

# **PLANNING ECONOMIC DIVERSIFICATION: A LOCAL ECONOMIC DEVELOPMENT STRATEGY TOWARDS ECONOMIC-BASE RESTRUCTURING**

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## **ABSTRACT**

**M**unicipalities in South Africa have undergone rigorous change that has not only manifested in terms of structural adjustments, but included expansion of roles to respond to the changing expectations of roles to respond to the changing expectations of communities. Municipalities have had to engender massive development interventions to respond to their domestic legislative obligations and a plethora of international treaties. Recent legislative obligations not only necessitate municipal philosophies of integration, development, people-centredness, transparency and accountability, but catalysts that conduct business in an unusual way. Local economic development (LED) is among the municipal drivers to facilitate growth. Municipal LED initiatives would be ineffective if they failed to incorporate economic diversification which is deemed a useful tool for local economic-base restructuring. Although the article refers to a South African municipality as a research focus area, the findings of the research apply to municipalities with a rural nature country-wide.

## **INTRODUCTION**

**M**unicipal governments have undergone rigorous change that has not only manifested in terms of structural adjustments, but expansion of roles to respond to the changing expectations of communities (Malefane 2005:88; Naudé 2001:7; Ntshulana-Bhengu 2004). South African municipalities have had to engender massive development interventions to respond to their domestic legislative obligations and a plethora of international treaties. Recent international responses to socioeconomic

problems gave birth to the formulation of economic development strategies and transformation agendas – transformations from economies based on a single commodity, to robust, well-diversified economies.

The cities of Hawaii, Brandon, Dryden and Georgia are listed as high-ranking cities from which cities in developing countries should learn. Experience in these cities suggests that local economic initiatives are a vital source of national economic development. Local economic development (LED) initiatives in South Africa --- and other African countries --- serve as municipal drivers to stimulate, facilitate and encourage growth for economic-base restructuring.

This article is based on six major issues. *Firstly*, the article describes the scope and limitations within which discussions unfold, *secondly* it provides the reasons for local economic-base restructuring, and *thirdly* it broadly conceptualises economic diversification and economic-base restructuring. The *fourth* issue is a discussion of current economic conditions in the Southern District Municipality (SDM), which has been split into three main sections: the size of the economy, economic growth, and a sectoral analysis. The *fifth* discussion covers a local economic analysis and its results, and the *sixth* presents a framework for planning economic diversification in respect of local economic-base restructuring.

## SCOPE AND LIMITATIONS OF THIS ARTICLE

**T**he scope of the article is based on a five-point scale limitation that includes the study area, urban/rural characteristics, data sets that have been used, generalisations in developing a municipal diversification model, and the concept of an economic base.

### Geographical location

This article focuses on the Southern District Municipality (SDM). The name SDM was in March of 2008 changed to Dr Kenneth Kaunda District Municipality (Moloi, 2008). The use of the name SDM is maintained as a validation of the data sets used in this research. The SDM is a district municipality in the North-West Province of South Africa. The district comprises five local municipalities, namely the towns of Matlosana (formerly known as Klerksdorp) and Tlokwe (formerly known as Potchefstroom), Ventersdorp, Maquassi-Hills (formerly known as Wolmaransstad) and Merafong. The analysis and its results quoted in this article are based on the local municipalities (see <http://www.sdm.org.za/>).

This article acknowledges that where people live and work (whether in urban or rural areas) as well as aspects of their local environment affect the scale and nature of their success or deprivation. It recognises that typical "urban" and "rural" characteristics influence people and their livelihoods. Urban characteristics are for example access to markets, assets and income-earning opportunities, infrastructure and services, whereas all of these are highly restricted in rural areas. The local municipalities of the SDM

comprise two main clusters, namely urban areas (Matlosana and Tlokweng) and rural areas (Ventersdorp and Maquassi-Hills).

## Characteristics

The data on which this article is based were acquired from projections contained in the SDM's growth and development strategy (GDS) (GDS 2008). These data sets contain the most recent official information and are widely used for planning purposes.

## Developing a municipal diversification model

Since most municipalities in South Africa and other African countries share similar socioeconomic characteristics, the conclusions and recommendations in this article would contribute significantly to the development of municipal economic diversification strategies. The findings reported in this article could provide significant support to local economic-base restructuring in most municipalities.

## The concept of an Economic base

This article is based on the assumption that industrial or sectoral expansion or contraction could have detrimental effects on local economies and existing job opportunities. Hence locating economic activities in areas where they have historically been absent represents a major change in the economic base of these areas. The article refers to the presence or absence of economic activity, it deals with how communities earn a living, and describes opportunities for employment and income in a local community. The growth, decline or stagnation of a local community depend on the community's basic economic activity which goes beyond local needs (Croll & Phifer, 2008:1).

## NEED FOR LOCAL ECONOMIC-BASE RESTRUCTURING

In South Africa, emerging LED practices have not occurred in a vacuum. These practices have been initiated in response to inadequacies and the failure of past policies to facilitate equitable socioeconomic growth and development. Local economic development came about in response to the need for municipal planning that had in the past been ignored in decisions on the location of industries and other employment-creating activities (Ndabula 1997:10; Dass 1995:14). Proper planning would reduce the economic vulnerability of municipalities because it promotes diversification of the local economic base.

Countless arguments underpin the need for local economic-base restructuring in South Africa and other African countries. Changing needs form part of the transformation agenda of municipal councils in redistributing the benefits of growth and wealth. The following are some of the reasons for local economic-base restructuring:

- Despite strong legislative and resources-based support of South African municipalities for local economic development, such development remains far below its potential

level and municipalities have fallen prey to too many economic challenges in their communities.

- The structures and strategies that were designed to effect economic development have largely remained unresponsive to the nature and complexity of the economic challenges facing municipalities. LED leadership is associated with much doubt about the required competence to produce something closer to the expected reality. The situation has given rise to the deployment of sector related national and provincial officials to assist with municipal economic development.
- The deployment of officials from sector related national and provincial departments have resulted in an imposition of LED initiatives that are unresponsive to local needs. These initiatives do not enjoy local support and remain insignificant in dealing with local economic issues. Another result is a growing mismatch between the local skills base and opportunities brought about by developing some sectors of the economy.
- Given the dynamics of the South African economy, municipal decision makers need to understand the weaknesses and strengths of their municipal economies. They should be able to identify and take advantage of comparative economic advantages. They should also recognise economically vulnerable areas and take steps to mitigate the adverse effects of changes in the global economy. One solution to this problem is to ensure a well-diversified economy in terms of industry mix.
- Municipalities tend to depend on dominant economic sectors, despite the associated risks of failing to produce the expected outcomes. High economic concentration makes an economy vulnerable to external events such as changes in the price of dominant commodities (Abouchakra *et al.*, 2008:2). Little attention has been given to economic diversification as a municipal strategy, causing dependence on a dominant economic sector which eventually fuels inadequate productivity and competitiveness.

