

The Political Economy of Federal Trade Commission
Administrative Decision Making in Merger Enforcement

by

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I. INTRODUCTION

The Federal Trade Commission (FTC) is an administrative agency charged, along with the Department of Justice (DOJ), with enforcing the antitrust laws. However, unlike the DOJ, the FTC litigates the antitrust cases it chooses to prosecute, known as "administrative complaints", in front of its own administrative law judges (ALJs), and then hears the appeal itself. While this process has raised concerns in the past (Posner (1969), ABA (1989)), it has been subject to little empirical investigation.

This study focuses on the formal decisions made by the FTC after an ALJ has conducted a full trial on the merits for a particular case. The analysis explores a number of issues with a data set generated by surveying all of the FTC's merger decisions from the 1950 reform of the Clayton Act to 1992. In particular, the structure of the FTC raises a number of interesting questions concerning how the institution actually responds to various internal and external pressures.

Our study finds that while the merits of a particular matter affect the commission's decision, internal political factors also matter. In particular, the number of commissioners who both vote to prosecute and then vote as a judge in a case impacts on the FTC's decision, as well as the political affiliation of the commissioners. Contrary to previous studies, however, we find little evidence of an external political effect on FTC judicial decisions.

II. THE FTC'S ADMINISTRATIVE PROCESS

The FTC enforces the antitrust laws in partnership with the DOJ. Much of the antitrust casework involves the evaluation of the competitive effects of proposed and consummated mergers. Decisions are made by a majority vote of the five Commissioners, in response to staff recommendations on particular cases. Commissioners are appointed by the President and confirmed by the Senate for terms of up to seven years.

If the merging firms choose to oppose an FTC enforcement action, the agency initiates a lengthy court process to attempt to obtain a permanent injunction against the merger.¹ After presiding at a trial on the merits, the ALJ issues an initial decision and an order to remedy any identified problems. This decision and any ensuing order may be appealed to the Commission by either the respondents or the FTC staff. The Commission then issues a "formal" decision on the merits, along with an order to resolve the competitive concern. The FTC decision can incorporate a complete review of the trial record, and is not constrained in any way by the findings of the ALJ.² If the Commission finds a violation, the respondents may appeal to a federal appeals court and, ultimately to the Supreme Court before an order is actually enforced.³

In effect, the administrative FTC is transformed into a federal court for the purpose of ruling on a merger. Along the lines of Cohen (1991), we expect that, in making these decisions, FTC commissioners can be modeled as utility-maximizers. We hypothesize that FTC administrative decision making on mergers is driven by three different types of factors. The first set of factors is the actual merits of a particular matter. Given the possibility of appeal, and that a reversal on appeal would diminish the reputation of commissioners, the stronger the merits of a case, the more likely the FTC is to

¹ Under the 1976 Hart-Scott-Rodino (HSR) Act, the FTC can also interdict a proposed merger by obtaining a preliminary injunction from a federal district court, with possible review from the relevant court of appeals. If the court declines to issue the injunction, the firms are free to merge, subject to the administrative process described here. Between October 1983 and September 1992, the FTC voted to challenge 75 horizontal mergers filed under Hart-Scott-Rodino. The Commission litigated 13 of these cases in federal court, winning ten injunctions. Administrative complaints coincided with the injunctions, although most of the defendants settled and abandoned their transactions. In the five cases that went to trial, the Commission dismissed one, ordered a divestiture in another and settled a third after a Commission decision on the merits. One is currently on appeal although the acquisition collapsed years ago and the last is at the Commission for a decision. Thus, only one or at most two of the 75 transactions will have survived the FTC process under the HSR Act.

² The DOJ uses the federal court system for merger law enforcement. While a preliminary injunction trial would be similar to one litigated by the FTC, the DOJ also can litigate cases against consummated mergers in a full trial on the merits. In recent years, however, the DOJ has started litigating combined preliminary injunction/full trials on the merits. This approach allows the court system to rule on the legality of a merger in a one step process.

³ We note that it has now been over twenty years since the Supreme Court decided a merger case on the merits, *U.S. vs. General Dynamics* 415 U.S. 486 (1974).

rule favorably for itself and against the relevant firms in a particular matter. We expect horizontal merger cases to be stronger than vertical or potential competition cases, holding other structural factors constant. It is also possible that the FTC's merger enforcement standards have changed over time, with more recent cases less likely to lead to merger orders, again holding other considerations constant. In particular, the Supreme Court's 1974 *General Dynamics* decision may have had an effect on the process, because the court ruled that merger decisions must look beyond market concentration and into other competitive aspects of a merger case.

