INEQUALITY AND ECONOMIC MARGINALISATION

Creating access to economic opportunities in small and medium towns

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ABOUT THIS RESEARCH

The 2007 Annual Report of the Accelerated Shared Growth Initiative of South Africa (AsgiSA) identified a need to focus on what was then called 'the second economy', and on mechanisms to ensure shared growth reaches the margins of the economy. The Second Economy Strategy Project was initiated in this context. It reported to the AsgiSA High Level Task Team in the Presidency, but was located outside government in TIPS.

A review of the performance of government programmes targeting the second economy was completed in early 2008. The project then commissioned research and engaged with practitioners and policymakers inside and outside government. A strategic framework and headline strategies arising from this process were approved by Cabinet in January 2009, and form part of the AsgiSA Annual Report tabled on 16 April 2009.

In South Africa, people with access to wealth experience the country as a developed modern economy, while the poorest still struggle to access even the most basic services. In this context of high inequality, the idea that South Africa has 'two economies' can seem intuitively correct, and has informed approaches that assume there is a structural disconnection between the two economies. The research and analysis conducted as part of the Second Economy Strategy Project highlighted instead the extent to which this high inequality is an outcome of common processes, with wealth and poverty in South Africa connected and interdependent in a range of complex ways. The different emphasis in this analysis leads to different strategic outcomes.

Instead of using the analytical prism of 'two economies', the strategy process placed the emphasis on the role of structural inequality in the South African economy, focused on three crucial legacies of history:

- The structure of the economy: its impacts on unemployment and local economic development, including competition issues, small enterprise, the informal sector, value chains and labour markets.
- Spatial inequality: the legacy of the 1913 Land Act, bantustans and apartheid cities, and the impacts of recent policies, looking at rural development, skewed agriculture patterns, and the scope for payment for environmental services to create rural employment.
- Inequality in the development of human capital: including education and health.

TIPS's work around inequality and economic marginalisation is built on the outcomes of this strategy process.

The research undertaken under the auspices of the Second Economy Strategy Project continues to be relevant today as government explores policy options to reduce inequality and bring people out of the margins of the economy. This report forms part of that research.

A list of the research completed is available at the end of this report. Copies are available on the TIPS website: www.tips.org.za.

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BRIEF

The task is to reflect on the building of the second economy in small and medium sized towns. This involves a review of secondary sources, as well as an input on quantitative measures to support the main arguments.

The paper should draw on:

i) Comparative policies for small and medium-sized towns elsewhere in the world

ii) South African studies of small towns

iii) South African sectoral policies (such as urban and rural development, land reform and business support) which can be promoted and expanded to small and medium-sized towns

iv) Other useful policies drawn from larger cities, which can be adjusted to smaller towns.

A. INTRODUCTION, BACKGROUND AND ARGUMENT

The economic significance of small and medium-sized towns is a controversial question. This issue has enjoyed several fashions in economic thought, ranging from a positive developmental image in the 1960s, to complete disinterest in the 1970s, and to a resurgence of interest in the 1980s (Pedersen 1990: 89).

Small towns are now seen as a necessary and important link to the development of rural regions, and the role of small towns as service centres, within a hierarchy of settlements, is emphasised. However, whereas the focus in the 1960s was on large-scale infrastructural projects, the new approach is to focus on developing local initiatives and resources for local development (Pederson 1990: 90).

But promoting economic development in small towns faces a major dilemma. Whereas most metropolitan areas can be regarded as economic growth hubs, small and medium-sized towns vary greatly, both in their economic base and economic prospects. With metros, their sheer demographic size and infrastructural resources mean that they can keep an economic momentum. In contrast, small and medium-sized towns are extremely diverse, with widely different types of economic base (e.g. tourism, agriculture or mining), and with very different economic fortunes (ranging from improving, static or deteriorating economic situations.

Consequently, the scope for the second economy in different towns varies greatly. There are no “one size fits all” solutions for small towns. “It is difficult to design policies that are sufficiently refined and discriminating to be effective” (CDE 2004: 14). Some towns have better markets, others have better non-agricultural growth opportunities (e.g. mining, tourism), and others have better natural resources. We should not attempt to “lift” successful policies or policy instruments from one country to another without careful consideration of market and institutional capacity, and livelihood structures (Dorward p. 14).

In this paper, the prospects for the “second economy” in small and medium-sized towns in South Africa will be examined. This requires an understanding of the second economy, as well as an understanding of the constraints and potentials of small and medium-sized towns – with due recognition that such localities may differ vastly from one another. But there are common features, which will be highlighted.

The following five arguments will be made:

The need for productive government spending in small and medium-sized towns: The future of small and medium-sized towns should be understood in relation to the spatial strategies of national and provincial governments (i.e. NSDP and PGDS). It will be argued that these towns require some level of *productive* government spending – i.e. expenditure which will raise local production and multipliers. Such spending could be on (for example) local orphanages, old age homes, recreation centres, prisons, technical colleges or tourist facilities. All these facilities would lead to direct or indirect employment or purchasing power. Significantly, such expenditure should be in addition to the normal “consumption” types of infrastructure, such as water, sanitation and housing expenditure.

Attracting investment: Without private capital, the prospects of small and medium-sized towns are poor. Such investments need not be in manufacturing; it could be in retail or services. This will bring additional jobs and opportunities for partnerships with local SMMEs.

Smart capital to find comparative advantages: To stimulate local economies, and to bring additional private sector capital into these towns, the comparative advantages of such towns need to be analysed (e.g. agriculture, tourism, agri-processing, social services, commerce). In many cases, these towns are located *outside* the apparent “areas with economic potential", as defined in the NSDP. Much more effort needs to be done to investigate and promote the real economic drivers of a town and its hinterland.

Understanding regional dynamics: To understand the comparative advantage of these towns, there is no "one size fits all" solution to small and medium-sized towns. This means that many towns should be understood in their *regional context.* Significantly, such regions would probably *not* coincide with municipal or even provincial borders. Even district boundaries may be too small to analyse and promote the comparative advantage of a *certain type of town* (e.g. Karoo towns, homeland towns).

Assisting the second economy more directly: In addition to government efforts to analyse comparative advantages and locate strategic capital, special efforts should be made to bring services for the second economy into these towns. Government or private spending is a *necessary* but *not a sufficient* condition. An injection of funding is required to stimulate the local economy (and to counteract many economic forces which detract from the performance of the local economies); but it is not sufficient to reach survivalist and micro-enterprises. Other strategies will be needed *in addition* to government expenditure. For example, every town should have a SEDA branch or provide training services on behalf of the Department of Labour.

The overarching argument is that *the fortunes of the second economy probably depend on the fortunes of the first economy,* but the first economy should be harnessed in ways that make them accessible to the second economy. To put it differently, the first economy is a necessary (but not sufficient) condition for the success of the second economy. In small and medium-sized towns, one can only stimulate the second economy *if there is a formal economy for it to hook into.* There are several reasons: (1) formal employment provides work experience; (2) formal investment creates a local economic surplus and multipliers, on which informal businesses can draw; and (3) one can then look for creative ways in which partnerships, networks and markets can be promoted, to link the first and second economy. In towns where there is already vibrant formal investment, the challenge is to use these advantages to build networks with informal and emergent enterprises.

Our argument is that small and medium-sized towns need strategic productive public or private investments, i.e. investments which generate jobs, salaries, incomes, opportunities for out-sourcing, skills training, local economic multipliers, and local markets (labour markets, commodity markets and eventually capital markets). Given the woeful lack o fexperience of many small-town survivalist entrepreneurs (particularly the township youth), the most effective form of preparation for new entrepreneurs is *formal employment*, particularly in contexts where local people have minimal exposure to modern economic institutions. The more formal employment opportunities are available, the greater the chance that new businesses will be created in future. This means that formal private or public sector investments, which initially create formal employment, may be a good method to enhance the second economy in the longer-term. Such an approach would also grow the local purchasing power at the same time as growing local technical skills for emergent entrepreneurs.

The paper reviews government strategies, and finds some useful suggestions for small and medium-sized towns. The paper concludes by making several specific recommendations for supporting the second economy in these localities: Promoting public or private investment in small and medium-sized towns; maximizing linkages between formal and informal enterprises; providing business support in outlying towns; promoting the effective functioning of local markets; promoting rural non-farm enterprises and peri-urban agriculture; enhancing economic diversification; and creating investment regions.

B. DEFINING THE SECOND ECONOMY

In order to clarify terms, businesses can be divided into the following categories (based on CDE 2004: 16).