## ECONOMIC DIVERSIFICATION AND ECONOMIC-BASE RESTRUCTURING

**E**conomic diversification is generally the process in which a growing range of economic output is produced. It refers to the diversification of markets for exports or the diversification of income sources beyond domestic activities (income from foreign investment) (UNFCCC<sup>1</sup> 2008; Scottish Executive Development Department 2005:11). Diversification requires the introduction of new industries through the expansion of an existing industry other than a single sector or dominant industry. Diversification is a form of growth strategy and a critical component of a sustainable economy (Abouchakra *et al.*, 2008:10) It involves a significant increase in performance objectives (usually sales or market share) beyond past performance levels (BR<sup>2</sup> 2008). The purpose of diversification is to allow entrance to new businesses that differ from current operations. Diversification in fact reduces the risk of having all the eggs in the same basket (Page 2002:7).

Diversifying a community's economic base is in essence an investment decision. Every investment requires the financial capital to invest and a satisfactory rate of return. Hence investment decisions have to be informed by pre-assessment activities that distinguishes between less desirable or weak sectors and strong sectors.

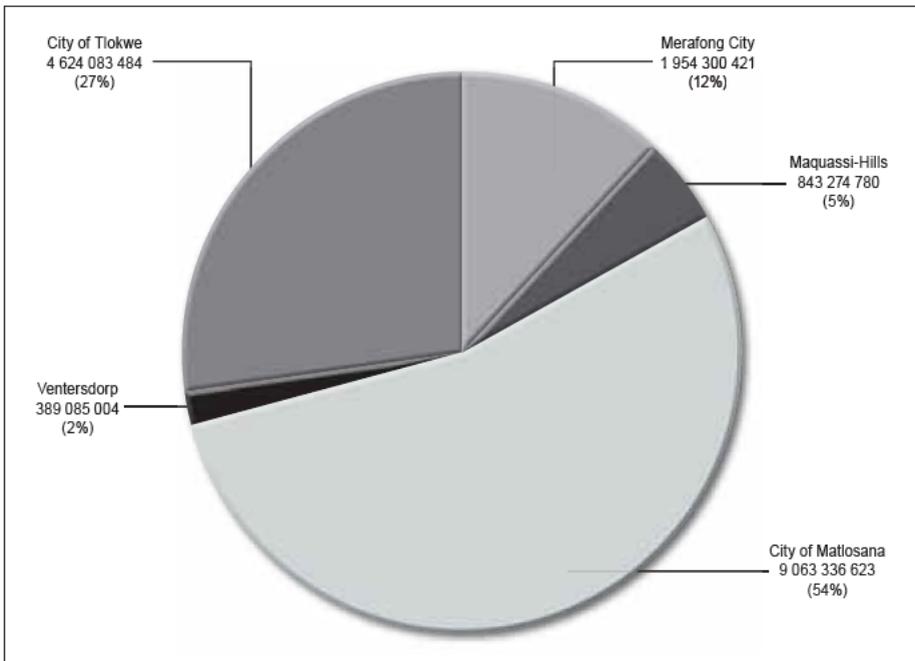
## CURRENT ECONOMIC CONDITIONS

To gain an understanding of the SDM's current economic conditions, three key economic features were investigated: the size of the economy, economic growth, and a sectoral analysis. The data used for this article were obtained from the SDM's growth and development strategy (GDS 2007). A brief discussion of the SDM's economic size follows next.

### Size of the economy

In 2004, the SDM's economy produced goods and services worth in excess of R16 billion, that is approximately 20% of the North-West Province's economy. The cities of Matlosana and Tlokwe were by far the largest economies of the SDM. Figure 1 illustrates the size of the SDM's economy in 2004.

Figure 1: The size of SDM's economy, 2004

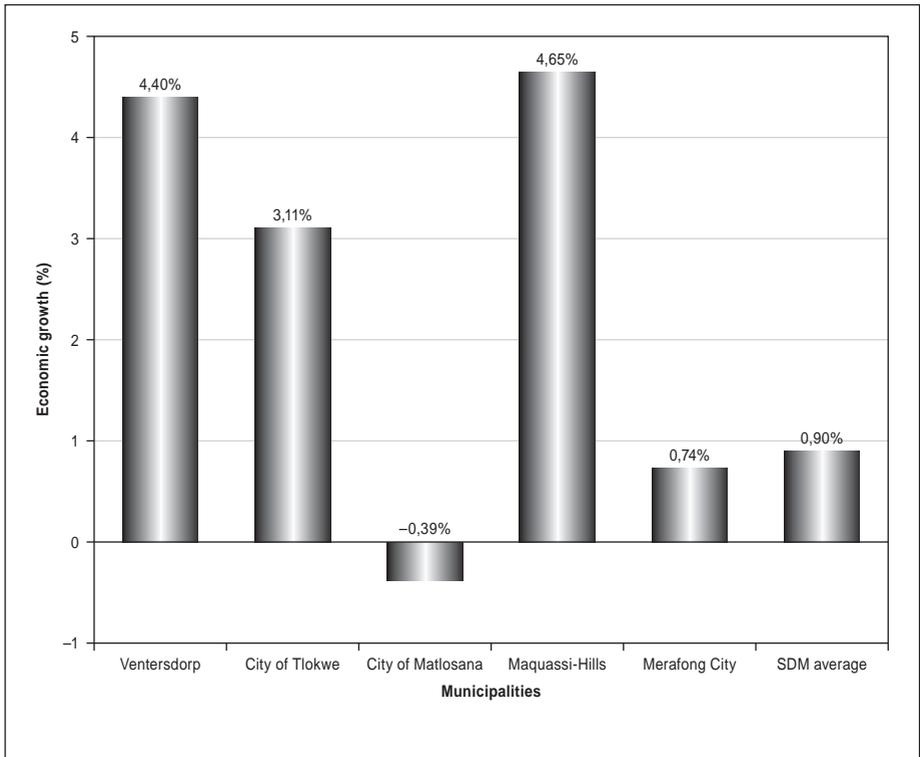


### Economic growth

Between 1996 and 2004, the SDM economy on average grew by only 0,9%, less than the national economy. The smaller SDM economies, which are also less dependent on mining and government services, grew faster (e.g. Maquassi Hills and Ventersdorp).