The second factor is how a case fits into the internal political structure at the FTC. This could be especially important given the process by which FTC complaints are decided. Complaints are first voted out by FTC commissioners and are then sent for trial before an ALJ, who is also an FTC employee. Once the ALJ makes his decision, the case is appealed back to the Commission, a commission often consisting of some of the same people who issued the complaint in the first place. Thus, unlike most of the American legal system, an FTC commissioner can be both the prosecutor and the judge on a particular case.⁴ Utility-maximizing commissioners may well be reluctant to publicly admit they were mistaken in prosecuting a particular matter. We hypothesize that the more commissioners voting on a formal decision who were also part of the decision to prosecute that matter, the more likely it is that the FTC will find in favor of its own case.

The Commissioners' political affiliations may also influence their decisions, with Republican commissioners hypothesized to be less likely to support cases than Democratic commissioners, all else equal. This hypothesis questions the "public interest" model of antitrust, because it claims politics affects antitrust decisions. However, if one admits to different interpretations of the "public interest", one can argue that Democratic and Republican commissioners are simply voting ideologically different

⁴ The 1989 American Bar Association (ABA) committee report on the Federal Trade Commission noted "no thoughtful observer is entirely comfortable with the FTC's (or other agencies') combining the prosecutory and adjudicatory functions. Whenever the same people who issued a complaint later decide whether it should be dismissed, concern about at least the appearance of fairness is inevitable (ABA 1989 at 35)". However, only a minority of the ABA committee recommended reform to separate the functions.

⁵ Contrast this observation with the work linking enforcement decisions to politics during the Reagan/Bush commission (see Coate, Higgins and McChesney, 1990). While the political composition of the Commission varied significantly from 1956 to 1988, the political composition of the Reagan/Bush commission changed little. Thus, changes in enforcement intensity linked to exogenous political

⁷ Of the seven excluded merger cases, five were horizontal mergers, one was a vertical transaction and one was a potential competition matter. The four industry cases involved both horizontal and potential competition issues. Complaints issued after 1988 are generally still working their way through

included barrier-to-entry findings (Barriers) usually in the FTC decision, though a few cases contained only barrier information in the ALJ decision. In recent cases, the finding was highlighted as an explicit part of the analysis, while in older cases, the information tended to be mentioned as an aside. As a check on this variable, the authors reviewed the specific industries involved in the transactions. While a few of the barrier determinations appeared incorrect (i.e. most observers would likely considered entry easy into the florist foil market in the 1990's), the great majority of the determinations appeared valid under Merger Guideline principles elucidated during the 1980's.) Of course, disputes would remain, with some believing entry to be easy in retailing, various brand name consumer products and distribution, while others would offer more sophisticated explanations for why entry would be deterred. Although the historical decisions tend to resolve disputes with a finding of entry barriers, no clear shift in policy was identified.⁹ In our model, the merits of a merger case depend

⁹ Evidence on competitive conditions and efficiencies were noted in recent cases, but were often omitted entirely in the older cases. Thus, no attempt was made to collect this data.

competition, and zero otherwise. Given these cases are generally considered less threatening to competition than horizontal mergers (holding the structure variable constant), we expect a negative sign for both variables.

For internal political factors, background information on the FTC was also collected. First, the initial complaint and the final decision, are linked with an index OLD for the number of Commissioners that both served on the Commission when the complaint was issued and subsequently voted on the final decision. This index ranges from 0 to 5. Consistent with Posner (1969), we expect that the number of OLD commissioners deciding a matter will have a systematic positive effect on the Commission's final decision. We expect that Commissioners who voted to prosecute a particular matter will be, on average, reluctant to admit, by finding for the parties in that matter, that the decision to prosecute could have been a mistake.¹⁰

To obtain some understanding of the partisan political influences inside the Commission, two political variables were computed at the time of the official decision.¹¹ The first variable (Republican) estimates the average political affiliation of the Commission, with the value 1 assigned to each

¹⁰ Another interpretation of such a result is that both prosecutions and final orders may in part represent idiosyncrasies of particular commissioners. If this were the case, the FTC administrative process could be seen as not have the normal checks against idiosyncrasies of a standard court system.

