THE STATE, INDUSTRY, AND MONEY CAPITAL: THE CASE OF THE VICTORIAN ECONOMIC DEVELOPMENT CORPORATION (VEDC)*

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The Victorian Economic Development Corporation (VEDC) occupies an important place in recent history . Hailed as a model of how to respond to the regional effects of the early 1980's recession and a perceived shortage of risk capital for industry, the VEDC was later to be cited as a spectacular example of the failure of particular political approaches to economic problems. The VEDC experience is also representative of some broader issues of economic policy and state finance in the 1980's.

Established in 1981 by the then Liberal Government, the VEDC was revamped and expanded by the Cain Labor Government upon coming to office in 1982. The VEDC became a centre-piece of the Victorian Labor Government's ambitious economic strategy for restructuring the State's industries. Between 1983 until its demise in mid-1988, the VEDC approved loans and other finance exceeding $500 million to Victorian-based companies. By way of comparison, total funds raised by firms under the federal government's Management and Investment Company (MIC) Scheme until June 1988 amounted to $230 million, while total invested funds invested by the MICs reached only $144 million (MIC Licensing Board 1987/88).

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The VEDC is of more than just historical curiosity. The history of the VEDC also has a contemporary significance. The VEDC lost more than $110 million and VEDC losses are helping to undermine the living standards of working people in Victoria. Victorian Government liabilities now exceed $50 billion, and the annual interest costs of that debt are approaching $2 billion (Ries 1992,p60). An austerity program has become necessary and spending cuts on education, health and welfare are likely to continue for much of the 1990's.

Moreover, many of the problems which the VEDC was set up to mediate have reappeared. Demands are again being raised for investment funds to be directed towards expanding manufacturing employment and export markets (especially firms in the traded sector), and for banks and the State to take a more active role in the development of small-to-medium sized industrial companies. All these were features of the VEDC's operations. Current demands are often even being framed by direct reference to the experience of the VEDC. Davidson has recently remarked that "[t]he VEDC has gone, but the problem of how to encourage new start-up ventures essential to the successful restructuring of the Victorian and national economy remains" (1992,p40).

Demands around these issues are coming from manufacturing and small business associations (Brain 1992), trade unions (Apple 1992), banks and even consulting groups (Carter 1992). They are being articulated through both of the Victoria's major political parties. In the 1992 election campaign the Victorian Liberal Party indicated that a Kennett Government would pursue an 'active' industry policy [1]. Since the election, Premier Kennett has continued to claim a high priority for industry policy (Gill & Callick 1993).

Two contending explanations of the VEDC have so far been advanced. One is that government intervention, especially in industry policy, is self-defeating. The VEDC was, on this explanation, misconceived and

1 Just before the recent Victorian elections (1992), the then Opposition leader, Jeff Kennett said for instance, "We are not just trying to pick winners in individual industries, but we are trying to identify the industries which give this country and this State the opportunity for growth... Yes there will be assistance by government" (*AFR*, 2 September 1992, p2).

therefore bound to fail. The other is that the idea for the VEDC was basically a good one, but that the corporation was badly managed (Murray & White 1992). This was the explanation that came out of the Government commissioned report into the VEDC (the Ryan Report 1988), one that has been widely promoted in the financial press. The two explanations will be briefly examined.

The VEDC - the State as Failed Entrepreneur?

The proposition that the VEDC's demise was based on the self-defeating nature of government intervention in industry rests directly or indirectly on a 'laissez-faire' conception of accumulation. It is a conception with a number of problems for understanding the history of the 1980's. To begin with, loan losses were not confined to government-owned lending institutions. In Australia, the four major domestic banks are carrying at least $30 billion in non-performing loans (Lewis 1992). The experience of international banks that entered the Australian capital market after deregulation is perhaps even more fateful. The combined losses of these banks arising from their Australian operations for the two years 1990 and 1991 alone were reported to exceed $1 billion (Lewis and Kaye 1992).

Big losses in the banking system are not just an Australian phenomenon. They were a feature of international banking in the second half of the 1980's. Whatever the reason, there was clearly something about banking in the 1980's that has produced losses across the international banking system. It suggests conditions that resist explanation simply around an axis of public or private ownership of banks. From this perspective, it is only the relative size of the bad loans incurred by the VEDC that is remarkable [2].

2 Even the scale of losses shouldn't be taken too far. Haig, commenting on the demise of the State Bank of Victoria, noted that other failed private merchant banking subsidiaries were absorbed by much larger parent companies, "so that public knowledge of their losses have been discreetly buried in paupers' graves by their rich parents" (1992).

Associated with such explanations is the popular perception of the State as a 'failed' entrepreneur. It is necessary to remember that it was private firms that actually lost the funds. It was private firms that borrowed from the VEDC and failed to use it to develop profitable production. As one commentator observed, "you can't just blame government, policy-makers and regulators for the failure of Victoria, and Australia during the '80's. At most fault are the entrepreneurs" (Jost 1992).

The VEDC and the 'Gap' Thesis

There are also weaknesses in the alternative view that the VEDC was a case of a sound idea badly executed. The establishment of the VEDC was justified largely on the grounds of a perceived capital market gap in the early 1980's. By the mid-1980's, capital markets in Australia, as elsewhere, were awash with credit. Yet it was precisely during this time that the VEDC was providing most of the roughly $500 million in finance extended to Victorian-based companies. Examination of the VEDC's history reveals that its importance lay not merely in providing access to finance for small to medium sized firms, but that the terms of that access were also crucial[3].

