Antitrust Deregulation and the Politics of the American Knowledge Economy

Anonymous

December 17, 2019

Abstract

Why has antitrust enforcement been so lax in recent decades? I show that, in 1981, the federal government began challenging large mergers and acquisitions at much lower rates. Why have Democrats, since 1981, been reluctant to police large mergers more aggressively? I argue that some of this reluctance stems from the political realignment associated with the construction of the American knowledge economy. Using a panel study of top income shares at the state level, I show that antitrust deregulation has exacerbated top end income inequality and that the effect is mostly experienced in several consistently Democratic states. Using multilevel regression and post-stratification on survey data, I find that younger and more affluent individuals and those in states that are the most exposed to the knowledge economy support regulation of mergers and acquisitions at significantly lower levels.

Word Count: 9,819 words
1 Introduction

After a long nascence, antitrust policy has sprung onto the public agenda. In March of 2019, when Senator Elizabeth Warren first proposed that federal antitrust regulators “break up” America’s largest technology companies, she became the first major presidential candidate in over 40 years to make antitrust enforcement a prominent part of her campaign platform. Since her announcement, Congress and antitrust officials have indicated that they will investigate the possible ways in which America’s technology companies abuse their market power, and the targets of those investigations have been preparing for the challenge (Kang and Vogel, 2019).

Given this turn of events, now seems a fitting time to revisit what we know about the politics of antitrust policy reform. The answer, unfortunately, is very little. Within the major political science journals, I found only three articles discussing the economic and political determinants of antitrust policy, the most recent of which was published more than 25 years ago (Lewis-Beck, 1979; Eisner and Meier, 1990; Wood and Anderson, 1993). Economists and legal scholars have argued that rising market power—an outcome of lax antitrust enforcement—is associated with rising economic inequality and rent-seeking (Siligitz, 2013; Baker and Salop, 2015; Khan, 2017; Khan and Vaheesan, 2017). But despite the broad purview of those who study American politics, we still do not know much about why antitrust policy has been so lax in recent decades and what political forces have sustained that increasingly tenuous equilibrium.

I argue that antitrust enforcement against large mergers and acquisitions (M&A) has been lax in recent decades in part because the Democratic party—the party that historically pushed for robust regulation—has increasingly sought the political support of constituencies that do not support more regulation. The argument proceeds in three steps. First, I revisit the debate that unfolded in this journal more than 25 years ago about the determinants of antitrust policy change (Eisner and Meier, 1990; Wood and Anderson, 1993). I find that, when the dependent variable is relative enforcement rates, the year 1981 emerges as a critical juncture in the setting of antitrust enforcement priorities and, after accounting for that shift, presidential partisanship is not a meaningful predictor of antitrust enforcement priorities. Where prior studies used simple counts of antitrust enforcement activity, like the number of cases filed in each year, I estimate the number of “large” deals that could have drawn closer regulatory scrutiny and use these estimates to calculate relative enforcement rates (the number of cases filed relative to the number of large deals). “Large” in this context means the acquiring company paid more than $50 million in 1948 dollars, or more than $400 million in today’s dollars. From this perspective, agency priorities substantially changed when Ronald Reagan assumed the presidency and nominated William Baxter to lead the DOJ’s Antitrust Division (DOJAD) in
1981, but have not meaningfully changed since then.

Why did Reagan succeed in changing antitrust priorities so dramatically and why have subsequent Democratic administrations failed to reverse the course that Reagan charted? Prior work mostly suggests that ideological and institutional changes within the bureaucracy associated with the rise of the Chicago School have caused stability in antitrust priorities in the post-Reagan period (Eisner, 1991; Stoller, 2019). Without diminishing the potential role of these ideological shifts, I test an alternative hypothesis related to the political realignment that took place within the Democratic party in the 1970s and 1980s as the party became increasingly committed to building an American knowledge economy (Geismer, 2015; Hacker and Pierson, 2010; Rodden, 2019). If, as these authors suggest, the Democratic party began courting more affluent professionals working in the knowledge economy and became less committed to organized labor as a central constituency, we would expect that realignment to affect the politics of antitrust policy.

In a second step, then, I look for evidence that the affluent professionals at the heart of this realignment have an economic interest in maintaining a lax antitrust environment. Because these groups of professionals tend to reside comfortably in the upper echelons of the income distribution, and their income is sensitive to changes in the amount of M&A activity from year to year, we would expect to see a significant and immediate relationship between M&A activity and economic inequality. I therefore use a panel study to explore how shocks in M&A activity affect income inequality at the state level in both the pre- and post-Reagan period while accounting for the differences among the states in their exposure to this kind of financial activity and to the knowledge economy more generally. The results suggest that growth in M&A has always exacerbated economic inequality, but prior to antitrust deregulation the effect was mostly confined to the state of New York. In the period after antitrust deregulation, the effect size grew in magnitude by more than a factor of two and it has spread to California, Connecticut, the District of Columbia, Florida, Massachusetts, Nevada, New Jersey, and Washington. Some of these knowledge economy states tend to heavily favor Democratic presidential candidates and are also leading sources of campaign contributions for Democratic politicians.

Does this economic interest translate into materially different attitudes towards antitrust regulation? In a third step, I use multilevel regression and post-stratification to try and answer this question. In the iPOLL Databank, there are five surveys for which raw data is available in which respondents answered some version of the question “do you favor or oppose having the federal government do more to regulate large mergers and acquisitions?”, and these polls span about thirty five years (1981, 1990, 1998, 2000, and 2014). I fit a multilevel model to this data and use census population statistics to see how differences across individuals

---

1 The survey results reported here and throughout this article were obtained from searches of the iPOLL Databank and other resources provided by the Roper Center for Public Opinion Research.
and states aggregate into state-level attitudes towards antitrust regulation in each of the last four decades (Park, Gelman, and Bafumi 2004). The results suggest that the political realignment associated with the knowledge economy transition explains some of the shift in Democratic attitudes. At the individual level, the main cleavages do not center on gender or race but on age and income: younger and more affluent voters are significantly less likely while older and less affluent voters are significantly more likely to support doing more to regulate M&A. At the state level, the main cleavages are unionization and exposure to the knowledge economy, not partisanship. And when these differences are aggregated into state level estimates of support for more aggressive antitrust enforcement, the results show that knowledge economy states have significantly lower rates of overall support for more aggressive federal enforcement. I conclude by discussing the broader implication of these findings for the current debate over antitrust policy.

