-distance telephone services) soon after America Online announced that it was increasing its monthly unlimited access rate to $21.95.[74]

It is the prospect of lower prices for consumers that largely explains the bitter opposition to the WorldCom-MCI merger orchestrated by the two firms' rivals. Last year, GTE proposed to buy MCI for $28 billion, claiming that a GTE-MCI combination would create "a dynamic competitive force capable of bringing the benefits of competition to all markets and all consumers, both nationally and globally."[75] After WorldCom won the bidding war triggered by British Telecom's initial offer, GTE filed a lawsuit seeking to block the WorldCom-MCI deal on antitrust grounds. Since then, the opposition coalition has been joined by BellSouth, Bell Atlantic, and an assortment of labor unions and consumer activists, all of whom are apparently united with GTE in the belief that last year's dynamic competitive force is this year's monopoly.

That opposition ultimately caused WorldCom and MCI to yield important ground. Prompted by Sen. Arlen Specter (R-Pa.) not to accept "a fig leaf remedy," the Justice

Department joined European regulators in demanding "substantial divestiture of Internet capacity" as a condition for approving the transaction.[76]

Proving that appeasement wouldn’t come cheap, MCI’s initial announcement of a plan to sell its wholesale Internet business to the British firm, Cable & Wireless plc, for $625 million in cash drew immediate criticism from GTE, which seemed to be prepared to settle for nothing less than complete divestiture of all of MCI’s Internet holdings, valued (by GTE) at $4 billion.[77] Requiring WorldCom to sell off UUNet would have been even better.[78] But when MCI later relented and began looking for a buyer willing to purchase all of its Internet assets, Cable & Wireless sued to bind MCI to its original agreement.[79] In the end, the British firm struck a deal to acquire all of MCI’s Internet holdings for $1.6 billion, a move that won the Justice Department’s conditional approval for the MCI-WorldCom merger.[80] MCI would rather have sold its Internet assets to another prospective buyer, but given the pending lawsuit, "it turned out to be a lot easier to continue with C&W."[81] Thusly does litigation shape the organization of industry.

Like the antitrust assault on Microsoft orchestrated by Netscape, the opposition of competitors to the WorldCom-MCI deal illustrates the politicization of merger law enforcement by groups that have strong interests in stopping transactions that would create more effective rivals. Used in that way, antitrust becomes a kind of protectionist playground that produces profits for firms, not because they serve consumers well, but because they have comparative advantages in mobilizing political influence.

Primestar Inc.

It doesn’t take a genius to figure out why MCI Communications Corp.’s headquarters are located in Washington, D.C. That, in Willie Sutton’s immortal words, is where the money is. It’s also where individuals and firms must go hat in hand to fend off attempts by government to pick their pockets by tax, regulatory, or other political means.[82] MCI has been spending a lot of time on Pennsylvania Avenue lately.

In the case at hand, MCI wanted to sell something. Perhaps it should have called GTE first. What MCI wanted to sell was a satellite slot it owns jointly with Rupert Murdoch’s News Corp. The buyer: Primestar Inc. The price: $1.1 billion. The problem with the transaction, according to the Justice Department, which sued to block it on May 12, 1998, is that competition between direct-broadcast satellite (DBS) television services and cable TV operators would be thwarted.[83]

Primestar, a DBS service that has been operating since 1990, is a joint venture of the nation's largest cable TV companies.[84] With 2.05 million subscribers, it is the second largest direct-broadcast satellite service. Together with DirecTV (3.53 million subscribers) and EchoStar (1.2 million subscribers), DBS reaches nearly 7 million homes; about 10 times that number of customers subscribe to cable TV.[85]

The gravamen of the Justice Department's antitrust complaint is that the proposed merger would give the cable companies that own Primestar "the last available satellite capacity for high-powered satellite TV." In a statement accompanying his department's lawsuit, Assistant Attorney General for antitrust Joel Klein charged that, "rather than compete . . . the cable companies decided to merge." He went on to argue that "the sale would inevitably lead to higher [cable TV] rates and called cable 'one of the most durable and powerful monopolies in this country.'" Klein apparently hopes that by preventing Primestar from purchasing the satellite slot, a less objectionable buyer will be found, namely rival EchoStar or DirecTV.[86]

Primestar, it is alleged, would use its ownership of the satellite slot, not to reach more DBS customers, but, by blocking access to it, to prevent rival DBS services from making competitive inroads into the cable TV market that Primestar's owners now collectively dominate. The satellite slot at issue is one of only three in existence with "footprints" large enough that programs beamed from them reach most of North America simultaneously. EchoStar and DirecTV use the other two slots,[87] giving them a competitive advantage over Primestar, which must beam its programs over satellites parked in less favorably placed slots-–a handicap that the Justice Department's action will, if successful, perpetuate.

Given that Primestar's existing and potential rivals also have the option of using other satellites, it is not at all clear that Primestar's purchase of the slot in question would be the catastrophe for competition its critics have made it out to be. Nor is it obvious how preventing Primestar from reaching its DBS customers through a satellite as well positioned as the ones used by its rivals promotes competition.

Once again, it is the rivals of one of the parties to a proposed merger that have lined up to challenge the deal. The list of opponents in this instance includes "DirecTV, Echostar, small cable operators, companies that use microwaves to send TV signals to subscribers and regional phone companies BellSouth Corp. and Ameritech Corp., which are trying to enter the cable business."[88] Those critics contend that Primestar's purchase of the valuable satellite slot "could potentially hurt them in one of two ways: by withholding popular cable programming the Primestar partners own, or by marketing 'bundled' cable and satellite TV service at a price that would substantially undersell competitors."[89] Case closed.

Besides, it is disingenuous in the extreme for Klein to argue that the fate of competition in markets served by one of this country's "most durable and powerful monopolies" hinges on blocking Primestar's purchase of one satellite slot, however valuable that slot may be. It is certainly true, as Klein says, that "in most cases, we have a choice of only one cable company and we are seeing constantly rising prices."[90] The reason that consumers have only one cable company choice in most cases is not the result of anti-competitive actions by cable operators, but the result of local governments' persistence in treating cable TV as a "natural monopoly" and, hence, granting exclusive franchises to favored cable operators.

Prices have been rising because Congress relaxed regulatory rules affecting cable rates without also encouraging cities and counties to remove the artificially created barriers to entry that prop prices up. Government intervention is not the solution to cable subscribers' complaints, it is the underlying problem. If the assistant attorney general is interested in promoting competition in the cable TV industry, he should attack monopoly at its governmental source.