¹¹ The political index for the Commissioners issuing a decision was based on the Commissioners participating in the matter.

¹² Independent Commissioners are assigned to the party with the minority at the Commission. One "independent" Commission Elizabeth Hanford is considered to have switched parties, counting initially as a Democrat (to avoid a Republican share of 80 percent) and then as a Republican (to avoid a Democratic share of 80 percent). She married Republican Senator Robert Dole while on the Commission.

President that made that Commissioner's initial appointment. We set this variable equal to the percentage of the Commission appointed by a Republican president. This variable ranges from 0 in the mid 1960's to 1 in the late 1980's. If Republican commissioners are less likely to support merger regulation, a negative sign would be observed for at least one of the variables. In theory, if the President is able to appoint individuals sympathetic to the position of his party, independent of a commissioner's formal affiliation, the variable for the party of the appointing President will be more significant, while if the appointed commissioners are more likely to represent party positions at the Commission, the official party affiliation variable will be more important.

For external political factors, consistent with much previous literature (for example, Weingast and Moran, 1983), we use the "liberal quotient", as measured by the group Americans for Democratic Action (ADA), for the FTC congressional oversight committees, subcommittees, subcommittee chairmen, as well as for Congress as a whole. We expect that the more liberal the median member of the relevant House and Senate oversight bodies are, the more likely the commission is to take an activist role and find for itself in a particular matter. However, we do not know if the influence resides at the full house level or is generated in the committee system. To test for various possibilities, we use, along the lines of Spiller and Gely (1992), ratings at four levels: subcommittee chairman, subcommittee, committee, and the full house.

We also hypothesize that the size of the respondent firms matters. It is possible that large firms may bring more political pressure to bear on the FTC to rule in their favor. Another way of interpreting such an effect, as McChesney (1991) suggests, is that decisions in favor of large firms may represent rent-extraction on the part of the FTC. On the other hand, large firms may be targets for "populist" antitrust and thus be more likely to lose. Two measures of size, the sales of the acquiring firm and the value of the transaction were considered. Most of the cases contained information on both the dollar value of the merger transaction and the sales of the acquiring firm. If the value was not reported, the Wall Street Journal index was used to search for the actual value. Likewise, if the sales of the acquiring firm were missing, various corporate indexes were consulted. The values were transformed to real

prices with the GNP price deflator.¹³ Logarithmic transformations were also considered to allow for a declining effect associated with increases in size.

Finally, we test to see if the pork barrel hypothesis applies to FTC decisions. We gathered data on the jurisdictions of the members of the FTC's House and Senate oversight committees and the location of the headquarters office of the various acquiring firms in the sample. A match was assumed for any Congressman or Senator representing the state in which the firm had its headquarters. Variables were calculated for both the subcommittee and full committee in both the House and Senate. In addition to reviewing the effects of each committee, one could add the representation at either the subcommittee or committee for both the House and the Senate to get an average measure of the "pork barrel" effect.¹⁴ If the Commission responded to these "pork barrel" concerns a positive effect would be observed.

B. Summary of the Data

To set a background for the analysis, we present a brief overview of the data. Summary information on win rates organized by the merits variables is presented first, followed by an initial analysis of the relationships between case outcomes and the internal political factors. The section concludes with a look at the relationship between win rates and the external political considerations.

Table 1 presents the FTC win rate for the three types of cases (hrTyd8 Tw -36 -20e mal O0e re merioire merio

¹³ On occasion, the transactions involved competitive concerns in more than one market (10 cases) or involved more than one challenged deal (12 cases). For those cases involving more than one market, the economic data were collected for the most serious overlap, while for cases involving more than one deal, the economic variables implicitly proxy a combined transaction. Likewise, the value of the deal represented the sum of all the transaction prices.

¹⁴ Data at the committee chairman level was not used, because few firms would be represented by a chairman and data for the entire house or senate was not used, because almost all firms are represented by a congressman or senator (foreign firms would not be represented by anyone.)

for vertical mergers. However, few vertical cases are included in the post-*General Dynamics* data, so no strong conclusions should be drawn. The link between merits and success is clear. In the three categories of cases, evidence on barriers to entry improves the likelihood of an injunction, and evidence of high concentration (greater than 2000) usually enhances the chance of success. Overall, the initial review of the data is compatible with our hypotheses that high barriers and Herfindahl findings are likely to lead to an injunction, and that potential competition cases are more likely to lead to dismissal, but casts a little doubt on the expectation for vertical cases.