Attributing the failure of the VEDC to bad management is also to assume that the State could have actually resolved the regional effects of the global crisis of accumulation then being experienced in Victoria. Even if it is possible to imagine a VEDC that was 'wisely' managed, its supervision of money capital would still have been subject to the same tendencies and forces as for all money capital. The VEDC had to ensure that the funds it advanced were used not merely in expanding production, employing labour, and earning enough to repay the debts, but also to enlarge the pool of profits. What makes expanded industrial accumulation possible (and therefore an industry policy successful) is

3 Fine for instance has remarked that, "access to IBC [interest bearing capital] is a mechanism of competition between industrial capitals" (1985). Clearly, the terms of access (form and extent of bank supervision, type of security and repayment program) are just as much matters of competition as is the interest rate.

an increase in the rate of (industrial) profit [4]. In the 1980's, a project of expanding accumulation in regional manufacturing was pitched against an international tendency toward declining rates of return on existing and new fixed capital investment (i.e. in expanded commodity production). The tendency was especially evident in manufacturing industries (Blair and Litan 1990).

A more useful way of understanding the VEDC's history is to look at tensions over the nature of the accumulation to funded out of the VEDC. What follows attempts an understanding of the VEDC as a state institution established as an attempt to supervise a transition to a new phase of local accumulation. Under the Cain Government, two different forms of accumulation were articulated through the VEDC, one linked to 'banking capital', the other to 'finance capital'. The history of the VEDC can in part be understood through attempts to fund these different and increasingly divergent accumulation patterns.

Some background to the changing economic and political conditions in Victoria is necessary, before the history of the VEDC can be advanced.

Manufacturing in Victoria After the Long Boom

From at least the mid-1970's onwards, the unwinding of the long post-war boom coincided with a decline in the profitability of manufacturing activity in most advanced capitalist countries, including Australia. One federal parliamentary report noted that from the early 1970's, `rates of return in the manufacturing sector (in Australia) were consistently below the average for all industries...' (HoR 1988, p27). Not surprisingly, there was a relative shift of investment and employment

4 Aglietta has argued that "Relations of competition can only be reorganised once the general transformations of the wage relation create a new overall cohesion for the rise in the rate of surplus value. The general crises of accumulation are the most striking manifestation of the fact that competition and market relations are subordinate to the class struggle"(1979,p297).

out of manufacturing activity in Australia [5]. The rate of growth in the real value of manufacturing capital stock in Australia had averaged around 6.0 percent per year during the 1950's and 1960's. During the 1970's, the corresponding annual rate of growth fell to less than 1 percent (BIE 1987a, p5). By the mid-1970's, the employment share of manufacturing in Australia had fallen to 20.8 percent (down from 26.2 percent a decade before). Significantly, from 1973-74 to 1977-78 the relative decline in employment became absolute. In that four year period alone, more than 100,000 workers were shed from manufacturing across Australia.

The relative sectoral shift of investment and production away from manufacturing during the 1970's had a particularly adverse impact on economic activity in Victoria, an economy with a higher relative share of manufacturing. In the decade ending 1982-83, Gross Non-Farm Product in Australia grew at an average real rate of 2.7 percent, whereas in Victoria the average annual growth was only 2.3 percent. Rates of population and employment growth in Victoria also lagged about one third below the national level.

On coming to office in 1982, the Cain Labor Government was confronted with both the regionally articulated effects of the global recession of the early 1980's as well as structural shifts in accumulation patterns in Victoria. One of the Cain Government's first initiatives was an expansionary budgetary program:

> After a decade of subdued growth, Victoria shared in the Australia-wide sharp decline in economic fortunes in 1982 and 1983. During the recession, consumer confidence slowed, manufacturing production, industrial investment and exports declined, and the labour market suffered severely. The first and foremost priority of the present government on coming to office was to revive the State's economy and create jobs for the benefit of all Victorians. A central element of this strategy was the program to boost capital works. (*TNS*,p 12-13).

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5 This did not necessarily mean that 'Australian' capitals did not continue to invest in manufacturing. During the 1970's, direct investment abroad in manufacturing by Australian based companies grew at an average annual rate of 12.9 percent (BIE 1984, p12).

Whereas the real value of the Victoria's budget sector capital works program had declined by around 20 percent between 1975/76 and 1979/80, it more than doubled in only three years 1981/82 to 1983/84 (up from $739m to $1573m). The capital works program was promoted as a way of mediating the effects of the recession for `all Victorians' and at raising both the level of employment and profits.

In the early 1980's, the argument that a `gap' in the capital market existed in Australia became a rallying cry for a range of business groups along with some state officials. In particular, small and medium sized firms were felt to have an unequal and constrained access to capital markets. It was argued that a lack of development credit for small-to-medium sized firms, particularly in export-oriented and science-based industries, was preventing many from expanding. By extension, it was concluded that this capital shortage was putting a brake on economic growth [6].

The argument led to two (divergent) policy recommendations. One current suggested that more funds would flow to companies with high growth potential if competition in the capital market was enhanced, and in particular by opening the domestic capital market to international competition. The conclusions reached by the Campbell Committee Inquiry into the Australian financial system in 1981 is broadly representative of this current. An increased supply of funds and greater competition from fund providers was one of the expected benefits of bank deregulation in 1984.

Another line of argument concluded that banks were structurally risk-averse, and a 'gap' in the market existed. Overcoming the structural gap required government assistance, even if just as a catalyst for redirecting private funds into development credit or venture capital. This was for instance a recommendation advanced by the Espie Committee into high technology firms in Australia (1983). The gap thesis became widely

6 The 'gap' thesis is not new. The first known use of the gap thesis was in England in 1931 - then called the `Macmillan gap' after the head of the parliamentary committee that reported on a difference that was found to exist between the cost and ease of borrowing between large and small firms (c.f. Balderstone 1991). Stutchbury (1986) has outlined the role of the `gap' thesis in South Australian postwar industry policy, both in the capital markets and manufacturing structure.

held and was the basis for a number of State interventions in the capital in the 1980's. The VEDC became one of the central ways that the Victorian Government addressed the perceived capital market gap.

