Justice's Merger Guidelines: Implications for 7th District banking

Diana Alamprese Fortier and John J. Di Clemente

A considerable amount of attention has been given the Department of Justice Merger Guidelines that were issued in June of 1982. One of the major areas of interest has been whether these Guidelines are more or less restrictive than the earlier (1968) version.[1]

The purpose of this article is to analyze and compare the 1968 Department of Justice Merger Guidelines with the 1982 version to determine whether the new Guidelines are more or less stringent than the 1968 Guidelines with respect to horizontal mergers within the context of the banking industry.[2]

First, the structure-conduct-performance paradigm and traditional measures of market concentration are reviewed. Second, the 1968 and 1982 Guidelines are presented and applied to a set of hypothetical bank mergers in local banking markets in the five states comprising the Seventh Federal Reserve District. Finally, an evaluation of the test results and their implications for future merger policy are set forth.

Why Guidelines?

The enforcement policy of the Department of Justice (the Department), as reflected in the 1968 Guidelines, had several interrelated objectives: (1) to prevent the elimination of a significant independent competitor in a market; (2) to prevent any one firm or group of firms from obtaining a dominant position in a market; (3) to prevent a significant increase in market concentration; and (4) to preserve the possibility of future deconcentration of relatively concentrated markets. The 1982 Guidelines state the objective more simply: to prohibit mergers that create or enhance market power or facilitate the exercise of such power.

The 1968 Guidelines, in effect until June 14, 1982, were to be reviewed and possibly amended periodically to reflect any significant changes in standards or policy of the Department. But although Department policy had changed over the past 14 years of merger enforcement, no amendments or formal changes were made in the 1968 Guidelines. As a result, as William F. Baxter, head of the Antitrust Division of the Department, stated in August 1981, "the [1968] Guidelines are now substantially at variance with the state of the law and with the Department's actual enforcement practices."[3]

The issuance of the 1982 Guidelines reflects the recent trend in merger decisions by the courts, enforcement policies of the Department, and recent economic research. As in the case of the 1968 Guidelines, the 1982 Guidelines attempt to reduce the uncertainty of the public, the legal profession, business, and government concerning the Department's antitrust policies. The underlying emphasis of the 1982 Guidelines is that, contrary to popular belief, not every merger is anticompetitive. Mergers may have a neutral or procompetitive effect by promoting capital investment and the reorganization and redevelopment of existing productive assets.

The Board of Governors of the Federal Reserve System (the Board) has generally incorporated the 1968 Guidelines into its analysis of commercial bank and bank holding company acquisitions and mergers pursuant to the Bank

Diana Alamprese Fortier and John J. Di Clemente are regulatory economists at the Federal Reserve Bank of Chicago.

[1]For conflicting points of view see, for example, Joe Sims and William Blumenthal, "New Merger Guidelines Provide No Real Surprises," *Legal Times of Washington*, June 21, 1982, p. 17; Gordon Spivack, "New Merger Guidelines Are Substantially Different," *Legal Times of Washington*, August 2, 1982, p. 38; and Eleanor M. Fox, "The new merger guidelines—a blueprint for microeconomic analysis," *The Antitrust Bulletin*, Fall 1982, pp. 519-591.

[2]Although the 1968 and 1982 Guidelines also deal with vertical and conglomerate mergers, this article narrows the emphasis to horizontal mergers in the banking industry.

[3]Testimony of William F. Baxter before the Subcommittee on Monopolies and Commercial Law, House Committee on the Judiciary, August 26, 1981.

Holding Company Act and the Bank Merger Act.[4] It is also likely that the Board will consider the 1982 Guidelines as a policy guide to horizontal merger enforcement.

The structure-conduct-performance paradigm

Economic theory postulates a relationship between market structure and the conduct and performance of firms within the market. Premised upon the existence of such a relationship, antitrust laws have been designed to detect and prevent undue concentrations of market power and trends toward cartelization and monopolization.

Under Section 7 of the Clayton Act, the antitrust authorities in the U.S. are mandated to challenge any acquisition " . . . where in any line of commerce, in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[5] Under this mandate the relevant product market needs to be determined. Based on this determination, a relevant geographic area must be carved out in which the firms in question compete. Finally, an assessment must be rendered as to whether the merger would substantially reduce competition if consummated.