Due to the declining wealth in gold mining, Matlosana's economy shrunk by an annual average of 0,39%. Figure 2 illustrates average annual economic growth between 1996 and 2004.

**Figure 2: Average annual economic growth, 1996-2004**

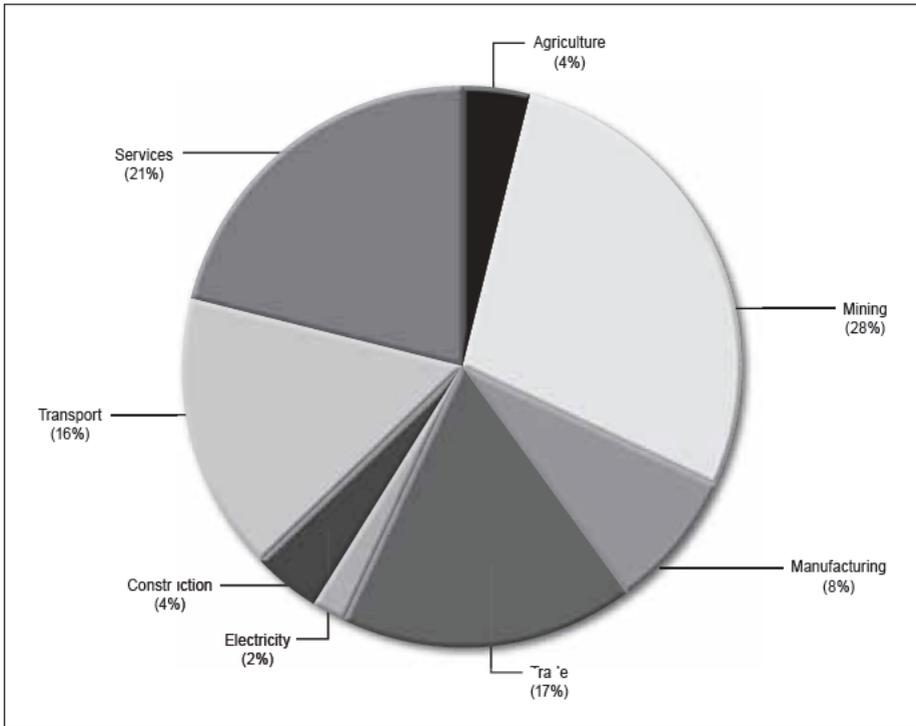


The total SDM economy is remarkably diversified, with 28% in mining, 21% in services, 17% in trade and 16% in transport. A sectoral analysis of the SDM's economy is discussed in the next part of this article, providing an overview of sectoral contributions.

### **Sectoral analysis of the SDM'S economy**

The rationale for a sectoral analysis of the SDM's economy is to portray associated areas of vulnerability (less desirable sectors) and economic strong points (growth sectors). The analysis results have been used to quantify the relative dependency of the SDM on certain dominant economic sectors. All planned or structured interventions to accommodate economic challenges should take full cognisance of the nature and complexity of these challenges. Investment decisions are based on analyses like these. Figure 3 illustrates the sectoral composition of the SDM's economy.

**Figure 3: Sectoral composition of the economy, 2004**



### **Agriculture**

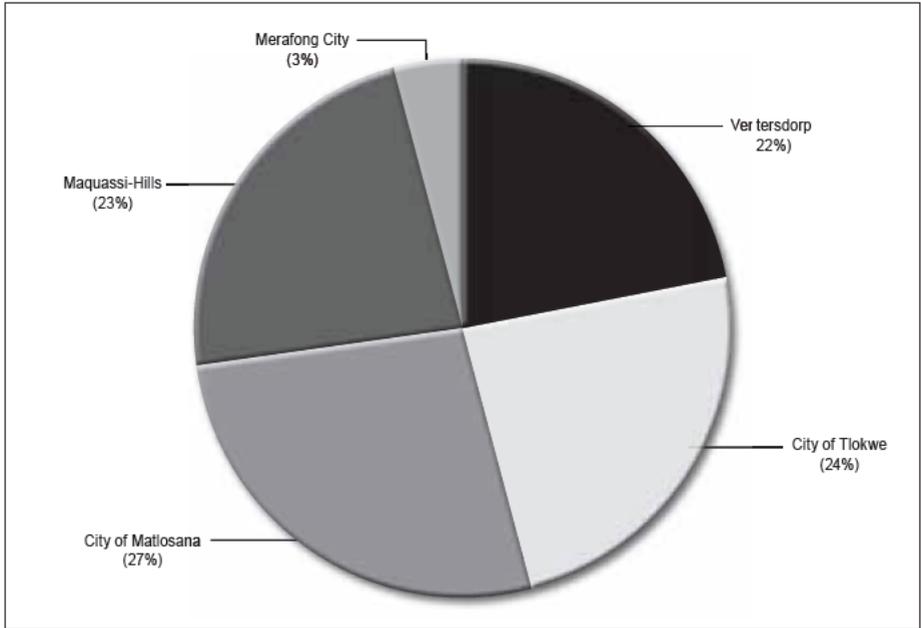
As shown in figure 3 above, the agricultural sector accounted for only 4% of the SDM's total economic output in 2004. This agricultural output is fairly distributed across the different municipalities. Figure 4 shows that the agricultural contributions of urban municipalities such as Matlosana and Tlokwe are significant – even exceeding those of rural, agriculture-based places such as Ventersdorp and Maquassi Hills. The contributions of the different municipalities to agriculture and agricultural production between 1995 and 2004 are shown in figure 4.