Survivalist enterprises are: very low income, usually no paid employees, directed mainly at keeping alive, unregistered, non-tax paying, and hence informal in status

Micro-enterprises: operating below the VAT registration limit, often unregistered for other purposes as well, fewer than five employees

Very small enterprises: fewer than 10 paid employees, but registered for tax and other purposes and hence formal in status

Small enterprise: Fewer than 50 employees, and formally registered

Medium enterprises: Up to 100 employees, or 200 in mining, manufacturing and construction.

Large enterprises: More than 100 employees, or 200 in the case of mining, manufacturing and construction.

This report defines "the second economy" as *Category 1 and 2* above. These categories sometimes overlap, but not always (CDE 2004: 19). But the existence of the other categories of business are, indirectly, very important for the welfare of the second economy.

C. SMALL AND MEDIUM-SIZED TOWNS – DEALING WITH DIVERSITY

In this paper, we will simply refer to "small towns" as an umbrella term, to include towns ranging from 5 000 to 100 000 people. The diversity can be illustrated as follows (data has not been verified):

Table 1: Different sized towns per province

Province	Towns 0-25 000 people	Towns 25-50 000	Towns 50-75 000	Towns 75-100 000
Eastern Cape	Aberdeen	Aliwal North	Alice	Grahamstown
	Bathurst	Graaff-Reinet	Butterworth	Zwelitsha
	Cala	Stutterheim		
Free State	Bethulie	Frankfort	Bothaville	Bethlehem
	Philippolis	Vrede	Ficksburg	Harrismith
	Petrus Steyn	Winburg		Parys
Gauteng		Bronkhorstpruit		Heidelberg
		Cullinan		
KZN	Bergville	Dundee	Ballito	
	Colenso	Empangeni	Howick	
	Pongola	Port Shepstone	Richmond	
Mpumalanga	Belfast	Kriel	Balfour	Bethal
	Groblersdal	Ogies	Delmas	Ermelo
	Marble Hall	White River	Piet Retief	Leandra
Northern Cape	Calvinia	De Aar	Jan Kempdorp	
	Colesberg	Postmasburg	Upington	
	Nieuwoudtville	Warrenton		
Limpopo	Thabazimbi	Musina	Warmbaths	Tzaneen
	Naboomspruit			
	Nylstroom			
North West	Koster	Bloemhof	Vryburg	
	Ventersdorp	Fochville		
	Reivilo	Ottosdal		
Western Cape	Ashton	Beaufort West	Mossel Bay	Worcester
	Calitzdorp	Knysna	Oudtshoorn	
	Hermanus	Robertson	Stellenbosch	

However, despite the elegance of the previous table, classifying small towns is not an easy task. Categorising towns according to population is insufficient: "It might not characterize a town's personality by breaking these into subjective or arbitrary classes" (Verma 2006: 142). Towns have a long historical background, creating a distinctive economic profile and climate.

There may be several methods to classify urban centres, for example, by site and situation, population, geographic size, functions, and social and cultural environment (Verma 2006: 143). The issue of "function" is often widely accepted as a useful form of classification. This usually focuses on non-agricultural activities, including administrative, industrial, commercial, and cultural. It is rare that a town is a mono-activity centre.

For example, Howard Nelson (1955) created a further classification. His categories are: Manufacturing, Retail and trade, Professional service, Transportation and communication, Public administration, Wholesale trade, Finance, insurance and real estate, and Mining.

In South Africa, towns can be classified in at least three ways: by function, by economic performance, and by historic economic legacy. The latter term refers to their situation in the erstwhile homelands of South Africa, characterised by traditional land tenure and predominantly subsistence agriculture, or by privately-owned land tenure and predominantly commercial agriculture. This is shown in Table 1 below. The asterisks (*) mark those towns which are located in traditional/subsistence areas:

Table 2: Small- and medium-sized towns, per economic status

	Improving economy	**Static economy**	**Deteriorating economy with an increasing dependence on social grants**
Medium-sized towns			
Agriculture	Bothaville (FS)	Tsomo* (EC)	
Tourism base	Hermanus (WC)		
Commercial base	Klerksdorp		
Mining base			Welkom, Odendaalsrus
Forestry base			
Fishing base			
Transport base	Beaufort West (WC)		
Administrative base			
Mixed base (diversified)			
Small towns			
Agriculture			Rouxville (FS) Venterstad (EC)
Tourism base	Dullstroom (Mpumalanga) Clarens (FS)		

	Improving economy	Static economy	Deteriorating economy with an increasing dependence on social grants
	Still Bay (WC)		
Commercial base	Kroonstad (FS) Bethlehem (FS)	Aberdeen (NC)	
Mining base	Kathu (NC)	Koffiefontein (FS)	
Forestry base	Ugie/Maclear (EC)		
Fishing base			
Transport base	Beaufort West (WC)	Victoria West (NC)	Noupoort (NC)
Administrative base		Trompsburg (FS) Carnarvon (NC)	
Mixed base (diversified)	Somerset East (EC) Graaff-Reinet (EC)	De Aar (NC)	

Table 2 is not complete, because full data is not available. However, it would be a useful exercise for provincial or district officials to complete this table for their own jurisdictions.

A brief glance at the table tends to suggest lines of inquiry for the future. For example, the larger commercial towns seem to have a built-in growth dynamic, based on a sufficient level of diversification. These towns seem to be "sucking in" economic energy from the surrounding small towns. Secondly, tourism towns seem to be doing well, because they bring in new capital and spending power. Thirdly, mining towns are either booming or significantly declining. Fourthly, many agricultural towns are either declining, or they have become diversified and are therefore becoming more robust. Fifth, towns within a distinct region may improve or deteriorate, because of the *regional* comparative advantage. For example, the prospects of the Karoo may improving, while those of deep rural towns in the old homelands may be declining. But these perspectives need a great deal more investigation. The crucial question is: We have to begin asking questions about *comparative advantage* of different *types* (and *sizes)* of towns.

In addition, the economy of small and medium-sized towns are greatly influenced by the *type* of product or service which predominates. For example, some agricultural commodities (such as mutton and wool) have been in a long-term decline; milk production has been hampered for many years by the low prices received by producers; agricultural towns benefiting from bio-fuels will show growth; the rise in the cost of energy and the consequent profitability of uranium will benefit towns such as Beaufort West; towns based on rail transport have been undermined by government transport policies; and some towns benefit greatly from changes in government spending priorities, such as the forestry industry in the Ugie/Maclear area.

To complicate matters, the recent move to a global economy has been painful for many towns because of the loss of manufacturing jobs, the vulnerability of export agriculture, and the increased competition in the energy and mining sectors. "The challenge is for small towns to determine their own destiny when they are subject to powerful external economic influences" (Daniels 1989: 415).

Given this diversity, there is no "one size fits all" solution to the second economy in small and medium-sized towns. In one town, the growth of formal sector employment (often by large corporates or large public works programmes) creates effective avenues of advancement; in other towns, such possibilities are closed off, and people have to rely on the second economy to make a living, whether as spazas, hawkers, commonage farmers or shebeen owners; and in yet other towns, there is significant in-migration of middle-class urbanites, who bring capital and innovative ideas with them.

Given this diversity, there are disagreements between those who believe that local efforts can generate sustainable growth, and those who feel that outside forces determine whether or not a small town will grow. The literature shows that there is a lack of a transferable formula for economic success. "Each community has to tailor a development strategy and program to meet its own needs and goals" (Daniels 1989: 414). This paper argues that, very often, both approaches are needed – the "kick-start" investment from outside, combined judiciously with assistance to local people to lift themselves by their own bootstraps.

D. WHAT CAN WE LEARN FROM THE INTERNATIONAL LITERATURE ON SMALL TOWNS?

In the international literature on small towns, the most useful concept to describe these localities are "service centres", serving the local market. The status of different service centres vary. Towns are based both on a horizontal specialization among local enterprises interacting with the same local market (e.g. a grocery store, butchery and garage serving the same local population), and on a vertical specialization and interaction with enterprises at higher levels of the urban hierarchy (e.g. a local doctor referring patients to more specialized physicians in the city) (Pedersen 1990: 96). The small town receives inputs from the larger higher-order centres. This system of service centres builds up into a hierarchy of settlements.

The role of small towns vis-à-vis larger centres may change, depending on extraneous variables. For example, very low rural incomes will reduce the local market, and discourage local entrepreneurs. Efficient long-distance transportation may reduce the local market, because local consumers may prefer to travel to larger centres where there are more sophisticated services and shops.

What are the prospects for the second economy in the local service centres? We need to examine the interaction among local enterprises, and between enterprises and their markets.