Lockheed Martin-Northrop Grumman

On March 23, 1998, a very busy Justice Department filed suit to block the acquisition of Northrop Grumman by Lockheed Martin. Appearing at a news conference announcing her department's unexpected action, Attorney General Janet Reno contended that the merger of two of America's five largest defense contractors would mean "higher prices and lower quality in advanced tactical and strategic aircraft, airborne early warning radar systems, sonar systems and several types of countermeasures systems that save our pilots from being shot down when they are flying in hostile skies." She continued, "This merger isn't just about dollars and cents, it's about winning wars and saving lives."[91] "We want to ensure," Reno went on to say, "that any defense merger protects our soldiers' lives and our taxpayers' wallets."[92]

Defense Secretary William S. Cohen echoed Reno's concerns. Appearing at the same news conference, Cohen said that "no previous merger has raised so many interrelated problems across so many markets. These problems are an outgrowth of the significant consolidation in the defense industry that has taken place in recent years."[93] Also speaking at the news conference, Klein added, "This merger, in an industry that is already highly concentrated, would completely eliminate competition and reduce innovation in many areas that are vitally important to our national security, ultimately diminishing the quality of the products supplied to the U.S. military."[94]

Until the attorney general announced her department's decision to sue, industry analysts had expected the Lockheed Martin-Northrop Grumman merger to easily clear regulatory hurdles.[95] After all, Boeing's acquisition of McDonald Douglas had recently gone through without a hitch, and few concerns had been raised about the defense industry's predictable responses to the significant reductions in Pentagon spending that began with the Soviet Union's collapse and accelerated under the Clinton administration.[96] Evidently, though, the antitrust authorities have determined that consolidation will go no further.

Once again, the Justice Department's stated concerns are misplaced. Owing to the weakness of incentives for government purchasing agents to search for low prices, economic efficiency has never been much of an issue in the defense industry to begin with. The Pentagon's procurement officers, who are the defense industry's main customers, and whose purchase decisions tend to be prodigal because they are spending taxpayers' money rather than their own, are more responsible for inflated prices paid for military systems than are the market shares of defense contractors. Indeed, there is some evidence that, even in highly concentrated industries, sales to government do not enhance the profits of large firms significantly; small-firm profitability is higher, primarily as a result of set-aside programs that limit competition on some government contracts.[97]

As a result of the ending of the Cold War and the massive cutbacks in defense spending overseen by the Clinton administration, the Pentagon's monopsony[98] of weapons procurement has been in steep decline. Consolidation and diversification to compete more effectively in global defense-electronics and related markets are the predictable responses to Pentagon downsizing. "Industry sources say that unless the Europeans can quickly carry out a similar consolidation, they risk losing out in world markets as well as being unable to negotiate trans-Atlantic tie-ups from a position of strength."[99]

Yet, based on unsubstantiated worries that a merger between Lockheed Martin and Northrop Grumman would compromise military preparedness at a time when "defense has become a jobs program"[100] (and the armed forces have become a social services agency), the Justice Department, as a condition of approving the transaction, sought "divestitures of businesses accounting for over half of Northrop Grumman's sales,"[101] thereby threatening to hinder the firm's global competitiveness. After the government rejected several proposed "structural separations" of businesses aimed at allaying its stated antitrust concerns, Lockheed ultimately conceded defeat and abandoned the merger.[102]

Lockheed Martin apparently made two major mistakes in formulating its plans to acquire Northrop Grumman. It failed to grease the political rails and it failed to "pay proper attention to Raytheon."[103] What goes around, comes around. Lockheed's criticisms of some of Raytheon's earlier acquisitions had forced divestitures. Returning the favor, Raytheon supplied 140 boxes of documents to the Justice Department outlining its "concerns" about Lockheed's proposed acquisition of Northrop and "waged an intense campaign to undercut" its rival.[104] In addition,

> had Lockheed been more alert, it might have launched the kind of effort that had been used successfully by it or others in previous mergers--lobbying Capitol Hill, working the executive branch and creating a drumbeat of support in the media. The company didn't hire high-powered public-relations consultants to promote the deal, as during the 1995 Lockheed-Martin Marietta marriage.[105]

So much for the scientific objectivism of public policy toward mergers.

The Politics of Antitrust

> There are a lot of competitors out there, and some of them are willing to try to use the political process to gain an advantage.
>
> --Bill Gates

It is an article of faith that antitrust policy is the bulwark of free-market institutions. The Antitrust Division and the FTC, it is widely thought, are vigilant guardians of a freely functioning competitive economy, pursuing single-mindedly the objective of protecting consumers against the abuses of monopoly. Yet laws that declare certain business practices to be illegal where they would substantially lessen competition are also laws that can be used strategically by politically well connected firms to obtain competitive advantages over their rivals.

What better victory for the competitor of two companies whose merger will make them a larger, more effective rival than to have the antitrust authorities intervene to prevent the transaction from being consummated, or to allow it to be consummated but only if key assets are divested? Systematic studies of merger-law enforcement by the Justice Department and the FTC suggest that competitors, not consumers, are the chief beneficiaries of the regulation of mergers by antitrust means.[106]

Many mergers result in the closure of outmoded production facilities, the replacement of incumbent managers, the streamlining of sales and product distribution networks, and the realization of economies of scale and other synergistic effects that promise to reduce costs. Those savings increase the wealth of the owners of the firm targeted for takeover and generate benefits for consumers by enabling products to be produced and sold more cheaply.

At the same time, however, competitors are faced with the prospect that the merger, if consummated, will create a more effective rival. They can respond by imitating the organizational innovations the merger partners plan to implement or by taking other steps to lower their own costs. Alternatively, the hard-pressed rivals can complain to the antitrust authorities of a possible violation of the law against mergers that substantially lessen competition. They will almost surely be joined on the issue by workers who face the prospect of losing their jobs and by local public officials in areas where plants are slated for closure who face the prospect of coping with higher unemployment rates and smaller tax bases.

It is conceivable, of course, that opposition by competitors to a proposed merger might be prompted by a public-spirited desire to protect consumers from the harmful effects of imminent monopoly. After all, who besides rivals will have access to the specialized industry information necessary to distinguish between efficiency-enhancing and market-power-increasing merger motives? Surely the antitrust authorities can see through and reject complaints by competitors that are nothing more than self-serving attempts to handicap their rivals.

Those possibilities have been explored in studies of stock market reactions to merger announcements.[107] Typically, the owners of the firms that propose to merge will enjoy positive "abnormal" returns on their investments relative to the owners of other firms in the economy. That effect is independent of the underlying motive for the merger. The expectation that profits will rise, either because the merger will lead to higher prices or because it will lead to lower costs, increases the discounted present value of an ownership position in the combined firm and, hence, raises the price investors are willing to pay for the firm’s stock.

The owners of rival firms will also experience abnormal returns on their investments, but the direction of the effect depends on whether the proposed merger is expected to create market power or to produce economic efficiencies. In the first case, the owners of the merger partners’ rivals will also enjoy positive abnormal returns. Competitors can expect to prosper in a more concentrated market environment in one of two ways: they can raise their own prices and share in the monopoly profits created by the merger or they can undercut the newly combined firm’s attempt to raise prices, thereby taking sales away from it and expanding their own market shares at their rival’s expense. By contrast, the owners of rival firms will experience negative abnormal returns if the merger is expected to produce cost savings that will place them at a competitive disadvantage.