### **Mining**

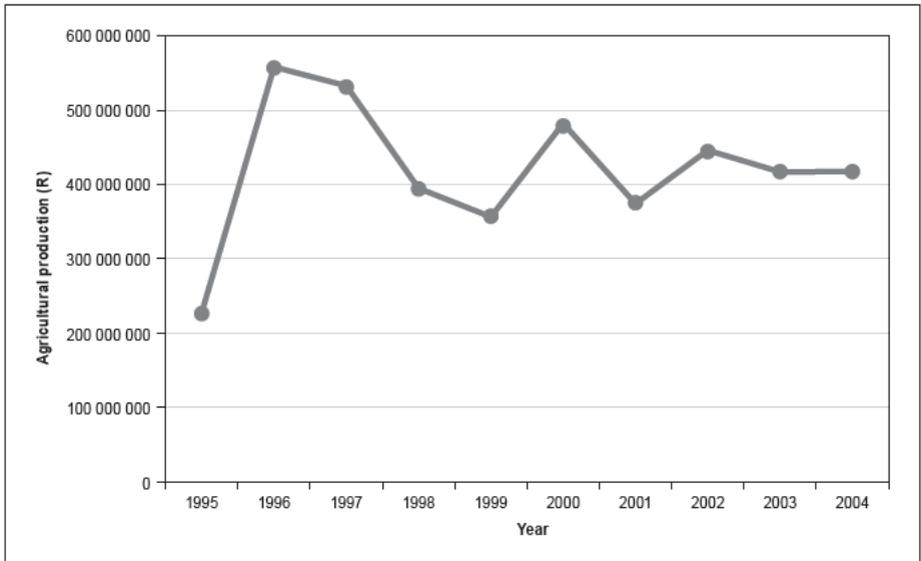
Mining was the dominant sector, accounting for 28% of the SDM's economic output in 2004. Mining acquired its status as the district's largest source of employment because this sector attracts a significant proportion of labour from most parts of the country and from abroad. As shown in figure 5 below, most mining activities in the SDM are located in the City of Matlosana (64%) and in Merafong City (29%).

The mining sector (especially gold mines) showed a rapid decline in production between 1995 and 2004.

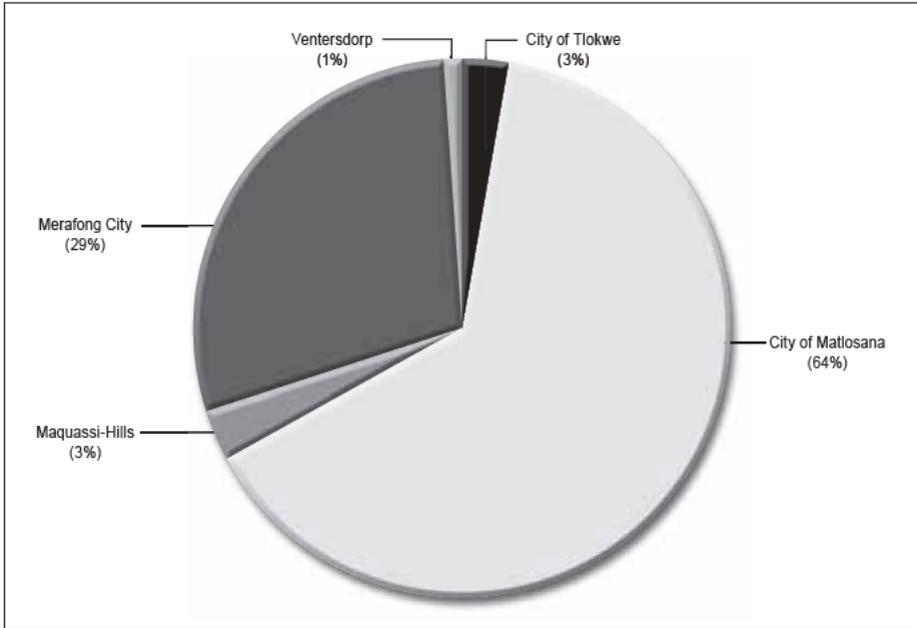
**Figure 4a: Mucial contributions to agriculture and agricultural production in the Southern District Municipality**



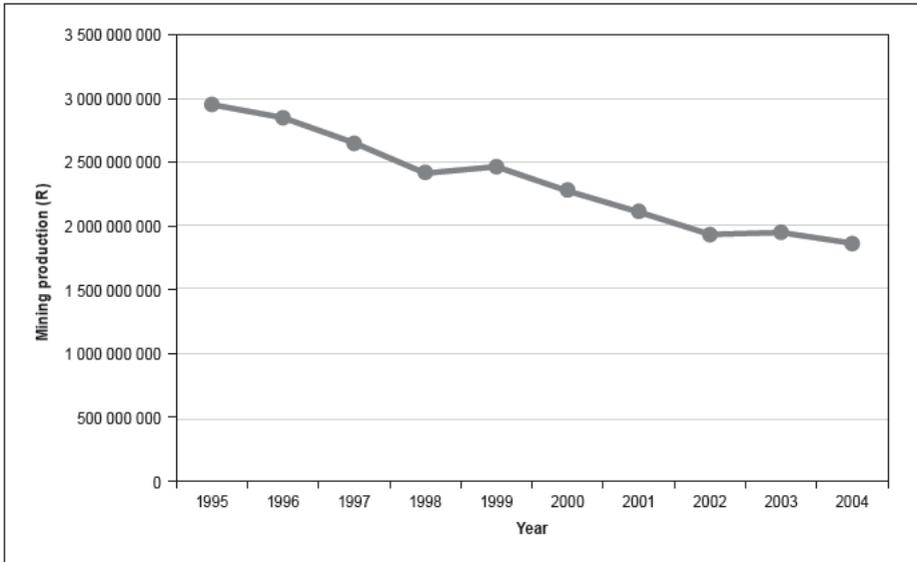
**Figure 4b: Agricultural production in the Southern District Municipality (Constant prices in Rand)**