Formation of the VEDC

The VEDC had been established in 1981 by the Thompson Liberal Government through a merger of two state instrumentalities - the Victorian Promotions Committee and the Victorian Development Corporation. The Victorian Promotions Committee (VPC) was established in 1956 to promote opportunities arising out of the Melbourne Olympics. By 1981, the VPC had become an investment attraction and export marketing arm of the Victorian Government. The Victorian Development Corporation (VDC) was established in 1972 to stimulate regional development of tourism and provide assistance for the restructuring of decentralised industries within Victoria (mainly through pay-roll tax subsidies, but also through concessional loans). In putting the two agencies together, the Thompson Government made initial steps toward providing for an expansion of finance to Victorian industries, but no actual expansion had occurred before the Liberal Government lost office. In 1981/82, loans were approved to the value of $8.9 million, a figure slightly under the average of annual loan approvals for the previous five years (VEDC Annual Report 1984/85, p3; Ryan 1988, p12).

In contesting the 1982 Victorian elections, the ALP Opposition announced plans for the expansion and upgrading of the VEDC. After the election, one of the Labor Government's first legislative initiatives was an amendment of the VEDC Act, to expand the scope and size of the corporation's financing powers. The VEDC's capital base was expanded to $20 million (by converting a $17.8 million Works and Services loan into equity capital) to allow the Corporation to undertake equity investment and raise further borrowings (Cathie 1984, p10). The VEDC was also given access to Government guarantees for expanded borrowing, and was later to borrow through the Government's lending agency, VicFin. These changes gave the VEDC access to international money markets on risk terms similar to that of the Victorian Government.

Included in the legislative amendments for the VEDC was provision for Government control over the general direction and rate of growth of lending, through financial targets and a `preferred industries' criterion. Preferred industries were defined as persons or firms engaged in activities likely to increase the sale of goods and services produced in Victoria by either selling or producing for export, competing against imports, or engaged in tourism activities. The redefinition of the preferred industries category, the establishment of quantitative targets and expanded financing powers established the basis for the Cain Government's restructured VEDC.

The VEDC's financing charter was widened to allow it to act as a `development financier' to enhance the competitiveness of firms in what was called the `trade exposed' sector of the economy, a concept expressive of the resurgent neo-mercantilist direction of State policy [7]. It was envisaged that the VEDC would do this in two ways - first, by providing a `gap' filling role in providing finance on reasonable security, and at `competitive' rates of interest (and with a flexible attitude to risk and repayment); second, by advancing equity funding along with management assistance to Victorian-based companies with high growth prospects.

The Cain Government's Economic Strategy

Early in its first term, the Cain Government prepared a series of economic statements titled *The Next Step* (*TNS*), aimed at articulating a new economic strategy for the State. The statements committed the Victorian Government not only to establishing the basis of a recovery from the cyclical recession, but also to identifying and developing new sources of growth for the Victorian economy. The VEDC was given a

7 Further discussion of the trade exposed concept is included in Bryan and Rafferty (1993), which examines the conflicting way the concepts of 'internationalisation' and 'competitiveness' have been defined in government economic policy in Australia.

central role in the Government's economic strategy. In reviewing past Government industry policies, the strategy papers characterised past assistance as being concerned basically with supporting the decentralisation of industry in Victoria. Under the old assistance regime, it was said that virtually all of the state Government's direct financial assistance went to manufacturing firms outside of an eighty kilometre radius of Melbourne.

The distribution of assistance associated with the previous policies was then contrasted with the geographic structure of industry in the state. The previous assistance regime concentrated assistance on regional manufacturing. Only fifteen percent of total employment in manufacturing was located outside of an eighty kilometre radius. The Cain Government concluded that these policies were designed for `a completely different set of problems' (*TNS*, p73). The shift in Government policies was therefore promoted as a transition from one of spreading growth throughout Victoria, to one of identifying and promoting new sources of growth. Industry policy was redirected toward promoting industries and companies with high growth prospects and export potential. It sought to assist small to medium sized firms gain access to finance and management assistance. The strategy papers identified three deficiencies or gaps in the capital market confronting Victorian industry, namely:

- the underdeveloped market for the supply of equity funds and management support for companies with growth potential (i.e. venture capital);
- the limited supply of longer term debt capital available to small to medium firms on reasonable terms and conditions; and
- the lack of specific types of development finance, such as export pre-shipment finance, for small to medium sized enterprises(*TNS*, p65).

Of the three, deficiencies in venture capital finance was considered to be the most important barrier to economic growth in Victoria. The Victorian Government had already announced plans to participate as a minority partner in a venture capital company applying for a MIC licence, but still considered that there was `a case for additional venture capital initiatives in support of the [Government's] industry development policies' (*TNS*, p67). These venture capital initiatives, coupled with augmenting the supply of longer-term debt capital, were expected to be fulfilled by the VEDC.

The shift in the *focus* of industry assistance was accompanied by changes in the *forms* of assistance. New assistance was directed at providing sources of finance for growth-oriented Victorian-based firms "... such as through provision of equity capital, loan assistance or short-term grants" (*TNS*, p22). The VEDC would play a "central role in providing a substantial increase in direct financial assistance to firms under these policies" (Cathie 1984,p10).

An Overview of VEDC Financing

The release of the Government's economic strategy in 1984 underpined the pivotal role the VEDC would play in implementing Government policy. The VEDC was empowered to operate `with a broad charter to facilitate and encourage the development of Victorian industry' (Ryan 1988, p3). Tables 1 and 2 chart the VEDC's expanding lending and financing base, while Table 3 shows the explosive growth in the VEDC's financing activities after 1984.