Similar considerations apply to the announcement of an antitrust complaint challenging the legality of a proposed merger or a subsequent court decision holding it in violation of Section 7. Both events will tend to reduce the wealth of the owners of the merging firms insofar as prospective monopoly profits or potential economic efficiencies will be lost if the transaction is not consummated.[108]

On the other hand, the stock price reactions experienced by rival firms will again depend on the market's evaluation of the competitive impact of the proposed merger. If the transaction is motivated by the prospect of acquiring market power, then events that make it less likely that the merger will proceed will be associated with negative abnormal returns for competitors. They too will be prevented from sharing in the monopoly profits or be prevented from increasing their sales at the prospective monopolist's expense. But if the merger is motivated by the prospect of achieving greater economic efficiencies, then rivals will avoid being placed at a competitive disadvantage if the transaction is blocked, and the owners of those firms will therefore enjoy positive abnormal returns on news of antitrust opposition.

In short, by studying the stock price effects associated with merger law enforcement events, insights can be gained both about the motives for mergers and the impact of antitrust action on competitive market conditions. One such study examined a sample of 82 horizontal mergers challenged by the Antitrust Division and the FTC between January 1963 and December 1981,[109] a period that covers the promulgation of the government's first set of Merger Guidelines (in 1968) as well as the imposition of premerger notification requirements (in 1976).[110] The evidence suggests that rivals typically experience either zero or positive abnormal returns following news of events reducing the likelihood of proposed mergers being consummated, findings that are inconsistent with the hypothesis that the transactions were motivated by the acquisition of market power.

The authors of the study conclude that, "while it is possible that the government's merger policy has deterred some anticompetitive mergers, the results indicate that it has also protected rival producers from facing increased competition due to efficient mergers."[111] What is perhaps more important, the evidence that merger law enforcement primarily benefits, not consumers, but the competitors of merging firms, was even more compelling following the implementation of premerger notification requirements: "the additional enforcement powers granted under the HSR (Hart-Scott-Rodino)Act apparently have not led the agencies to pick cases better."[112]

Avoiding a competitive disadvantage by complaining of violations of the anti-merger law seems to be a workable business strategy. There is also evidence that it may be a profitable tactic for firms targeted for takeover. A study of 100 takeover targets that sued their suitor, charging fraud, antitrust violations, or violations of state or federal tender offer regulations, found that the suits added 17 percentage points, on average, to the initial premiums offered to stockholders of those firms that were eventually taken over.[113] Thus, the anti-merger law provides a mechanism through which the rivals of merging firms can prevent the creation of more efficient competitors and takeover targets can increase the prices at which they are eventually bought out. Those prospective benefits provide obvious incentives for firms to "invest" in antitrust processes for their own private gain.

Congress, in turn, has an interest in antitrust processes, but not to promote free markets and other broad and, hence, ill-defined social objectives that have no effective political constituency. Instead, members of Congress could be expected to favor an activist antitrust agenda because, like most other forms of government intervention, antitrust enforcement selectively helps or hurts various groups. Labor unions, local public officials, consumer activists, customers, suppliers, stockholders, competitors, and the merging firms themselves all have stakes in the outcomes of merger law enforcement. The members of Congress must balance the demands of those groups in ways that are consistent with their own political self-interests.

For their part, the antitrust agencies respond to pleas for protectionism because they must use their discretion to enforce the laws the way Congress wants them enforced. The logic of collective action predicts that the well-being of consumers will receive less weight in the political balance than the parochial objectives of better organized groups.[114]

Evidence regarding the influence of Congress on bureaucratic decisionmaking, including antitrust law enforcement, has been thoroughly documented.[115] Such influence is brought to bear by specialized congressional committees that exercise proximate control of agency budgets, oversee the confirmation process for presidential appointees, and review and recommend changes in the authorizing legislation for each bureau.

Quite clearly, merger law enforcement is not immune to political pressure. Three FTC economists found that both economic and political factors play roles in decisions to challenge mergers.[116] The study, published only after the commission’s general counsel agreed to withdraw a threat to bring criminal charges against two of the authors in return for including a disclaimer in their article stating that the FTC has "major disagreements with the methodology, analysis, inferences, and conclusions contained" therein,[117] examined information collected in response to all Hart-Scott-Rodino "second requests" issued by the FTC between June 14, 1982, and January 1, 1987.[118] The resulting sample contained 70 FTC merger law enforcement actions. In 27 of the cases, the commission voted out a complaint challenging the proposed merger under Section 7; in the other 43 cases, the merger partners were granted clearance to consummate their transaction.

Statistical models designed to explain the commission's decision to oppose a particular merger included variables measuring the extent of agreement between the lawyers and economists assigned to the case on the economic merits of the transaction. Specifically, the models applied the evaluative criteria laid out in the Merger Guidelines-– market shares and market concentration, the existence of barriers to entry, and the likelihood of collusion.

The models also included measures of the pressure exerted on the commission with respect to merger investigations under way. The extent of that pressure was gauged by the amount of news coverage devoted to each of the proposed transactions and by the number of times commission officials were called to testify before congressional committees during the 12-month period centered on the date of each second request.

All of the variables were found to be statistically significant. In particular, a merger was more likely to be challenged the higher was the measured level of concentration in the relevant market, the higher were barriers to the entry of new firms thought to be, and the greater was the perceived threat of collusion between the remaining firms. (When the FTC's lawyers and economists disagreed on those issues, the commission sided with the lawyers more often than not.) More external pressure-–more news coverage and more calls to appear before Congress-–was also found to increase the probability that the commission would vote to oppose a merger.[119]

On the basis of that and other evidence, the authors concluded that

> there is a constellation of identifiable interests who benefit from the FTC's stopping mergers. Politicians, their organized constituents opposed to mergers, and agency attorneys apparently are among the principal beneficiaries. . . . [T]his

> combination of personal interests creates an upward bias in the way the Merger Guidelines are applied, resulting in a greater propensity to challenge mergers in the marginal case. Greater appreciation of the ways that antitrust works, and in particular the role of politics in the process, should begin to dispel the notion that antitrust can be viewed as driven simply by congressional and bureaucratic concerns for competition.[120]

One need only have witnessed the feeding frenzy triggered by WorldCom's planned acquisition of MCI Communications Corp. to appreciate the "constellation of identifiable interests" attempting to influence the enforcement of a law that is supposed to be about the purely formal economic problem of assessing a merger's impact on competitive market conditions. The coalition of groups opposed to this particular transaction included GTE. (one of the disappointed suitors for MCI outbid by WorldCom), Bell Atlantic (another corporate rival), the AFL-CIO, and the Communications Workers of America (two labor unions harboring fears that the merged firm will be nonunion), the Reverend Jesse Jackson (who claims that WorldCom-MCI will cater to business customers "at the expense of low-income and minority residential customers"), consumer activist Ralph Nader, and the United Church of Christ.[121] Among other things, lobbyists for those various organizations have applied pressure on the White House, taken out large ads in newspapers, and blanketed "journalists and Congress with anti-merger material."[122]

Opposition to mergers by competitors is understandable. Indeed, such opposition is prima facie evidence that the planned combination is pro-competitive, promising lower costs and lower prices. Silent acquiescence by rivals would be expected if a merger foreshadowed higher prices and profits. As the WorldCom-MCI case illustrates, however, the antitrust laws have become a weapon of convenience for special pleaders of all stripes who are apparently willing to go to almost any length to protect their own selfish interests by stopping mergers. The only response that seems to be off the table in this politicized antitrust environment is the one demanded by competitive market forces, namely, for rivals to work harder, to use resources efficiently, and to do a better job of satisfying consumers' wants.