Under both Guidelines the enforcement of the antitrust laws relies primarily on structural criteria, focusing on market power, market structure, and the likely effect of mergers on these factors. The Guidelines may thus be viewed as indicia for assessing the probability of tacit and explicit collusion.

Market structure refers to the number and size distribution of firms within a given market. Market power is a murky term that suggests the power of each seller to set its own prices without losing all or substantially all its customers, even if prices are set above perfectly competitive levels. This power is believed to be derived from a substantial market share and has been, and continues to be, the target of advocates of competition.

The principal test of competition under both the 1968 Guidelines and the 1982 Guidelines is based not upon the actual conduct of firms in a market but rather upon the likely effect implied. Both Guidelines are premised on the concept that a probability of noncompetitive pricing can be inferred from the number and size distribution of the firms in the market. As Bain notes, one may envisage a three-stage sequence of causation from market structure to market conduct and resulting market performance. That is, structure is systematically associated with or determines what conduct will be; conduct determines what performance will be; and, thus, structure is associated systematically with performance.[6]

Inferring market conduct from market structure begs the question as to how competitively markets behave in fact. The traditional structure-conduct-performance approach relies, instead, on the assumption that highly concentrated markets, markets in which few relatively large firms compete, are noncompetitive.

Termed oligopolistic markets, such markets may or may not be acting competitively. Posner notes that " . . . tacit collusion or noncompetitive pricing is not inherent in an oligopolistic market structure but, like conventional cartelizing, requires additional, voluntary behavior by the sellers."[7]

Whether collusive pricing is successful requires that firms in oligopolistic markets weigh the potential gains against the costs of collusion. The costs, as noted by Posner, are of two types: (1) costs of arriving at a common price above the competitive price level and (2) costs of preventing cheating on the agreed-upon price by members of the group.[8] If the potential gains

[4]See for example: *Sun Banks of Florida Inc., Federal Reserve Bulletin*, vol. 68 (June 1982) p. 374 and *Policy Statement of the Board of Governors of the Federal Reserve System for Assessing Competitive Factors Under the Bank Merger Act and Bank Holding Company Act*, 47 *Federal Register* 9017 (March 3, 1982).

[5]Clayton Act, Section 7 amended, 15 U.S.C., Section 18.

[6]Joe S. Bain, *Industrial Organization*, John Wiley & Sons Inc. (1959), p. 295.

[7]Richard A. Posner, "Oligopoly and The Antitrust Laws: A Suggested Approach", *Stanford Law Review*, June 1969, p. 1578.

[8]Richard A. Posner, *Antitrust Law: An Economic Perspective*, University of Chicago Press (1976), pp. 51-2.

from collusion are not sufficient to outweigh the costs involved, collusion would not be attempted.[9]

While it is agreed that competition does not disappear as markets become more highly concentrated, it is also recognized that highly concentrated markets are conducive to collusion and noncompetitive pricing. Posner notes that "Some degree of concentration thus appears to be a necessary condition of successful collusion . . ."[10] Also, in markets characterized by only a few firms, or only a few firms of great relative size, the firms must realize their policies affect one another. That is, the firms recognize their interdependence and may develop a common price policy without express collaboration, "just as an experienced string quartet learns to play as a unit."[11] While market concentration does not compel collusive pricing policies, it facilitates their implementation.

Those who criticize the use of market structure as the test of competition prefer to focus on the pricing policies and behavior of firms thought to be in an oligopolistic market. One problem with this approach is determining methods of identifying and measuring market conduct that is noncompetitive. Bain notes that " . . . actual patterns of market conduct cannot be fully enough measured and described to permit empirical establishment of meaningful associations between market conduct and performance, or between market conduct and structure. It is thus expedient to test directly for net associations of market structure to market performance, leaving the detailed character of the implied linkage of conduct substantially unascertained."[12] Thus, expediency rules the day under both Guidelines.

It should be emphasized that conclusions regarding market conduct inferred from market structure are rebuttable. Under the antitrust laws, evidence of high concentration establishes a *prima facie* case of noncompetitive market behavior. This presumption may be overcome by a showing of actual competitive market behavior.[13] A finding of high concentration in a market in which two competing firms propose to merge is only the beginning of the antitrust analysis.