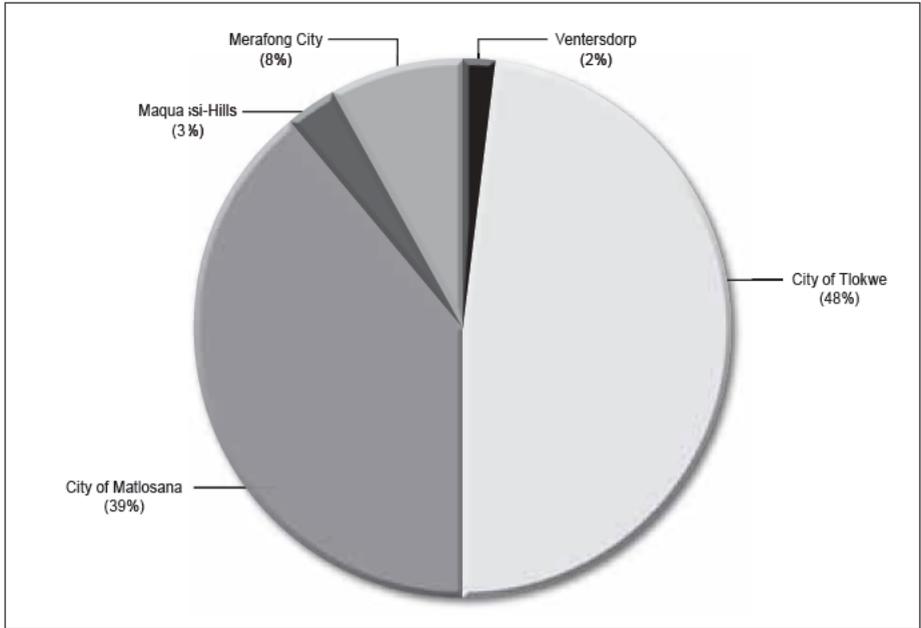
**Figure 5a: Municipal contributions to mining and mining production in the Southern District Municipality**



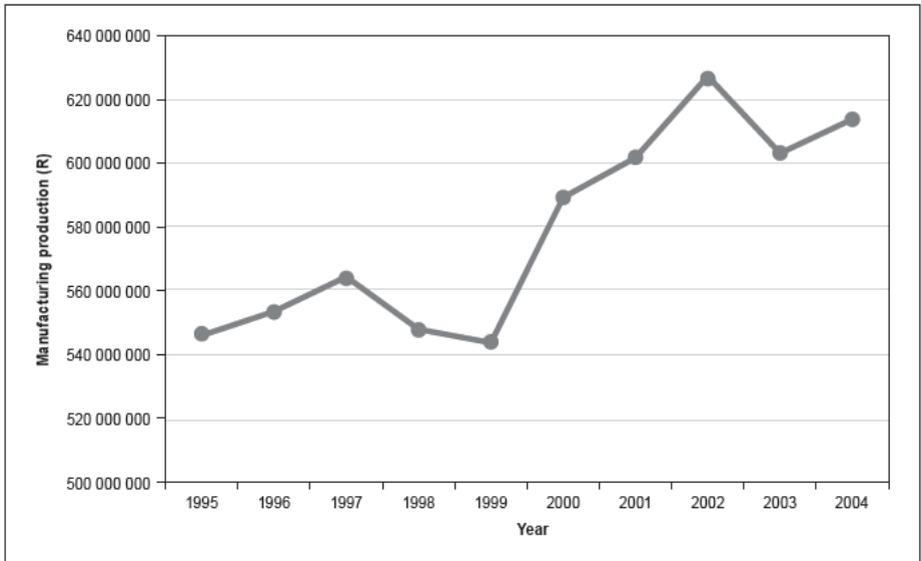
**Figure 5b: Mining production in the Southern District Municipality (Constant prices in Rand)**



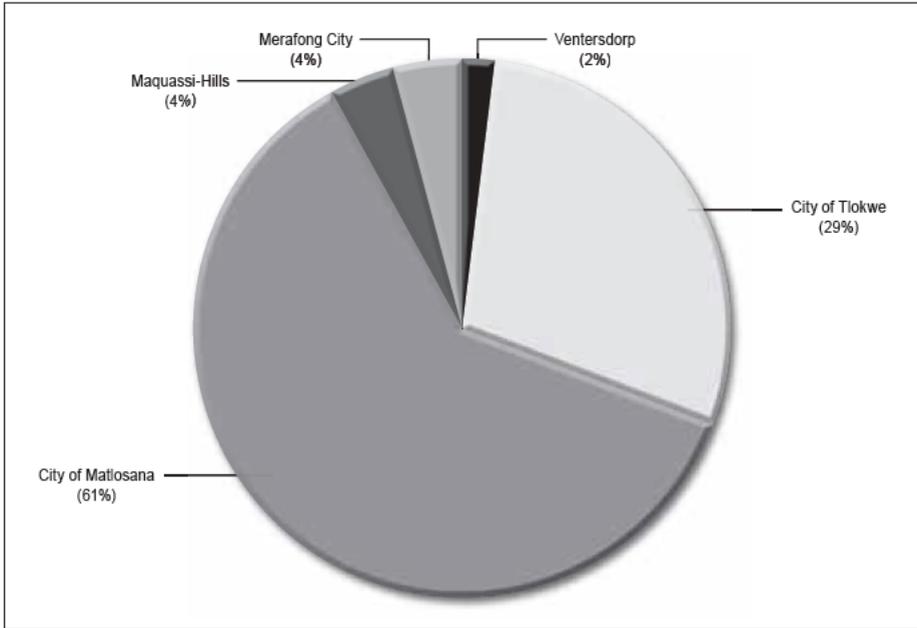
**Figure 6a: Municipal contributions to manufacturing and manufacturing production in the Southern District Municipality**



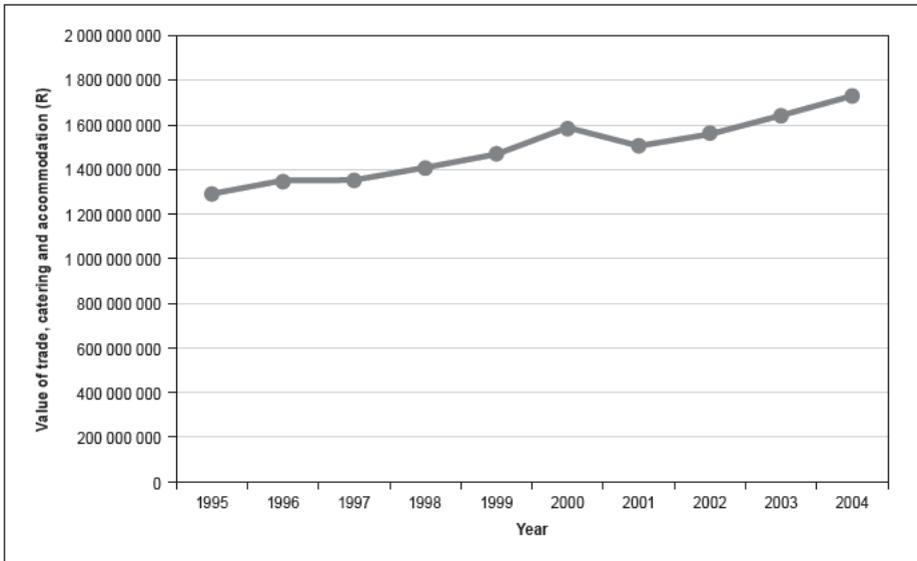
**Figure 5b: Manufacturing production in the Southern District Municipality (Constant prices in Rand)**



