
*Merger Control with Transfers from the Capital
Gains Tax*

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Problematical

- How to regulate mergers?
- On which criterion the regulation commission must take its decision?
- Does there exist good tools for the merger regulation?
- Can we introduce taxation in merger control to create other incentive tools?

Merger effects and price implications

- The two main effects of a merger:
 - The increase in market power effect;
 - The synergy gains effect.
- The merger effect on prices:
 - Either the synergy effect is higher: the price decreases;
 - Or the market power effect is higher: the price increases.

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Assumptions on costs

- 3 symmetric firms produce an homogeneous good;
 - Marginal costs identical and constant before the merger: Cm^{NM} ;
- 2 firms among them propose a merger;
 - $Cm_{\theta}^I(\theta) > 0$ and $Cm^O = Cm^{NM}$ constant;
- The Agency must intervene;
 - $Cm_{\Delta}^I(\Delta, \theta) > 0$
 - $Cm_{\Delta}^O(\Delta, \theta) < 0$;
 - $Cm_{\Delta\Delta}^I(\Delta, \theta) > 0$
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Divestments and synergies

- We consider two types of synergies:
 - Low level of synergies: $\bar{\theta}$;
 - High level of synergies: $\underline{\theta}$;
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Regulation issues

- Two important problems for the Antitrust Agency in its regulation task:
 - Information asymmetry over synergies;
 - Lack of regulatory tools.
- Antitrust Agency Motivations:
 - To obtain information over the true level of synergy;
 - To find tools to regulate mergers more efficiently;
 - To build an incentive contract to screen between insiders.

Medium of exchange and tax structure

- Media of exchange:
 - The takeover bid system: All cash exchange;
 - The share exchange system: All stock exchange;
 - The mixed bid system: A ratio of cash p and a ratio of stocks $(1 - p)$.
- The Capital Gains Tax:
 - The tax codes in the countries generally award a tax-deferred status to a pure exchange merger (all in stock);
 - On the contrary they require a capital gains tax to be paid immediately when cash is incorporated into the bid.

Originality and Drawbacks

- The original aspect of the paper:

The Agency relies on the capital gains tax to implement a transfer;

- The drawback of such a tool:

This regulation tool is limited: There is a t^{max} .

- The takeover bid legislation is constrained: tax rates are fixed by governments;
- The Agency cannot ask more transfer than the transfer defines by the costlier procedure all in cash.

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=> A Limited Liability problem occurs.

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- [5] If Insiders accept, the contract is implemented; if they refuse, the economy stays in the pre-merger situation at no cost.

The Agency's program

Under imperfect information and limited liability, the AA program is:

$$\max_{\{(\underline{\Delta}, \underline{t}); (\overline{\Delta}, \overline{t})\}} \nu \cdot [CS(\underline{\Delta}, \underline{\theta}) + \underline{t}] + (1 - \nu) \cdot [CS(\overline{\Delta}, \overline{\theta}) + \overline{t}]$$

s.t. :

$$\left\{ \begin{array}{l} (\underline{IR}) \quad U^I(\underline{\Delta}, \underline{\theta}) - \underline{t} \geq 2\overline{\Pi} \\ (\overline{IR}) \quad U^I(\overline{\Delta}, \overline{\theta}) - \overline{t} \geq 2\overline{\Pi} \\ \\ (\underline{IC}) \quad U^I(\underline{\Delta}, \underline{\theta}) - \underline{t} \geq U^I(\overline{\Delta}, \underline{\theta}) - \overline{t} \\ (\overline{IC}) \quad U^I(\overline{\Delta}, \overline{\theta}) - \overline{t} \geq U^I(\underline{\Delta}, \overline{\theta}) - \underline{t} \\ \\ (\underline{LL}) \quad \underline{t} \leq t^{max} \\ (\overline{LL}) \quad \overline{t} \leq t^{max} \end{array} \right.$$

Resolution of the model

- First and Second Best results:

- $\overline{\Delta}^{FB} > \overline{\Delta}^{SB}$ and $\underline{t}^{SB} < \underline{t}^{FB}$

- $\underline{\Delta}^{FB} = \underline{\Delta}^{SB}$: No distortion at the top;

- $\underline{\Delta}^{SB} > \overline{\Delta}^{SB}$

- $\underline{t}^{SB} < \bar{t}^{SB}$

- Limited Liability and asymmetric information results:

- $\underline{\Delta}^{LLAI} = \underline{\Delta}^{FB}$

- $\overline{\Delta}^{LLAI} = \overline{\Delta}^{LLPI}$ and $\bar{t}^{LLAI} = \bar{t}^{LLPI}$: No distortion at the bottom;

- $\bar{t}^{LLAI} = t^{max} > \underline{t}^{LLAI}$

Literature

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