Conclusion

One hundred years of antitrust enforcement in the United States has produced precious little evidence that the laws have achieved their stated objectives. Antitrust was wrong-headed at its conception and it has been deformed in its application into a kind of domestic equivalent of trade protectionism, operating mostly to the benefit of less efficient firms that, unable or unwilling to struggle to win the competitive race in the rough-and-tumble of an unforgiving market, have turned to Washington for succor.

There is an even more fundamental objection to antitrust law enforcement as currently practiced. In open, competitive markets a firm becomes a takeover target when an alert entrepreneur perceives that a profit can be made by acquiring control of the firm's assets and pursuing actions--such as replacing incumbent managers, rearranging production lines and distribution channels, closing outmoded production facilities, canceling unwise investment projects, and so on--that will improve the company's performance (make it more efficient).

Since they were implemented in 1978, the premerger notification rules contained in the Hart-Scott-Rodino Act have imposed a duty on such risk-takers to announce publicly the discovery of previously hidden profit opportunities. While consummation of merger transactions is delayed in order to comply with government requests for information from the prospective merger partners, other suitors previously unaware of the existence of undervalued assets are given time to step forward with takeover offers of their own. The HSR process thus enables those rival suitors to free ride on the information revealed by the premerger announcement.

Free riding lowers the value of information about the existence of merger profit opportunities in the economy. The waiting periods imposed on merger transactions also raise the cost of corporate takeovers by giving target firms opportunities to implement defensive strategies, such as repurchasing stock, acquiring debt, or filing a lawsuit. Both of those effects reduce the incentives of entrepreneurs to search out information about undervalued productive assets and to exploit it through merger.[123]

There is an even more direct cost of premerger notification: the burden of complying with government's information requests can be immense. For example, attorneys representing Kohlberg Kravis Roberts & Co. (KKR) amassed

680 cartons of company documents to comply with the FTC's subpoena regarding KKR's proposed acquisition of RJR Nabisco. In order to meet the FTC's submission deadline for that quantity of materials, which required the services of 150 lawyers to assemble, the firm "discovered that the cheapest way to get everything there was to rent a DC-9."[124]

The costs imposed on merging firms and the law enforcement benefits enjoyed by their rivals have been purchased at the expense of consumers. The time for modest reform of antitrust policy processes has passed. Root-and-branch repeal of what Federal Reserve chairman Alan Greenspan a generation ago referred to as a "jumble of economic irrationality and ignorance"[125]--and what modern scholarship has shown over and over again to be a playground of special pleaders--is called for.

As long as government has the power to help or hurt various interests by regulating merger activity in the economy, the groups that have a stake in law enforcement outcomes will rationally strive to shape those outcomes in their own favor. It is therefore not the special-interest groups that are to blame, but the state's fatal conceit that it knows better than mere businessmen how industries ought to be organized.[126] By disposing of antitrust and all other

> systems either of preference or restraint . . . the sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interests of society.[127]

To be sure, businessmen struggle mightily to bring order to seemingly chaotic competitive environments. Their attempts to control prices and crush their rivals seem to demonstrate "why antitrust enforcement must be strong when markets run free."[128] Adam Smith's oft-quoted line that, "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices," has become a defense of vigilant antitrust intervention. What almost everyone ignores is Smith's warning in the next sentence: "It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice."[129]

Notes

1. According to George Bittlingmayer, the first of the great merger waves was actually caused by antitrust enforcement. When the courts declared early on that the Sherman Act prohibited price-fixing agreements, mergers to obviate the need for those agreements were the predictable response. Merger activity then declined significantly following the Supreme Court's decision in U.S. v. Northern Securities Co., 193 U.S. 197 (1904), which made the merger alternative less attractive. See George Bittlingmayer, "Did Antitrust Policy Cause the Great Merger Wave?" Journal of Law and Economics 28(April 1985): 77-108. A second merger wave followed hard on the heels of passage of the Clayton and Federal Trade Commission Acts in 1914, and merger activity peaked a third time in 1968. The leveraged buyouts of the 1980s have been credited with producing a fourth merger wave of historical proportions. The various explanations for the underlying causes of merger activity are laid out in William F. Shughart II, The Organization of Industry, 2d ed. (Houston, Tex.: Dame Publications, 1997), pp. 132–38. For a summary of the controversy about how many merger waves, if any, there have been, see William F. Shughart II and Robert D. Tollison, "The Random Character of Merger Activity," RAND Journal of Economics 15(Winter 1984): 500–509.

2. William J. Baer, "Report from the Bureau of Competition." Remarks before the American Bar Association's Antitrust Section, Washington, April 2, 1998, p. 1.

3. "FTC Chairman Discusses Merger Wave and Merger Enforcement at the FTC; Focus is Staples and Boeing," Federal Trade Commission News Release, September 23, 1997.

4. Assistant Attorney General for Antitrust Joel Klein, for example, believes that "the natural state of markets is not to move toward increasing competition." Without antitrust, he warns, "the competitive structure of our economy would erode significantly." See Joel I. Klein, "The Importance of Antitrust Enforcement in the New Economy," Address before the Antitrust Law Section Program of the New York State Bar Association, January 29, 1998, p. 11. Klein, who claims not to have an "overarching theoretical model . . . to lower on the economy," is profiled in John R. Wilke and Bryan Gruley, "Trustbuster Joel

Klein, Once Viewed as Timid, Comes on Like a Tiger," Wall Street Journal, May 15, 1998, p. A1.

FTC chairman Robert Pitofsky is a long-time critic of the efficiency rationale for resale price maintenance and other so-called vertical restraints of trade. See Robert Pitofsky, "In Defense of Discounters: The No-Frills Case for a *per se* Rule against Vertical Price Fixing," Georgetown Law Review 71 (December 1983): 1487-95. A recent statement of his views is contained in Robert Pitofsky, "Vertical Restraints and Vertical Aspects of Mergers--–A U.S. Perspective," Remarks before the Fordham Corporate Law Institute, 24th Annual Conference on International Antitrust Law and Policy, October 16-17, 1997.

5. "Network externalities" and "path dependence," two of the theories du jour not addressed here, are discussed in Stan Leibowitz and Stephen E. Margolis, "The Fable of the Keys," Journal of Law and Economics 33 (April 1990): 1-25; and Stan Leibowitz and Stephen E. Margolis, "Policy and Path Dependence from QWERTY to Windows 95," Regulation, no. 3 (1995): 33-41.