2 The Basic Facts of Antitrust Policy Change

To understand why the events surrounding the election of 1980 are so important, it helps to briefly review how the modern antitrust framework came into existence. Congress erected the three central planks of federal antitrust law governing M&A (the Sherman, Clayton, and Federal Trade Commission Acts) before World War I, largely in response to the growth of corporate trusts observed at the end of the nineteenth century. None of these laws had substantial impact at first, as a conservative Supreme Court generally interpreted the laws in ways that were deferential to business and even used the laws to stifle the growth of labor unions (Purcell 2000). But starting around 1938, antitrust enforcement entered a period of maturation. In 1935, the Supreme Court unanimously held the National Industrial Recovery Act unconstitutional and ended President Roosevelt’s experiments with corporatist approaches to economic recovery (Hovenkamp 1985, Hawley 1995). Subsequently, a new group of policymakers who believed that economic concentration was exacerbating the Depression and corrupting American politics acquired more influence in the executive branch. Roosevelt appointed Robert Jackson in 1937 and then Thurman Arnold in 1938 to lead the DOJAD, and those two officials started a wave of anti-monopolization litigation that continued well into the 1950s (Kovacic 1989).

Federal merger policy during the period at issue in this study—from about 1950 to the present—can then be roughly decomposed into two major periods. In the first period, federal antitrust officials escalated the aggressive New Deal approach to M&A that began with Jackson and Arnold. Many scholars and policymakers began arguing in the late 1950s that the government was still not doing enough to prevent
business consolidations and pushed for substantial reform and stronger antitrust enforcement (Kovacic, 1989). These arguments generally influenced federal law and policy in the direction of making antitrust enforcement more robust. The Celler-Kefauver Act of 1950 closed a loophole in the Clayton Act by adding asset purchases, as opposed to stock purchases, to the list of prohibited conduct. The DOJAD promulgated a new set of more aggressive guidelines for evaluating mergers in 1968 (Hovenkamp, 1985). And the Hart-Scott-Rodino Antitrust Improvements Act of 1976 required companies to notify antitrust officials of all potential mergers above certain asset and price thresholds. By prohibiting companies from completing mergers until a waiting period had passed, the Act gave antitrust agencies time to evaluate the potential anti-competitive effects and take necessary action.

By the middle of the 1970s, an intellectual counter-movement emerged to challenge the reigning consensus about antitrust enforcement priorities, and that movement has deeply influenced antitrust policy to the present day (Hovenkamp, 1985; Kovacic, 1990; Eisner and Meier, 1990; Wood and Anderson, 1993). This conservative critique, often associated with the Chicago School of Economics, differed from prior orthodoxy in many respects, but especially when it came to M&A. Leading scholars argued that oligopolistic markets were much more competitive than previously assumed and that monopolized markets often self-correct in the absence of government intervention (Baumol and Ordover, 1985; Hovenkamp, 1985). Some financial economists also argued that mergers were an important way of disciplining corporate executives who pursued business strategies other than maximizing shareholder value (Davis and Stout, 1992; Lazonick and O'Sullivan, 2000). By 1982, this perspective prevailed. President Reagan appointed James Miller III as chairman of the FTC and William Baxter to lead the DOJAD in 1981. Both officials were firmly in the conservative camp and their tenure witnessed substantial policy change, including the DOJAD’s promulgation of new merger guidelines in 1982 and 1984 and the FTC’s issuance of comparable policy statements.

3 Testing Political Theories of Antitrust Policy Change

Most of these basic facts about antitrust policy are well settled in the literature. But while legal and political scholars generally agree that antitrust enforcement underwent a sea change at some point between the early 1970s and 1982, there has been some disagreement over when precisely that change took place and why it occurred. The conventional view among most legal scholars is that Ronald Reagan’s presidency was the primary catalyst. In this view, the year 1981 marks a critical juncture in resetting antitrust priorities. A contrary view is that the DOJAD laid the seeds for reform long before Reagan was elected by creating an
Office of Economic Policy, staffing the office with economists sympathetic to the conservative view, and giving those economists more power in determining whether staff lawyers should challenge a merger (Eisner and Meier, 1990). In this view, antitrust policy change was slow and gradual even if it accelerated under Reagan, and it arose from ideological capture within the bureaucracy (Carpenter and Moss, 2014, Ch. 4) rather than from presidential direction. A third view suggests that both Congress and the president substantially shape antitrust enforcement priorities, and that the president does so in ways that are not easily captured by partisanship alone but must instead account for each president’s idiosyncratic preferences (Wood and Anderson, 1993).

Each of these theories is rooted in believable descriptive facts about the evolution of antitrust policy, but the empirical results are somewhat ambiguous. Both of the two main empirical studies described above relied on interrupted time series regressions with thirty or fewer observations and seven or more predictors (Eisner and Meier, 1990; Wood and Anderson, 1993). The small sample sizes and the large number of independent variables make it difficult to assess the true significance of these authors’ findings. A more important limitation, though, resides in the selection of the dependent variable. Both studies sought to explain changes either in pure counts of enforcement activity and resources (the number of cases filed, the dollar amount of budget allocations, etc.) or in the relative mix of DOJAD cases (the percentage of total cases challenging mergers or price fixing behavior). However, when it comes to estimating the effect of Reagan’s victory on antitrust enforcement with respect to M&A, the critical outcome is arguably the rate at which the DOJAD challenged transactions involving large companies. In other words, such an analysis requires a measure of the number of DOJAD cases filed relative to the number of large deals that could have been challenged under pre-1981 standards.

