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Consumer surplus vs. welfare standard in a political economy model of merger control

Damien J. Neven [a,*], Lars-Hendrik Röller [b]

[a] Graduate Institute of International Studies, Geneva, Switzerland
[b] Wissenschaftszentrum Berlin and Humboldt University, Germany

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Abstract

This paper considers the political economy environment that an antitrust agency is operating in and asks under what circumstances a consumer surplus standard yields higher welfare than a welfare standard. In particular, we address how institutional settings—such as transparency and accountability—interact with the choice of an appropriate standard. We consider a framework in which the antitrust agency can be influenced by third parties (at a cost in terms of real resources) and in which the agency is imperfectly monitored. A welfare comparison between the two standards reveals that neither standard dominates. The consumer surplus standard is attractive relative to a welfare standard, when lobbying is efficient, when accountability is low, where mergers are large and when a marginal increase in merger size is highly profitable.

JEL classification: L40; H11

Keywords: Merger control; Political economy; Antitrust policy; Capture

1. Introduction

The purpose of this paper is to evaluate alternative standards that can be assigned to an antitrust agency in charge of merger control. It is striking that some of the major antitrust agencies appear to operate with objectives that differ from welfare maximization. In particular, both the U.S. as well as EU merger control can be interpreted as maximizing consumer surplus rather than aggregate welfare.[1]

* Corresponding author.
E-mail address: neven@hei.unige.ch (D.J. Neven).
[1] See for instance Gellhorn and Kovacic (1994).

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In a world with no regulatory failures, excluding firms' profits from the objectives assigned to the antitrust authority is hard to justify.[2] However, in a setting where institutional and political economy considerations are taken into account, the welfare implications of various standards that are given to the antitrust authority are more subtle. In particular, it may be welfare enhancing to assign a standard that is not first-best.

This paper considers the political economy environment in which an antitrust agency operates and asks under what circumstances a consumer surplus standard yields higher welfare than a welfare standard.[3] In particular, we address how institutional settings—such as transparency and accountability—interact with the choice of an appropriate standard. We model the political environment that the antitrust agency is subject to through a common agency framework (à la Bernheim and Whinston, 1986).[4] In this context, interested parties provide inducements to the antitrust agency which are contingent on the outcome of the merger review.

More specifically, we consider a situation that can be characterized by a three stage process. In the first stage, a merger is notified and the interested parties provide contingent bids to the agency. In order for the merger to be potentially welfare enhancing we assume that there are efficiency gains, which are known to the firms and the antitrust agency.[5] We consider three interested parties: consumers, the merging firms, and the (non-merging) competitors. Consumers do not lobby the antitrust agency. This may arise for at least two reasons. First, consumers may not be well informed about the consequences of proposed mergers (we will assume that consumers cannot observe the characteristics of the merger) and accordingly may not be able to formulate appropriate contingent bids. Second, consumers may face prohibitive transaction costs in representing their interests. These costs could be associated with the traditional problems of free-riding and collective action with numerous agents.

We further allow for an inefficient lobbying technology, which we associate with transparency. With greater transparency influence activities have to take indirect routes which are typically less efficient. For instance, influence takes place through indirect means like expensive lunches or the promise of lucrative jobs in the private sector (the "revolving door"). Whereas pure transfers do not entail any efficiency losses, indirect means of influencing the agency typically involve some real resource cost.[6]

In the second stage, the antitrust agency decides whether or not to allow the proposed merger. The agency observes the bids and the characteristics of the merger. Most importantly, the antitrust agency is held accountable to the standard that has been assigned by law (i.e. either

[2] There is a large literature on what the goals of antitrust should be, see for instance Harberber (1971) and Scherer (1993). In this paper we concentrate on consumer surplus and net social welfare, as those are the objectives that have received the most attention.

[3] We will use the term welfare standard for what is commonly referred to as net social welfare standard.

[4] The common agency framework has been used to model a number of other policy decisions. See for instance, Grossman and Helpman (1994) or Rama and Tabellini (1998). Policy choices have also been analysed using models of representative democracies, in which agents with different policy preferences come forward in the electoral process (see Besley and Coate (1997)). Recently Besley and Coate (2000) have also proposed a model which encompasses both approaches. Empirical evidence suggests that influence by interested parties is an essential feature of merger control (see for instance Neven et al. (1994)). Political competition will also matter at the time when merger law are designed but may be less important. Even though it would be desirable to consider both aspects, our model thus focuses on what is arguably the more important aspect of political economy interactions in merger control.

[5] We therefore do not focus on political economy issues surrounding the "efficiency defense" debate, i.e. where firms may have some private information about the efficiencies of the merger. For a paper that analyzes informational lobbying see Lagerlöf and Heidhues (2002).

[6] See also Posner (1975).