PRIME MINISTER

MEETING WITH MR. FOWLER

You have read all the papers in the folder below except David's note attached to this minute. The draft Radical Options paper (at Flag H) stands as the final version. Mr. Fowler is not submitting a paper on presentation. He believes that effective publicity in the months ahead depends on the positive presentation of the various initiatives at Flags C, D, E and F.

David Norgrove has produced a valuable analysis of Mr. Fowler's Radical Options paper. David's important point is, in my view, in the last two paragraphs. The aim should be to create a constituency for more radical change. Such a constituency exists in education. It does not yet exist in health. Our task over the next few years should be to create a constituency for radical change without frightening off the public.

This is the last meeting which Ken Stowe will attend with you before he moves from DHSS. You might want a brief word with him after the meeting.

N.L.W.

N.L. WICKS
28 January 1987

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PERSONAL AND CONFIDENTIAL

PRIME MINISTER

TOWARDS BETTER HEALTH CARE: A CASE FOR CHANGE

No-one could disagree with the diagnosis that the pressure of demand for better health services will continue to increase. In economic terms, health care is almost certainly a luxury good, where demand rises more than proportionately with income. There is considerable scope for higher productivity in our health service. But this is likely always to be captured to help pay for increased output or to meet the amount by which pay increases exceed provision in the public expenditure plans.

The paper for discussion tomorrow is interesting and stimulating. But it seems to me to suffer from a confusion of objectives. In assessing the options it describes the key factors as their effect on the tax burden and their ability to generate additional resources for the health care sector as a whole. The thrust generally is to try to find less painful ways of financing more health care.

This is, however, to start from the wrong end. The starting point should be to ask how signals can be created both for those who use the health services and those who provide them which would allow them to take an undistorted view of the level of services which can be afforded. If a real market cannot be created we need to mimic it as far as possible. The problem of the health service is seen in the paper as a macro problem of financing. The true problem is a micro problem: that individuals cannot feel the costs of health care, or even know what they are.

This is illustrated in the distinction the paper draws between a tax-based system and an insurance-based system. The essence of a tax-based system is that finance is provided according to income and without regard to the individual's actual use of the health service or an assessment of the risk

that he may need to use it. The insurance-based system is likely to be identical in nearly every respect (both in the way it is perceived and in its economic effects) unless contributions are based on actuarial assessments and the health record of the person concerned or a contribution record buys a higher standard of service (as National Insurance Contributions do).

Turning to the individual options discussed in the Annex, the paper suggests that the buoyancy of the National Insurance Fund could be used to finance some or all of the demand-led part of the NHS. "This would not affect the level of public expenditure but might reduce the PSBR".

As the paper says, more financing through the National Insurance Fund need not affect expenditure, though only provided the change in financing has no effect on the total of expenditure. But in that case I do not see how there could be any effect on the PSBR.

The advantage of using the National Insurance Fund in this way would be much as for any form of hypothecation: it would secure greater transparency of the link between expenditure and revenue. Pressure for higher spending would feed directly into a need for higher revenue. The weakness of the proposal is that, unless insurance contributions were paid on actuarial and health record considerations, there would be no strengthening of the link between expenditure and contributions at the level of the individual. More important, with rising incomes and falling unemployment, the National Insurance Fund is likely in the coming years to be very buoyant. A surplus on the National Insurance Fund could easily become a highly potent source of pressure for higher spending on the NHS.

The proposal to raise more revenue through hotel charges would reduce public expenditure and create an incentive for individuals to be sparing in their use of health service

resources. Appendix A, however, suggests that the potential income is likely to be less than £1 billion at the very outside. It is not likely to be a buoyant source of income, nor would it fundamentally change the nature of the financing of the health service. It may be worth doing for its own sake but it is not a solution to the long-term problem of the demand for health care.

The proposal for increased revenue through commercial activity is certainly worth developing.

The proposal for introducing greater choice includes a suggestion for a voucher or capitation fee system. This would accord well with your approach towards education reform.

The proposal for the introduction of private capital would need to meet the usual criteria.

The proposals under the insurance-based strategy would need to answer the question how far they were truly insurance-based and how far they were in reality tax-based.

I wonder whether the time is yet right to pursue the more radical options. The ground has not been prepared. Equally important, the machinery is nowhere near in place to put them into effect: it would be pointless to start lengthy controversial discussions about options which would not be put into effect in the next Parliament. The need now is to make a start on the information needed before more radical changes can be considered. In particular, inter-region and inter-district charging is worthwhile in its own right and a necessary starting point for more radical change: insurance, vouchers, capitation fees, etc., all have to be based on a knowledge of costs. The DHSS could be asked to pursue this with greater urgency and to propose a timetable for its full introduction.

On less radical options:

- greater use of National Insurance Contributions needs to be discussed with the Chancellor;

- you will have your own views about the political feasibility of hotel charges;

- Mr. Fowler could produce more detailed proposals on possible commercial activities;

- proposals for the introduction of private capital cannot be discussed without specific examples.

N.L.W.

DAVID NORGROVE

28 January 1987

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