**Figure 7a: Municipal contributions to trade, catering and accommodation in the Southern District Municipality**



**Figure 7b: Value of trade, catering and accommodation in the Southern District Municipality (Constant prices in Rand)**



## ***Manufacturing***

Manufacturing accounted for 8% of the SDM's total economic output and was the third lowest sector after both construction and agricultural sectors (4%). Manufacturing is strongest in Potchefstroom (48%), followed by Matlosana (39%). Together these two municipalities produced 87% of all manufactured goods in the SDM. Figure 6 below demonstrates municipal contributions to manufacturing and manufacturing production in the SDM.

## ***Trade***

The predominant trading areas of the SDM are Matlosana (61%) and Tlokwe (29%). The trade sector has shown constant growth between 1995 and 2004. Figure 7 below shows the municipal contributions to trade and trade, catering and accommodation facilities in the SDM.

## ***Services***

Most of the services (business, financial, government and nonprofit) are available in either Matlosana or Tlokwe. Highly developed infrastructure networks (eg roads, telecommunication, electricity, sanitation) are available in both Matlosana and Tlokwe and appear to be the main sources of attraction for businesses and service sector institutions. These two cities represent the manufacturing and services hubs of the SDM. Figure 8 below shows the municipal contributions to services and service output in the SDM between 1995 and 2004.

## ***Construction***

The construction sector accounted for 4% of the SDM's total economic output in 2004. Construction is by far the largest industry in Matlosana (75%). Despite Tlokwe also being highly urbanised, Matlosana's construction sector was seven times larger than that in the city of Tlokwe in 2004. Figure 9 below reflects the municipal contributions to construction and growth in between 1995 and 2004.

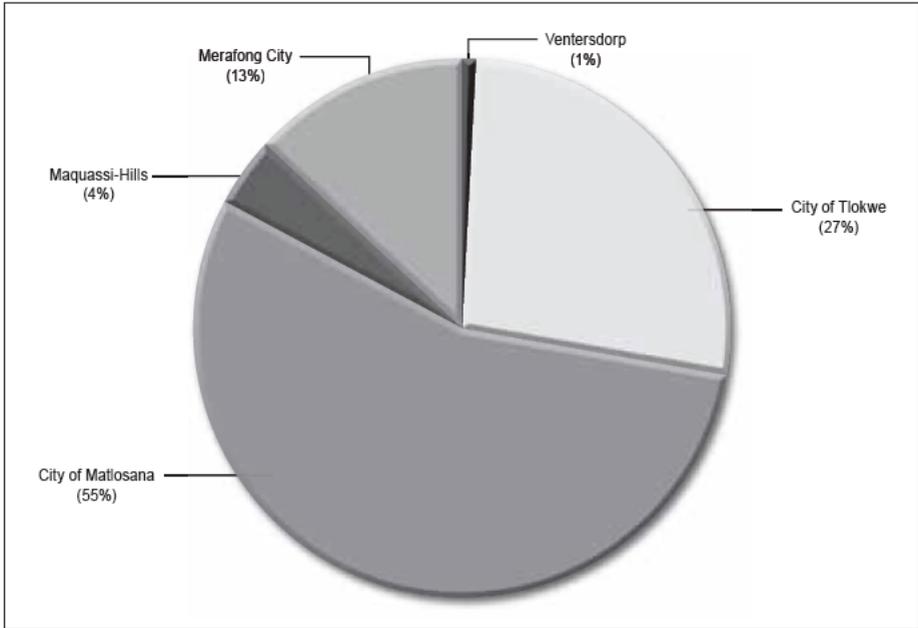
Although construction performance declined between 1998 and 1999, the sector has since recovered and contributes significantly to the economy of the district.

## ***Transport***

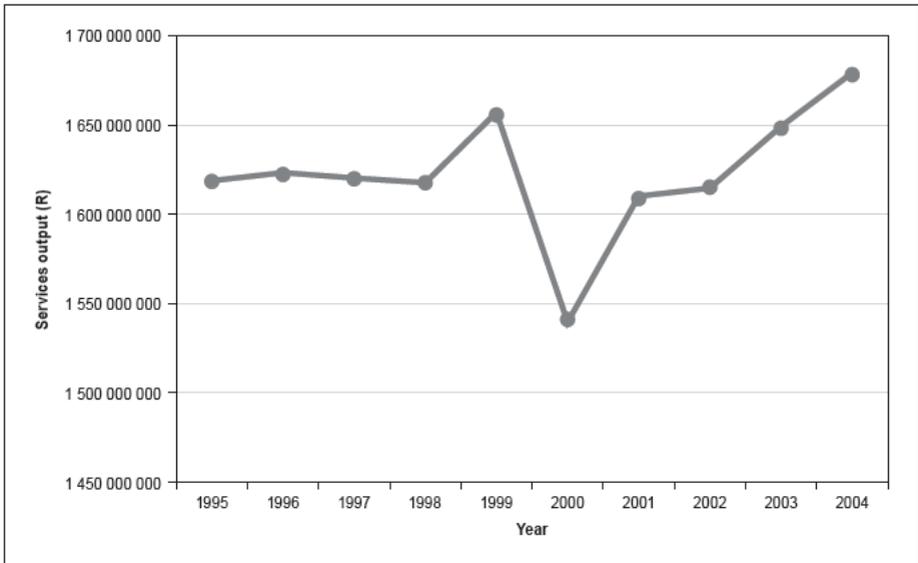
The transport sector has shown enormous growth and accounted for 16% of the SDM's total economic output. The transport sector is bigger in the more populated areas (e.g. Matlosana and Tlokwe). This sector has shown constant growth between 1995 and 2004. Figure 10 below shows the municipal contributions to (T&C) as well as sector growth between 1995 and 2004.

The performance analysis and its results (see below) are based on the sectoral analysis presented above. The performance analysis provided answers to two very important questions.