It is possible to search for a relationship between either the number of "OLD" commissioners or the political affiliation of the Commissioners and the likelihood of a Commission merger order.¹⁵ To start the analysis, cases are organized into five classifications, one for each of the last five Presidential eras. Given continuity of policy as Vice-Presidents replace Presidents, the length of the periods range

To

¹⁵ Information is also available for the relationship between the ALJ and final FTC decision. In general, the Commission upholds the ALJ decision (36 of 50 orders and 13 of 20 dismissals.) However, the Commission reversed the ALJ decision in thirty percent of the cases, with liability found in two-thirds of these decisions.

¹⁶ The Clinton administration obtained effective control of the FTC in early 1995, two years into the Presidential term. However, this delay appears linked to an unusual pattern in the expiration of the Commissioners' terms and the lack of any Commission resignations.

Finally, the overall win rate appears to increase with the number of "OLD" commissioners. If one or two commissioners served on the prosecuting commission, the win rate averages around 60 percent. On the other hand, if three or more Commissioners served on the prosecuting commission, the win rate exceeds 90 percent.

A similar analysis can be undertaken for the political orientation of the Commission. Table 3 illustrates the winning percentage by Presidential era and percentage of Republicans on the deciding panel. While it is difficult to see any political effect in the Eisenhower, Kennedy, Nixon and Carter eras, the Reagan cases seem to show a decline in the likelihood of an order as the number of Republicans on the Commission increases. Moreover, the same general pattern appears to emerge in the overall data.

FTC winning percentages can also be organized by the political control of Congress. Table 4 is based on congressional data on various Senate and House oversight bodies organized into four categories. A congressional entity is considered conservative if the median ADA rating is less than 40, moderately conservative if the ADA rating is between 40 and 50, moderately liberal if the ADA rating is between 50 and 60 and liberal if the ADA rating is over 60. Senate and House ADA data for four classifications, the entire chamber, the committee, the subcommittee and the subcommittee chairman are used in the analysis. Average winning percentages for FTC cases are computed for each cell in the table, with percentages based on fewer than five observations marked with an asterisk. Abstracting from the small sample cases, the Senate data generally shows the expected rise in success rates with the

A final test would replicate the Faith, Leavens and Tollison test. The winning percentage of the firms with "representation" in Congressional committees was actually lower than the winning percentage of the control group (although the result was only significant for the Senate subcommittee). Thus, the initial review of the data does not support the pork barrel hypothesis.

In general, the initial analyses of the data are suggestive of a number of our hypothesized findings, but more detailed analyses is necessary before any strong conclusions are drawn. Thus, we turn to an econometric model of FTC decision making to investigate the various findings.

IV. ESTIMATION RESULTS

A statistical model will be presented here to attempt to explain the Commission's win rate as a function of the various independent variables. Since the FTC can either rule for or against itself on a particular case, the relevant dependent variable will be binomial, that is, either 0 or 1. Therefore, a limited dependent variable estimator such as the probit is an appropriate procedure for this econometric question. We analyze the data in two steps. First, we estimate probit coefficients for the merits and internal political variables and then we estimate a larger model that adds external political variables.

To set the background for the probit analyses, Table 5 calculates means for all the relevant variables for the period 1950-1974 (the pre-*General Dynamics* era), 1974-1992 (the post-*General Dynamics*

of 1.56. On the other hand, the variable proxying the average political affiliation of the commissioners, Republican, remained largely the same over the two eras. The other political variable, defined by the party of the President that appointed the commissioners, identified a significant swing towards the Republican party which matches the change in White House control over the two eras.

Overall, the cases tend to involve both larger firms and transactions after 1974, with the

¹⁷ While the limited data preclude an exact test, the explanatory power of the time trend model exceeds that of a model incorporating only a dummy variable for the 1974 *General Dynamics* decision.