In the first year of the VEDC's operation under the Thompson Liberal Government (1981/82), $11 million of new finance was approved, roughly equivalent to the average annual financial accommodation offered by the VDC over the previous five years. In 1982/83, the first year under the Cain Government, the VEDC's loan approvals climbed to 122 (out of 148 applications) totalling $14.3 million. The VEDC then experienced an exponential growth in financing activities.

In 1983/84 the number of loan approvals jumped to 167, and the value of approvals more than doubled to $33.1 million. In 1984/85, the number of loan approvals climbed to 215 (out of 238 applications) totalling $65.6 million. The Annual Report for the year noted that "the majority of approvals went to small-to-medium sized businesses in

Victoria, the mainstay of the VEDC's clients...". Of the 215 loan approvals in 1984/85, 182 were for amounts of less than half a million dollars each. Nevertheless, the remaining 33 approvals for amounts in excess of $500,000 (totalling $39.0 million) accounted for about 60 percent of the total value of loan approvals. In February 1986, the VEDC became the holder of the Victorian Government's shareholding in the new domestic banking licence of the Hong Kong and Shanghai Bank, at a cost of $30 million.

Table 1: VEDC - Summary of Selected Balance Sheet Items

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
ASSETS						
Total Loans	39.0	40.3	62.7	131.9	203.9	266.2
Bad Debt Provisions	0.8	0.8	2.8	3.5	12.7	84.3
Net Loans	38.1	39.5	59.9	128.3	192.2	181.9
Total Equity Investments	1.9	0.8	2.2	39.1	14.4	37.6
Equity Loss Provisions					1.2	27.4
Net Investment		0.8	2.2	39.1	13.2	10.2
Short Term Deposits		18.4	5.1	21.3	39.8	25.3
Other Assets		3.7	4.1	7.5	9.7	10.3
Total Assets	56.1*	62.4	71.3	196.2	254.8	227.8
LIABILITIES						
Borrowings		36.3	42.7	156.5	210.8	276.6
Other Liabilities		3.0	4.7	4.0	11.3	23.6
Total Liabilities	48.8	39.3	47.4	160.5	222.1	300.1
NET ASSETS	7.3	23.1	23.9	35.7	32.7	(72.4)
(represented by:)						
Contributed Capital	2.2	20.0	20.0	32.6	32.6	32.6
Accumulated Surplus		2.1	2.7	2.0	0.1	(105.0)
Reserves		1.1	1.1	1.1	0.05	0.05
TOTAL CAPITAL (and reserves)	7.3	23.1	23.9	35.7	32.75	(72.5)

nb. Totals do not add due to insufficient data. Brackets indicate negative items.

* Denotes estimate.

Source: VEDC *Annual Reports* and Ryan (1988).

In 1985/86, loans remained the core of the VEDC's (expanding) financial operations. Again, the value of lending outpaced the number of approvals. While the number of loan approvals reached 274 (27 percent more than in 1984/85), the value of approvals had climbed to $121.7 million (84 percent more than 1984/85). It was reported that 233 of the 274 approvals were for amounts less than half a million dollars, and these represented about a third of the value of loan approvals ($41.6 million). In 1985/86, the VEDC's Annual Report emphasised that activities had '...been concentrated on assistance to a large number of smaller enterprises and that the Government wishes this to remain the central focus of the Corporation' (p8). New loan approvals made in 1985/86 brought the VEDC's total value of loan advances outstanding to more than $131 million. The VEDC's expansion was given further impetus by an expansion in its equity base from $20 to $32.5 million. A new associated company to the VEDC was also established in that year.

The Victorian Investment Corporation (VIC) Ltd was established under the VEDC to:

> facilitate investment in these larger, longer term projects without distorting the existing activities of the VEDC (such as a $14 million equity contribution to the Australian Medical Research and Development Consortium) (VEDC Annual Report 1985/86, p8).

It was expected that the VIC would operate as a specialist 'venture capital' company, although the size and nature of investments suggested that it was to operate more as a large-scale development financier. The VEDC provided $2 million of the $15 million capital base of the VIC, and its accounts were consolidated with the VEDC's.

In 1986/87, the VEDC made 366 loan and leasing approvals totalling almost $200 million. Only 16 loan applications (less than one in twenty) were declined by the VEDC in that year (Ryan 1988, p19). Despite an explosive growth in lending approvals over the three years ending 1986/87 (loan approvals totalled $380 million), total outstanding loans by the close of the 1987 financial year, was just over $200 million (Table 3). This suggests that VEDC lending was occurring largely for short term purposes. The spread of VEDC financing activities had also widened to include loans, leasing, equity, export incentives, small business assistance and performance guarantees associated with trade finance.

Table 2: VEDC: Summary of Selected Income and Expenditure Items

	PROFIT AND LOSS ($m)					
	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
INCOME						
Interest	5.6*	6.2*	11.43	15.3	27.3	33.3
Dividends			0.02	0.08	0.17	0.02
Profit on Inv. Sales					11.9	
Other Income			1.55	0.1	0.2	1.6
TOTAL INCOME			13.0	15.5	39.6	34.8
EXPENDITURE						
Interest	3.8	4.5	7.9	12.1	25.3	35.4
Bad & Doubtful Debt			2.0	1.1	9.9	100.2
Wages & Salaries	3.0*	3.0*	1.2	0.8	1.1	1.6
Other Expenditure			1.0	1.0	1.4	2.8
Total Expenses	6.8	7.5	12.2	15.0	37.7	139.9
Operating Surplus			0.8	0.5	1.9	(105.1)
Add Accumulated Surplus			1.8	2.7	2.0	0.1
Reserve Transfers			-	-	1.1	-
Less Dividends Paid			-	(1.2)	(4.9)	-
Net Accumulated Surplus			2.7	2.0	0.1	(105.0)

* Denotes estimate.

