Do Remedies Affect the Efficiency Defence? An Optimal Merger Control Analysis

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✓ Merger control: screening and selection of merger projects,

to clear and promote 'beneficial' ones

and prevent or modify 'harmful' ones

✓ Two-step process:

- competitive assessment / efficiency defence

(trade-off: market power v. cost savings - Williamson (1968))

- enforcement: prohibition or conditional approval / merger remedies

(structural or behavioural commitments to preserve competition)

✓consequences of ex ante assessment and intervention (1):

→ information problem

possibility to make both type errors

(allow anticompetitive mergers, reject competitive ones)

✓consequences of ex ante assessment and intervention (2):

→ incentive provision

- through remedies

(more lenient merger control? - Seldeslachts et al. (2006)

penalizing intervention? - Farrell (2003))

- through efficiency defence

(look for and plan in advance efficiencies when allowed to argue them - Jorde and Teece (1990))

✓Objective:

examine the optimal combination of efficiency defence and merger remedies, given:

- their interaction in terms of ex ante incentives

- the asymmetric information and need to minimize assessment error costs

✓ incentive effect of

- merger control

  Besanko and Spulber (1993), Neven et al. (1993),

  (Persson (2004), Ecer (2005), Barros (2003),…)

- merger remedies

  Farrell (2003), Vasconcelos (2005), Seldeslachts et al. (2006)

✓ efficiency defence as information-processing procedure

- cost of evidence production

  Lagerlöf and Heidhues (2005), Medvedev (2004)

- optimal pattern of information disclosure

  Gonzalez (2004)

Framework

- Two types of merger projects (market power vs. efficiency gains)

$$\bar{e} > \underline{e}\ , \quad \Pi(\bar{e}) \geq \Pi(\underline{e}) \geq \Pi_i$$

- $\bar{e}$ endogenously obtained, through costly ex ante effort, uncertain and privately-known to insiders:

$$\Pr(\bar{e} \,/\, \text{effort}) = q \in (0,1)\ , \quad \Pr(\bar{e} \,/\, \text{no effort}) = 0$$

- The AA only observes public, exogenous, cost-free, binary imperfectly correlated signal: $s \in \{ \underline{s}\ , \overline{s}\ \}$, $\Pr(\overline{s} \,/\, \bar{e}) = \Pr(\underline{s} \,/\, \underline{e}) = \sigma \in [1/2,1]$

- The AA maximizes "W", but opposite effects: $W(\bar{e}) \geq W_i \geq W(\underline{e})$

- Remedy application:
  - effective (prevents welfare loss): $W^R(\underline{e}) \geq W_i$
  - costly commitment: $\Pi(e) > \Pi^R(e) > \Pi_i\ , \quad \forall\ e \in \{\bar{e}\ ;\ \underline{e}\ \}$
  - no longer effort incentive

Timing

1- the AA commits (through guidelines) to a merger policy – choice of decisions rule:

- clear any merger submitted with remedy
- clear a merger if good signal
- clear a merger if either good signal or remedy proposed

NB: efficiency defence = commitment to take into account signal

2- firms' private effort decision

3- firms notify merger, possibly with remedy

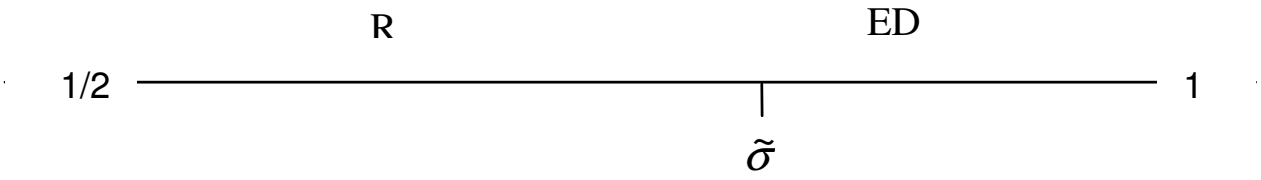
4- signal observed and decision rule applies

Efficiency Defence – incentive device

✓ Opportunity to allow the ED

choice between: - clear a merger if remedy proposed
- clear a merger if good signal

(R1) ⇒ the ED is optimal for a sufficient assessment quality



✓ need for sufficiently accurate assessment - to ensure effort exertion
- and minimize cost of errors

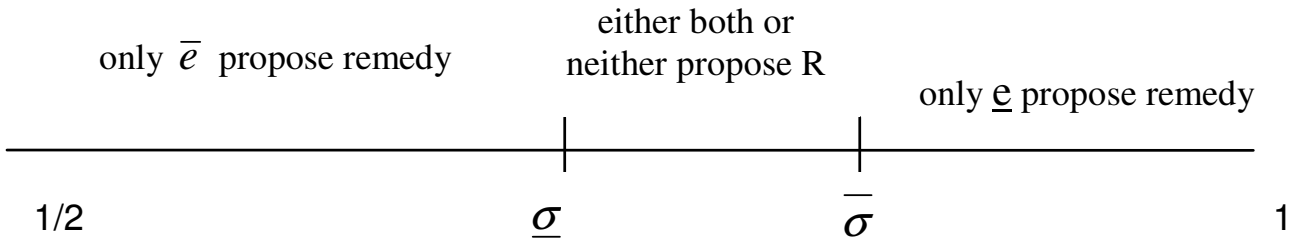
✓ benefit of ED: incentive to exert effort (↓ unjustified refusals)
cost of ED: welfare loss from unjustified approval (imperfect signal)

can the remedy + ED improve the outcome ?