6. After describing the record number of merger filings submitted to his agency over the last few years, director of the FTC's Bureau of Competition William Baer comments somewhat peevishly that "with no significant increase in resources, we are stretched pretty thin." Baer, "Report from the Bureau of Competition," p. 1.

7. Greg Ip, "Dominant Firms Attract Antitrust Probes and Investors," Wall Street Journal, May 12, 1998, p. C1.

8. In addition to launching a large number of merger investigations, the Clinton administration apparently plans to mount a broad review of concentration trends in the U.S. economy. See Jackie Calmes, "Administration to Study Business Concentration," Wall Street Journal, May 13, 1998, p. A2. Similar government studies have been conducted in the past, the first being produced by the Bureau of Corporations, an agency created by President Theodore Roosevelt to investigate the great trusts. See Gabriel Kolko, The Triumph of Conservatism: A Reinterpretation of American History, 1900-1916 (New York: Free Press, 1963); and Ron Chernow, Titan: The Life of John D. Rockefeller, Sr. (New York: Random House, 1998).

Later, the so-called Neal Commission recommended declaring market shares in excess of 12 percent prima facie evidence of monopoly power that would trigger antitrust proceedings leading to the dissolution of the offending firms. P. C. Neal et al., "White House Task Force on Antitrust Policy," Antitrust and Trade Regulation Report, no. 411, Special Supplement, part 2, May 27, 1969. The Neal report inspired the late Sen. Philip D. Hart (D-Mich.) to introduce The Industrial Reorganization Act of 1972 (S. 1167), a bill that would have required antitrust proceedings to be initiated against any large firm earning an after-tax rate of return on sales of more than 15 percent.

Gene Sperling, chairman of Clinton’s National Economic Council, stressed that the White House isn’t aiming for any particular regulatory or legislative outcome from its new concentration study.

9. Joseph A. Schumpeter, Capitalism, Socialism and Democracy, 3d ed. (New York: Harper & Row, 1950), p. 84.

10. Ibid.

11. Ibid.

12. For evidence that output in the trust-dominated industries of a century ago was expanding faster than output in the economy as a whole and that the prices charged by the "robber barons" were therefore falling faster than the general level of prices, see Thomas J. DiLorenzo, "The Origins of Antitrust: An Interest-Group Perspective," International Review of Law and Economics 5 (June 1985): 73-90. A more general attempt to correct the popular misconceptions of the era is contained in Burton W. Folsom Jr., The Myth of the Robber Barons (Herndon, Va.: Young America’s Foundation, 1996). For pointed criticisms of the antitrust cases brought against the trusts, see Dominick T. Armentano, Antitrust and Monopoly: Anatomy of a Policy Failure, 2d ed. (Oakland, Calif.: The Independent Institute, 1990).

13. Chernow, pp. 339-40.

14. The American Enterprise Institute’s Irwin Stelzer, for instance, says that his "friends at conservative think tanks think the antitrust laws are just another form of regulation. They are not. They are the biggest bulwark we have against the spread of regulation by government." Quoted in Alan Murray, "It’s Time Gates Placed Trust in Trustbusters," Wall Street Journal, March 9, 1998, p. A1.

15. Competitive Impact Statement, U.S. v. MCI Communications Corp., Civil No. 94-1317 (D.D.C. June 15, 1994).

16. Microsoft's protracted encounter with the antitrust authorities has been discussed extensively. See, for example, John E. Lopatka and William H. Page, "Microsoft, Monopolization, and Network Externalities: Some Uses and Abuses of Economic Theory in Antitrust Decision Making," Antitrust Bulletin 40(Summer 1995): 317-70; Robert A. Levy, "Microsoft and the Browser Wars: Fit to be Tied," Cato Institute Policy Analysis no. 296, February 19, 1998; and Richard B. McKenzie and William F. Shughart II, "Is Microsoft a Monopolist?" Independent Review 3 (Fall 1998), forthcoming.

17. Evidence reported below in fact suggests that the merger partners' rivals have been the chief beneficiaries of law enforcement efforts under section 7 of the Clayton Act. For a general introduction to that view, see William J. Baumol and Janusz A. Ordover, "Use of Antitrust to Subvert Competition," Journal of Law and Economics 28 (May 1985): 247-65; William F. Shughart II and Robert D. Tollison, "The Positive Economics of Antitrust Policy: A Survey Article," International Review of Law and Economics 5 (June 1985): 39-57; and William F. Shughart II, Antitrust Policy and Interest-Group Politics (New York: Quorum Books, 1990).

18. A representative, though much later, case reaching this conclusion is U.S. v. Celanese Corp. of America, 91 F. Supp. 14 (S.D.N.Y. 1950).

19. Swift & Co. v. Federal Trade Commission, 272 U.S. 554 (1926).

20. For persuasive evidence that the asset "loophole" may not have been an unintended consequence of the Clayton Act's passage, see Robert B. Ekelund Jr., Michael J. McDonald, and Robert D. Tollison, "Business Restraints and the Clayton Act of 1914: Public- or Private-Interest Legislation?" in Fred S. McChesney and William F. Shughart II, eds., The Causes and Consequences of Antitrust: The Public-Choice Perspective (Chicago: University of Chicago Press, 1995), pp. 271-86.

21. Notification requirements apply if the firm making the acquisition has total assets of $100 million or more (or annual sales of at least $10 million) and the if the firm to be acquired has at least $10 million in assets or annual sales. Any merger transaction meeting those size

limits is covered if the acquiring firm proposes to gain control of more than $15 million worth (or 15 percent) of the target firm's stock or assets. The Hart-Scott-Rodino Act also establishes a 30-day timetable (15 days if the acquisition is in the form of a cash tender offer) for the agency having jurisdiction to decide whether or not to oppose the merger. That waiting period can be extended by 20 days (10 days for a cash transaction) if, by issuing a "second request," the government requests additional information about the transaction. The dollar values spelled out in the Hart-Scott-Rodino Act have not changed since the law was passed in 1976. Inflation and the boom in stock prices, which have greatly increased the number of transactions exceeding the HSR thresholds, are key factors in explaining the government's recent heavy merger case workload.

22. The usefulness of the Merger Guidelines as a source of information about the administrative criteria that antitrust agencies will apply in deciding whether to challenge proposed mergers is questionable. One study has shown that about 21 percent of the merger cases brought under the 1968 Merger Guidelines involved firms whose market shares fell <u>below</u> the stated thresholds. Virtually none of those cases could be explained by the exceptions spelled out in the document. (The Guidelines provide that mergers in industries exhibiting a "trend toward concentration" or transactions that would eliminate a "maverick" firm that had been "an unusually competitive factor in the market" are subject to challenge without regard to market-share and market-concentration standards.) According to the author of the study, "The Guidelines have not been a reliable signal of the enforcement policies of either the Antitrust Division or the Federal Trade Commission." See Robert A. Rogowsky, "The Justice Department's Merger Guidelines: A Study in the Application of the Rule," in Richard O. Zerbe Jr., ed., <u>Research in Law and Economics</u> (Greenwich, Conn.: JAI Press, 1984), vol. 6, pp. 135-66.