The literature on town or locality-based growth and development is fraught with theoretical differences. Daniels (1989) has usefully outlined eight theories of local government, to which Pedersen (1990) has added a ninth:

The *neoclassical model* focuses on trade as the engine of growth (Daniels 1989: 417). Towns should determine their "comparative advantage", and specialize in those goods and services that they do best. The price mechanism and markets remain unfettered by government regulation, as the most efficient ways to allocate goods and services. Ideally, capital will move to capital-shortage areas, and labour will move to where labour is in short supply. Individual communities will compete with one another to keep and attract firms, capital and labour.

Export base theory is a variant of neoclassical theory. It emphasises the growth of businesses that export goods and services as the key to local economic growth. Their market is regional, national, or even international in scope. The usefulness of exports is that it brings new money into the locality, which can stimulate local multipliers. Typical "exports" are agricultural commodities, processed agricultural products, mining resources, and tourism.

Central place theory: Describes communities according to the size of trade area and the economic functions of the community. Lower order central places have small businesses that offer day-to-day convenience goods and services, but the trade areas are rather limited. Higher order central places offer a wider range of goods and services. The key variable here is the nature and density of interactions between a town and its rural hinterland, or between a town and its smaller urban satellites.

Role of local government: Unlike the neoclassical model, this approach focuses on the role of government in providing tax breaks, loans and subsidies to attract wealthy individuals and companies. Economic growth is still based on endogenous growth, but it has to be orchestrated by a public body.

The growth machine hypothesis: Central places can stimulate their own growth, but this depends heavily on the growth of the population in the immediate vicinity. The economic fortunes of towns depend on the ability to attract investment, and thereby to attract population. In developed countries small towns as self-induced growth machines may have limited growth capacity, especially as retail centres (Daniels 1989: 418). In South Africa, in contrast, population growth is taking place in almost all small towns, but investment is often lacking. The difficulty in the South African case is the purchasing power of these small-town populations, which dampens the incentive to invest.

The internal combustion theory: This approach holds that local entrepreneurs, through their own ingenuity and willingness to accept risk, can form businesses and fill a niche – either as export industries or as local secondary base companies. The theory emphasises the importance of retaining and expanding existing firms and fostering the creation of new local businesses. Government has a role to maintain local services (e.g. water, roads, schools) which will help develop new businesses. This approach is a hybrid of the neoclassical export base theory and central place theory.

Outside determinants of local economic growth (exogenous determinants): Government spending, interest rate policy, national supply and demand, and decisions of nationally based firms affect the economic basis of small towns. For example, in the manufacturing cycle of a new product, as production matures, branch plants may be built in small towns, due to lower land and labour costs (Daniels 1989:418).

Political economy: The distribution of wealth and political power within a community, and between the community and outside forces, determine a locality's economic prospects. Types of dependency include (1) direct dependency, when key sectors of the local economy are controlled by outside owners, (2) trade dependency, when locally produced goods and services are sold in distant markets over which the local inhabitants have little control, (3) financial dependency, the need to import capital to stimulate economic development, and (4) technical dependency, the need to import trained personnel and technology (Daniels 1989: 418). Theories of political economy and dependency are important in small town settings, because they address the issue of *equity* – who gains and who loses in the process of economic development and what is a fair distribution of income, wealth and power. Unlike the previous theory, which emphasised dependence on external variables, this approach attributes causal significance to local as well as exogenous variables. For example, class relations within a town may lead to shopping patterns that undermine local businesses.

In terms of new "network theories" (Pedersen 1990: 97), the interaction between enterprises is determined by factors such as ownership, size, technology, market and financial relations. The small enterprises can function as complementary to the large firms, and the productivity of the large firms could b enhanced by a network of small service and production enterprises.

This diversity of theories shows that small and medium-sized towns are very complex, with multiple internal and external dynamics. All these theories point to factors that are potentially relevant to specific localities. It does not help to artificially choose between these theories at this stage. *Much more rigorous research is needed in different South African towns, to determine the causal variables which are most powerful in different situations.* The implications of these theories and variables for the promotion of the second economy still need to be examined in detail, and researched empirically – an activity which is beyond the scope of this paper. But the overarching argument is that the fortunes of the second economy in small and medium-sized towns probably depend on the fortunes of the first economy within those towns – and the local "first economy" is often decisively influenced (although not completely so) by dynamics located outside the town. But the nub of the argument is: One can only stimulate the second economy if there is a formal economy for it to hook into.

This argument is strongly influenced by the work of C.K. Prahalad, in his seminal book *The Fortune at the Bottom of the Pyramid* (2005). Prahalad focuses on the potential of large corporations, multi-national corporations, government agencies and NGOs to provide more effective products and services to "the four billion at the bottom of the pyramid". He argues that poor people often do have money to spend, and do have entrepreneurial skills, but they need to "hook into" markets, whether as consumers or as producers. Poor people "need to be exposed to the range and variety of opportunities that inclusive globalisation can provide" (2005: 5). One example, from India, is the provision of access to web-based market information to small-scale farmers – which could be relevant either to traditional producers in the ex-homelands, or to commonage stock-farmers in many South African towns.

So for the meantime, we flag the importance of a whole range of factors: The nature of towns' economic comparative advantage; the types of local and foreign-owned investment; the dynamism of the local business community; the networks between local firms and between them and outsiders; the initiative of central and local government; and the economic interactions between towns and their hinterlands.

A collection of case studies from the United States showed that successful economic development involves: (1) capitalizing on existing resources, (2) a strong planning component, (3) leadership, (4) training and education, (5) aggressive pursuit of state and federal grants, (6) low interest loans, (6) industrial recruitment, (7) historical preservation (Daniels 1989: 422). These diverse ideas can all play a role in boosting the local economy of small towns. The additional challenge, in the case of South Africa, is to make such interventions meaningful to second-economy entrepreneurs.

For all these theories, a necessary condition for the creation of livelihoods in a non-metropolitan region is the existence of a *sufficient economic surplus* in the region (Pedersen 1990: 98). Such a surplus may be derived from local agricultural production, from wages to public servants, pensions to local citizens, tourists, development aid, government grants, investment by outsiders, construction projects or military establishments. Some money must be available locally to circulate, to create the purchasing power which can be spent on second-economy firms.

In terms of this argument, it is critical that government departments examine the impact of their expenditures on small towns. In many cases, government departments decide unilaterally to establish (or, more frequently, to close) key institutions in small towns. Examples are hospitals, schools and training colleges. Such decisions have major unintended consequences on the economic viability of such towns (Atkinson and Marais 2006).

The structure of the urban system depends on the size of its economic base. Such an economic base can be created in several ways: (Pedersen 1990: 98):

- Local distribution of local products (products made locally and sold to the local community)
- Collection and processing of local products (typically, but not necessarily agricultural products) for export out of the region
- Distribution of products produced outside the region (typically consumer goods, and inputs for local production)
- Local processing of non-local inputs for a non-local market (enclave industries)
- Providing services to non-local people (e.g. tourism, old age homes).

These functions may be carried out by formal, large-scale, multi-location organisations or by small (formal or informal) single-location enterprises. Different types of economic base lend themselves to different kinds of entrepreneurs. Collecting and processing of local export products will usually be carried out by large enterprises and organisations, because they require large capital resources, and are often based on technologies with large scale economies. The small enterprises will primarily supply products and services which are both produced and distributed locally, while goods imported into the region may be distributed by both small and large enterprises. Enclave industries may be both small and large enterprises, but will usually be linked to larger external enterprises (Pedersen 1990: 98). Local services could be undertaken by small or large companies (e.g. small B&Bs or large tourism resorts), or even by NGOs. Once again, research on South African towns should be undertaken to highlight these types of dynamics.

A wide variety of strategies can be employed to boost the local economy (Daniels 1989: 420-3), and to grow the local surplus:

- Promoting diversification, e.g. industrial recruitment often linked to the Export Base theory. Some towns may focus on attracting high technology industries, or on tourism.
- Downtown revitalization (linked to the Internal Combustion theory, combined with some outside government assistance), such as the US Main Street Program focuses on downtown revitalization in small communities. It is also a Central Place strategy, an attempt to strengthen the retail base of the community.
- Boosting service industries may benefit local towns. This could include old-age homes, orphanages, boarding schools, training colleges, and tourism.