Efficiency Defence **and** Remedies – optimal merger control?

✓ Opportunity to allow both the ED and R:
clear merger if either good signal or remedy proposed

(R2) ⇒ the R modifies notification strategy
may induce self-selection effect

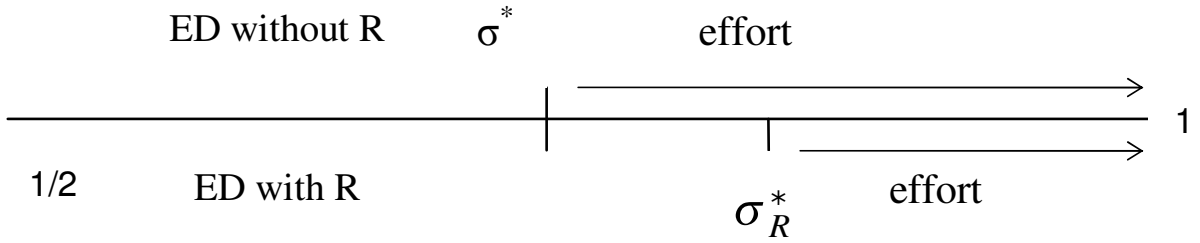


✓ for higher (lower) σ, lower (higher) opportunity cost for $\underline{e}$ to attempt the efficiency defence

✓ benefit from R: may completely prevent welfare loss from unjustified approvals
(through self-selection effect)

(R3) ⇒ R modifies expected payoff and therefore effort-stage strategy

remedy application lowers the effort incentive of the ED



✓ R increases the opportunity cost of ED

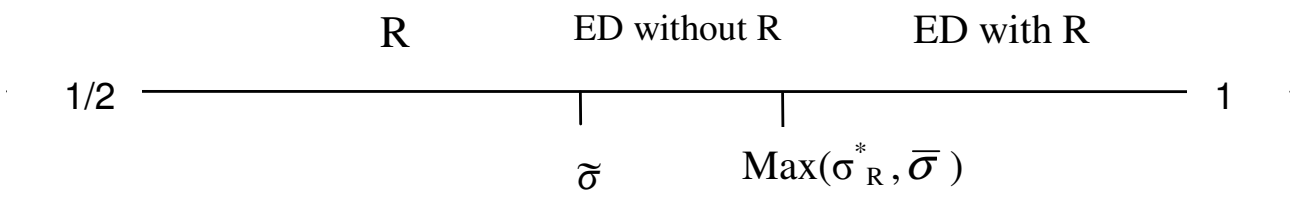
(firms can always safely merge with R without exerting effort)

→ the optimal merger control ought to account for:

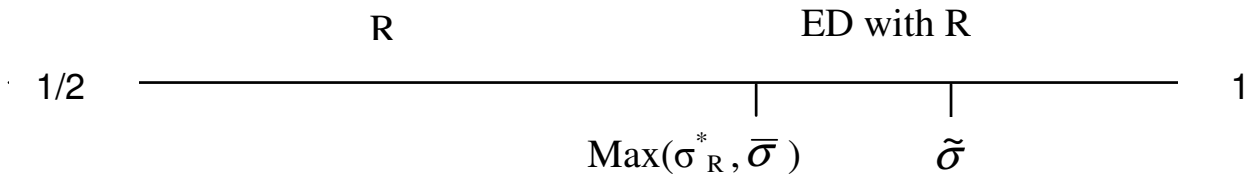
- ED provides effort incentive towards more efficient mergers (reduces unjustified refusals), but allows unjustified approvals
- R may prevent unjustified approvals (by inducing self-selection of merger projects), but lowers effort incentives

(R4) ⇒ optimal merger policy:

✓ the less costly the "welfare loss" of accepting inefficient mergers,
the more effort incentives can be optimally provided through the ED without R



✓ the costlier the "welfare loss" of unjustified approvals,
the earlier the adoption of ED with R,
and incentive-provision neglected



(R4) ⇒ optimal merger policy:

✓ whenever the welfare cost of an unjustified approval is relatively low,
or the welfare benefit expected form an efficient merger is very high,

→ the AA will privilege provision of higher effort incentives
by allowing ED but refraining from R

✓ whenever the social cost of unjustified approvals is prohibitive/ very high,

→ the AA will optimally allow the ED together with R (current legal framework),
so as to induce self-selection of merger projects
and prevent the approval of inefficient, socially harmful mergers,
although effort incentives are neglected