Measures of concentration

Economic theory and legal precedent have established that highly concentrated markets are deserving of special scrutiny under the antitrust laws. But how is concentration to be measured? On this point the 1968 and 1982 Guidelines differ.

The concentration ratio as a measure of overall market concentration is the keystone to the 1968 Guidelines. Under the 1968 Guidelines market structure is classified as either "highly concentrated" or "less highly concentrated", depending on the value of the four-firm concentration ratio.

Within each concentration classification the 1968 Guidelines specify market shares of merging firms which would violate the Guidelines. Permissible market shares are higher in less highly concentrated markets. Mergers in markets that are characterized by a trend toward concentration are the subject of special antitrust concern under the 1968 Guidelines (see Table 1).

The 1982 Guidelines break ground with the old Guidelines by utilizing the Herfindahl-Hirschman Index (HHI) as a summary measure of market concentration. As in the 1968 Guidelines, market concentration classifications are developed—"highly concentrated", "moderately concentrated", and "unconcentrated". However, under the 1982 Guidelines the level of concentration in a market is based on the value of the *post-merger* HHI.[14]

[9]For an account of the feasibility of collusion see George Stigler, "A Theory of Oligopoly, *Journal of Political Economy*, February 1964, p. 229, and for conditions conducive to collusion see Posner, *Antitrust Law: An Economic Perspective, op. cit.*, pp. 53-66.

[10]Posner, *Antitrust Law: An Economic Perspective, op. cit.*, p. 52.

[11]George J. Stigler, *The Theory of Price*, The Macmillan Co. (1954), p. 229.

[12]Bain, *op. cit.*, p. 295.

[13]*U.S. v. Marine Bancorporation*, 418 U.S. 602, 631-632 (1974).

[14]The post-merger HHI is calculated by adding the change in the HHI resulting from the merger to the pre-merger HHI. In short, the change in the HHI is equal to twice the product of the market shares of the merging firms. Given a market with a pre-merger HHI of 1600, if a firm with a 20 percent market share merges with a firm with a 3 percent market share the change in the HHI would be $(20 \times 3) \times 2 = 120$ and the resulting HHI would be 1720.

Table 1

1968 Department of Justice Horizontal Merger Guidelines

Challengeable market shares*

	Acquiring firm	Acquired firm
Highly concentrated market: 4-firm concentration ratio of 75% or more	4%	4% or more
	10%	2% or more
	15% or more	1% or more
Less highly concentrated market: 4-firm concentration ratio less than 75%	4%	5% or more
	10%	4% or more
	15%	3% or more
	20%	2% or more
	25% or more	1% or more
Market with trend toward concentration	Acquisition of a firm with a market share of 2% or more is subjected to challenge. A trend toward concentration is present when the aggregate market share of any grouping of the largest firms in the market from the two largest to the eight largest has increased by approximately seven percent or more from any year five to ten years prior to the merger up to the time of the merger.**	

*Percentages not listed in the following tables should be interpolated proportionately to the percentages that are shown.

**See Department of Justice Merger Guidelines, May 30, 1968, p. 10.

The likelihood of a challenge to a merger within each concentration class depends upon the amount of increase in the HHI resulting from the merger. Other factors being equal, the permitted amount of increase in concentration resulting from a merger varies inversely with the post-merger level of market concentration (see Table 2).

Comparison of the 1968 and 1982 Guidelines

The 1982 Guidelines present detailed procedures for establishing the relevant product and geographic market. The determination of the provisional product and geographic market under the 1982 Guidelines is essentially the 1968 product and geographic market analysis based on product and geographic substitutability at prevailing prices. The 1982 Guidelines necessarily broaden the market definition by considering the dynamic element of changes in demand and supply patterns resulting from a given hypothetical change in price. That is, the provisional product and geographic market is expanded to take into account product and geographic substitution in response to a small but significant and nontransitory increase in price. (As a first approximation the Department will analyze the change in demand and supply patterns over one year in response to a five percent price increase.)