- Local government strategies would include taxing the local business community to invest in infrastructure, local business and job training. Local governments can also design their taxing systems in order to attract investment.
- The elderly are an important source of internal and external combustion in small towns. “Retirement counties” in the US and Canada show strong population growth, and transfer payments (such as pensions) make up over one half of all income in these counties. In South Africa, many small towns have a large retired population, which brings private and government pensions into the local economy.
- Towns can focus on assisting new entrepreneurs, for example by means of business incubators.
- Changing transport patterns can have a major significance. The deregulation of routes and rates can create a disadvantage for shippers from smaller communities using railroads. But this may lead to the improvement in trucking services, which will benefit different routes. The rapid rise in the petrol price in South Africa may change transport systems in future, and make rail transport more profitable, which will benefit railway towns. Consequently, transport policy should be designed in conjunction with the impact on small towns.

Significantly, these strategies depend strongly on effective local change agents, whether the local business class, the municipality, NGOs or investment coalitions. This requirement creates a major disjunction between those towns which have a fairly vibrant middle class, running shops and providing services, and those towns which have become a virtual rural proletariat or an unemployed wasteland dependent on social grants. It is unlikely that any of these latter towns would have the organisational capacity and economic vision to undertake any of these strategies.

Even if such strategies are attempted, there is no guarantee of success. There is no inherent reason for small towns to be economically successful. In fact, the decline and even disappearance of small towns is a common phenomenon in almost all countries in the world.

But it does suggest that a great deal more can be done, with more innovation and imagination, to stimulate small town economies. In fact, this poses a challenge to the underlying philosophy of the NSDP, which focuses primarily on “areas with economic advantage”. The NSDP tends to promote economic activity where it is already taking place. A contrary approach would be a counter-cyclical policy, to distribute economic stimulation precisely to more backward areas. This is the approach taken by the European Union, through its LEADER programme. Analysts in third world countries have also argued the case for evening out spatial and socio-economic disparities: “Strenuous attempts have to be made for achieving a more equitable distribution, over the whole national space, of productive forces and units and of means of production, employment, consumption and investments, as well as of services such as schools, hospitals, and vocational training” (Mukherji 2006: 328).

In the case of South Africa, dplg’s new LED Framework (2006: 27) urges the need to identify and exploit the competitive advantage of the 52 municipal regions in South Africa. This provides a very good basis on which to build.

E. POVERTY, MIGRATION AND CLASS DYNAMICS IN SOUTH AFRICAN SMALL TOWNS

The sheer extent of poverty in small towns in South Africa should not be underestimated. A seminal paper by Sean Archer (1990), about the Karoo town of Hanover, illustrates the depth of poverty amongst the unemployed underclass. This study is admittedly out of date, as it preceded the extension of the social grant system after 1994. However, is study does point to chronic structural unemployment, and it deserves to be conducted again, to determine longitudinal trends.

Archer estimated that business activities in Hanover provided 24 jobs, not all regular or full-time. The Hanover urban middle class was estimated at between 90-100 households, perhaps employing domestic workers. So non-farm employment was estimated at 130-150 jobs, in an estimated population of around 5 000. Viable alternatives for the labour force were conspicuously lacking in Hanover. There was little scope for self-employment, for petty trade or the supply of services, and domestic production of food for consumption within the household (vegetables, eggs and chickens) was all but nonexistent. Monetisation of consumption, particularly of food, was an aspect of proletarianisation clearly in evidence in Hanover. The levels of schooling years completed were well below the national average (Archer 1990: 487).

Today, 18 years after Archer's article, some changes have taken place in small towns. The most significant are: (1) the growth of the black middle class, usually linked to government services; (2) the out-migration of white youth, and the in-migration of elderly affluent whites – at least to the more attractive towns; (3) the globalisation of agriculture, which has led to farm consolidation and a decline in the number of white farmers and black or coloured farm-workers; consequently (4) rapid in-migration of very poor, and poorly skilled, unemployed farm workers; and (5) the rapid expansion of government services to the poor, which acts as a magnet causing poor people to stay on in local towns.

Throughout Africa, urban growth rates in many small towns are high (Pedersen 1990: 91). The same trend is found in South Africa:

Table 3: Small towns in the Free State

	Cities	Regional towns	Middle-order towns	Small towns
1991	1 028 841	124 042	257 515	245 168
2001	1 097 182	158 617	355 661	435 607
% change per annum 1991 – 2001	0,9 %	3,1 %	3,5 %	8,9 %

Source: Marais (2004)

Small and medium-sized towns have experienced a minor demographic revolution. As noted above, this is due to rapid in-migration of farm workers (due to economic and labour dynamics in the commercial farming sector). But it is also due to widespread migration of people away from the erstwhile homelands, towards small towns (Cross et al, 1998).

The migration of people away from the erstwhile homelands (e.g. Transkei and Ciskei) to the erstwhile "white South African towns" is an interesting phenomenon. It is likely that such people still have land available in the rural areas. However, their need for social services (access to social grants, and better quality schools and health care), as well as their desire for a formal sector job, encourages them to leave the rural areas (possibly keeping some family members there as a fall-back). In the eastern Karoo, there appears to have been a major growth in the black population.

In the towns with a static or shrinking formal sector, this in-migration leads to a growing number of unemployed people. A proportion of these individuals and families may attempt some kind of informal economic activity.

The social grants system, together with the system of public expenditure, has contributed to this trend. Many farm workers have migrated voluntarily to the towns. Some of them have preferred to become unemployed urban residents, so that they can access social services (grants, schools and clinics) in the towns, in a context where public transport between farm and town is virtually non-existent, and many services to farms have virtually disappeared (such as farm schools and mobile clinics).

A further complication in small and medium-sized towns, is the likelihood of out-migration of middle-class people. It is primarily people with a background in the formal sector, possibly as middle management in public or private organisations, that are likely to establish formal small businesses (CDE 2004). In small towns, this is an extremely valuable sector of the population, because such small businesses can create employment, as well as outsourcing possibilities for other businesses. In towns where this stratum of population tends to leave, because of perceived better prospects in the cities, it has a major stifling effect on the local economy.

Conversely, there are towns which attract a new class of middle-class people (a phenomenon often referred to as "reverse migration"), whereby city-based skills, capital and networks are brought to the small towns. Many of these people are retirees, who do not contribute directly to the local economy. However, some of them venture into new enterprises, as part of a mid-life career change.

F. THE STRENGTHS AND WEAKNESSES OF THE SECOND ECONOMY IN SMALL TOWNS

The following are some superficial generalisations regarding the state of the economy in small towns, keeping in mind the vast differences among towns.

1. In many small towns, the survivalist and informal businesses are owned by black and coloured people, but increasingly also by white people (the phenomenon of "white spazas"). Many of these entrepreneurs are in the agricultural sector, mainly on municipal land (commonage), and an increasing number are found in the legal or illegal alcohol trade. Some of the informal businesses are in the taxi sector, operating longer-distance routes to nearby larger towns or cities.
2. The local market is limited, and often dominated by one or a few established (often white-owned) enterprises. Shoppers in many small towns use public or private transport to shop in larger towns, causing a leakage of purchasing power.
3. A growing number of "Asian" immigrants are usurping the spaza sector. They tend to provide good service (long opening hours, fairly good supply of products), but they seem to undercut the local black and coloured traders, who are being driven out of the sector. This impressionistic view needs to be verified by research.
4. Many people who borrow from loan sharks spend this funding on consumption, and not investment. This contributes to local poverty.

