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The "Economic" Analysis of Transnational Mergers

WILLIAM JAMES ADAMS

No congregation of lawyers can be considered complete without a token economist. The role of the economist consists of describing the *economic* mode of analyzing the legal problem under consideration. Unfortunately from the standpoint of the token, economists rarely agree on criteria appropriate for the appraisal of economic phenomena. With respect to transnational corporate mergers, four modes of analysis may be described legitimately as economic.

Two of the modes of analysis should be familiar to all members of the antitrust bar. The first of these might be called "competition as a quasi goal of society." It is based on this argument: In a market economy, it is impossible to achieve economic efficiency in the absense of competition in relevant markets. Moreover, competition is compatible with, perhaps even conducive to, the realization of other social goals such as decentralization of political, economic, and social power. Given the difficulty of measuring directly the true elements of social performance, the state of competition in relevant markets can safely be considered a proxy for them.

Reasoning of this sort appears frequently in U.S. judicial opinions discussing the antitrust laws. Such reasoning would lead the student of transnational mergers to investigate the effects of such mergers on the state of competition in relevant markets—principally those found in the countries of the acquiring and acquired firms.

A great deal of research of this sort has been performed—at least on the theoretical plane.[1] Unsurprisingly, transnational mergers are seen to have both desirable and undesirable effects on the state of competition. To understand why, imagine an industry in country A organized as a tightly knit oligopoly comprised exclusively of mononational firms. Now imagine acquisition of one of the oligopolists by a large firm domiciled in country B and engaged in the same line of business. On the one hand, the transnational merger might destabilize comfortable oligopolistic agreements in country A.

This article is adapted from a presentation made by Professor Adams at the Symposium on Transnational Corporate Concentration held at the University of Michigan Law School on November 9 and 10, 1979. Professor Adams is associate professor of economics and law at the University of Michigan.

The multinational firm has wider horizons than do its mononational counterparts. As a result, the kinds of behavior which it finds desirable may be anathema to the mononationals. Even if the two types of firms have the same goals, cognitive differences between firms heterogeneous in nationality may render collusion less successful than it might otherwise be. On the other hand, this transnational merger might elevate barriers to new competition in both countries. If the multinational firm is large in relation to the mononational firms in country A, it might operate as a giant among pygmies—making entry into that market distinctly less attractive than it would have been otherwise. If the multinational firm's rivals in country B perceive a need to match the initiated integration pattern,[2] then potential entrants into market B may feel the ante necessary to enter the industry there has been elevated. For these reasons, among others, the net effect of the transnational merger on the state of competition is ambiguous.

Not all economists embrace the view that competition should always be treated as a desideratum. The dissenters frequently reason that although competition is needed to guarantee efficiency in the allocation of resources among industries, competition can be incompatible with efficiency in the production of particular goods. If technology exhibits increasing returns to scale over wide ranges of output, then large market shares may be needed to produce at low unit-cost. Moreover, market power may be conducive to rapid technological change. In such situations, the gains in efficiency associated with competition must be compared with the losses in efficiency—static and dynamic—associated with competition. Competition itself is desirable only when the benefits exceed the costs.[3]

This view may be called the competition for the sake of efficiency mode of analysis. It pervades the decisions rendered in European antitrust proceedings. Such a view suggests that transnational mergers should be evaluated on the basis of direct evidence regarding their impact on economic efficiency. Evidence of this type can be found in the literature on multinational corporations. Some such evidence bears on whether multinational or mononational corporations should be considered the better managed. Other such evidence bears on the extent to which multinational corporations facilitate the international diffusion of advanced technology and labor skills.[4] Still other evidence bears on the extent to which efficient scales of operation are attained more often by multinational than by mononational companies.

If we confine our attention to the written decisions of antitrust authorities, these are the two types of economic analysis we find. However, the written decisions fail to convey an accurate impression of the kinds of economic issues on which many decisions turn. The discerning reader will find two other types of analysis lurking in the shadows; the concealed arguments weigh more heavily in the outcomes than do their more obvious counterparts. As a result, it would be a mistake to characterize the difference between U.S. and European views on mergers in general, and transnational mergers in particular, as being the treatment of competition as an end versus the treat-

ment of competition as a means for achieving economic efficiency. Certain economic doctrines motivate European antitrust policy.

The first of these focuses on questions of distribution. In one form or another, the argument comes down to this: direct foreign investment changes the international distribution of income. To the extent that national governments care only about incomes accruing to their own citizens, they should favor or oppose transnational mergers on the basis of whether their own citizens are likely to gain or lose income from the transaction.

Among the key economic questions associated with this position are where does the acquiring company obtain the funds needed to finance the transnational merger, what do the sellers of the acquired firm do with the money they receive from the buyers, and what will the acquiring company do with the cash flow of the acquired company? These questions cannot be answered satisfactorily until particular transnational mergers have been studied in great detail.

The fourth economic framework for analyzing transnational mergers, like the third, does not focus on the impact of such mergers on economic efficiency. Rather it focuses on the ability of national governments to implement national economic policies. The argument runs like this: national governments are responsible for the welfare of their constituents; they devise and attempt to implement economic policies accordingly. Inevitably, at some point during the process of implementation, governments must rely on the business community. The business community must exhibit two characteristics—admittedly, characteristics difficult to realize simultaneously—if it is to be helpful to government. On the one hand, some firms in each industrial sector should possess market power sufficient to ensure the capability of accomplishing governmental goals. On the other hand, despite their power, such firms should remain sufficiently dependent on governmental favors to ensure that they will act in the public interest.