The basic difference between the concentration ratio and the HHI as measures of market concentration makes a precise comparison of the 1968 and 1982 Guidelines difficult. Nonetheless, a comparison can be made by converting the market shares of the 1968 Guidelines into an HHI.[15]

The 1982 Guidelines broaden the range of permissible market share combinations within each concentration class. Moreover, the 1982 Guidelines create a "safe harbor" for mergers in that any merger in an unconcentrated market is likely to go unchallenged. The "trend toward concentration" clause of the 1968 Guidelines has been eliminated. Thus, the 1982 Guidelines reflect a possible weakening in the importance

[15]See Table 3: "Comparison of the 1968 and the 1982 Horizontal Merger Guidelines", which suggest that under the 1982 Guidelines there will be a relaxation of merger enforcement.

Table 2

1982 Department of Justice Horizontal Merger Guidelines

Post-merger market concentration	Level of Herfindahl-Hirschman Index	Post-merger change in Herfindahl-Hirschman Index and likelihood of a challenged merger
Highly concentrated	Greater than 1800	Greater than 100—likely to be challenged
		50 to 100—depends on other factors*
		Less than 50—unlikely to be challenged
Moderately concentrated	1000 to 1800	Greater than 100—likely to be challenged; other factors considered*
		Less than or equal to 100—unlikely to be challenged
Unconcentrated	Less than 1000	Any increase—unlikely to be challenged

Lead firm proviso

The lead firm proviso states that a merger is likely to be challenged if the merger is between the lead firm and a firm with a market share of one percent or more provided that the lead firm has a market share of 35 percent or more and is approximately twice the size of the second largest firm in the market.

*In addition to the post-merger concentration of the market and the size of the resulting increase in concentration, the Department will consider the presence of the following factors in deciding whether to challenge a merger: ease of entry; the nature of the product and its terms of sale; market information about specific transactions; buyer market characteritstics; conduct of firms in the market; and market performance. (For a detailed explanation of these factors see Sections III (B) and III(C) of the 1982 Department of Justice Merger Guidelines.)

of arresting anticompetitive tendencies in their early stages.[16]

The new Guidelines establish special criteria to identify markets with individual dominant sellers as distinguished from markets in which the exercise of market power is carried out collectively by several firms (see Table 2). Referred to as the "lead firm proviso," their objective is to prevent any one firm from obtaining a dominant position in a market. Although no specific lead firm criteria are outlined in the old Guidelines, the prohibited market shares stated suggest an implicit lead firm standard. Moreover, the old Guidelines are more stringent in that, regardless of the market share of the second largest firm, a merger between firms with market shares of 25 percent and 1 percent would be challengeable even in a less highly concentrated market.

In the analysis of certain merger defenses the old and the new Guidelines do not differ. Neither set of Guidelines gives much credibility to the efficiency and economies of scale argument as a mitigating factor in an otherwise challengeable merger. To qualify as a mitigating factor, the merger must produce substantial cost

[16] *U.S.* v. *The Philadelphia National Bank*, 374 U.S. 321, 362 (1963).

Table 3

Comparison of the 1968 and the 1982 Horizontal Merger Guidelines*

1968 Guidelines			1982 Guidelines
Challengeable Market Shares			
Highly concentrated market			Highly concentrated market
Acquiring firm	Acquired firm	Converted to change in Herfindahl-Hirschman Index	Post-merger change in Herfindahl-Hirschman Index and likelihood of a challenged merger
4%	4% or more	(4 × 4) × 2 = 32	Greater than 100—likely to be challenged
10% or more	2% or more	(10 × 2) × 2 = 40	50 to 100—depends on other factors
15% or more	1% or more	(15 × 1) × 2 = 30	Less than 50—unlikely to be challenged
Less highly concentrated market			Moderately concentrated market
4%	5% or more	(4 × 5) × 2 = 40	Greater than 100—likely to be challenged; other factors considered
10%	4% or more	(10 × 4) × 2 = 80	
15%	3% or more	(15 × 3) × 2 = 90	
20%	2% or more	(20 × 2) × 2 = 80	Less than or equal to 100—unlikely to be challenged
25%	1% or more	(25 × 1) × 2 = 50	

*NOTE: Provided there is no change in the concentration classification from the old to the new Guidelines, none of the mergers listed as being challengeable under the 1968 Guidelines are likely to be challenged under the 1982 Guidelines. For markets classified as unconcentrated under the 1982 Guidelines, any increase in the Herfindahl-Hirschman Index is permissible. Thus a more lenient standard is reflected under the new Guidelines.

savings not attainable by other means. Nor do the 1968 or 1982 Guidelines allow approval of an otherwise significantly anticompetitive merger under the failing firm defense without strict scrutiny.