23. The Herfindahl-Hirschman Index is calculated by summing the squared market shares of all of the firms in the relevant antitrust market.

24. Market shares and market concentration head the list of symptoms to look for in diagnosing market power because the greater is a firm's share of the relevant market, the larger is its share of the benefits of restricting output. See Gregory J. Werden, "Identifying Market Power in Electric Generation," <u>Public Utilities Fortnightly</u>, February 15, 1996, p. 17.

25. According to the most recent version of the Merger Guidelines, "a market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area would likely impose at least a ‘small but significant and nontransitory’ increase in price, assuming the terms of sale of all other products are held constant." The Guidelines go on to say that "a relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test." See "Department of Justice and Federal Trade Commission Horizontal Merger Guidelines," April 2, 1992, section 1. That language is unchanged in its essentials from the first revised Merger Guidelines issued in 1982.

26. On the incentives of bureaucrats to produce "visible" output, see Cotton M. Lindsay, "A Theory of Government Enterprise," Journal of Political Economy 84 (October 1976): 1061-76. The internal workings of the antitrust agencies are explored in Suzanne Weaver, The Decision to Prosecute: Organization and Public Policy in the Antitrust Division (Cambridge, Mass.: MIT Press, 1977); Robert A. Katzmann, Regulatory Bureaucracy: The Federal Trade Commission and Antitrust Policy (Cambridge, Mass.: MIT Press, 1980); and Kenneth W. Clarkson and Timothy J. Muris, eds., The Federal Trade Commission since 1970: Economic Regulation and Bureaucratic Behavior (Cambridge: Cambridge University Press, 1981).

27. The problems and pitfalls of defining relevant antitrust markets are discussed in Shughart, Organization of Industry, pp. 227-65.

28. For this and other market-definition aberrations, see Franklin M. Fisher, "Diagnosing Monopoly," Quarterly Review of Economics and Business 19 (Summer 1979): 7-33.

29. Rogowsky, pp. 156-57.

30. According to a food industry expert, the difference between "gourmet" spices and ordinary spices "is that one comes in a fancy bottle and is sold in upscale stores, and the other is sold in cans at your local Safeway." Quoted in Warren Brown, "Faced with Lawsuit, McCormick Drops Bid for Spice Islands," Washington Post, May 24, 1988, p. C1.

31. Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

32. The number of submarkets in which the Brown-Kinney merger supposedly thwarted competition was greatly overstated in the government's original complaint. When adjustments are made eliminating wholesale shoe shipments erroneously included in the Justice Department's estimates of Brown's own share of the retail shoe market, only 29 cities remain in which the combined sales of Brown and Kinney actually accounted for 5 percent or more of total retail sales. The combined market share of the two firms averaged 8 percent in those 29 cities. All told, there were just 15 cities in which the two firms' combined market share exceeded 15 percent of total retail shoe sales and only 9 cities in which it exceeded 20 percent. See John L. Peterman, "The Brown Shoe Case," Journal of Law and Economics 18 (April 1975): 81-146.

33. Brown Shoe at 325.

34. Franklin M. Fisher, "Horizontal Mergers: Triage and Treatment," Journal of Economic Perspectives 1 (Fall 1987): 23.

35. U.S. v. Philadelphia National Bank, 374 U.S. 321 (1963). The Court identified the checking account as a product distinctive enough to justify treating commercial banking as a line of commerce separate from credit unions, thrifts, and other financial institutions. As a matter of fact, the majority stated flatly that it did not want to hear any economic analysis of the boundaries of the relevant market, warning of "the danger of subverting congressional intent by permitting a too-broad economic investigation."

36. U.S. v. Aluminum Co. of America (Rome Cable), 377 U.S. 271 (1964).

37. U.S. v. Continental Can Co., 378 U.S. 441 (1964).

38. U.S. v. Von's Grocery Co., 384 U.S. 270 (1966).

39. U.S. v. Pabst Brewing Co., 384 U.S. 546 (1966). Somewhat ambivalent about the extent of the relevant geographic market, the majority held that all the government need show was that the merger had a "substantial anticompetitive effect somewhere in the United States."

40. "It is only because we lack confidence in our ability to measure elasticities, or perhaps because we do not think of adopting so explicitly economic an approach, that we have to define markets instead." Richard A. Posner,

<u>Antitrust Law: An Economic Perspective</u> (Chicago: University of Chicago Press, 1976), p. 125.

41. <u>Federal Trade Commission v. Staples, Inc.</u>, 970 F. Supp. 1066 (D.D.C. 1997). See Jonathan B. Baker, "Econometric Analysis in <u>FTC v. Staples</u>," Remarks before the American Bar Association's Antitrust Section, Economics Committee, Washington, July 18, 1997 (revised March 31, 1998), p. 1.

42. "FTC Chairman Discusses Merger Wave," p. 1.

43. Jonathan B. Baker, "Unilateral Competitive Effects Theories in Merger Analysis," <u>Antitrust</u> 11 (Spring 1997): 21.

44. Ibid.

45. Baker, p. 2.

46. <u>Staples</u> at 1075.

47. See John DeQ. Briggs and Howard T. Rosenblatt, "FTC Looks beyond the Market Shares," <u>Legal Times</u>, May 4, 1998, p. 536.

48. Baker, p. 1.

49. Ibid.

50. Jerry A. Hausman, one of the economic experts retained by Staples, argued that the FTC's pricing study was flawed because it compared simple averages of selected office supply prices in various cities without weighting the prices included in the index by how many units of each product people actually buy. See Gail DeGeorge, Catherine Yang, and Geoffrey Smith, "Superstores on Notice," <u>Business Week</u>, March 24, 1997, p. 30. The FTC's study also seems to have committed what might be called the "comparison shopper fallacy": Grocery store A advertises that customers shopping there have the lowest average weekly grocery bills of any store in town. Grocery store B counters by advertising that <u>its</u> customers' weekly grocery bills are the lowest in town. How can both ads be true? The answer is that shoppers at store A purchase a different basket of groceries than shoppers at store B, buying a little more milk and a little less bread, for instance, because milk is slightly cheaper there and bread costs slightly more. The FTC's pricing study assumed that consumers would buy the same basket of office supplies at every store, thereby ignoring their responses to differences in the relative

prices of the items selected for inclusion in the price index.

51. "FTC Chairman Discusses Merger Wave," p. 1 (emphasis in original).

52. Baker, p. 3.

53. Staples at 1082.

54. In a footnote, Baker states that "all of our regression models . . . included variables to account for potential rivalry by firms other than superstores." However, he is not more specific about the basis for his conclusion when he says in the following sentence "that firms other than superstores provided little competitive constraint on Staples' pricing." Baker, p. 5.

55. William A. Niskanen, "Welcome to the FTC Follies! Kicking Around the Staples-Office Depot Merger," Legal Times, June 16, 1997, p. 26.