Table 3 also shows that the number of VEDC equity investments increased over 1986/87 from 22 to 31, totalling $14.2 million. The then Minister for Industry, Technology and Resources, Robert Fordham, noted that these investments "constitute(d) an important 'hands on' involvement with the many practical problems confronting Victorian industry" (VEDC Annual Report 1986/87, p2).

The 1986/87 annual report also showed the first signs of a financial crisis brewing in the Corporation (Table 2). While the accounts recorded a surplus of $1.9 million, the result masked an increasing failure rate amongst assisted firms. Just prior to balance date, the VEDC sold its share in the Hong Kong and Shanghai Bank for $42 million, a profit of $12 million (Howard, 1987). The sale helped to bolster the VEDC's accounts and soften the blow from a very large increase in bad and doubtful debts of $10 million (from $3.5 million to $13.9 million).

Table 3: VEDC - Summary of Selected Funding Data

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
New Loans Approvals	122	167	215	254	376	224
New Loans (value $m)	14.3	33.5	65.8	117.4	192.3	110.3
No. Approvals < $0.5m			182	223		
($m)			26.9	41.6		
No. Approvals > $0.5m			33	51		
($m)			39.0	80.0		
Approvals for Metro Area (%)			63.0	60.0	70.0	
Number of Lending Staff	N.A.	27*	25*	11	11	20
Average of Loans per Staff ($m)	N.A.	1.1	2.6	12.4	17.8	14.5
Leasing Approvals ($m)	N.A	10.1	7.7	9.8	6.7	N.A.
Equity Investments ($m)	0.7	1.5	14.9	36.9	14.2	23.2

* Denotes estimate.

High rates of VEDC funding advance continued after the stockmarket collapse of October 1987. Of 257 applications made in 1987/88, approval was granted to 224 totalling $110 million. Loan approvals in 1987/88 brought total loans outstanding (before provision for bad and doubtful debts) to more than $266 million. Equity investments also grew at a fast pace over that year, rising from $14.4 million to $37.6 million. Much of the growth in the year's equity financing, however, can be attributed to the sub-underwriting of the unsuccessful Wallace International share float. Added to this, the VEDC converted several large loans to equity in other firms, virtually as rescue attempts for companies unable to meet interest commitments (Ryan 1988). By the close of the 1988 financial year, the VEDC's provision for doubtful debts had soared to $84.3 million (almost one third of the total loan portfolio). Losses on equity investments were proportionally even greater, and reached $24.4 million out of total equity investments of $37.6 million.

By late October 1988, the VEDC's loan problems had become unsustainable, and the Corporation was completely insolvent. In early November the VEDC's loan portfolio was taken over by the larger and more profitable Rural Finance Corporation (Dunstan, 1988). Less than two weeks later, Premier Cain appointed a chartered accountant, Fergus Ryan, to investigate the VEDC. While no evidence of corruption was found, Ryan was critical of poor management levels and standards.

Between 1984 and 1988, during the most explosive period of growth in VEDC lending, capital markets in Australia were awash with international credit [8]. Annual growth of credit in Australia averaged around 20 percent per annum over the second half of the 1980's (INDECS 1990,p141). New capital raising by listed companies in the 1980's also grew at rates unprecedented in the post-war years (Foster and Stewart 1991, p137). This included significant capital raising on Second Board markets, formed specifically to cater to the needs of small-to-medium sized firms seeking equity finance.

The 'gap' thesis had formed one of the main grounds for the expansion of the VEDC. It remains to be explained why the VEDC expanded its annual lending approvals at such an explosive pace during a period of unprecedented credit availability in the economy. Instead of simply facilitating access to capital markets for Victorian firms, the terms of that access seem to be the most significant characteristic of VEDC lending. The manager of BLE Capital (Westpac's venture capital subsidiary) has argued that the VEDC finance was characterised most by its concessional nature. The VEDC was able to lend to firms at rates below which other financial institutions could borrow their funds:

> They (the VEDC) were making advances below the rate at which a lending institution could borrow... We could not

8 An indicator that the source of much of the credit growth in Australia was international was that gross foreign debt in Australia climbed from around $20 billion in 1982 to almost $140 billion in 1989.

> compete with that" (Tilley, quoted in Duncan and Uren 1989, p46).

The VEDC itself recognised this. Its financing was explicitly pitched to be "between bank's requirements for security and finance companies' interest rates, (as well as offering) a flexible risk attitude, providing clients with financial services to their needs" (VEDC Annual Report, 1984/85).

Behind the VEDC's advance of two basic types of funding, development finance (such as loan and leasing finance), and venture capital (a combination of equity and management assistance), lay an important distinction between the nature of the relationships involved. It was anticipated in the Government's economic strategy that the VEDC would become a significant venture capital financier. Venture capital is typically advanced as equity rather than debt. However, by June 1988 only around 12 percent of the VEDC's outstanding finance (before provisions for bad debts and investments) was accounted for by equity investments. A large proportion of funds advanced by the VEDC was in the form of loans, and not equity. There are legal differences between capital advanced as either debt or equity. A more important distinction can be located in the economic character of the relationship. The crucial difference between venture capital and development credit is the nature of economic supervision and control exerted on assisted firms by providers of money (Thompson 1987). The economic differences between venture capital and bank loans (or industrial credit) was one of the central underlying tensions in the operations of the VEDC. The characteristics of venture capital and development finance are now discussed in turn.