An effective failing firm defense requires that three conditions be satisfied. First, the allegedly failing firm must demonstrate an inability to meet financial obligations in the near future. Secondly, the firm must be unable to reorganize successfully under Chapter XI of the Bankruptcy Act. Finally, the firm must have been unable to obtain less anticompetitive offers of acquisition.

As with the 1968 Guidelines, the 1982 Guidelines consider nonstructural factors in the decision whether to challenge a proposed transaction. The old Guidelines apply nonstructural factors more as an additional standard for an otherwise unchallengeable merger based on structural criteria. The new Guidelines use nonstructural factors more as discriminating factors in judging an otherwise close case as determined solely by structural factors.

For a given level of market concentration, the 1982 Guidelines take into consideration "other factors" which would affect the probability of successful (profitable) tacit and explicit collusion. The most important of these "other factors" is the ease of entry. If, after taking into account market concentration, market shares, and ease of entry, the decision to challenge a merger is still close, the following factors will be considered: the nature of the product and its terms of sale; market information about specific transactions; buyer market characteristics; the

conduct of firms in the market; and market performance. These factors are judged as to whether they enhance or facilitate the ability of firms in a particular market to exercise market power[17] (see Table 2).

Methodology

To assess the relative stringency of the 1968 and the 1982 Guidelines with respect to the banking industry, a series of hypothetical horizontal mergers are proposed in rural and metropolitan banking markets.

A necessary predicate to the analysis of any merger is the determination of the relevant market, both in terms of its product dimension ("line of commerce") and its geographic dimension ("section of the country"). It is assumed for the purpose of this analysis that commercial banking constitutes a distinct line of commerce.[18] It is further assumed that relevant geographic markets may be approximated by Standard Metropolitan Statistical Areas (SMSAs) and nonSMSA county boundaries.

While it is clear that political boundaries per se are not enough to establish markets in bank merger analysis,[19] the purpose of this article is to render an overall impression regarding the relative stringency of the 1982 Guidelines vis-à-vis the 1968 Guidelines. This being the case, greater precision in geographic market delineation is not warranted. The relevant geographic markets utilized in the present study consist of 296 rural markets (nonSMSA counties) and 45 metropolitan markets (SMSAs) located in the five states of the Seventh Federal Reserve District.[20]

[17] See Section III C of the 1982 Department of Justice Merger Guidelines.

[18] See for example: *U.S. v. The Philadelphia National Bank* 374 U.S. 321 (1963); *U.S. v.Phillipsburg National Bank & Trust Co.* 399 U.S. 350 (1970); *United Bank Corporation of New York*, *Federal Reserve Bulletin*, vol. 67 (April 1981) p. 358; and *Hartford National Corporation*, *Federal Reserve Bulletin*, vol. 68 (April 1982) p. 242.

[19] *U.S. v. Connecticut National Bank* 418 U.S. 656, 670 (1974).

[20] As of June 30, 1980, there were 333 nonSMSA counties in the five subject states. In this study, markets having only one or two banking organizations are eliminated. Thus, 296 nonSMSA markets are used. As of the same date, 45 SMSAs were located completely within the boundaries of the five states.

Hypothetical mergers

The following hypothetical mergers are used to assess the relative stringency of the 1968 and 1982 Guidelines:

- (Case I) the merger of the two largest banking organizations;
- (Case II) the merger of the two smallest banking organizations;
- (Case III) the merger of the third and fourth largest banking organizations; and
- (Case IV) the merger of the fourth and fifth largest banking organizations.[21]

For each of the 341 banking markets, the proposed hypothetical mergers are judged as to their permissibility under the 1968 and 1982 Guidelines. The four-firm concentration ratio and HHI for each market are based on the total domestic deposits held by commercial banking organizations therein.[22]

The number and percentage of mergers in contravention of each set of Guidelines are presented in Tables 4 and 5. The results indicate that, based solely on structural criteria, the 1982 Guidelines when applied to bank mergers in the Seventh District reflect a less stringent horizontal merger policy than did the 1968 Guidelines. The following analysis presents the test results on a case-by-case basis for rural banking markets and metropolitan banking markets.