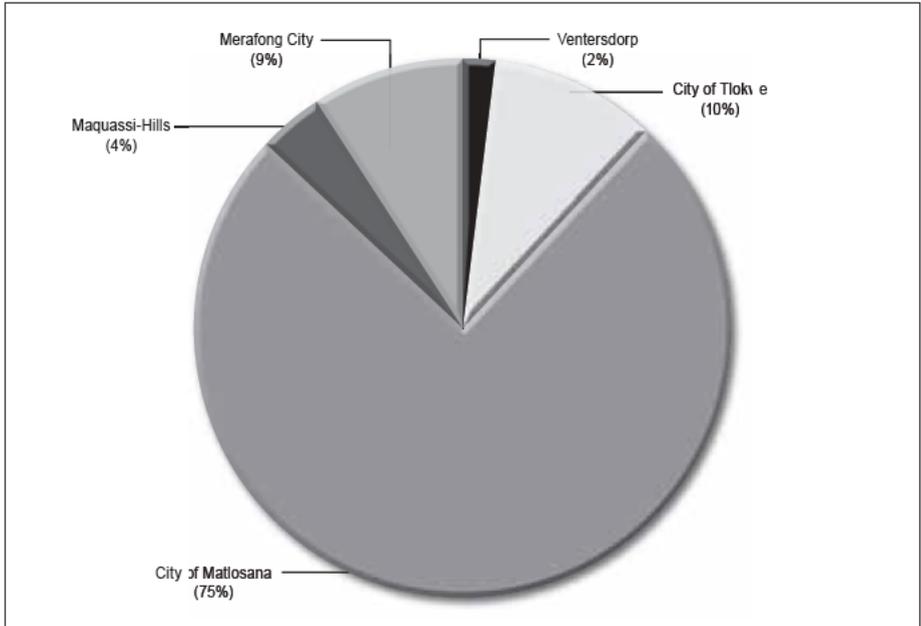
**Figure 8a: Municipal contributions to service and services output in the Southern District Municipality**



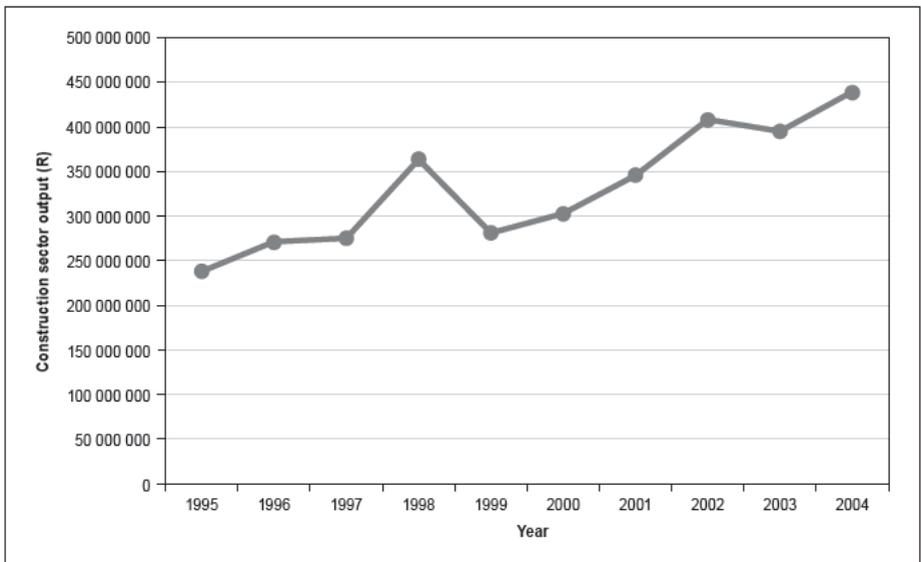
**Figure 8b: Services output in the Southern District Municipality (Constant prices in Rand)**



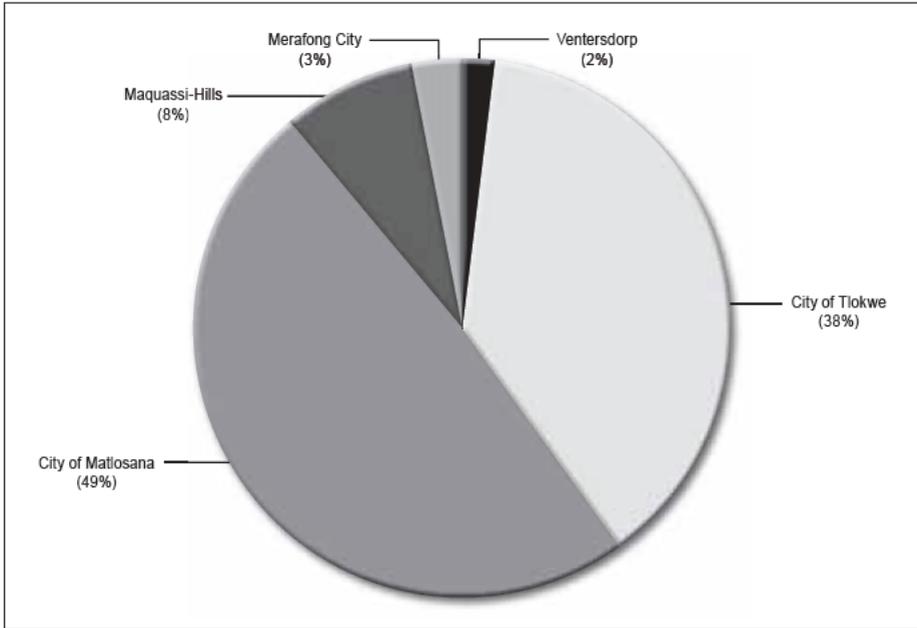
**Figure 9a: Municipal contributions to construction sector output in the Southern District Municipality**