5. A key distinction is between those towns situated within commercial farming areas, and those within traditional land tenure areas. In the case of the former, a growing bifurcation between "town" and "country" has occurred, as hard-pressed, globalizing farmers increasingly bypass small towns and instead use the more sophisticated facilities in larger towns and cities. Furthermore, in the extensive farming areas (mainly livestock farming), the population of the farms (both farmers and farm workers) has decreased to such an extent that they exert little purchasing power in the small towns. (This is not always the case, however – the farms situated in areas with a mild climate, and which grow labour-intensive products such as vegetables, are still an important reservoir of purchasing power). Also, few commercial farms sell their products in the small towns – the main marketing channels are now located in bigger centres.
6. Small business support services, such as SEDAs, are located far from most towns. In the Eastern Cape, for example, the main office in Cacadu district is located in Port Elizabeth, and one outlying office is now planned for Graaff-Reinet – leaving numerous towns without business support. Travel costs to larger centres are prohibitive for many informal entrepreneurs, and they therefore cannot access business support.
7. Many government programmes do not penetrate to rural areas. This includes initiatives such as the Apex Fund (SAMAF), Khula Enterprise Finance, the National Empowerment Fund (NEF), the Tourism Enterprise Programme (TEP), and even SEDA offices (DTI 2005). Virtually the only programme that reaches local communities is SAB's Kickstart programme, but this has increased the number of illegal alcohol outlets.
8. Many key support providers (e.g. tax consultants, lawyers and even banks) are situated far away. For those companies trying to become formally registered, and operating within the law, access to such services becomes a major hurdle.
9. Training is difficult to access. The Department of Labour (DoL) has stringent criteria about who can access training. It insists that aspirant trainees must *already* have a job. This disqualifies the many unemployed people who could benefit from training. Also, the DoL insists that a group of at least 20 people must be available to do a training course – which is often difficult in small towns, where the market could hardly keep a few people gainfully employed in any specific trade.
10. Municipal procurement can be an important strategy for SMME support (Nel and Goldman 2006: 39). But in many municipalities, municipal out-sourcing tends to be constrained by the vested interest of organised labour (SAMWU), which resists attempts to contract temporary labour to undertake menial tasks (such as litter removal).
11. Private capital is generally small in scale, and cannot undertake corporate social responsibility (CSR), which reduces the amount of money and technical support available for new start-up enterprises.
12. The manufacturing base in small towns is typically limited, so that workers tend to have few opportunities for training and acquiring technical skills. People have limited experience in working in large organisations, and therefore lack an effective business network (CDE 2004: 55).
13. Few small towns have Chambers of Commerce. This makes it very difficult for municipalities to engage systematically with the local business sector. In addition, many black and coloured councillors have shown a steady disregard for local business interests, which further alienates government and business.

14. Prematurely formalizing businesses, e.g. by means of business hives, has not been successful, and there are numerous cases of “white elephants” built with LED funding.

But the private sector in small and medium-sized towns does enjoy certain advantages:

1. Generally low crime against property
2. A well-functioning postal system
3. Improved levels of telecommunications, both landline and cellular
4. Many towns have fairly good inherited infrastructure (water, sanitation and electricity), although deteriorating maintenance is causing some of it to crumble.
5. Poor people in small towns tend to have strong networks and social capital, which can facilitate borrowing and practical support.
6. Transport costs within the towns are generally lower, and people often move about on foot or by bicycle, which lowers transport costs (however, trade with other centres raise transport costs)
7. Property is still relatively cheap, whether to purchase or rent, and many towns have vacant erven or buildings. (However, while property may be cheap in comparison to urban prices, it is often prohibitively expensive for second-economy entrepreneurs to purchase).
8. Peri-urban agriculture is often possible, on municipal commonage land.

We now turn to official government thinking on business support in small towns; thereafter, we make some alternative suggestions.

G. CURRENT GOVERNMENT STRATEGIES

1. The ISRDS

The only systematic exposition of government’s intention to promote economic development in outlying areas is the Integrated Sustainable Rural Development Strategy (ISRDS) (Government of South Africa, 2000). The ISRDS contains many valuable ideas for future development of small towns, including the key role of local government, a strong focus on economic development, the integration of sectoral programmes, the need to promote local economic multipliers, the diversification of the local economy, and the need for partnerships between public and private spending. Special mention was made of the significance of small towns: “Rural towns are critical to the development opportunities of their hinterlands. Provision of key services in rural towns increases the multiplier for incremental incomes, since rural people can spend more of it closer to home …” (2000: 25). Significantly, the ISRDS advocated a “nodal” approach, whereby its principles would be applied first in a few districts, and only later extended to the reest of South Africa (2000:27).

Since the ISRDP (the Programme equivalent of the ISRDS) was launched, certain difficulties have emerged. The author is not aware of a proper evaluation of the ISRDP.[1] Consequently, the following comments are rather impressionistic. Firstly, it seems that the implementation of the Strategy has led to a strong focus on infrastructure (housing, water, sanitation etc), and not on economic growth. The fact that the nodes were chosen with scant knowledge of local economic dynamics (Everatt n.d.: 12) may have contribute to the excessively heavy focus on infrastructure delivery rather than economic activity. Secondly, the nodes have not proven replicable, because many government departments have directed large (and

[1] The evaluation that was undertaken in 2004 (Everatt, Dube and Ntsime 2004) focused primarily on institutional and process factors.

probably non-replicable) sums of money towards the nodes. Thirdly, the performance of municipalities in the nodes have been below expectations, creating institutional bottlenecks in the spending of funds. Fourthly, it does not seem as if the strategy has leveraged much private finance and investment.

2. The SEDA system

There are several additional indications that government does want to extend its business support system to small and medium-sized towns – even though such a geographic priority is never explicitly mentioned. Officially, government wants to create comparable support services in urban/metropolitan and rural areas (DTI 2005: 22). The business support strategy has a spatial dimension, because it is precisely aimed at special geographic areas (poor areas and areas with high unemployment) (DTI 2005: 25). "Special effort will be made to ensure that support reaches all regions of the country" (DTI 2005: 39). Some of ASGISA's focus areas are relevant to small towns: agro-processing, mining, crafts and tourism (DTI 2005: 16).

Implicitly, DTI's strategy is likely to stimulate delivery points in specific localities: "At the local level, steps will be taken to co-locate as many small enterprise support agencies as possible, in order to create integrated access points for aspiring and existing entrepreneurs. Special efforts will be made to integrate local municipality and business support initiatives into these access points" (DTI 2005: 28).

Government's main instrument to provide business support is the SEDA system (Small Enterprise Development Agencies). At present, SEDA offices to be concentrated in the provincial capitals and the main towns, and do not reach the outlying towns. They will gradually decentralise to somewhat smaller towns, usually one or two per district municipality, from where they will provide an outreach service to small towns. SEDAs aim to involve "Implementation Agents" (IAs) in the outlying small towns, but it appears to have had some difficulty in finding appropriately skilled and experienced businesses to act as IAs. Once again, there is a need to evaluate the effectiveness of SEDAs in the rural towns.

Impressionistic evidence about the SEDA in the southern Free State suggests that its procedures are overly bureaucratic. For example, to recruit an existing business as a service provider (usually a mentor to an emerging business), requires a rigorous process of selection, based on numerous formal criteria listed in a long application document. This is sufficient to frighten away most potential service providers. Furthermore, the SEDAs are still oriented towards helping new entrepreneurs to write business plans – a formal mechanism which is often completely unrealistic in the turbulent, changeable, and vulnerable existence of informal enterprises.

The impact of the SEDAs have not been felt widely in rural areas. In all kinds of ways, government failure may be as pressing as market failures, for example in the area of small business support (CDE 2004: 30). Successful small business support requires several things: (1) active participation of the business community, (2) are well funded, and have skilled technical staff, preferably with business experience, (3) are not highly bureaucratic, and (4) should address a clear market failure. They should play a facilitative role.

At this stage, the performance of SEDAs in rural towns still need to be evaluated against such criteria. An opinion expressed in 2004 was that government's business support strategies have been too few, too thinly spread, too bureaucratic and lacking in relevant entrepreneurial skill. South African business support policy has been flawed because it overemphasized providing access to finance, and the direct delivery of support services, resulting in the creation of a costly but struggling bureaucracy (CDE 2004: 62).

In this author's opinion, the SEDA system is only likely to make a difference to second-economy entrepreneurs if it radically revises its system of support. It needs to be locally available, and needs sufficiently skilled and experienced to give start-up businesspeople relevant and immediate business advice. It also needs to tap into existing systems of informal support, such as that provided by agricultural co-ops and commercial farmers to emergent farmers. However, as it now stands, potential mentors have to go through such a rigorous, bureaucratic and demanding application process to qualify as SEDA mentors, that there is almost no possibility of harnessing local systems of mutual support and goodwill. So the SEDA system remains detached from the fabric of the local society and economy. Once again, this requires further empirical investigation.

But the other difficulty faced by the SEDAs is a more structural problem – that there must be a greater circulation of money in the local economy to offer real markets for second-economy entrepreneurs. This raises the key question of government and private investment in the small towns.

In fact, it may well be the case that the most important role of the SEDAs would be to assist private investors and government departments or municipalities to outsource effectively to second-economy entrepreneurs.

3. The RIDS

An interesting government idea, in terms of the Regional Industrial Development Strategy (RIDS), is the creation of a "Thematic Fund" to support innovative regional development initiatives (DTI 2005: 12). This holds some hope for small towns in regions which can identify a specific niche product or service. But, as yet, this interesting regional approach is aimed at industry, and not at agriculture or the service sector.

In addition, DTI maintains that small firms can also benefit from government export promotion strategies. Government has entered into bilateral trade agreements with a number of countries. This provides potential opportunities for small enterprises to penetrate foreign markets through exports (DTI 2005 38). Whether small enterprises in outlying towns are ever likely to become part of a government export scheme appears unrealistic, at this stage. For example, interviews conducted in the Western Cape suggest that WESGRO's focus remains predominantly on high-tech sectors found in the coastal areas.