This may be designated the *dirigiste* approach to the evaluation of mergers. I believe that it, and, to a lesser extent, the distributional mode of analysis, are used extensively in European antitrust affairs. How else can one explain the attempts of several European governments to create national champions—domestic firms large enough to fight their governments' battles in various market arenas?[5] Surely the desire to ensure productive efficiency cannot be considered a plausible answer. Such a policy would prompt attempts to merge small- and medium-size enterprises—not the largest of oligopolists.

If distributional and *dirigiste* modes of analysis prevail in Europe, then the following three observations are in order. First, no amount of evidence regarding economic efficiency in general, or economies of scale in particular, will suffice to determine how a European government will choose to treat particular mergers. If economists wish to influence such treatment, they will have to investigate more fully the effects of transnational mergers on the ability of national governments to implement national economic policies. Studies of the following types of questions would be needed: What kinds of

industrial structures permit firms to execute governmental economic policies successfully? In particular, is great seller concentration necessary? If so, is it sufficient? Second, what kinds of policy instruments must the government wield in order to insure that it can induce firms to behave in the public interest? For example, is the creation of governmental enterprises in key sectors of the economy helpful? Is it necessary? What are the key sectors of the economy in this context?

In effect, what economists must do is assess the cost-effectiveness of *dirigiste* economic policy. My own feeling is that *dirigiste* governments, for example, the French, have paid a high price for reliance on large firms to execute their economic policies.[6] In the first place, I suspect that the price has been high in pecuniary terms. Great market power is often accompanied by great political power. As a result, the firm most able to satisfy governmental desires is the firm most able to extract a handsome *quid pro quo*. In breeding firms resistant to the powers of competition, governments may well have been breeding firms resistant to governmental control. In the second place, I fear that the political price of the *dirigiste* strategy may be even larger than the pecuniary price. As the formulators of economic policy begin to rely heavily on large business corporations, they begin to rely less heavily on the organs of government. To the extent that governmental institutions are responsible de facto to all citizens, and to the extent that business enterprises are not so responsible, *dirigiste* economic policy saps the strength of political democracy. In this connection, it is ominous to note that many of the original proponents of indicative planning now consider it to be excessively elitist in practice.[7]

My second observation relates to the question of whether or not transnational mergers are likely to be controlled soon by some transnational authority. As much as ever, national governments see the need for national economic policies. In no small measure, this need may be attributed to the rapidity and force with which macroeconomic disturbances are transmitted across national frontiers.[8] Until supranational institutions succeed in creating a stable economic order for the world, national governments are unlikely to surrender their most potent methods of controlling their economies. There is some reason to believe that, rightly or wrongly, many governments consider the control of mergers to be one such method. The unwillingness of the Council of the European Communities to grant broad authority to control mergers to the European Commission is certainly consistent with such a view. In any event, those who would control multinational corporations via supranational authorities should be concerned more with an international macroeconomic policy than with international antitrust laws or codes of conduct for transnational corporations, for only through a consideration of a nation's macroeconomic concerns can supranational institutions deal effectively with problems of transnational corporate concentration.

Finally, it is obvious that different modes of economic analysis can lead to different conclusions regarding the desirability of particular transnational

mergers. It is important, therefore, that governments choose wisely among the economic criteria already discussed. Unfortunately, until government officials declare openly that factors other than economic efficiency and competition affect the desirability of mergers, economists—prone as they are to take official pronouncements at face value—will not conduct the relevant empirical research. And policy makers, observing no evidence to contradict the wisdom of their decisions regarding transnational mergers, may unwittingly tread a path which does not serve the public interest.

NOTES

1. *See e.g.*, R. CAVES, INTERNATIONAL TRADE, INTERNATIONAL INVESTMENT, AND IMPERFECT MARKETS (Princeton Special Papers in International Economics No. 10, 1974).
2. *See*, F. KNICKERBOCKER, OLIGOPOLISTIC REACTION AND MULTINATIONAL ENTERPRISE (1973).
3. *See*, Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968).
4. *See, e.g.*, Dunning and Steuer, *The Effect of United States Direct Foreign Investment in Britain on British Technology*, MOORGATE AND WALL STREET, (Autumn 1969), 5–33.
5. Industrial policies favorable to the creation of national champions are advocated in L. STOLERU, L'IMPERATIF INDUSTRIEL (1969).
6. *See* S. COHEN, MODERN CAPITALIST PLANNING: THE FRENCH MODEL (2d ed. 1977): J. ZYSMAN, POLITICAL STRATEGIES FOR INDUSTRIAL ORDER: STATE, MARKET, AND INDUSTRY IN FRANCE (1977).
7. Indicative planning consists of establishing voluntary output, input, and price targets for particular industries.
8. *See* R. COOPER, THE ECONOMICS OF INTERDEPENDENCE: ECONOMIC POLICY IN THE ATLANTIC COMMUNITY (1968).