56. Baker, p. 4.

57. Staples at 1089.

58. Baker, p. 8. According to FTC chairman Pitofsky, Staples establishes that "efficiencies cannot trump anti-competitive effects." "FTC Chairman Discusses Merger Wave," p. 2. In terms of aggregate welfare, however, a cost saving is a cost saving, whether it is retained by the firm or passed on to consumers. See Oliver E. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs," American Economic Review 58 (March 1968): 18-36.

59. Niskanen.

60. "Antitrust Policy in America: A Case of Office Block," The Economist, March 15, 1997, p. 65.

61. Niskanen.

62. The implications of stock market reactions to news of events related to merger law enforcement are discussed more fully below.

63. Even more ironically, the FTC's conclusion that office supply superstores compete only with other superstores may mean that Staples, Office Depot, or Office Max can now acquire mail-order firms and other office supply

retailers with impunity because those competitors are not "in" the relevant antitrust market. See Ronald A. Bloch, "What's the Market? A Modest Fantasy," Legal Times, May 4, 1998, p. 546.

64. Stephanie N. Mehta, "Holders Clear Deal of MCI, WorldCom," Wall Street Journal, March 12, 1998, p. A3.

65. John R. Wilke and Jared Sandberg, "Justice Widens Investigation in WorldCom-MCI Dealings," Wall Street Journal, March 10, 1997, p. A3.

66. Ibid.

67. U.S. v. Terminal Railroad Association of St. Louis, 224 U.S. 383 (1912).

68. David Reiffen and Andrew N. Kleit, "Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?" Journal of Law and Economics 33 (October 1990): 419-38.

69. Ibid., p. 430.

70. Ibid., p. 437.

71. When the market price of an input includes a markup over the marginal cost of producing it (because the input market is "imperfectly competitive"), a firm's incentive for integrating backward hinges on its ability to replace market transactions in the input at prices greater than marginal cost with internal-to-the-firm transfers at prices equal to marginal cost. Jack Hirshleifer, "On the Economics of Transfer Pricing," Journal of Business 30 (July 1956): 172-84. See also Roger D. Blair and David L. Kaserman, Antitrust Economics (Homewood, Ill.: Irwin, 1985), pp. 295-304.

72. John D. Rockefeller Sr. once said that he knew "of no parallel case in other branches of business where the competitor felt injured because he could not use his rival's capital and facilities for his own advantage and the disadvantage of the owner of the capital and facilities." Quoted in Chernow, p. 169. Clearly, Rockefeller was too optimistic.

73. Wilke and Sandberg. The proposed merger between AT&T Corp. and Tele-Communications, Inc. (TCI), the nation's largest cable TV operator, also promises to create an aggressive new competitor in the market for Internet access. See Leslie Cauley, "AT&T Appears Close to a Deal

to Acquire TCI for $30 Billion," Wall Street Journal, June 24, 1998, p. A1.

74. Ironically (or perhaps not), America Online's chairman, Stephen M. Case, was appointed by shareholders to the board of WorldCom-MCI. See Mehta.

75. "GTE Corporation Proposes Merger with MCI in Transaction Valued at $28 Billion," GTE Press Release, October 15, 1997, quoting letter from Charles R. Lee, chairman and CEO of GTE, to Bert C. Roberts Jr., chairman of MCI.

76. John R. Wilke, "Regulators May Push WorldCom, MCI," Wall Street Journal, May 27, 1998, p. A3.

77. Jared Sandberg, "MCI Is Selling Wholesale Internet Unit, but European Trust Issues May Remain," Wall Street Journal, May 29, 1998, p. A3.

78. "AT&T Says That It's Interested in Buying MCI's Internet Unit," An Interactive Journal News Roundup, May 20, 1998. The list of potential buyers also includes British Telecom, IXC Communications Inc., Level 3 Communications Inc., Qwest Communications International Inc., and Intermedia Communications Inc. Not surprisingly, GTE is also said to be interested. Catherine Yang and Peter Elstrom, "Selling the World on WorldCom," Business Week, June 1, 1998, p. 152.

Perhaps hoping to get a leg up on its rivals in the bidding contest for MCI's Internet unit, Level 3 jumped on the merger-opposition bandwagon, hiring "high-powered litigator David Boies to press its case with U.S. and European regulators." On the other hand, Level 3's action may just be simple revenge. MCI and WorldCom have refused to enter into a peering agreement with the firm, allowing it to connect to their Internet backbone, because "Level 3 doesn't yet meet the companies' standards of providing 'high-quality' [transmission] service." See John J. Keller, "Level 3 Assails WorldCom, MCI, Says It Already Acts as a Monopoly," Wall Street Journal, May 20, 1998, p. B14.

79. Jared Sandberg and John R. Wilke, "MCI Offers to Sell Assets to Speed Deal," Wall Street Journal, June 12, 1998, p. A3.

80. Jared Sandberg and Stephanie N. Mehta, "C&W to Buy MCI Internet Assets, Easing Way for WorldCom Deal," Wall Street Journal, July 15, 1998, p. B6.

81. Ibid.

82. See Fred S. McChesney, Money for Nothing: Politicians, Rent Extraction, and Political Extortion (Cambridge, Mass.: Harvard University Press, 1997).

83. John R. Wilke, "Antitrust Suit to Block Primestar Purchase," Wall Street Journal, May 13, 1998, p. A3.

84. Primestar's largest shareholder is TCI Satellite Entertainment, a unit of cable giant Tele-Communications Inc. Other cable industry owners include Time Warner Inc., MediaOne, Comcast Corp. and Cox Communications Inc. Paul Farhi, "U.S. May Fight Murdoch-MCI Satellite Plan," Washington Post, March 27, 1998, p. E1.

85. Wilke, "Antitrust Suit."

86. Ibid.

87. Farhi.

88. Ibid.

89. Ibid.

90. "Justice Department Sues to Block Primestar, Murdoch Merger," National Journal's CongressDaily, May 12, 1998.

91. David Lawsky, "US Files Suit to Block Lockheed-Northrop Merger," Reuters News Media, March 23, 1998.

92. "Justice Department Goes to Court to Block Lockheed Martin's Purchase of Northrop Grumman: Merger Is Single Largest Ever Challenged," U.S. Department of Justice Press Release, March 23, 1998, p. 1.

93. Ibid., pp. 1-2.

94. Ibid., p. 2.

95. Elizabeth Owen, "Defense, Inc.: Lockheed Buys Northrop Grumman," Time Daily, July 3, 1997.

96. Before merging with McDonald Douglas, Boeing purchased Rockwell's defense business. Over the past few years, "Lockheed acquired part of General Dynamics, then merged with Martin Marietta and absorbed Loral, itself an amalgamation of several electronics companies. Raytheon, now the third-largest contractor, bought E Systems and Hughes Aircraft. Northrop merged with Grumman, and that

combination then acquired the defense portion of Westinghouse." See Harvey M. Sapolsky and Eugene Gholz, "How About an Antitrust Probe of the Pentagon?" Wall Street Journal, May 21, 1998, p. A16.

