The election of a Conservative government in May 1979, led by Mrs Thatcher, wrong-footed both ODA and CDC. Whereas Labour policy had been for an expanding aid programme, the new government’s determination to restrain the growth of public expenditure resulted in an immediate cut. In June a reduction of £50 million for the current year’s budget was announced. Already, ODA was in trouble with the Treasury for overspending its 1978–79 budget. To mitigate the situation, it had made a plea to CDC to refrain from drawing £15 million of its loan allocation (out of £34 million) in March, against an understanding that it would be restored in the following financial year. CDC acceded reluctantly, and then the change of government took place. This resulted in ODA’s separate ministry status being abolished and, instead, it was made a department of the Foreign and Commonwealth Office.

The new chairman Lord Grey had a meeting with the new minister Neil Marten in July, but the elaborately prepared brief went to waste. Marten was unable to give any guidance on the future direction of aid policy or the role of CDC, pending a review by senior ministers. By August ODA had decided that CDC’s contribution to the cut in the aid budget would be a reduced allocation of £30 million for the current year, as against the previously advised figure of £38 million, and that no commitment could be made to restore the £15 million already foregone at ODA’s request from the previous year’s allocation.

The immediate impact of the funding cut back was not all that dramatic, since CDC was running large cash balances at the time. This arose from the slow rate of disbursement of funds on investment projects, especially in the agricultural sector, as well as on account of projects that lapsed for one reason or another, whereas CDC would normally draw its annual ration of funds from the aid budget on an
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entitlement basis. In order to help overcome the potential embarrassment of excess liquidity, CDC had followed a policy during the previous two years termed ‘controlled over-commitment’. This envisaged a high rate of Board investment approvals in the knowledge that the rate of disbursement would actually be much lower. Originally set at £60 million, approval rates were raised to £90 million in 1979, though disbursements were expected to be only £30–40 million, which was much closer to the availability of cash from the aid budget and self-generated funds. Actual disbursements in 1977 and 1978 had been £36 million and £33 million respectively. However, there was an underlying assumption that commitments would be turned into investments and that Treasury loan drawings were on an upward curve, so that the arithmetic would eventually be in balance. The sleight of hand removal of £15 million in March 1979, followed by the summer cut of £8 million, could be accommodated in cash terms at the time, but it carried a more sinister message for the assumptions upon which CDC had been operating.

CDC’s response to this transformation of its funding environment was nevertheless surprising. A paper in November 1979 carefully reviewed several options and sought guidance from the Board. The decision was to select the most aggressive option: to retain the £90 million level of new commitments for another year, dropping thereafter to £70 million, adjusted for inflation. How was this possible? The Board appears to have been strongly influenced by management concerns at the adverse effects of high inflation on the real value of the loan portfolio. Between 1974–77 the inflation rate had averaged nearly 18 per cent and a calculation had been made that CDC needed to add £47 million a year to its loan portfolio at current prices if its real value was to be sustained. This analysis underpinned the argument for trying to maintain a high level of investment activity. The other consideration was that in the discussions with ODA over the cut back in aid programme allocations, officials had broached the idea of CDC topping up its funding requirements with commercial borrowings. ODA had also mentioned the possibility of using part of its allocation to subsidise interest rates on commercial borrowings. In short, the way seemed to be opening for CDC to access financial markets, to the extent that government funding was not available. The model endorsed by the Board envisaged total CDC commercial borrowing building up to a maximum of £140 million over the following five years, as against a total of government borrowing of £440 million.

In February 1980 CDC was advised that the aid budget allocation for 1980–81 would be further reduced to £25 million, whereas the figure indicated before the change of government for that year had been £42 million. Despite the evidence that its model had become unrealistic,