The second column highlights the results of a broad "merits and internal politics" model. Of perhaps greatest interest is the coefficient for the number of "OLD" Commissioners. The positive sign of this variable indicates that commissioners are more likely to vote for administrative complaints if they were members of the commission that chose to prosecute those cases. Thus, it appears to matter if Commissioners act as both prosecutors and judges.

The coefficient on the party affiliation variable, Republican, has the expected sign and is statistically significant, indicating that the political composition of the commission impacts on merger decisions.¹⁸ In particular, as Republicans replace Democrats, the commission becomes relatively less likely to enjoin a transaction. The coefficient on the variable for the political party appointing the Commissioner, President, however, is insignificant (and takes on an opposite sign than what was expected.) Therefore, the party of the President making the appointment does not appear to be relevant.¹⁹ Given the FTC Act prevents one party from obtaining more than three seats on the Commission, it is possible that the Senate's confirmation process precludes the President from appointing members from the opposition party that are too far out of step with the opposition party's mainstream viewpoint. Thus, for example, Democrats appointed by a Republican president would tend to vote like Democrats.²⁰

We reestimated the model without the weak political variable (President) and the results are reported in the third column. While the explanatory power of the model falls slightly, the similarity of the coefficients suggests the basic results are robust to the exact specification of the model.

External political variables for firm size and congressional ideology are added to the final model of Column 3 (Table 6) to generate the results in Table 7. Four formulations of the case-specific

¹⁸ The significance of both variables increases dramatically if date is deleted from the model.

¹⁹ The President variable is not significant if the Republican variable is omitted from the model to minimize the potential for multicollinearity.

²⁰ An alternative explanation is that individuals appointed to the Commission vote to please their party to assure consideration for future jobs once their current term expires. In effect, the views of the appointee change once appointed to the Commission.

²¹ The coefficient does reach a standard significance level in three of the 16 runs. Moreover, the significance of the coefficient improves for other specifications of the model.

²² Significant results tend to be obtained for the Senate subcommittee and subcommittee chairman if the time shift parameter is removed from the model. This choice would appear inappropriate, because the shift is necessary to account for a change in legal standards. The significant Senate result may be caused by a contemporaneous conservative shift in the Senate oversight subcommittee in the mid

This outline is slightly surprising given our tabulations and the previous research showing a relationship between Congressional control and FTC decisions. One possibility is the addition of the internal political variables to the model capture political effects linked to Congressional factors. Another possibility is the longer time period (1956-1992) obscures a Congressional power that ebbs and flows between the Senate and the House and among the various committee groups. While focusing on smaller periods of time could minimize this problem, it would create another problem associated with small samples.²³

Table 8 reports our test of the pork barrel hypothesis. The first model of Table 8 uses the number of relevant congressmen and senators on the FTC's oversight subcommittee, while the second model uses the number on the oversight committee. The pork barrel coefficient is not significant in either of these specifications, nor in any of the several other specifications we attempted. This result suggests the earlier support for the pork barrel hypothesis cannot be replicated in a more general model over a broader time period. Again while smaller time periods could be studied, the lack of data makes this approach difficult.

The merits-internal political model in Column 3 of Table 6 appears to be the most appropriate equation for predicting Commission decisions. For a horizontal merger case, with the "OLD" commissioners and Republican variables at their means and the time index set to June 1995, we find the presence of barriers can raise the probability of an order from 5 percent to 87 percent for a Herfindahl of 3000. Changes in the Herfindahl have smaller effects, with a Herfindahl of 2000 associated with a 75 percent change of an order and a Herfindahl of 4000 linked to a 95 percent chance of an order.

Internal political variables also have an impact on the outcome of the case. For a horizontal decision in June 1995 that finds barriers to entry and a Herfindahl of 2000, the probability of an order can range from 24 percent for a Commission controlled by Republicans and no "OLD" commissioners

²³ If one introduces a shift variable to allow the coefficient on the Senate and House variables to change after the *General Dynamics* decision, one finds a significant positive effect on the Senate and subcommittee ADA rating and a significant negative effect on the House and subcommittee rating for the post 1974 period. These results cannot be replicated with the post-1974 sample.

to 96 percent for a Commission dominated by Democrats and three old Commissioners. However, these bounds are somewhat unrealistic, because a Commission in transition from one party to the other is unlikely to have many "OLD" commissioners. Given the remaining terms of actual Commissioners, it is likely to be dominated by Democrats, but with one or two "OLD" commissioners. This would suggest a probability of a Commission order against the merger under discussion of between 78 and 90 percent. Overall, the model suggests that both the merits and internal politics are extremely important in the outcome of merger cases.