97. William F. Chappell and William F. Shughart II, "Market Structure, Sales to Government, and the Theory of Oligopoly," Journal of Economic Behavior and Organization 19 (1992): 69-81.

98. Just as a monopolist is a product's sole seller, a monopsonist is a product's only buyer. For a theoretical model showing that "from the standpoint of social welfare, the structural condition of bilateral monopoly [a single buyer dealing with a single seller] is preferable either to a monopoly seller dealing with competitive buyers or a monopsony dealing with competitive suppliers," see Roger D. Blair and Jeffrey L. Harrison, Monopsony: Antitrust Law and Economics (Princeton, N.J.: Princeton University Press, 1993), pp. 109-29.

99. Barry James, "Lockheed Deal Squeezes Europeans," International Herald Tribune, July 4, 1997, p. 17.

100. Sapolsky and Gholz.

101. "Lockheed Martin and Northrop Grumman to Challenge Government Attempt to Block Combination," Lockheed Martin Press Release, March 23, 1998.

102. Frederic M. Biddle and Thomas E. Ricks, "Lockheed Martin Cancels Merger after Talks with Pentagon Fail," Wall Street Journal Interactive Edition, July 17, 1998. See also Frederic M. Biddle, "Lockheed Cancels Merger after Talks with Pentagon Fail," Wall Street Journal, July 17, 1998, p. A4. Northrop Grumman's stock fell by more than 5 percent on the bad news.

103. Thomas E. Ricks and Jeff Cole, "How Lockheed Martin Misread the Radar on Northrop Grumman," Wall Street Journal, June 19, 1998, p. A1.

104. Ibid.

105. Ibid.

106. See McChesney and Shughart and the studies cited below.

107. For a general introduction to this methodology, see G. William Schwert, "Using Financial Data to Measure the

Effect of Regulation," _Journal of Law and Economics_ 24 (April 1981): 121-58.

108. Indeed, there is evidence that the adverse wealth effects of government merger policy go far beyond those borne by the owners of the firms involved in the challenged transaction. The values of all mergers--including uncontested mergers--ongoing at the time an unfavorable Supreme Court ruling is announced seem to be affected negatively. See Abagail McWilliams, Thomas A. Turk, and Asghar Zardkoohi, "Antitrust Policy and Mergers: The Wealth Effect of Supreme Court Decisions," _Economic Inquiry_ 31 (October 1993): 517-33.

109. B. Espen Eckbo and Peggy Wier, "Antimerger Policy under the Hart-Scott-Rodino Act: A Reexamination of the Market Power Hypothesis," _Journal of Law and Economics_ 28 (April 1985): 119-49. Two earlier studies reached essentially the same conclusions. See Robert Stillman, "Examining Antitrust Policy toward Horizontal Mergers," _Journal of Financial Economics_ 11 (1983): 225-40; and B. Espen Eckbo, "Horizontal Mergers, Collusion, and Stockholder Wealth," _Journal of Financial Economics_ 11 (1983): 241-73.

110. The premerger notification process established by the Hart-Scott-Rodino Act actually took effect on September 5, 1978, concurrently with the publication of the applicable rules in the _Federal Register_ 43 (1978): 33-450.

111. Eckbo and Wier, p. 121.

112. Ibid.

113. Gregg A. Jarrell, "The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?" _Journal of Law and Economics_ 27 (April 1985): 151-77.

114. Mancur Olson, _The Logic of Collective Action: Public Goods and the Theory of Groups_ (Cambridge, Mass.: Harvard University Press, 1965).

115. See, for example, Richard A. Posner, "The Federal Trade Commission," _University of Chicago Law Review_ 37 (1969): 47-89; R. Douglas Arnold, _Congress and the Bureaucracy: A Theory of Influence_ (New Haven, Conn.: Yale University Press, 1979); Roger L. Faith, Donald R. Leavens, and Robert D. Tollison, "Antitrust Pork Barrel," _Journal of Law and Economics_ 15 (October 1982): 329-42; Barry R. Weingast and Mark J. Moran, "Bureaucratic Discretion or Congressional Control? Regulatory

Policymaking by the Federal Trade Commission," Journal of Political Economy 91 (October 1983): 765-800; and William E. Kovacic, "The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement: A Historical Perspective," in Mackay, Miller, and Yandle, pp. 63-120.

116. Malcolm B. Coate, Richard S. Higgins, and Fred S. McChesney, "Bureaucracy and Politics in FTC Merger Challenges," Journal of Law and Economics 33 (October 1990): 463-82.

117. See David R. Henderson, "Antitrust Busters," Reason, August-September 1995, pp. 62-63. The general counsel's stated objection to the article's publication was that the authors had improperly relied on nonpublic information taken from the commission's files. The fact that publication was permitted conditional on including the disclaimer seems to belie that concern.

118. As explained earlier, the Hart-Scott-Rodino Act establishes a 30-day timetable (15 days if the acquisition is in the form of a cash tender offer) for the agency having jurisdiction to decide whether or not to oppose the merger. That waiting period can be extended by 20 days (10 days for a cash transaction) if, by issuing a "second request," the government requests additional information about the transaction.

119. In a later paper using the same data, Coate and McChesney show that models that include only variables measuring internal FTC evaluations of the economic merits of proposed mergers do not predict commission decisions as well as models that also include variables measuring the weight of external political pressure. (The commission was again found to have been influenced more by its lawyers than by its economists.) See Malcolm B. Coate and Fred S. McChesney, "Empirical Evidence on FTC Enforcement of the Merger Guidelines," Economic Inquiry 30 (April 1992): 277-93.

120. Coate, Higgins, and McChesney, pp. 23-24.

121. "Mauling Mergers," Wall Street Journal, May 18, 1998, p. A22.

122. Ibid.

123. In this regard, premerger notification is likely to generate adverse capital market effects similar to those associated with the disclosure requirement imposed on cash takeover bids by the Williams Act. See Gregg A. Jarrell

and Michael Bradley, "The Economic Effects of Federal and State Regulation of Cash Tender Offers," Journal of Law and Economics 23 (April 1980): 371-407.

124. "For Further Details, See Carton No. 587," Wall Street Journal, March 15, 1989, p. B1.

125. Alan Greenspan, "Antitrust," in Capitalism: The Unknown Ideal, ed. Ayn Rand (New York: New American Library, 1967), p. 70.

126. Friedrich Hayek coined the phrase "fatal conceit" to describe the grandiose mindset of central planners. See F. A. Hayek, The Fatal Conceit: The Errors of Socialism, vol. 1 of The Collected Works of F. A. Hayek, ed. W. W. Bartley III (Chicago: University of Chicago Press, 1988).

127. Adam Smith, An Inquiry into the Nature and Consequences of the Wealth of Nations, ed. Edwin Cannan (1776; Chicago: University of Chicago Press, 1976), vol. 2, bk. 4, ch. 9, p. 208.

128. Alan Murray, "Reading Rockefeller and Busting Up the Trusts," Wall Street Journal, May 18, 1998, p. A1.

129. Smith, vol. 1, bk. 1, ch. 10., p. 144.