Figure 1 illustrates how the selection of the dependent variable can influence the analysis. Panel A shows the number of cases that the DOJAD filed against Fortune 500 companies in each year from 1955 to 1997. The number of cases filed is substantially lower after 1980 than before, but it is not clear whether or not the change was part of a longer downward trend. Panel B shows the proportion of the DOJAD caseload involving merger challenges, and is similarly amenable to multiple interpretations. Together, the figures suggest a secular (albeit substantial) decline in the number of DOJAD lawsuits filed against large companies and the proportion of lawsuits challenging mergers regardless of company size, with the decline starting around the early 1970s and continuing into the early 1990s. Against prior expectations of dramatic change in 1981, they offer underwhelming proof.

In contrast, Panel C in Figure 1 shows the percentage of proposed mergers reported to the FTC or the
Figure 1: Panel A shows the number of DOJAD antitrust cases brought against Fortune 500 companies from 1955 to 1997. Panel B shows the percentage of DOJAD antitrust cases challenging a merger from 1955 to 1997. Source: Gallo et al. (2000). Panel C shows the percentage of proposed mergers where the FTC or the DOJAD issued a request for more information before allowing the deal to proceed or initiating a challenge (formally, a “second request”). Source: Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (1983-2015).

DOJAD where either agency took the step of requesting more information from the merging entities before approving or challenging the transaction. I obtained this data from the appendices of the annual reports the agencies submit to Congress (Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (1983-2015). In contrast to the metrics above, it does not show pure counts or caseload shares but instead shows requests relative to the amount of economic activity (the number of proposed mergers) in each year. This data is only available starting in September of 1978, but
it demonstrates a precipitous decline in this rather cursory form of scrutiny between 1979 and 1982, from more than 12 percent to about 4 percent of all proposed transactions. Antitrust officials were aware of and sensitive to this shift. In public reports, President Reagan’s appointee, James Miller III, argued that the trend reflected a learning process causing businesses to submit fewer objectionable proposals. Commissioner Michael Pertschuk disputed Miller’s “Panglossian” view and argued that the shift reflected a clear change in administrative priorities (Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 1982-1983).

A central claim in this study is that, while illustrative, statistics on case counts or caseload shares are not the best statistics to use when looking for evidence of shifting agency priorities because they do not account for rapidly changing economic circumstances. The election of 1980 arguably sent a clear signal to the business community that enforcement priorities would substantially change under the new administration, and M&A activity subsequently exploded. Of course, we would also expect the caseload share to shift away from policing mergers and towards other antitrust violations conservatives cared more about, like price fixing. But the much more significant shift should be the shift in the number of cases challenging mergers relative to the number of mergers that could have been challenged under pre-1981 standards. My hypothesis is that such a statistic will provide strong evidence of a critical juncture in antitrust enforcement priorities.

To test this hypothesis, I used a generalized additive model to estimate the number of large deals executed from 1955 to 2015, and then estimated the probability of a challenge in each year by dividing the number of merger cases the DOJAD filed by the total number of large deals. I consider a deal to be “large” and vulnerable to regulatory change using the transaction value, or the purchase price. This is consistent with the regulatory view which has historically focused on the value of acquired assets in individual deals and in the aggregate. The FTC, for example, tracked all mergers in manufacturing and mining from 1948 to 1978 and tabulated them according to the value of assets acquired, with a “large merger” series including all deals with acquired assets worth more than $100 million in nominal (not adjusted) dollars. Here I use a lower transaction value, $50 instead of a $100 million, to get more variation in early years, but importantly, I also adjust the threshold for inflation to capture deals of comparable size across years. The model therefore estimates the number of deals in each year where the deal value exceeded $50 million in 1948 dollars, or about $400 million in today’s dollars.

I describe the procedure for estimating the number of large deals in each year at length in the replication file and provide only a brief summary here. In essence, I use transaction level data on M&A in recent

2Small percentages of proposed mergers subject to such a request actually get challenged.
decades to estimate the number of large deals executed each quarter using known correlates of aggregate M&A activity, and then use the model to impute the number of large deals in prior years. The SDC Platinum database published by Thompson Reuters provides comprehensive data on mergers and acquisitions from 1982 to the present, including the transaction date and value. The Center for Research on Securities Prices (CRSP) also provides comprehensive data on publicly traded companies that have been delisted because of a merger from 1955 to 2015 including the date of delisting. I use the acquired company’s stock market valuation one month prior to the delisting as a proxy for deal value. The Federal Trade Commission publishes the number of deals involving publicly traded companies in mining and manufacturing from 1955 to 1979, and that series can be extended using SDC Platinum Data with appropriate filters. Similarly, aggregate M&A activity is known to be highly correlated with other macroeconomic statistics like aggregate amounts of corporate debt (Baker and Wurgler (2000), pp. 2250). The Flow of Funds (FOF) database published by the Federal Reserve provides quarterly measures of corporate debt from 1955 to the present. I follow Phillippon (2015) in first fitting a model estimating quarterly counts of deals above the inflation adjusted threshold from 1982 to 2015 using SDC data as the dependent variable and CRSP data and FOF data as predictors. I then impute expected deal counts from 1955 to 1981 using the longer time span of the predictors. Last, I sum the quarterly counts to obtain annual measures.

I follow a similar procedure for estimating DOJAD enforcement activity. The official DOJ workload statistics contain the total number of merger cases filed from 1970 to 2015, but are not available for earlier years. I therefore use comparable measures published by Gallo et al. (2000) from 1955 to 1997 to estimate a linear model, and impute official measures from 1955 to 1969.

