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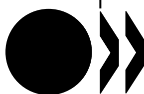

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DOES COMPETITION KILL OR CREATE JOBS?

Contribution from Swaziland

-- Session I --

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DOES COMPETITION KILL OR CREATE JOBS IN SWAZILAND?

-- Swaziland[1] --

Introduction

1. By way of introduction, it is necessary to explain that the *Swaziland Competition Act of 2007* ("Competition Act") is concerned with the protection of the competitive process in the economy and the protection of consumer welfare. The Competition Act also established the Swaziland Competition Commission ("the Commission") which commenced operations in 2010. The law is applicable to all economy activity within the country, all private firms regardless of their origin and state corporations. However, certain trade practices carried out by state corporations are exempt under Section 3.

2. In attempting to answer the question as to whether competition kills jobs in Swaziland, there are two matters to highlight at the onset. The first is that the "Competition Act" does not require the Swaziland Competition Commission ("the Commission") to include an assessment of employment effects in the determination of competitiveness of markets within the context merger control and prevention of anticompetitive practices. The other is that there is no well-established economic theory on the nature of the relationship between competition and employment or labour demand in a specific market or economy. But this is an important question since unemployment is one of the primary concerns of the government of Swaziland and society in general; unemployment is one of the causes of poverty in Swaziland. Therefore, this paper identifies pertinent policy issues that should be considered in an examination of the relationship between enforcement of competition law and employment (if any) in Swaziland.

1. Competition and Private Investment

3. The link between enforcement of competition law and employment is most likely an indirect one emanating from the relationship between competition and private investment. The worldwide consensus is that greater private investment as opposed to public investment in business has a significant positive relationship with economic growth and welfare improvements. This is attributed to the ideology that the private sector, within the context of a competitive market economy that is supported with quality economic institutions, allocates productive resources efficiently through a spontaneous order which solves the problems of production, exchange of goods and services and assignment of resources in an economy. Kay (2004) clearly state that centrally planned economies fail because they stifle innovation and lack an effective coordination mechanism. It is no surprise, therefore, that from time to time the government of Swaziland like those of other developing countries pronounces its endeavour to increase the role of the private sector in the economy in terms of the *National Development Strategy of 1998*, Section 59(2)(b) of *The Constitution of the Kingdom of Swaziland of 2005*, *The Poverty Reduction Strategy and Action Plan* of 2007 (PRSAP) and *Private Sector Development Strategy.*

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4. Private investment can take the form of greenfield investment or expansion of capacity or mergers and acquisitions (M&As). Firms (foreign or domestic) are concerned with profit maximisation, that is setting the optimal amount of output and price per unit of a product where the marginal cost (i.e. the cost of producing an additional unit of output) equal marginal revenue (i.e. the change in the revenue that arises when one additional unit of a product is sold). Therefore, they consider the structure of a market in making investment decisions. Depending on industry specific factors, market structure can cause firms to behave in a certain way to earn profit. However, firms can also influence the market structure when they influence costs of entry (or expansion) and the degree of competition post-entry.

5. Firms operating in uncontestable markets are likely to be inefficient in allocating resources and may exercise of market power. Therefore, enforcement of competition law contributes to liberalisation of investment opportunities, for foreign and domestic firms including SMMEs, by constraining incumbent firms from exercising of market power.

6. The Commission regulates M&As in terms of Section 35 of the Competition Act which requires all proposed mergers to be filed before implementation. The Commission seeks to prevent M&As that are likely to substantially lessen competition or create a monopoly. The *Competition Commission Regulations Notice of 2010* ("Competition Regulations") provides a non-exhaustive list of factors to be considered in the review of mergers some of which are related to trade policy and the promotion of small, medium and micro enterprises (SMMEs). The investigation and adjudication processes are greatly influenced by the consumer-welfare standard. This standard entails examining the observable characteristics of the parties to the transaction and the market setting in which they operate to ascertain if the merger is likely to increase the ability of the merged entity to control prices and output in the relevant market (Katz and Shelanski, 2007). Merger approvals result in a decrease market concentration thus either dividing market shares among many sellers or increasing internal rivalry or both. In certain cases, a merger that is likely to increase market concentration by removing an effective competitor is approved provided the Commission is of the view that it will create sufficient efficiencies that will off-set the harm to consumers. In examining the efficiency defence presented by the parties to the transaction, the Commission relies on international practice, for instance, the conditions and procedure stipulated in the *Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings* published by the European Union.