The VEDC and Venture Capital

A venture capital relationship differs from the relationship associated with industrial credit. Venture capital has been described as an `alternative model' for organising capital investments (Sahlman 1990). Whereas lenders of industrial credit tend to confine their supervision to passive forms (like setting and monitoring repayment programs), venture capital financiers exert direct and active management influence over firms. "Venture capitalists usually take concentrated equity positions in the companies they fund and exercise significant influence on management" (Barry et. al. 1990, p447).

The designation of venture capital has typically been associated with high risk forms of investment in small-to-medium sized research-based firms. To minimise the risk associated with such investments and accelerate the process of product development or marketing, the venture capital relationship involves both the provision of money capital (usually in the form of equity, options or convertible loans), and `... individual management support by the venture capitalist' (DITAC 1988,p2). Whereas the form of management involvement differs (depending on whether the venture capital firm is associated with a trading company like Elders, an industrial company like BHP, or a banking company like Westpac) direct management involvement is a defining characteristic of the venture capital relationship. Typically, the relationship would involve the venture capital firm in board membership *and* financial, marketing or production planning assistance [9]. For this reason, the role of venture capitalists is often compared with leverage buy-out specialists, large stockholders and other active investors.

Firms receiving venture capital finance have typically been small and involved in research-oriented activities. Upon initial receipt of venture capital finance, they had not reached the stage of commodity production. Consequently, the venture capitalist often invests in the future earnings potential (of the investee), virtually without security. While such investments entail a greater risk, the attraction for venture capital firms has been the prospect of capturing high returns.

Internationally, venture capital expanded rapidly during the 1980's, following a trend that began in the late 1970's in the USA and some other countries. With many manufacturing industries being characterised by conditions of relative overcapacity, new investment

9 'Patient equity capital coupled with management support are two key features of the venture capital process' John Button, Minister for Industry Technology and Commerce, (DITAC 1988,pv).

was being focussed increasingly on two areas: cost reduction, and the search for new or niche markets. Cost reducing investments intensified the search for new more efficient production processes, while a redistribution of consumption expenditure to the so-called middle class encouraged the development of new products and services. Both areas were conducive to the growth of venture capital circuits.

Perhaps the most influential example of the potential profitability of investment in venture capital activities was the experience of 'Silicon Valley' in California in the 1970's. The example of venture capital assisted companies like Apple Computers, Intel, Federal Express, Microsoft and Compaq Computers helped create hopes that venture capital would continue to produce spectacular profits for investors in the 1980's [10]. The expectation that such `high rates of return would be repeated in the 1980's spurred unprecedented growth in the venture industry' (Jones 1988, p14). In the US, for example, the volume of venture capital funding grew from $287 million in 1978 to $4.1 billion by 1987 (Barry et. al. 1990).

Venture capital involves a form of financial relationship that closely approximates what has earlier been termed 'finance capital'. The designation of finance capital refers to a relationship between money and production, in which part of the management function of industrial capital is integrated with that fraction of the class providing the money capital (DeBrunhoff 1978,p55). The contemporary significance of such a designation is not that money capital is now necessarily dominant over production (or in its institutional proxy that banks are now more powerful than industrial firms), as suggested by Mintz and Schwartz (1990), Brewster Stearns (1990), and others. Rather it is that the circuits of money capital and industrial capital are more closely integrated, and that the forms and level of scrutiny and supervision are transformed (Bryan 1985; Thompson 1987; Poulantzas 1979).

10 Sahlman noted the example of the Apple Computers company. In 1978 and 1979, venture capitalists invested slightly more than $3.5 million in Apple Computers. When Apple went public December 1980 the approximate price of the venture capital investment had climbed to $271 million (1990,p482).

Venture capital firms were not only offshoots of banks and other financial institutions. Venture capital firms and funds were spun off from a variety of industries, drawn towards the prospect of high returns. As one writer observed:

> The steady increase in the number of corporations with formal venture capital programs results from a growing attitude that, to remain competitive, large corporations must have a way to access the stream of advanced products and new market opportunities developed by smaller, entrepreneurial companies. (Jones 1988, p12)

In the 1980's in Australia, venture capital companies were established by banks, and life offices, but also by large trading and industrial firms, including BHP and CRA.

The involvement of the venture capital firm in active management stamps a particular quality on venture capital relationships. That quality also has a quantitative dimension. Usually, venture capital investors are involved intensively in only a limited number and range of firms. Sahlman characterising venture capital funding suggested that, `[a]lthough a typical large venture-capital firm receives up to 1,000 proposals each year, it invests in only a dozen or so new companies' (1990,p475). A report on the Australian venture capital industry commented that growth in financing was being constrained not so much from lack of available funding, but from a lack of available management time in venture capital firms:

> Many [venture capital firms] have found that the unavailability of management time, rather than the limited funding to be the single most important reason for restricting the number of investments. (DITAC 1988, p2)

It is instructive that along with investment values, the MIC Licensing Board Annual Reports contained estimates of management time 'invested' by venture capital firms. The 1987/88 Annual Report, estimated that MIC companies devoted 47,000 hours of management time on investee businesses (p20).

It was in the context of attempts to establish the basis of an expanded venture capital circuit that the Cain Government signalled the intention to reconstruct the VEDC as a venture capital financier. The Victorian Government's economic strategy in 1984 presumed that VEDC had already developed a range of skills necessary to provide venture capital finance to industry. In June 1986, detailing the 'second stage' of the Government's economic strategy, the Victorian Investment Corporation (VIC) was established as an associate of the VEDC. These initiatives suggested an intensification of efforts to secure venture capital finance. There were other initiatives that also pointed in this direction.