Given annual estimates of the number of merger cases filed and the number of large deals from 1955 to 2015, I calculate enforcement rates or percentages by taking the ratio. By this measure, enforcement rates reached their peak in 1961 when the DOJAD filed 28 cases but only 10 large deals were consummated. To obtain a measure resembling a likelihood of challenge, I normalize these estimates by dividing by this maximum value (2.8). The resulting metric estimates the likelihood of facing a DOJAD challenge relative to the high enforcement rates of 1961.

Figure 2 illustrates why it is essential to interpret regulatory activity relative to the amount of economic activity that is meant to be regulated. Panel A shows the number of cases the DOJAD filed from 1955 to 2015 challenging a merger. Much like the first two panels of Figure 1, the numbers vary but there is no easily discernible trend. Panel B shows the number of large mergers executed in each year over the same time frame, based on the estimates described above. It shows that the amount of M&A activity exploded around
1980, most likely in anticipation of relaxed regulatory scrutiny. Panel C shows the relative enforcement rates obtained by taking the number of cases from Panel A, dividing by the number of large deals from Panel B, and normalizing the numbers so that they portray the likelihood of a challenge relative to the high enforcement rates of 1961. It provides strong evidence of a critical juncture in 1981. Assume, for example, that the average relative enforcement rates are roughly 50 percent and 1 percent before and after 1981 based on the plot. Before Reagan was elected, if the number of deals executed increased by 10 percent relative to the number of deals executed in 1961, firms could expect the number of DOJAD challenges to be about 55 percent of the number of cases filed in 1961. After Reagan was elected, firms could expect DOJAD challenges to be about 1.1 percent of the number of cases filed in 1961 for the same relative increase in M&A activity.

The analysis above supports the conventional view that antitrust policy changed dramatically in a short period of time around the early 1980s. To determine precisely when the change took place I estimated a Bayesian changepoint model (Carlin, Gelfand, and Smith [1992]) of the following form:

\[
y_t = \phi y_{t-1} + a_1 x_t + b_2 z_t \quad \text{for } t \in (2 : k) \tag{1}
\]

\[
y_t = \phi y_{t-1} + a_2 x_t + b_2 z_t \quad \text{for } t \in (k + 1 : T) \tag{2}
\]

where \( k \) is a potential change point, \( y_t \) is relative enforcement rates, \( x_t \) is the DOJAD’s annual budget appropriation, and \( z_t \) is presidential party affiliation. The model is first order autoregressive under the assumption that agency officials and bureaucrats will base the current year’s priorities on the last year’s priorities with some modifications. In terms of specifying distributional assumptions, the change point \( k \) was drawn from a uniform distribution on the interval \((2, T)\) where \( T \) in this case is 61 (for the 61 years between 1955 and 2015), and the autoregressive coefficient, \( \phi \), was drawn from a uniform distribution on the interval \((0,1)\). The remaining coefficients on budget restraints \((a_1 \text{ and } a_2)\) and presidential party \((b_1 \text{ and } b_2)\) were given uninformative normal priors.

The results obtained by estimating equations (1) and (2) using the JAGS Gibbs sampler in R are shown in column (1) of Table 1. Because budget appropriations increase (almost) monotonically over the entire period, the negative coefficients \( a_1 \) and \( a_2 \) suggest that relative enforcement rates trended down before and after the change point, despite increasing budgets, though the trend is more negative after the change point. More importantly, the 95 percent confidence intervals for the coefficients measuring the effect of presidential party affiliation, \( b_1 \) and \( b_2 \), effectively surround zero. As a result, we cannot reject the null hypothesis that the
Figure 2: Panel A shows the number of DOJAD cases challenging a merger from 1955 to 2015. Panel B shows the number of large mergers in each year over the same time frame, based on imputed estimates from 1955 to 1981 as described in the text. Panel C shows the likelihood of facing a regulatory challenge, which is obtained by dividing the number of cases from Panel A by the number of mergers in Panel B, and normalizing relative to the maximum in 1961.

partisanship of the sitting president has no bearing whatsoever on the likelihood of challenging large mergers in either period after we control for the substantial change in enforcement priorities at the change point. Because those coefficients are effectively zero, I dropped them from the model and ran a second simulation to (slightly) improve precision on the estimate of the change point, $k$. The results are shown in column (2) of Table 1. The 95 percent confidence interval for $k$ is (26.0, 27.9) with a mean of 26.7. This suggests the change point is precisely estimated and took place in the 27th year, or 1981.
Table 1: This table shows the mean estimated coefficients and 95 percent confidence intervals (in parentheses) obtained from estimating Equations 1-2 using the runjags library in R (Denwood, 2016). The dependent variable in each model is DOJAD enforcement rates relative to 1961, as explained in the text. The parameter $\phi$ and the pairs $(a_1, a_2)$, and $(b_1, b_2)$ respectively capture dependence on the prior year’s enforcement rates as well as budget appropriations and presidential party affiliation before and after the change point, $k$.

Table 1: This table shows the mean estimated coefficients and 95 percent confidence intervals (in parentheses) obtained from estimating Equations 1-2 using the runjags library in R (Denwood, 2016). The dependent variable in each model is DOJAD enforcement rates relative to 1961, as explained in the text. The parameter $\phi$ and the pairs $(a_1, a_2)$, and $(b_1, b_2)$ respectively capture dependence on the prior year’s enforcement rates as well as budget appropriations and presidential party affiliation before and after the change point, $k$.