Mergers in rural markets

The analysis of 902 hypothetical mergers in 296 rural (nonSMSA) banking markets demonstrates that the 1982 Guidelines are somewhat less restrictive than the 1968 Guidelines. In each of the four cases more mergers are permitted under the 1982 than under the 1968 Guidelines.

- Case I mergers exhibit the least variance between the 1968 and 1982 Guidelines. All of the proposed Case I mergers are challengeable under the 1968 Guidelines while 99.0 percent are subject to challenge under the 1982 Guidelines.

[21] In markets with fewer than four banking organizations, Cases III and IV are not analyzed.

[22] Deposit and structure data are as of June 30, 1980.

Table 4

Horizontal mergers in rural markets

State	Markets	Challengeable under old (1968) guidelines	Challengeable under new (1982) guidelines	Difference: old (1968) minus new (1982)
	(number)	*(number, percent)*	*(number, percent)*	*(number)*
CASE I (Largest and second largest)				
Illinois	72	72(100)	72(100)	0
Indiana	48	48(100)	48(100)	0
Iowa	86	86(100)	86(100)	0
Michigan	43	43(100)	43(100)	0
Wisconsin	47	47(100)	44(94.0)	3
All 5 states	296	296(100)	293(99.0)	3
CASE II (Smallest and next smallest)				
Illinois	72	33(45.8)	28(38.9)	5
Indiana	48	43(89.6)	43(89.6)	0
Iowa	86	54(62.8)	43(50.0)	11
Michigan	43	26(60.5)	21(48.8)	5
Wisconsin	47	21(44.7)	20(42.6)	1
All 5 states	296	177(59.8)	155(52.4)	22
CASE III (Third largest and fourth largest)				
Illinois	49	49(100)	47(95.9)	2
Indiana	8	8(100)	8(100)	0
Iowa	57	57(100)	57(100)	0
Michigan	13	13(100)	13(100)	0
Wisconsin	28	28(100)	25(89.3)	3
All 5 states	155	155(100)	150(96.8)	5
CASE IV (Fourth largest and fifth largest)				
Illinois	49	49(100)	43(87.8)	6
Indiana	8	7(87.5)	7(87.5)	0
Iowa	57	56(98.2)	55(96.5)	1
Michigan	13	10(77.0)	9(69.2)	1
Wisconsin	28	28(100)	25(89.3)	3
All 5 states	155	150(96.8)	139(89.7)	11

- The challenge rate for Case II mergers is, not surprisingly, lower than the challenge rate for the other three merger cases under both sets of Guidelines. Under the 1968 and 1982 Guidelines 59.5 percent and 52.0 percent of Case II mergers, respectively, are subject to challenge.
- All Case III mergers would be objectionable according to the 1968 Guidelines whereas 96.8 percent of such mergers would be challenged under the 1982 Guidelines.
- Case IV mergers represent the greatest difference in the challenge rates between the two sets of Guidelines. Of the Case IV mergers, 96.8 percent would be challenged under the 1968 Guidelines while only 89.0 percent would be challenged pursuant to the 1982 Guidelines.