State Extension Services

The restructuring and expansion of Victorian state assistance measures in 1984 included not only the greater provision of credit to industrial and commercial firms, but included the introduction of a range of other measures relating to management issues in small-to-medium sized firms. The economic strategy introduced a range of extension services for small-to-medium sized firms. The services provided such firms assistance to "upgrade their entrepreneurial skills and improve the level of innovation, design, technology and marketing" (*TNS*, p75).

The Cain Labor Government introduced a range of new management extension services to be coordinated through the Department of Industry Technology and Resources. These included subsidies for business planning consultancies in such areas as design, management practices, corporate planning and export market development. Extension services were also fostered through the establishment of technology and design centres, and a range of services associated with quality management.

In 1985, these measures were given further impetus when the Cain Government announced increases in funding for business planning services offered by the Small Business Development Corporation (later to transferred to the VEDC). This was given further ideological weight by the publication of a discussion paper in 1986, which argued that `Australian management skills are comparatively poor and that this is having an adverse effect on our competitiveness (DITR 1986). In July 1986, a *Technology Statement* (TS) was released which proposed a further expansion of state assistance to high technology industries. It noted that it was small firms that had been more innovative and research-oriented in recent years. The preponderance of foreign ownership amongst large firms was seen to be partly responsible for lower levels of research and development amongst larger firms (1986,p6).

In early-1987, the second stage of the economic strategy was encapsulated in the publication of *The Next Decade* (*TND*). It signalled a further expansion of the Government's state extension services for small-to-medium sized firms. In *TND*, economic growth in Victoria was linked even more closely to a project of increased innovation and growth in small-to-medium sized firms. *TND* noted that while a general decline in employment and activity could be observed in many existing industries (dominated by larger and more established firms), industries and firms of more recent origin with a technological emphasis were experiencing stronger (if more volatile) growth patterns:

> With certain notable exceptions, the commercial development of technology in Victoria has been driven by small firms. The achievement of many of these firms has been outstanding and the Government will continue to nurture these achievements. (TS 1986, p1).

The two statements went further than the earlier strategy in arguing that the decisive moments in competition between firms (and by extension in national competitiveness) had shifted from scale to management performance and technological leadership. It was suggested that `the quality of manufacturing technology and processes is becoming more important than input costs and scale factors in industrial competitiveness' (TS, p3). The second stage of the Victorian Government's economic strategy also redefined the focus of state assistance toward export oriented expansion, through `direct targeting on export growth' (*TND*, p5). The greater focus on export oriented growth included both a greater targeting on export oriented firms, as well as the introduction of new export assistance initiatives. New assistance measures included pay-roll tax exemptions for expanded export production and initial efforts to establish an international trading house, as well as export market training.

Importantly, the revised economic strategy redefined extension services. These services were expanded and tied explicitly to growth through export sales. Attempts were also made to link access to some forms of credit and export incentives to measures to ensure `the take-up better production, management and marketing practices' (*TND*, p60).

State officials from Victoria were also the driving force behind a Commonwealth/State agreement in mid-1986 that established the National Industry Extension Service (NIES). The NIES Scheme was established following the Clark Report in 1983 and the Cashman Report in 1984, which both concluded that a more systematic and co-ordinated extension service was needed if small and medium sized industrial firms were to become more internationally competitive and export-oriented. The basic objective of NIES was to develop an expanded, co-ordinated and more targeted range of services for developing manufacturing and certain other trade exposed activities in the services sector.

Two areas of state assistance were targeted for particular expansion under the joint federal/State extension service. The first involved programs based on industry field officers and business planning. The second involved the provision of a comprehensive range of information for small-to-medium sized firms. The NIES scheme was not just a program for coordinating certain forms of Federal, State and commercial industry extension assistance. Significantly, NIES also sought to provide a greater focus for assistance by `contact with firms as they seek to solve real *day to day* problems and seek to exploit real market, or product opportunities' (*TS* 1986). NIES was modelled on state extension services in agriculture, where the state's involvement in the `day-to-day' problems and operations of individual producers (along with forms of credit) has been articulated most fully.

It is therefore possible to locate a growing presence of elements of a finance capital relationship being articulated through State industry policy in Victoria. Against this however, is the fact that the majority of funds advanced by the VEDC were as bank (or industrial) credit. Finance capital remained at the margin of the VEDC's assistance to industry, and was articulated largely at an ideological level. The VEDC in operation can therefore be characterised predominantly through forms of money capital advance as a precursor to a project of industrial accumulation.

The VEDC and Banking Capital

From at least the late 1970's, a growing number of 'Australian-based' firms began to fund their expansion through direct access to international money markets, unmediated by local financial institutions. Other firms, however, remained reliant on domestic capital markets for credit. Lack of sufficient size acted as a bar to some firms wishing to access international money markets. The desire to secure access to an increased pool of credit (and tilting the terms of access of such credit away from banks toward the borrowers) became the grounds upon which a political coalescence of capitals occurred in the first half of the 1980's. The restructuring of the VEDC can thus be seen against the drive by an ambitious group of capitalists (and would-be capitalists) for access to cheap and easy credit (in the face of attempts to establish a circuit of finance capital). For such capitals, the VEDC would supply the preconditions for expanded industrial and commercial accumulation, by providing ready-access to cheap and flexible credit.

Banks (as the institutional source of interest-bearing capital) attempt to minimise the risk associated with such loans by calculations of industry and regional profitability, and through such other measures as securing the loans against forms of property, by risk premiums on different classes of lending, and by the establishment and supervision of repayment programs .

The VEDC, by contrast, advanced money to high risk ventures (often with no short-term capacity to service a loan), with little security to offer against the loans, and inadequate prudential supervision on the loans. The flexible approach to repayment and relatively low borrowing charges (due to a virtual absence of a risk premium in the interest rate) made VEDC finance very attractive to borrowers. It lent to firms not only with little security, but also with little cash flow either. Such risky lending would have normally been supplemented by greater supervision of borrowers (much closer scrutiny of repayment schedules for instance).