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$a_1$</td>
<td>-0.06</td>
<td>-0.06</td>
</tr>
<tr>
<td></td>
<td>(-0.1, -0.02)</td>
<td>(-0.09, -0.03)</td>
</tr>
<tr>
<td>$a_2$</td>
<td>-0.21</td>
<td>-0.2</td>
</tr>
<tr>
<td></td>
<td>(-0.29, -0.13)</td>
<td>(-0.27, -0.13)</td>
</tr>
<tr>
<td>$b_1$</td>
<td>-0.07</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>(-0.48, 0.35)</td>
<td>–</td>
</tr>
<tr>
<td>$b_2$</td>
<td>0.15</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>(-0.21, 0.51)</td>
<td>–</td>
</tr>
<tr>
<td>$k$</td>
<td>26.73</td>
<td>26.7</td>
</tr>
<tr>
<td></td>
<td>(26, 27.98)</td>
<td>(26, 27.88)</td>
</tr>
<tr>
<td>$\phi$</td>
<td>0.4</td>
<td>0.41</td>
</tr>
<tr>
<td></td>
<td>(0.17, 0.62)</td>
<td>(0.19, 0.63)</td>
</tr>
<tr>
<td>N</td>
<td>61</td>
<td>61</td>
</tr>
</tbody>
</table>

The most important takeaway from this analysis is that, when we use an appropriate metric of DOJAD enforcement priorities—the percentage of large mergers challenged in a given year—we see evidence of a critical juncture starting with Reagan’s presidency in 1981. This supports the conventional view of antitrust policy change. The next most important finding is that, even after Democrats regained control of the presidency in 1993 and again in 2009, they did little to return the DOJAD to its pre-1981 policy of challenging almost half of all large mergers that were proposed in each year, even though this kind of policy shift can be (and was) implemented without Congressional approval. The DOJAD did revise the merger guidelines in 1992, in 1997, and again in 2010. But the data shows that these revisions tinkered at the margins, at best. In the next section, I try to understand why recent Democratic administrations have not engaged in aggressive antitrust enforcement.

4 Lax Enforcement Under Democratic Presidents After Reagan

For some policy observers, the empirical results described above may come as little surprise. In a new book, Stoller (2019) argues, for example, that key political appointees to the DOJAD in Democratic administrations of the 1960s and 1970s began to embrace conservative ideology on antitrust issues so that, by the time of Reagan’s victory in 1980, liberal support for more aggressive enforcement within the bureaucracy had all
but vanished. In this respect, Stoller (2019) adds descriptive heft to a similar theory articulated earlier by Eisner and Meier (1990) and Eisner (1991). One drawback of these theories is that, in focusing on ideological shifts, the authors fail to explore the possibility that some core Democratic constituencies may not want the government to regulate M&A more aggressively.

Without diminishing the possible role of ideology, it would be helpful to understand more about public attitudes towards antitrust enforcement and how the change in antitrust enforcement priorities demonstrated in section 3 fits into the broader political realignment associated with the Democratic commitment to building an American knowledge economy (Hacker and Pierson 2010; Geismer 2015; Rodden 2019). In her historical study of the Route 128 corridor surrounding Boston, Geismer (2015) argues that George McGovern’s victory in the Democratic primary of 1972 symbolized a much deeper realignment within the Democratic party, in which the party moved away from its traditional affiliation with organized labor and towards a “new center” composed of relatively affluent suburban professionals participating in the knowledge economy. Hacker and Pierson (2010) offer a similar view but suggest that this process accelerated in the late 1970s and early 1980s when organized business interests and wealthy donors increasingly threw their financial support behind Republican candidates, which forced the Democratic party to forge new business alliances to level the financial playing field. Rodden (2019) similarly contends that some of these changes reflect the Democratic party’s increasing commitment to urban constituencies despite significant demographic change in urban constituencies, with knowledge economy workers becoming much more densely represented in urban areas.

Despite their differences, these theories all imply that policy preferences amongst Democratic representatives on antitrust enforcement may have changed because the Democratic party has increasingly sought the support of new constituencies that may not share the traditional aversion to big business that characterized the post-New Deal era. In fact, in some respects, antitrust policy is an ideal policy environment in which to test this hypothesis. On the one hand, organized labor was adamant that the high levels of merger activity that began under Reagan were destroying jobs for blue collar workers (Fallick and Hassett 1996). On the other hand, M&A requires a great deal of financial and legal services to complete, so the same economic trends tended to benefit the white collar professionals that reside at the “new center” of the Democratic realignment. The public generally recognized the differential impact. In a 1990 survey, for example, 80 percent of respondents said that corporate mergers and takeovers help the lawyers and bankers who arrange them, while 62 percent said that the deals hurt the employees of the companies involved (Shulman 1990).

Below, I explore some of these claims through two sets of analyses. First, I test the possibility that M&A benefits affluent professionals like lawyers and bankers using state level data on income inequality. After
finding that merger waves do exacerbate income inequality, I then test the hypothesis that the states where these economic effects are most acutely felt have significantly lower levels of public support for doing more to regulate M&A.

### 4.1 Antitrust Deregulation and Rising Income Inequality

To test for a plausibly causal effect between relative growth in M&A activity and income inequality, I leverage the fact that in 1981, each of the fifty states plus the District of Columbia was differentially suited to take advantage of the explosion in financial activity that came with antitrust deregulation. My identification strategy is based on the econometric model for heterogeneous treatments developed by Card (1992) and others (Rajan and Zingales, 1998; Baker, Bloom, and Davis, 2016; Angrist and Pischke, 2008). Following a procedure similar to that used in section 3, I first estimate the total dollar value of global M&A completed in each year where the transaction value was more than $100 million in 1948 dollars, which is approaching $1 billion in today’s dollars. I then use the time series showing M&A activity relative to total income, $X_t = \log\left(\frac{M_t}{I_t}\right)$, as capturing a common national shock to which each state is differentially exposed. I estimate each state’s exposure to these shocks and to the knowledge economy more generally, $\xi_{i,t-1}$, using each state’s share of total GDP earned in the prior year in an industry like legal services, much in the way that Card (1992) estimated exposure to a new federal minimum wage with the share of teenage workers likely to be affected. For example, if in 1986, the total amount of income generated in legal services was $10 billion and New York generated $1 billion of the total, then its exposure to the knowledge economy in 1987 would be 10 percent. My main specification is:

$$I_{s_{it}} = \alpha_i + \beta_t + \delta\xi_{i,t-1} + \gamma(\xi_{i,t-1} \times X_t) + \epsilon_t$$

where $I_{s_{it}}$ is a top income share in state $i$ and year $t$, $\alpha_i$ and $\beta_t$ are state and year fixed effects, and $X_t$ and $\xi_{i,t-1}$ are defined as above. The coefficient on the interaction term, $\gamma$, captures the main effect of interest. Additional information about the motivation for this model is available in the Supplemental Information (pp.3-8).