V. CONCLUSION

Our review of FTC administrative decision making generate a number of interesting initial conclusions. The mix of cases appears to have changed over time, with a movement away from vertical and potential competition mergers. Winning percentages were initially high, but fell in the 1970s. Econometrics results indicate that both the economic merits and internal political factors affect Commission merger decisions. In particular, the ability of commissioners to act as both prosecutor and judge on a particular matter can significantly increase the likelihood of a merger order. Likewise, a Republican-dominated Commission appears less likely to oppose a transaction. Somewhat surprisingly, however, we were unable to find an impact of external political factors on the FTC's decisions.

While the statistical significance of the number of "OLD" Commissioners suggests an internal political problem with the administrative process, the political variables clearly suggest that the FTC Act has been successful in achieving some political balance at the Commission. Abstracting from personalities, Democratic (Republican) appointees of Republican (Democratic) Presidents tend to vote similar to Democratic (Republican) appointees of Democratic (Republican) Presidents. In contrast to previous studies, however, external political orientations or pork barrel considerations do not appear to significantly influence judicial decisions of the FTC.

Table 1

FTC Win Rates by Type of Case and Merits
(before and after General Dynamics' Decision)

	1950 - 74	1974 - 92	Total	Cases
Horizontal				44
0	75	29	53	15
1 - 2000	100	64	75	16
2000+	100	83	92	13
Average	90	58	73	
Vertical				12
0	0*	-	0*	2
1 - 2000	100*	100*	100	5
2000+	100*	100*	100	5
Average	80	100*	83	
Potential				14
0	0*	0*	0*	4
1 - 2000	100*	50*	67*	3
2000+	100*	67*	86	7
Average	83	38	57	

*Less than 5 cases in a cell

Table 2

Winning Percentages by Number of "Old" Commissioners

Number of "Old" Commissioners

FTC Era	0	1	2	3	4	5	Mean
Ike	100	100	100	100	100	-	100
Kennedy	100	57	-	100	100	100	84
Nixon	-	67	80	86	100	-	80
Carter	-	75	50	-	-	-	63
Reagan	0	50	37.5	0	-	-	38
Overall	83	63	58	87	100	100	71
Cases	6	24	19	15	5	1	

FTC Eras

Ike 1954 - 1961
 Kennedy 1962 - 1969
 Nixon 1970 - 1977
 Carter 1978 - 1981
 Reagan 1982 - 1992

Table 3

Winning Percentage by Average Political Affiliation of Commission

Percentage of RepuA

Table 4

Winning Percentages by Type of Political Control

	Senate	Committee	Subcommittee	Chairman
Conservative	64	59	45	41
Moderate - C	73	70	73	100*
Moderate - L	75	75	58	88
Liberal	50*	100	92	79

	House	Committee	Subcommittee	Chairman
Conservative	75	78	77	100*
Moderate - C	85	71	83	100*
Moderate - L	55	71	58	100*
Liberal	-	33	65	68

* Less than 5 cases in class

Conservative	ADA < 40
Moderate - C	40 ≤ ADA < 50
Moderate - L	50 ≤ ADA < 60
Liberal	60 ≤ ADA

ADA - Americans for Democratic Action Congressional Vote Rating

Table 8
Regression Results - Pork Barrel Model

Variable	Subcommittee Number	Committee Number
Constant	0.735 (0.587)	0.649 (0.486)
Herfindahl	.00495 (1.88)	.00485 (1.84)
Barrier	2.805 (3.73)	2.730 (3.59)
Vertical	-0.762 (-0.953)	-0.807 (-1.05)
Pot. Corp.	-1.402 (-1.73)	-1.340 (-1.61)
Time Shift	-.0504 (-2.36)	-.0515 (-2.49)
Old Comm.	0.553 (1.72)	0.510 (1.64)
Republican	-4.87 (-2.06)	-4.653 (-1.96)
Pork Barrel Index	0.156 (0.48)	.0941 (0.48)
Adj. R-Square	0.576	0.571
Success Rate	92.8%	90.0%
Log Likelihood	-19.02	-19.02

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