There is an urgent need for a meaningful regional strategy, which can delimit regions according to their economic characteristics and potential, and not according to artificial government jurisdictions.

4. Municipal initiatives

According to DTI, municipalities can play a key role in promoting small business. "The capacity-building needs of LED and small business development personnel in local municipalities and municipality-owned enterprises will be assessed an addressed to ensure the development and delivery of appropriate training and other capacity-building measures" (DTI 2005 42). However, given the technical skills, and the self-defeating appointments systems in many rural municipalities, such capacity-building are likely to be doomed before they start.

The most successful cases of municipal support are those municipalities which have established semi-autonomous Development Agencies. However, such DAs depend crucially on the people appointed to lead them. They absolutely have to have private sector experience – this should be a non-negotiable criterion in appointments. People with experience in government bureaucracies are singularly unsuitable to lead investment facilitation organisations.

A further set of useful ideas is contained in the 2006 LED strategy of dplg. This document is emphatic that economic development is desirable and possible in rural areas and small towns (pages 8, 17). Many of its recommendations have resonance with our arguments, which will be elaborated on below. For example, it advocates local innovation (page 4), a regionalist perspective (page 6), promoting competitive advantages of localities and regions (page 9), the need for building viable markets (page 38), promoting local multipliers (pages 25 and 39), and marketing and branding investment regions (page 34). The LED Strategy argues for new Sustainable Developmental Community Investment Programme (SDCIP) (page 26), which seems eminently suitable to small and medium-sized towns. Enterprise support is a key factor, and the Strategy argues for a more demand-driven approach, whereby service providers compete to provide support for local entrepreneurs (page 35).

H. PROMOTING THE SECOND ECONOMY IN SMALL TOWNS

The issue of the second economy small and medium-sized towns is a spatial one: To what extent do the size and nature of these urban places affect the likelihood of the second economy graduating into more robust enterprises? A key research priority is to "investigate the conditions under which SMMEs *do* grow" (CDE 2004: 54). We have to learn about what works – and this may well differ radically between one locality and another.

Because of their spatial and economic characteristics, small and medium-sized towns offer certain distinctive possibilities and constraints for emergent businesses and micro-entrepreneurs. This section contains some recommendations.

5. Kick-starting public and private investment in small towns

This is not a return to the 1960s policies of generating local growth in peripheral regions by implanting one or a few larger enterprises in a region (Pedersen 1990: 101). Such investments created enclave economies. Instead, the market enhancement approach can be promoted by several types of public interventions:

1. Using public infrastructure to attract and boost sectors such as tourism or agro-processing, preferably as public-private partnerships, and based on latent local economic potential; or
2. Providing major public services (e.g. new training colleges, prisons, orphanages, old age homes, agricultural research stations, observatories), which draw on local advantages (such as affordable land or vacant buildings).

The most immediate impact of these changes will be on *employment,* and not on the second economy. Initially, and on an ongoing basis, this refers to the need to create employment, and municipal actions targeted at creating employment represent important options for poverty alleviation (Nel and Goldman: 22). However, employment has a major stimulating effect on local economic multipliers. With more money in circulation, more small traders and producers can make a living. This approach has the significant benefit of increasing the money supply, and hence the local purchasing power, markets and economic multipliers in a specific locality – on which survivalist enterprises can draw.

Furthermore, successful small enterprises are often born of work experience in the formal sector (CDE 2004:12). Hence the formal sector is an important ingredient in the local economy. Focusing purely on survivalists is a poor recipe for business growth. In small towns, the high level of structural unemployment often means that young school-leavers do not get work experience. They are therefore almost fatally disadvantaged when it comes to establishing their own enterprise. They often lack the most basic office knowledge (such as how to write a letter or send a fax, or how to draw up a budget). The chance of such micro-entrepreneurs graduating into formal businesses is extremely remote. This suggests that investment to stimulate *formal* business growth will be an important component in a strategy to stimulate the second economy. Also, CDE warns, it is important to help unemployed youths to become *employable* before trying to turn them into employers (CDE 2004: 21).[2]

Larger-scale public and private investments are therefore needed in the small and medium-sized towns. Such investments should not be scattered randomly in peripheral regions; they should be based on an acute analysis of local assets, advantages, under-utilised resources, and latent economic potential. They should also be accompanied by supplementary measures to grow the local resource base, particularly by means of technical skills training, and measures to assist the second economy (survivalist enterprises) to "hook into" these new opportunities by providing niche products or services (such as growing vegetables for prisons and old age homes, or providing cleaning services). What we have learnt from the unsuccessful decentralization processes of the 1960s in Africa, is that "no amount of external subsidy is likely to have any lasting effect on local development if there are no actors in the area who are able and willing to exploit the subsidy for the benefit of the region" (Pedersen 1990: 102).

6. Boosting production by local residents

A crucial intervention is to enhance the local market and grow the "local surplus". The local "surplus" can be increased by promoting the survivalist informal economy, including local agriculture (crops and livestock), street trading and home-based enterprises (Nel and Goldman 2006: 22). In particular, the strongest productive sector of the second economy is agriculture – whether as piggeries on small-holdings, sheep-farmers on municipal commonage, mealie producers on traditional lots, milk producers in small-scale dairies, or vegetable producers on backyard plots.

But the focus should not only be on production, but also on markets. The availability of local and regional markets for small-scale agricultural production should be investigated, on a town-by-town basis. The remarkable success of the National Wool Growers Association to boost emergent sheep farmers in the Eastern Cape is a good example of a strategic intervention. In many small towns, there are potential opportunities to sell vegetables (e.g. in the local grocery stores or spazas), or to sell meat to butcheries. But the first economy is often suspicious of the quality of local produce, or the regularly of delivery. These relationships should be promoted (for example, by agricultural co-operatives or by SEDAs).

As local production increases, market density increases. Periodic and permanent markets will develop; in time, as the local purchasing power increases, full-time jobs and business opportunities will develop. This creates space for new traders, whether hawkers, spazas or formal shops. This becomes the basis for the development and growth of urban places (Pedersen 1990: 101), creating opportunities for small firms to formalize and to expand. This growing diversification of the local economy will benefit the local middle-income households

2 This raises the vexed question of rigid labour market regulation (such as minimum wages, hiring-and-firing and affirmative action). Flexible employment contracts should be developed, particularly for the youth (say under-25s), with remuneration arrangements and working conditions that are well adapted to the needs of dynamic enterprises (CDE 2004: 32).

which have sufficient money to use the new services, and still have a demand which is sufficiently simple to be satisfied locally. But it would also benefit the small enterprises.

7. Building networks between formal and informal enterprises in small towns

In the literature, a distinction is often dawn between "pro-growth" and "pro-poor" local economic development (for example, Nel and Goldman 2006: 27).[3] But the distinction between these approaches should not be overstated. There is a great deal of potential synergy between conventional private investors and the second economy. In the survey of 18 small-town municipalities (Nel and Goldman 2006: 36), at least 12 saw no distinction between economic growth and pro-poor Local Economic Development.

Such synergies may have to developed creatively by government – they may develop spontaneously in a community, or they may not. Internationally, the philosophy known as "Making Markets Work for the Poor" (MMW4) aims at encouraging poor people to produce and sell products, in effective markets which encourage competition (to keep prices reasonable). This helps to reduce prices of inputs (because it removes monopolistic practices) and increases prices of outputs (because it finds new markets):

> "For the poor, the operations of markets are especially important. Markets offer the primary means through which poor people can participate in economic activity. They can do so as producers (farmers, business owners), as employees (i.e. providers of labour) and as consumers (of goods and services). Markets operating in an inclusive manner serve the poor by offering them the things they need – jobs, opportunities, finance, products – to increase their incomes. Conversely where markets are working exclusively, poor people have fewer chances to participate and benefit from economic growth. The condition of income poverty is therefore linked inextricably to the functioning of markets" (Gibson et al, 2004: 2).

The analysis of local markets is a critical factor in devising strategies and interventions for small and medium-sized towns. In each town, the labour market, product markets, input markets, consumer markets and credit markets need to be analysed. We must be careful to generalise between one town and another. A few unusual institutions, firms or even personalities in a locality can make a huge difference to the access – or lack of it – enjoyed by poor people.

Furthermore, the best way of encouraging entrepreneurship is to increase the number of ventures that successfully provide value-adding services to the *formal* sector (CDE 2004: 9), because that is where real money and markets are to be found. Enterprises, who offer goods and services to the poor, will most likely remain survivalist, operating on extremely small profit margins.