To estimate this equation, I use top top 0.1 percent fiscal income shares as the main dependent variable. Though labor income statistics might be preferable to fiscal income statistics, they are yet not available in long time series at the state level. I therefore use fiscal income statistics but control for a possible effect through capital income by controlling for state level capital gains and the interaction between a state’s exposure to
capital markets (its share of capital gains in the prior year) and relative growth in M&A activity. I use each state’s share of total income in legal services in the prior year as my main measure of exposure because it is highly correlated with the share of income in securities and commodities brokerage (which covers investment banking), but is more granular and is consistently reported across the shift from SIC to NAICS codes in 1997. It is also well correlated with a measure of exposure based on the advisory fees earned from reported mergers, as shown in the replication file. I estimate equation using first differencing instead of demeaning to deal with state fixed effects because the estimates are more conservative and because it substantially reduces autocorrelation in the residuals. I also use the square root of the number of tax units in state \( i \) and year \( t \) as weights to reduce the observable heteroskedasticity that is likely due to measurement error surrounding income statistics from smaller states (less than 2 million tax units) (Jayaratne and Strahan, 1996, pp. 649). Standard errors are clustered at the state level.

Table 2 presents the main results. The main finding is that growth in M&A activity relative to total income accurately predicts some fluctuations in fiscal income inequality across both periods, but the effect size for the top 0.1 percent has more than doubled since 1981, even after we control for the possible effect due to capital gains in the second period. This strongly suggests that the income of affluent professionals at the top of the income distribution is sensitive to changes in M&A activity. The results are robust to variations in functional form, to the use of the top 1 percent of fiscal income as a dependent variable, to the use of a lagged average of exposure that smooths fluctuations within states, to the use of alternative measures of exposure based on M&A advisory fees or shares of income in securities and brokerage services, and to the inclusion of controls for capital gains at the state level, exposure to capital markets, and capital gains earned by way of M&A activity.

One concern with the approach above is that it may not capture all of the important differences between the states in their exposure to the knowledge economy. As an exploratory exercise, I also estimated a Bayesian equivalent of (see Supplemental Information, pp.8-9) in which I allowed the coefficients, \( \delta_i \) and \( \gamma_i \), to vary by state \( i \). This muddies the water for statistical inference, as \( \gamma_i \) now captures some combination of an effect and un-modeled heterogeneity in exposure. But as an exploratory exercise, the results are nevertheless interesting and help identify states that may be acutely exposed to the knowledge economy.

Table 3 presents the main results. The first key finding, shown in column (1), is that growth in M&A activity did not significantly increase fiscal income inequality from 1963-1980 anywhere except New York. This is consistent with New York being the center of legal and financial services for M&A activity before

---

3 In the state level GDP data published by the Bureau of Economic Analysis, the finance and insurance industry code is at the three-digit code level (523x) while the legal services code is at the four digit level (5411).
Table 2: This table shows the main results of estimating equation 3. All three models include state and year fixed effects (estimates not shown). The dependent variable in each model is the top 0.1 percent’s share of fiscal income. The state’s share of legal services in period t − 1 is used as a measure of exposure to the knowledge economy (δ in Equation 3). The main effect of interest (γ in Equation 3) is the interaction between this measure of exposure and X_t, which measures M&A activity relative to total fiscal income in year t, on the log scale (see text). Models (1) and (2) cover different time periods, 1963-1980 and 1981-2015 respectively. In model (3), I added controls for inflation adjusted capital gains at the state level plus each state’s exposure to capital markets (its share of capital gains in the prior year) and that exposure interacted with X_t. It covers the time period for which this data was available (1989-2015).

deregulation. The second key finding is that, in the period of antitrust deregulation from 1981-2015, growth in M&A activity significantly increased fiscal income inequality in only eight states plus the District of Columbia, and many of the regions that seem to be the most exposed to the knowledge economy by this measure tend to also favor Democratic presidential candidates. In 1980, few might have predicted that antitrust deregulation would financially benefit anyone outside of a select group of professionals in New York. But the explosion in M&A activity that antitrust deregulation wrought has fundamentally altered the economic landscape so that today, groups of affluent professionals who reside in at least six consistently Democratic states plus the District of Columbia have incomes that are intensely tied to the lax antitrust regime that Reagan inaugurated.