7. The Commission is also responsible for preventing harmful unilateral conduct in terms of Section 34 and restrictive business agreements in terms of Sections 30, 31 and 32 of the Competition Act. By enforcing these provisions, particularly by proscribing agreements that restrict competition, the Commission can increase the number of competitors in a market. For example, the Commission in *The Gables (Pty) Ltd v Pick 'n Pay Retailers (Pty) Ltd and The Hammond Brothers (Pty) Ltd* ruled that the provision in the new lease agreement which sought to prevent entry of other supermarkets in the shopping centre for a further period of 30 years after the initial 10 years had expired was anti-competitive. The lessor (The Gables) had expanded the shopping centre and increased the gross lettable area from 11294 square meters to 30110 square metres with potential to increase the number of tenants from 54 to 123. The Hammond Brothers (Pty) Ltd trading as Pick 'n Pay Hammond was the anchor tenant (lessee) and opposed to the entry of Shoprite Checkers which had already entered into agreement with the lessor to occupy the newly developed site as another anchor tenant. The Commission's view was that the exclusion of other supermarkets restricted competition and hence decided against the lessee resulting in Shoprite Checkers becoming a second tenant in the shopping centre. According to The Gables (Pty) Ltd, 600 jobs were going to be created once all of the new tenants occupied the space.

2. Private Investment and Employment

8. As previously mentioned, private investment can take the form of M&As and these are regulated by the Commission. Before assessing the effects of M&As on employment, it is important to first consider the following drivers of firms' participation in (M&As). The first is shareholder wealth maximisation which can be achieved when, for example, a merger creates economies of scale which are realised when the average costs decreases as output increases. Alternatively, the acquiring firm can aim to create economies of scope which occur if the relative total cost of producing a variety of goods and services in one firm is below the total cost realised when producing each good or service separately in two or more firms. Other than production, sources of economies of scale and scope may be in purchasing or advertising or research and development. The cost savings realised by the firm are often referred to as efficiencies and an increase in efficiencies make the merged entity more competitive (Besanko, Dranove, Shanley and Schaefer, 2004; Lehto and Bockerman, 2008; and Margolis, 2006).

9. The second is manager's self-interest which can be manifested by the acquisition of competitors to increase firm size and enhance managers' personal status while adversely affecting profitability of the merged entity (Schumpeter, 1934 in Lehto and Bockerman, 2008).

10. The third is a set of miscellaneous factors that can create an environment favourable to M&As. One of them is changes in regulation for example those relaxing restrictions on expansion (Heffernan, 2005). The other is technological change which can encourage revenue earning product innovations and/or reduce costs of producing existing products. However, Katz and Shelanski (2007) assert that competition authorities tend not to approve M&As that result in more concentrated markets if the merged entity will only benefit consumers through technological change rather than through reduced prices and increased output.

11. Turning to how M&As affect employment, the overriding factor in this relationship is the profit maximisation goal of firms. Firms hire workers when they see an opportunity to make profit out of them and fire them when the opportunity disappears. The merged entity may opt to downsize overlapping activities to reduce costs and the result could be reductions in the workforce (Margolis, 2006). There are two reasons why laying off workers may be easy to implement. First, firms are at liberty to make contracts including in regard to wages and other terms of employment with little government interference. Second, it is relatively easy to employ more workers during peaks of the business cycle because workers with the same characteristics that were possessed by laid-off workers voluntary offer their services when an opportunity avails itself.

12. Results from various countries show mixed countries and there is no universal theoretical framework on how and to what extent M&As affect employment. Lehto and Bockerman (2008) suggest that the consequence on employment depends on the type of M&As which may be described in terms of: (1) the distance between the target and acquiring firm; (2) the nationality of the acquiring firm (domestic or foreign); and (3) the institutional nature of an acquirer (which can be another firm or another form of M&A such as internal restructuring. An assessment of the adjustment of employment in three industries in Finland, which are: manufacturing; construction and services; and trade including hotels and restaurants showed two main relationships. First, cross-border M&As in which the acquirer is foreign and not located in Finland at the time of the M&A have a negative impact only in manufacturing. Second, domestic M&As with a foreign-owned acquirer who is located in Finland have a substantial negative impact on employment in construction and other services and this could be explained by the fact that pre-merger the parties' assets sharing is also restricted by geographical limits (Lehto and Bockerman, 2008).

13. Margolis (2006) examined both the characteristics of firms and how different hazard rates of individuals and their characteristics influence continued employment in acquiring and acquired firms. He

found that workers in administrative functions are disproportionately laid off when the sources of efficiency are from reduction of fixed costs in central administration. Some of the characteristics are observable such as age, gender, level of education and skill and others are unobservable. Margolis, however, disputes the notion that lay-offs are always linked to cost-savings; he argues that some workers leave the employer voluntarily after a merger and some firms that are not involved in M&As also lay off workers whenever their efficiencies are threatened.