Corporate out-sourcing to small companies can lead to reduced costs, technical advice, loans, improved market access, improved supply, closer compliance with environmental regulations, and branding benefits (CDE 2004: 5). As Pedersen notes, "the line of demarcation between small and large enterprises is not fixed" (1990:99). Small and large enterprises develop in response to each other and under the influence of the available technologies, the national and regional policies, and the general level of development. They

[3] Even more misleading is the artificial distinction between the terms "pro-poor" and "pro-market". (Nel and Goldman 2006: 27). Survivalist enterprises have to engage the market too! As we argue below, Making Markets Work for the Poor is a key strategy to improve the prospects of survivalist enterprises.

can also develop synergies. The advantage of large enterprises is their ability to exploit scale economies, introduce new skills and technologies, and create employment. The small enterprises typically operate in market niches where it does not pay for the large-scale sector to operate, e.g. in markets where purchasing power is low. This means that the small- and large-scale sectors often do not compete directly.

If the market for the small enterprises expands, it may become attractive for the large organisations to go in direct competition and attempt to take over the market, for example, by establishing local retail branches (Pedersen 1990: 100). In such cases, the small enterprises would benefit by refining their niche products or services, supplying these directly to the large companies, or to the local market. The intervention by large companies, which would promote local formal employment, would assist in growing the local market and purchasing power, which would benefit small entrepreneurs indirectly.

Small town economies are often dominated by branches of large retail chains. These branches or franchises have the merit of bringing goods to the towns at prices which are affordable. But there may well be niche opportunities to supply local goods to them (e.g. fresh produce). But these large retailers have to be assisted to develop working relations with local producers. Once again, this is where the SEDA system should provide support.

In the same vein, there are many out-sourcing opportunities which municipalities should consider. In particular, sectors such as waste management, sanitation (e.g. maintaining drains and cleaning riverbeds), and road repairs hold much potential for out-sourcing to fairly unskilled workers. The SEDA offices should assist in drafting effective contracts to guide these relationships (and the opposition by municipal unions should be firmly dealt with).

8. Providing accessible and effective business support

As noted above, it is glaringly obvious that the sheer lack of business experience by small and informal entrepreneurs in the rural towns makes business support a very urgent necessity. SEDAs need to be staffed by people with business experience, and they need experts who can provide business advice to specific sectors. They also need to be able to create partnerships between survivalist and formal enterprises. Most importantly, they have to understand the life-world and constraints of informal operators, to understand what works. Furthermore, existing institutions such as agricultural co-operatives – even if white-owned or managed – are potentially useful agencies to involve in providing business support.

Business support should go beyond simply providing advice and business plans. It should provide assistance to emergent enterprises at every stage, from accessing land and inputs to creating business networks with other institutions. As argued above, if significant public investments in *productive* projects are undertaken in small and medium-sized towns (such as old age homes, orphanages, and training colleges), it creates the opportunity for local residents to provide goods and services, and this kick-starts local multipliers. But business support may be required to craft these business relationships so that they are effective, profitable and sustainable.

9. Towns and their rural hinterlands

In South Africa, the link between farmers and non-farm livelihoods has not yet become important for policy-makers in rural municipalities. In commercial as well as traditional farming areas in South Africa, there is a perceived bifurcation between town and country. In a survey of 19 municipalities containing small towns, not one mentioned Agriculture as either their lead sector, or their second most important sector, or even their third most important sector (Nel and Goldman 2006: 32).

The relationship between towns and their rural, agricultural hinterlands is an important factor in small-town growth and entrepreneurial prospects. But it is very complex.

In the traditional farming areas, farms tend to be small-scale family operations. These areas have been hard-hit by urban unemployment, reverse migration and HIV/AIDS, which has undermined the capital base and the labour availability of the farming operations. In many cases, the erstwhile "homelands" of South Africa are more similar to farming conditions elsewhere in Africa than the commercial farmland of South Africa. Consequently, some of the literature drawn from Africa may be relevant.

In this context, a key argument is that the small towns can play an important role in diversifying rural incomes. The international literature points to the importance of the "rural non-farm economy" (RNFE) (Barrett *et al* (2001), Rigg (2005), Reardon *et al* (2001), and the linkages between farming and non-farming enterprises in small towns (Leinbach 1991). Some terminological clarification is called for. "Non-farm" refers to activities that can be located on the farm, but are not agricultural; while "off-farm" refers to activities that are spatially located in towns. The main advantages of such activities is that they are a form of economic diversification, thereby reducing farmers' risks, and also creating sources of capital which can be re-invested in agriculture. Some of the motives for diversification are related to "push factors" (responding to risk, diminishing returns to specific economic activities), while others are related to "pull factors" (finding new urban economic opportunities).

In sub-Saharan Africa, non-farm activities are important for immediate food security through providing money to buy food, to buy farm inputs, and to provide outlets for production (Machethe, Reardon and Mead, 1997: 377). As Reardon *et al* claim, "The term 'rural' [is] increasingly not synonymous with 'agricultural'. Consequently, [policies] must be designed to include activities aimed at the rural environment as a whole, including the countryside and the small and medium-sized urban nuclei" (2001: 407).

Significantly, these urban diversification opportunities may be in non-agricultural sectors, whether the private sector (e.g. the taxi industry), or they may be in the public sector (e.g. school teachers). In Philippolis, for example, a small-scale farmer on local commonage land subsequently branched out into the taxi industry, and he has recently opened a guest house.

As far as RNFE is concerned, the same trend is echoed in the commercial farming areas, where many commercial farmers who run family farms increasingly take on town-based employment on a part-time basis.

Yet international research has found a positive relationship between non-farm income and household welfare, and between non-farm income and rural development. Additional research is needed, in specific localities, about how such linkages between agricultural activities and non-farm activities work in practice, and how local accumulation strategies work.

Rigg (2005) states emphatically that access to land is *not* the most important causal factor for rural livelihoods any more. Hence smallholder agriculture support, while necessary, is not the only policy required for rural livelihoods any more. Urban business support is equally important, particularly as the best form of livelihood support may be to enable rural people to escape from farming. This would also help to free up land for the more successful farmers to expand their land holdings. And even more importantly, the *linkages* between agriculture and urban activities (such as small-scale processing and retailing) should be promoted.

This raises several policy issues regarding diversification. Small towns should be developed as "growth poles", which provide a critical mass of interacting industries and services. New rural activities should be selected as "keystone sectors", which build bridges with other sectors (e.g. tourism). This means that key small town issues need to be addressed, such as technical support for marketing, storage and processing facilities, transport (roads and vehicles), the provision of water and electricity, promoting literacy and education, access to capital at reasonable interest rates, effective postal systems and telecommunications.

The relationship between agriculture and non-farm livelihoods is not always easy to accommodate institutionally. In many countries, the rural non-farm economy tends to fall into an institutional "no-man's land", between Departments of Agriculture, Industry, Tourism and Labour (Reardon *et al*, 2001: 407). Until institutions such as SEDAs (and their outlying offices) manage to cross these sectoral chasms, there would be no promotion of effective rural-urban economic linkages, and much of the potential of small towns would remain dormant.

10. Rediscovering the importance of the "peri-urban"

In the same spirit as RNFE, peri-urban areas offer many opportunities for synergies between agricultural and non-farm livelihoods. Many rural towns are surrounded by municipal commonages, which are increasingly used by black and coloured emergent farmers. There have been calls for commonage to be regarded as a key part of land reform. Anderson and Pienaar (2003:31) argue that:

> "Commonage provides a relatively inexpensive and potentially very effective option for land reform. The municipal government system means that the necessary regulatory framework for rights administration and land management is already in place. Municipal legislation both empowers local authorities to act as agents of development and ensures that management is devolved to the lowest possible level. The municipality as the land holding entity is not a top-down, absentee landlord, but a key agent of local economic development."

There are several arguments for commonage making a useful contribution to urban livelihoods. (Atkinson and Buscher 2006: 441). Firstly, commonage land is often the only natural resource available for poor urban communities, particularly in land-locked areas without access to fisheries. Commonage is readily accessible to the poor, because it is located close to residential areas, and does not require much capital to develop. It should therefore be a first-line strategy for supporting household food production.

Secondly, municipalities already own commonage land. It does not have to be purchased at great expense. This suggests that commonage development has *prima facie* importance as a component of land reform.