The VEDC's explosive increase in lending was not matched by its capacity to supervise the loan portfolio. In 1985/86 the number of lending staff actually declined. Ryan concluded that the VEDC had been under-resourced for a considerable period of time (1988, p49). Until the October 1987 stockmarket crash, this lack of supervision had not become critical, because VEDC credit often functioned as a form of `mezzanine' finance. VEDC finance acted as a short-term or interim source of funds for companies (often used until they sold equity to capital markets, such as the Stock Exchange Second Board).

The stock market collapse and its aftermath graphically heightened the tensions in the VEDC not just over the *nature* of VEDC management, but also as to the *adequacy* of that management. After the stock market crash, small high risk companies on the Second Board were severely affected. Of the 228 companies listed on the Second Board in 1987/88, only 86 (or around 30 percent) recorded a profit at all. Even fewer (less than 20 percent) improved profitability, and only 13 percent paid a dividend. By the end of financial year 1988, the market capitalisation of second board companies had more than halved compared to its peak in mid-1987 (Kohler 1989,p1). The dramatic turnaround in the second board also closed off further access to equity markets for many VEDC-assisted companies. The VEDC also continued to lend at a frenetic pace after the Stock Market collapse. Many of the companies receiving VEDC loans and equity were already in a distressed state and were soon back in financial difficulties.

Conclusion

After a spectacular expansion of lending and financing activity between 1982 and 1988, the VEDC's demise came as a severe blow to the Victorian Government. One writer suggested that the VEDC's demise was the beginning of a 'sclerosis' in the Labor Government (Davidson 1990, p9). The history of the VEDC has been identified here as mediating and embodying tensions in relations of competition between capitals. Specifically, the VEDC highlighted differences between two ways that money and productive circuits are integrated. On the one hand, the VEDC attempted to establish the preconditions for an integration of money and production, where the State would assume part of the role of industrial capitals - through taking on part of the role of management and supervision. On the other, the VEDC provided money capital to propel the accumulation project of a class of local capitalists in manufacturing. Both forms of money capital advance expressed the increasing importance of external finance (debt and equity) compared to internal funding (retained earnings) as a source of new investment (Bryan 1985, EPAC 1985). The VEDC also represented a regional mediation of international circuits of money capital directed toward promoting increasing employment and economic activity.

The open question as to whether the VEDC funds and supervision would articulate a relationship of finance capital or banking capital ran through much of the VEDC's history. One astute account of the VEDC captured this sense of contradictory funding projects, and concluded that,

> the key factors in the VEDC failure appear to be confusion over its key role as a venture capitalist' and a provider of development finance, compounded by an explosive growth in lending that could not be adequately assessed by the available staff.
>
> The essence of the VEDC function was to provide capital at the early stage of enterprise development which would not otherwise be available through conventional financial institutions.
>
> In other words, from the start it was intended to take risks that were unacceptable to conventional financial institutions.
>
> The key to the success of this type of operation is risk management. This means that not only do venture capitalists and development financiers have to provide money, they have to take a close day-to-day interest in the commercial activities of their clients. (Davidson 1988,p1)

While elements of a relationship of finance capital can be located in VEDC activities, they remained at the margin. For most of the VEDC's history, the major consequence of finance capital's intervention through the VEDC was at the ideological and political level.

A number of questions remain. One important question relates to capital-labour relations and how the conditions of expanded accumulation in manufacturing production will be secured (Aglietta 1979, MacWilliam 1989). Another relates to problems of commodity circulation. The reorientation of production toward global commodity markets raises the problem of securing those sales beyond the boundaries of the nation-state. Whether the accumulation project of an export-oriented fraction of capital in Australia can be sustained in a global economy experiencing sluggish growth and showing protectionist tendencies remains problematic. It is significant here that trade policy has emerged as a central axis of current economic debate.

By encouraging growth in local accumulation through commodity export, but without significant economic, political or military means of securing those markets, the State may have actually been encouraging not commodity export, but capital export. For individual capitals, direct investment in overseas markets has become a common form of expansion.

Finally, have the changed economic conditions of the last few years has constrained an accumulation project of a class of local industrial capitals, and widened the space for circuits of international finance capital. After the demise of the VEDC, the Victorian Government continued to fund venture capital through state superannuation funds. Recent initiatives by other fund institutions to establish venture capital arms may seem to point to such a shift. Against this, however, is evidence that venture capital activities have continued to decline, and that despite State efforts to expand such circuits, small manufacturers were reported to have `not substantially increased production for export' (Hadler 1988). A lack of potentially profitable investments in MIC venture capitalists had led to a situation where "MIC's have left a high proportion of their capital in the bank, and it is in the interest from this cash that is paying the managers of the various funds" (Roberts 1989). Levels of venture capital funding have also contracted internationally. In an effort to keep funds flowing, venture capital companies have been moving away from high-technology and toward 'non- or low-technology areas'- the so-called green chip investments (Jones 1988). Whether the MIC's and other venture capital institutions currently designate a relationship of finance capital therefore remains problematic.

It may not be through venture capital that an expanded circuit of finance capital is articulated in Australia. Banks and superannuation funds may be assembling the preconditions for such circuits directly, under pressures from the collapse of a number of companies, the continuing under-performance of many others, and the pushing and prodding of the state (Rafferty 1993). The structural preconditions for such a relationship have been made possible by changing circuits of money capital in Australia, which extend from the late 1970's, including shifts in new funding from retained earnings to sources of external finance (Bryan 1985). If so, it is nevertheless clear that the state will continue to play a crucial role in such a transition.

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