The key takeaway, here, is that the popular perception that M&A deregulation worked for the benefit of lawyers and bankers but to the detriment of employees has at least some basis in fact. In a sense, it has always been true that M&A activity exacerbates income inequality. But in the period of antitrust deregulation that began with Reagan, the magnitude of that effect has grown substantially and its geographic location has spread well beyond New York City. In the next section, I explore the possible impact of these changes on public support for having the federal government do more to regulate M&A.
Table 3: This table shows the main results of estimating a Bayesian form of equation 3 that allows for heterogeneity in \( \delta_i \) and \( \gamma_i \) using the runjags library in R (Denwood, 2016). The results for states that do not have a significant effect in any period are not shown.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>3.15</td>
<td>15.3</td>
</tr>
<tr>
<td></td>
<td>(-0.5, 6.3)</td>
<td>(8.28, 22.63)</td>
</tr>
<tr>
<td>Connecticut</td>
<td>3.37</td>
<td>52.66</td>
</tr>
<tr>
<td></td>
<td>(-1.42, 8.68)</td>
<td>(9.14, 100.13)</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>2.24</td>
<td>49.44</td>
</tr>
<tr>
<td></td>
<td>(-3.67, 6.74)</td>
<td>(28.33, 70.46)</td>
</tr>
<tr>
<td>Florida</td>
<td>3.31</td>
<td>25.12</td>
</tr>
<tr>
<td></td>
<td>(-1.4, 8.3)</td>
<td>(10.2, 39.92)</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>3.28</td>
<td>56.55</td>
</tr>
<tr>
<td></td>
<td>(-1.27, 8.27)</td>
<td>(29.5, 84.49)</td>
</tr>
<tr>
<td>Nevada</td>
<td>3.14</td>
<td>55.72</td>
</tr>
<tr>
<td></td>
<td>(-1.94, 8.5)</td>
<td>(-0.09, 117.8)</td>
</tr>
<tr>
<td>New Jersey</td>
<td>3.37</td>
<td>27.12</td>
</tr>
<tr>
<td></td>
<td>(-1.01, 8.18)</td>
<td>(3.39, 52.07)</td>
</tr>
<tr>
<td>New York</td>
<td>2.86</td>
<td>9.63</td>
</tr>
<tr>
<td></td>
<td>(0.22, 5.32)</td>
<td>(4.02, 15.26)</td>
</tr>
<tr>
<td>Washington</td>
<td>2.99</td>
<td>47.75</td>
</tr>
<tr>
<td></td>
<td>(-2.48, 7.88)</td>
<td>(14.21, 83.45)</td>
</tr>
</tbody>
</table>

4.2 Antitrust Deregulation and Public Support for Regulation

While antitrust issues do not have a prominent place in public opinion surveys, some questions have been asked consistently enough over time to enable a basic understanding of how views on antitrust regulation have evolved in the post-Reagan period. In this section, I focus on 16 polls that asked respondents whether the federal government should make it easier or harder for companies to merge. I ignore differences in question wording (see the replication file for more information) and consider responses to fall into one of three categories: support for doing more, taking no position or opposed to doing more, and either refusing to answer the question or responding “I don’t know.” The aggregate annual trends (where outcomes of multiple polls in the same year have been averaged) are shown in Figure 3. The results suggest that Reagan took advantage of a unique policy window in 1981 when the public was largely opposed to more federal regulation. Public attitudes quickly swung in the other direction as antitrust policy changed, with those favoring more regulation exceeding 60 percent through most of the late 1980s. Since the late 1980s, the gap between those who favor and oppose more regulation has drastically narrowed (from about 40 to about 10 percent), though overall support has been somewhat consistently between 45 and 55 percent.

For five of these sixteen polls, raw data is available for further analysis. To determine what economic
Figure 3: This figure shows the percentage of respondents who favor (green) or oppose (blue) doing more to regulate M&A, or who either refused to answer the question or did not know how to respond (red). The data includes 16 separate polls but response percentages in the same year are averaged to produce 11 annual observations since 1981. Source: iPOLL Databank provided by the Roper Center for Public Opinion Research.

and demographic cleavages have influenced public opinion towards antitrust regulation since 1981, I fit the following multilevel model using these raw data sets (Park, Gelman, and Bafumi 2004):

\[
\Pr(y_{jt} = 1) = \logit^{-1}(\text{stateyear}_{i[j],t} + \text{income}_j + \text{educ}_j + \text{age}_j + d*\text{hispanic}_j + \text{race}_j + e*\text{sex}_j)
\]

(4)

\[
\text{stateyear}_{i[j],t} = \text{state}_{i[j]} + \text{year}_t + a*\text{partisan}_{i[j],t} + b*\text{union}_{i[j],t} + c*\text{exposure}_{i[j],t-1}
\]

(5)

where partisan\(_{i[j],t}\) in state \(i\) and year \(t\) was based on the average Democratic presidential vote share in the two elections prior to year \(t\), union\(_{i[j],t}\) captures the share of each state’s private sector labor force that is a union member, and exposure\(_{i[j],t}\) captures each state’s exposure to the knowledge economy as above (the share of total income in legal services earned by each state in the prior year). Along with time invariant aspects of each state (\(\text{state}_i\)) and average effects across all states in each year (\(\text{year}_t\)), the estimated coefficients on these three variables (\(a\), \(b\), and \(c\)) influence average levels of support for more regulation in the state-year model. The term \(i[j]\) denotes the state \(i\) that individual \(j\) belongs to. The individual model
includes six basic demographic variables that were reported in each poll. Because gender and hispanic heritage are binary variables, the effects of those characteristics are modeled as simple regression coefficients \((d\) and \(e\)) (Park, Gelman, and Bafumi, 2004, p. 377). The binary dependent variable \(y_{jt}\) represents whether individual \(j\) in polling year \(t\) favors more regulation of M&A. All of the regression and multilevel coefficients were given uninformative normal priors.

To deal with missing data, I used the MICE library in R to do multiple imputation for each poll. As a result, the final analysis is actually based on five separate datasets each one containing data on all five polls but with different values imputed for missing observations. I then calculated average coefficients and standard errors across all five datasets according to Gelman and Hill (2007, Section 25.7). Most of the demographic data was relatively straightforward to clean except income. For income, I imputed income within the stated polling categories, assigned each observation a monetary value equal to the median of the real or imputed income bracket, adjusted that value for inflation, and then re-categorized individuals as having a household income of less than $50,000, from $50-100,000, or more than $100,000 in 2014 dollars. For more details, please refer to the replication file.