Thirdly, commonage development has – in theory - great potential for spin-off economic development, such as local markets, local capital accumulation, local skills training, and linkages between farms and non-farm activities. As argued above, non-farm activities are potentially very important to the welfare of farm households.

Fourthly, it offers a valuable opportunity for experience and learning in collaborative or co-operative social institutions, such as commonage committees, farmers' associations, banks and co-operatives. These institutions are typically located in the small towns. Commonage is therefore a valuable "school for economic citizenship" for people who have been marginalised and disempowered for almost all their lives. It can also help in creating a new generation of young farmers, and thereby restore the image of agriculture as an attractive career option.

Commonage farmers are very diverse, and some show signs of becoming viable small farmers, and even emerging commercial farmers. The following categories of commonage farmers have been identified (Atkinson and Buscher 2006: 450):

- *Survivalists:* Households with few alternative sources of income (perhaps other than social grants or pensions), and who are likely to continue using livestock to fulfill basic food security needs.
- *Micro-farmers:* They have other livelihoods, and want to keep only a certain limited number of livestock, as an income supplement, or as a hobby, or for cultural purposes.
- *Emergent small-scale farmers:* They show signs of commercialization: for example, they may have bank accounts, they would like access to loans, they may want to farm on their own (i.e. not in a group), and they would like to farm on a larger scale, to make some profit. These farmers may be good candidates for ownership of small-holdings, where they could either undertake small-scale agriculture, or combine this with other income-generating activities.
- *Proto-capitalist farmers:* People who may have other livelihoods, but would like to go into commercial farming on a full-time or large-scale basis. For them, livestock and capital accumulation is important. Acquiring property may also be important. These farmers would be ideal candidates for a "step-up" land reform strategy, i.e. opting out of commonage use and finding their own farm.

Municipalities are increasingly recognizing the importance of urban agriculture or small-scale farming in peri-urban areas (Nel and Goldman 2006: 39). But there is still no coherent strategy in this regard. This very fertile issue-area is a victim of the institutional chasm between government departments (Economic Affairs, Agriculture, Industry and Tourism). Are peri-urban areas agricultural or urban? At present, these sectoral departments rely on municipalities to produce inter-sectoral linkages, via their Integrated Development Plans (IDPs). But no effective guidance has been provided to municipalities about peri-urban development, and so the potential of this very strategic opportunity remains unexplored.

11. Rural diversification: The example of biofuels and wool

Improving agricultural production can have major benefits for farmers, as well as the small towns where they sell their products and obtain inputs. Such initiatives will help to promote rural production, investment and marketing

One of the success stories of agricultural extension services, run as a partnership between government and private producer organisations, is the support to Eastern Cape wool farmers. There are about 200 000 black wool farmers in southern Africa, mainly in the Eastern Cape, Free State and Lesotho, who own about 20 million sheep. Efforts to improve the market access of these poor farmers began in the late 1990s when the National Wool Growers Association (NWGA) encouraged farmers to form farming associations. This meant that farmers would shear wool, grade it, pack it, and transport it as an association. With the support of the NWGA, this project increased the technical skills and bargaining power of farmers, and they began to access new outlets (CDE 2006: 54). The NWGA provided large shearing sheds where they could work together. By sharing marketing, they managed to by-pass local monopolistic wool traders.

The same kind of systemic agro-processing intervention can be made with regards to biofuels, in areas with traditional farmers. This will benefit the agricultural enterprises as well as the local small towns. Today, oil prices are rising to record highs, and there is a new urgency to climate change targets for reducing fossil fuel emissions. In South Africa, the coal industry has a limited life, and has major air pollution consequences. Biofuels (biodiesel and bioethanol) are based on processes of fermenting the sugars and cellulose of plant material. The UN estimates that ethanol may constitute 10% of petrol used by 2026 and 30% by 2050.[4]

Biodiesel can currently be made profitably from soya (in the mild climate of the eastern part of South Africa).[5] Maize and sugar can make bioethanol profitably. The sugar industry has 48 000 small farmers.[6] Subsistence farmers can be employed as contractors to manufacture biofuels, producing for central silos.[7]

Furthermore, biodiesel can be utilised for energy generators in remote areas.[8] This can lead to profitable secondary industries being established. It has been calculated, for example, that energy provision to the traditional farming areas in Mpumalanga can launch 100 farmers in producing chicken and aquaculture, each with 300 ha of land, employing an additional 200 workers. Small towns will benefit from the local financial surplus generated, because it will stimulate urban multipliers.

12. Promoting regional synergies

In order to stimulate capital investment in small towns (whether by local residents or outside investors), new market opportunities must be created in these towns. In many cases, small town opportunities are too limited, but combined with similar towns in a regional neighbourhood, a critical mass of economic opportunity may become evident. Such regional possibilities may have to be kick-started by government or non-state facilitation, together with strategic capital investments.

The South African experience of regionalism is a chequered one. Regional industrial decentralization policies under *apartheid* were ineffective and have been discredited. After 1994, the emphasis shifted to local and district municipalities, based on formal demarcation of municipal boundaries. Thus far, many municipalities have failed to do justice to the economic potential within their boundaries, and extremely few have managed to establish economic synergies with their counterparts across local, district and provincial borders. At present, municipal and provincial boundaries operate as rigid boundaries preventing co-operation, even when common interests are glaringly obvious. This rigidity is an intentional by-product of the IDP and PGDS processes. There are no “political brownie points” to be had from collaborating across borders.

There is much more to be done to promote regional collaboration between small and medium-sized towns – as long as there is a real economic basis for such collaboration. Such an economic basis could be built on ecological issues (for example, a similar climate which enables similar products to be produced), or a tourism niche market, transport conduit or watershed. One example is the potential economic benefit (and intense bureaucratic obstacles) facing the Lake !Gariep project, which is meant to involve the Free State, Eastern Cape and Northern Cape. Branding and “products of origin” would be important aspects of

[4] S Hofstatter, “Biofuel lessons from Brazil”, FW 20 January 2006.
[5] “Biofuels set for blastoff”, FW 28 april 2006
[6] Nico van Burick, “Biobrandstof: SA boere kan voorsien”, LBW, 19 May 2006.
[7] A Groenewald, “Biobrandstof kan krisis versag”, LBW 14 Oct 2005.
[8] A Groenewald, “Biobrandstof kan krisis versag”, LBW 14 Oct 2005.

such a strategy. Another example is the new desert tourism route along the west coast, linking the Western Cape and Northern Cape to Namibia.

Multi-jurisdictional networks are needed for rural development (Bradshaw 1993: 171). In the US, Councils of Government have been established, but with very limited powers. A multi-jurisdictional approach will require large enough scope to attract new economic activities to an area. Multi-jurisdictional approaches assist sharing of expertise, economies of scale of functions and programs (e.g. bulk purchasing), specialization (providing sufficient expertise and equipment), and leveraging (the potential increases to multiply the effort of a project to link it to other projects). There is an urgent need for appropriate, flexible, innovative regional institutions to be created. They need not be created by government; they could be private sector-driven, but with strong and mutually supportive links to municipalities and government departments. "Smart money" may be required from government, to create regional networks and possibly assist the creation of regional institutions to promote investment in these localities.

I. CONCLUSION

This paper provided an overview of the economic diversity of small and medium-sized towns, and argued that support and interventions need to be closely tailored to local economic realities.

It remains a priority is to attract public or private formal investments to these towns. Much more imaginative and assertive methods can be adopted to secure such investments. By promoting formal sector employment, potential entrepreneurs gain valuable work experience. Furthermore, formal institutions can be encouraged to enter into partnerships with survivalists.

Thus far, government policies have recognised many of the priorities faced by small towns: the key role of local government, a strong focus on economic development, the integration of sectoral programmes, the need to promote local economic multipliers, the diversification of the local economy, and the need for partnerships between public and private spending. In particular, the ISRDS and the latest LED Strategy of dplg provide valuable pointers to economic development of small towns.

However, government spending needs to operate on a more strategic spatial basis, to create productive investments in small and medium-sized towns. Such expenditure will help to create the local surpluses which are required for second-economy operators to connect with the formal economy. In addition, the right kind of business support services in small towns remains need to be provided – with a particular emphasis on creating effective linkages between emergent entrepreneurs and formal businesses and investments.

A much more strategic regional approach should be considered, based on regional similarities and potential advantages. Public funding may be necessary to investigate such economic potential, and to facilitate the creation of regional public and private networks to attract investment to small and medium-sized towns.

Other methods would be to promote rural non-farm livelihoods, peri-urban commonage agriculture, rural industrialization and outsourcing of agricultural production, and regional branding and marketing, to attract large-scale investments.

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