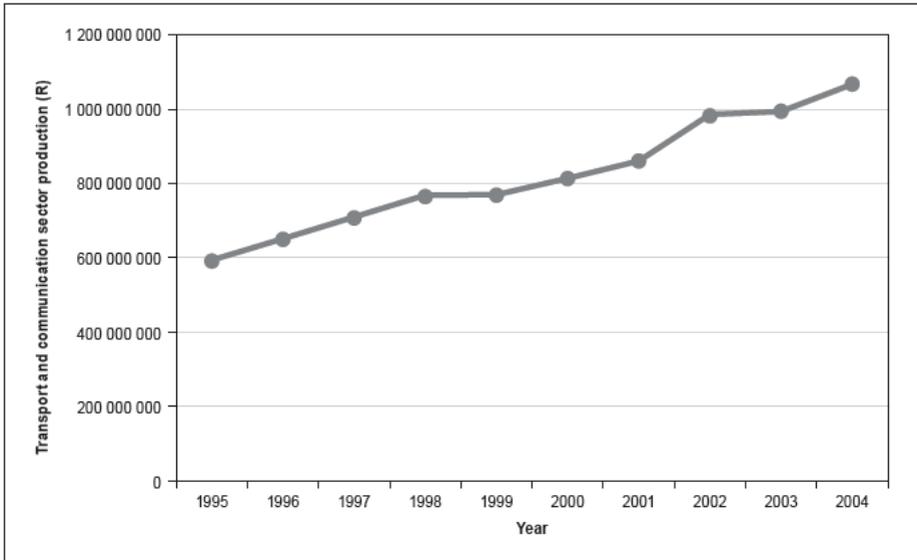
**Figure 9b: Construction sector output in the Southern District Municipality (Constant prices in Rand)**



**Figure 10a: Municipal contributions to transport and communication in the Southern District Municipality**



**Figure 10b: Transport and communication sector production in the Southern District Municipality (Constant prices in Rand)**



## LOCAL ECONOMIC PERFORMANCE ANALYSIS AND RESULTS

The performance analysis provided answers to two very important questions, namely whether the SDM's economy is diversified, and whether it contributes to restructuring of the district's economic base. The answers to these questions are not simple.

### Is SDM's economy diversified?

The answer to this question is neither a simple yes nor an unqualified no. The broad economic picture reflected figure 3, shows that the economy is well diversified with significant economic contributions from the mining (28%), services (21%), trade (17%), and transport (16%) sectors. However, analysis of the local economies indicates the opposite. What this inconsistency signifies is that the broad picture (diversity in terms of the sum total of sector contributions from all the municipalities) masks the economic diversity reality in the district.

In terms of the analysis and its results, this SDM's economy is not diversified. Two major categories of dependence on dominant sectors have been identified. The first is of urban dependence on the dominant but declining mining sector, and the second is of rural dependence on an unexploited agricultural sector. These two categories of dependence are discussed below.

In explaining the first phenomenon, evidence from the sectoral analysis reveals an urban economy (the cities of Matlosana and Tlokwe) that is well diversified but nevertheless vulnerable to ups and downs in the dominant mining sector. The SDM's urban economy has largely depended on mining sector production which however declined since 1995 (see figure 5). This decline has had serious socioeconomic implications for the district. One consequence of the decline has been job losses. It is a matter of record that the number of employed people dropped from 152 685 to 134 482 between 1995 and 2004. More than 18 000 workers have lost their jobs as a result of retrenchments in the mining sector during this period. However, as growth has been measured in other economic sectors, it was assumed that the job losses associated with a declining mining sector could be substituted elsewhere.

Figure 4 outlined a rural dependence on untapped agricultural production. Both rural areas of the SDM (Ventersdorp and Maquasi Hills) have accounted for economic contributions of 22% and 23% respectively – the highest sectoral contributions to the local economy. However, the agricultural output of Ventersdorp and Maquassi Hills, who both focus on agricultural output, could have been higher. Evidence from the analysis has revealed the opposite in urbanised areas, indicating that agricultural potential could be better exploited.

### Does growth contribute to local economic-base restructuring?

The discussion below provides an answer to this question, but also suggests that interventions should address proper planning for locating industry and other employment-creating activities. The sectoral analysis showed skewed development patterns in the

urban/rural divide. The urbanised areas (e.g. Matlosana and Tlokwe) have received more attention than their rural counterparts (Ventersdorp and Maquassi Hills). The reality is that urban nodes, where major business transactions take place, continue to attract more investment than the rural areas. Economic sectors such as manufacturing (see figure 6), trade, catering and accommodation (see figure 7), services (see figure 8), construction (see figure 9) and transport and communication (see figure 10) are all located in the urban areas of the SDM that recorded growth between 1995 and 2004.

The commercial and industrial sectors make considerable contributions to local taxes, meaning that the urban areas represent a larger source of revenue to the district's economy. On the other hand the rural areas have virtually no commercial or industrial base. Based on this unequal situation, it can be concluded that the SDM's economic growth is inconsistent with and does not contribute to local economic-base restructuring. The district's economic vulnerability is due to inadequate sector diversification, largely because of the strong reliance on mining by urban areas and on agriculture by rural areas for the economic well-being of the district. This reliance (or dependence) has catastrophic implications for the economies of both urban and rural areas in the SDM.

The above discussion highlights the need for a development plan that would lessen local economic dependency and advance economic diversification in the SDM's economy.

## CONCLUDING REMARKS AND RECOMMENDATIONS

It can be concluded that dependence on a dominant economic sector has severe risk implications for the economy of the SDM. The SDM's dependence on mining sector production serves as an example of these implications. Municipal decision makers in the local municipalities of the SDM need to understand how economic weaknesses and strengths come about. They have to take advantage of comparative economic successes, but also recognise areas of economic vulnerability and take steps to mitigate the adverse effects of changes in the global economy. One way of achieving this goal is to ensure well-diversified economies in terms of sectoral mix in their local municipalities. The diversification of local economies not only will it enhance the district's level of diversification, but will create sectoral competition that is both necessary for increasing economic opportunities and transforming economic base of municipalities.

Part of the action that municipal decision makers have to take is to ensure that their LED strategies incorporate economic diversification to reduce the risks of economic vulnerability in the district. A well diversified economy is less sensitive to the ups and downs associated with particular sectors because the risk is spread evenly across a number of economic sectors. A diversified economy is important in creating a viable municipal economic base. In order to achieve a diversified economy of the district, supporting infrastructure networks would have to be set up to source investments consistent with a rural setting. In other words, the dominance of agriculture as the only source of investment in rural municipalities has to be countered. The rural economies should become diversified, as do the urban economies. And, since agricultural production is basic, it could stimulate growth in other sectors of this economy.

## NOTES

- 1 The United Nations Framework Convention on Climate Change (UNFCCC or FCCC) is an international environmental treaty produced at the United Nations Conference on Environment and Development (UNCED), informally known as the Earth Summit, held in Rio de Janeiro in 1992.
- 2 BR is used to refer to Business Reference. It is an online encyclopaedia of Management. See <http://www.referenceforbusiness.com/management/de-Ele/diversification-strategy.htm>

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