The results from estimating model 5 are shown in Figure 4. The results from the individual level model suggest that the main cleavages are not race or gender. Though women are slightly more likely to support...
more regulation than men, and whites are slightly more opposed to more regulation than other racial groups, the differences are somewhat small compared to the other effects seen in the model, most notably age and income. Adults aged 18-34 are significantly more opposed to regulation than adults who are 65 or older for example, which suggests that one of the main cleavages in public opinion about antitrust policy is generational. Respondents who were 65 years or older in 1980 and 1990 were old enough to remember the Great Depression and were certainly old enough to remember the New Deal consensus on antitrust policy that ended with Reagan. That demographic appears to have much more favorable views towards more regulation. Similarly, those who have a household income less than $50,000 are significantly more likely to support more regulation than those who make $100,000 per year or more.

The results from the state level model are also somewhat revealing, in that exposure to the knowledge economy and union membership have roughly equal and opposite effects on average levels of support (though the coefficients are not precisely estimated), while state partisanship plays an insignificant role in predicting aggregate antitrust attitudes. The difference in these estimated coefficients is meaningful because partisanship, unionization, and knowledge economy exposure are weakly correlated (they have Pearson correlation coefficients ranging from 0.12-0.25). As a result, it is unlikely the effect of partisanship is being absorbed, for example, in the estimates for the other two variables. Both sets of findings (from the individual and state year model) are consistent with the view that political realignment has caused Democratic officials to base antitrust policy priorities on the preferences of younger and more affluent voters who are integrated into the knowledge economy, even if those priorities are somewhat at odds with the views of older and less affluent voters in states with higher levels of union membership.

Finally, to see how these effect sizes aggregate into state-level differences in support for having the federal government do more to regulate mergers, I implemented post-stratification using IPUMS-USA census data from the census year nearest to the polling year. In short, model 5 allows me to compute the predicted probability of support within 720 separate demographic categories (3 income levels, 5 education levels, 4 age brackets, 3 race categories, and 2 categories each for gender and hispanic heritage) for each of the fifty states plus the District of Columbia (51 state categories) for a total of 36,720 categories in each polling year. Those predicted probabilities are then effectively weighted by the share of the state’s population in each of the census categories (Park, Gelman, and Bafumi 2004 p. 376) to impute average levels of support for each state and year.

Figures 5 and 6 show the main results. If political realignment has influenced Democratic preferences towards antitrust regulation, we would expect the knowledge economy states to have materially different
preferences for more regulation. Both figures support this argument. In Figure 5 partisanship is a weak predictor of changes in attitudes: moving from one extreme to the other opens up a difference of about 3 percentage points in average levels of support for more regulation. When the District of Columbia is excluded (right), a comparable support gap exists between the knowledge economy states and other states who support Democratic presidential candidates at 10 percentage points above the national average. A similar gap of 2-2.5 percentage points exists between knowledge economy states and other states with union membership rates 10 percentage points higher than the national average, as shown in Figure 6. The knowledge economy states therefore appear to be substantially different from their peers, even at similar levels of Democratic presidential support and union membership, when it comes to advocating for greater federal oversight of M&A.

Figure 5: These figures show the predicted levels of support for having the government do more to regulate M&A at the state level as a function of average presidential vote share in the two elections prior to the polling year. In each figure, the data is pooled for all five polling years (1981, 1990, 1998, 2000, and 2014) and both variables have been de-meaned within each polling year. The figure on the left includes the District of Columbia while the figure on the right excludes it. Each figure shows the relationship for the knowledge economy states (black, see text) and all other states (grey). Regression lines are included as a visual aid but are not reported.

5 Conclusion

Perhaps ironically, the firms targeted most prominently in the ongoing debate about resuscitating American antitrust enforcement are large technology firms like Google, Amazon, and Facebook, firms often perceived as being the victors in the knowledge economy transition. But thus far, that debate has placed too much emphasis on American technology firms and not enough attention on the many other industries and sectors
Figure 6: These figures show the predicted levels of support for having the government do more to regulate M&A at the state level as a function of the state’s share of its private sector work force that has union membership in the polling year. In each figure, the data is pooled for all five polling years (1981, 1990, 1998, 2000, and 2014) and both variables have been de-meaned within each polling year. The figure on the left includes the District of Columbia while the figure on the right excludes it. Each figure shows the relationship for the knowledge economy states (black, see text) and all other states (grey). Regression lines are included as a visual aid but are not reported.

where market concentration is rising (Autor et al. 2017). And it has placed too much emphasis on breaking up those companies that have already attained staggering levels of market capitalization and not enough emphasis on policing the behavior that allows most companies to become and remain dominant economic actors: mergers and acquisitions.

Should policy makers seek to police M&A more heavily, even those who hail from the party tradition-
ally associated with greater intervention—the Democratic party—will likely face some substantial political obstacles. In this article, I have sought to better understand what those obstacles might be. I find, first, that federal regulation of M&A changed substantially with the Reagan administration, but that Democratic administrations since Reagan have done little to bolster DOJAD enforcement. I then find that this reluc-
tance may have an electoral connection. The affluent knowledge economy professionals who have been the focus of Democratic party recruitment for almost fifty years seem to have a concrete economic stake in lax enforcement; they also have significantly lower levels of approval for more government intervention.

I interpret these results to mean that, while broader reform may be difficult, it is not hopeless. In the last polling year available, 2014, all states had predicted levels of support for more regulation above 50 percent. And, as I demonstrate above, there is a substantial relationship between antitrust deregulation and rising economic inequality, which is also a prominent issue on the Democratic agenda. But for those in favor
of broader reform, the now well known facts about rising market concentration may not provide sufficient impetus for serious change. Instead, reformers may need to confront the political legacy of the knowledge economy transition.

References