14. In Swaziland, there is no information the effect of M&As on employment. The Commission does not monitor changes in employment in acquiring and acquired firms due to the lack of the legal requirement to do so. When the assessment of the relationship is carried out in Swaziland, it may be useful to consider M&As over a long period of time including those that were consummated before the Competition Act came into force. These include: (1) the Royal Swaziland Sugar Corporation Limited (RSSC) and Mhlume Sugar Company; (2) Cadbury and Kraft; and (3) Swaziland Bottling Company and Swaziland Beverages. As regard the RSSC and Mhlume Sugar Company merger, in 2001, shareholders of RSSC agreed to a merger with the neighbouring Mhlume Sugar Company; both firms were involved in the agriculture sector as sugar cane growers and manufacturing as millers. The merged entity, RSSC was launched in 2002 and it accounts for two-thirds of the country's sugar. Sugar is Swaziland's major export product with a significant proportion of sales attributed to preferential market access in the European Union, Africa and United States. In *Swaziland Agricultural and Plantations Workers Union v Royal Swaziland Sugar Corporation Limited* it was stated that in 2004, RSSC declared 700 redundant positions. RSSC had informed the union that the company was not performing well and there were differences in opinion between the workers and employer on the cause of the poor performance. RSSC reported that it had already implemented cost-cutting measures which did not affect employees but there had been little improvement hence the decision to make certain position redundant. The termination agreements were concluded in February 2005 but the packages and repatriation took effect at a later stage. The Court could not prevent the redundancies and retrenchments. But it is worth mentioning that RSSC outsourced some of its services and some former employees became suppliers to the firm.

3. Policy Issues for Consideration

15. What is important in this matter is not only how many jobs are lost as a result of M&As in the short-term (1-3 years) but how employment changes as competitiveness of an industry increases in both the short term and medium-to-long term. In the absence of barriers to entry, labour intensive industries can create more jobs if there is growth in real gross domestic product (GDP) and real private investment. In such cases, the increase in the overall number of jobs attributed to other firms may compensate for the short-term reduction of jobs due to M&As in an industry. In other industries, the M&As may have the overall effect of decreasing jobs but if there are substantial improvements in efficiencies and price competition or product quality or both, competition authorities and policy makers must consider these benefits to society as well.

16. Having said that, prevention of job losses and/or job creation in Swaziland is a critical policy issue that should be discussed beyond the context of enforcement of competition law in view of the unfavourable labour market characteristics. According to *The Swaziland Integrated Labour force Survey of 2010*, the labour market has the following characteristics: (1) a high unemployment rate (40.6% and 28.5% based on the relaxed and strict definition, respectively in 2010); (2) low average wages compared to those prevailing in high income countries for similar jobs; (3) irregular and uncertain incomes for some workers in the private sector; (4) un-paid employment for some for those employed on own-account or self-employed; (5) low women's participation in both the public and private sector and more females employed in the informal sector compared to their male counterparts; (6) a small proportion of total workers employed in jobs that require tertiary qualifications (managers, professionals and technicians) (7) existence of casual wage jobs which cause some workers to be unemployed from time to time; (8) lack of job-related

social security for some workers in both the public and private sector; and (9) lack of formal employment contracts for some workers. In addition, the Swaziland Government is the largest single employer, accounting for 21.7% of total employment while 41.6% and 32.5% is accounted for by the private and informal sector, respectively.

17. The main causes of the high unemployment rate are low aggregate demand and low private sector investment. Swaziland's real GDP grew on average by 2.3 percent each year between 2001 and 2011, much lower than the 5% required each year to reduce poverty (PRSAP). The private sector is not well diversified; some markets are controlled by government through state-trading enterprises. Therefore, to increase overall demand for labour, there is need for policy interventions to facilitate rapid private investment and real GDP growth.

18. Policy interventions should consider the determinants of private investment decisions, especially the macroeconomic factors and other factors that are not within firms' control. Acosta and Loza (2005) analysed the relationship between private investment and macroeconomic factors and found that in Argentina in the short run such decisions are dependent on shocks in returns (exchange rate, inflation and trade liberalisation) and in aggregate demand. In the long run, well-developed financial and credit markets and investors perception of long-term fiscal sustainability had a greater role. Naa-Idar, Ayentini and Frimpong (2012) found that in Ghana in the long run, private investment was positively influenced by GDP growth (estimate for aggregate demand) and trade liberalisation but negatively affected by high levels of external debt. They found a positive relationship between private investment and inflation contrary to the positive relationship found in other countries by other researchers.

19. In designing the interventions, government should ensure consistency and coherence in laws and regulations governing the following: international and domestic trade; foreign investment; SMMEs; deregulation of state trading enterprises; registering businesses; redistribution of income; and fiscal management. The interventions would change the status quo and therefore create some adjustment costs. Therefore, their implementation would have to be properly managed in order to cause the desired improvement in private investment and employment while increasing overall welfare.

4. Conclusion

20. In Swaziland, the relationship between enforcement of competition law and employment is most likely an indirect one arising from the contribution of the enforcement of competition law to private investment through liberalisation of economic opportunities. While unemployment is a big problem, it should not be dealt with piecemeal, for example, by attaching conditions relating to continued employment of workers in acquiring and acquired firms because such actions cannot reduce unemployment. Mergers should be encouraged if they result in increased competition in a market, especially through price and/or quality, and improve cost savings of the merged firm but discouraged if they only result in higher concentration and market power regardless of the impact on the number of workers post-merger. Reducing unemployment requires greater focus on improving the laws and regulations that impede private investment and real GDP growth.

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