Table 5

Horizontal mergers in metropolitan markets

State	Markets	Challengeable under old (1968) guidelines	Challengeable under new (1982) guidelines	Difference: old (1968) minus new (1982)
	(number)	*(number, percent)*	*(number, percent)*	*(number)*
CASE I (Largest and second largest)				
Illinois	8	8(100)	8(100)	0
Indiana	11	11(100)	11(100)	0
Iowa	6	6(100)	5(83.3)	1
Michigan	11	11(100)	11(100)	0
Wisconsin	9	9(100)	9(100)	0
All 5 states	45	45(100)	44(97.8)	1
CASE II (Smallest and next smallest)				
Illinois	8	0(0)	0(0)	0
Indiana	11	4(36.4)	4(36.4)	0
Iowa	6	0(0)	0(0)	0
Michigan	11	0(0)	0(0)	0
Wisconsin	9	0(0)	0(0)	0
All 5 states	45	4(8.9)	4(8.9)	0
CASE III (Third largest and fourth largest)				
Illinois	8	8(100)	6(75.0)	2
Indiana	8	8(100)	8(100)	0
Iowa	6	6(100)	5(83.3)	1
Michigan	11	11(100)	11(100)	0
Wisconsin	9	9(100)	9(100)	0
All 5 states	42	42(100)	39(92.8)	3
CASE IV (Fourth largest and fifth largest)				
Illinois	8	4(50.0)	4(50.0)	0
Indiana	8	7(87.5)	7(87.5)	0
Iowa	6	6(100)	3(50.0)	3
Michigan	11	8(72.7)	6(54.5)	2
Wisconsin	9	7(77.8)	5(55.6)	2
All 5 states	42	32(76.2)	25(59.5)	7

- Overall, 86.1 percent of all mergers proposed in rural markets violate the 1968 Guidelines, in contrast with 81.6 percent under the 1982 Guidelines.

Mergers in metropolitan markets

A comparison of the 1968 and 1982 Guidelines relative to 174 mergers in 45 metropolitan markets similarly indicates that the new Guidelines are less stringent than the old.

- All Case I mergers are objectionable under the old Guidelines compared with 97.8 percent under the new Guidelines.
- Case II mergers show no difference between the challenge rate under the two sets of Guidelines and experience the lowest challenge rate, 8.9 percent, of the four cases tested in

metropolitan markets.

- Of the Case III mergers, 100 percent violate the 1968 Guidelines while 93.3 percent are challengeable under the 1982 Guidelines.
- Case IV mergers present the greatest difference between the old and the new Guidelines. In this case 76.2 percent would be forbidden by the 1968 Guidelines whereas only 59.5 percent, a decrease of 16.7 percentage points, would be objectionable under the 1982 Guidelines.
- In total, for the mergers proposed in metropolitan markets, 70.7 percent are violative of the 1968 Guidelines, whereas 64.4 percent are subject to challenge under the 1982 Guidelines.

Comparison of rural and metropolitan markets

The criteria embodied in the 1982 Guidelines, on average, are more receptive to horizontal mergers than were the previous guidelines. Furthermore, the impact of the 1982 Guidelines should be most apparent in metropolitan markets rather than in rural markets. On a percentage basis, fewer mergers are challengeable in metropolitan markets than in rural markets regardless of which set of Guidelines are used.

This is not surprising, for rural markets by their nature tend to be highly concentrated due to the scarcity of local banking alternatives. On the other hand, metropolitan markets are distinguished from rural banking markets by having a relatively larger number of banking organizations; relatively lower levels of concentration (as measured by both the concentration ratio and HHI); and more markets in which the smallest banking organizations hold minimal market shares (e.g., less than one percent).[23] Mergers among the smaller organizations in these markets are likely to go unchallenged.

Conclusion

Horizontal mergers in the banking industry are more likely to go unchallenged by the Department under the new Guidelines.[24] If the Board adhered strictly to the new Guidelines it too would be less likely to challenge certain bank mergers. This suggests, that, other things equal, more bank mergers are likely to be proposed and fewer challenged under the 1982 Guidelines than would have been if the 1968 Guidelines remained in effect. The impact of this change should be most apparent for intermediate-sized banking organizations in metropolitan markets (i.e., Case III and Case IV mergers). Of course, the actual enforcement policy of the Department and the Board may be more stringent (or lenient) that the Guidelines themselves suggest.

---

[23] This contention is supported by the mean values of the four-firm concentration ratio, pre-merger HHI, and number of banking organizations in rural and metropolitan markets:

Variables	Mean values	
	Rural	Metropolitan
Four-firm concentration ratio	88.5	73.5
Pre-merger HHI	3377	1938
Number of organizations	5.8	30.6

[24] A similar conclusion was reached with regard to the effect on merger policy in New England banking markets. (Joseph E. Gagnon, "The New Merger Guidelines: Implications for New England Banking Markets", *New England Economic Review*, Federal Reserve Bank of Boston, July/August 1982, pp. 18-26.