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From the Private Secretary

1 July 1988

Dear Geoffrey,

NHS REVIEW

The Prime Minister held a further meeting yesterday to discuss the review of the National Health Service, the eighth in the present series.

I should be grateful if you and copy recipients would ensure that the record of this discussion is shown only to those with an operational need to see it.

Those present at the meeting were the Chancellor of the Exchequer, the Secretary of State for Social Services, the Chief Secretary, Treasury, the Minister for Health, Sir Roy Griffiths, Sir Robin Butler, Mr. Wilson and Mr. Monger (Cabinet Office), and Mr. O'Sullivan (Policy Unit). The meeting had before it papers dated 28 June from the Chancellor of the Exchequer on tax relief, from the Chief Secretary, Treasury, on financing hospitals, and from the Secretary of State for Social Services on contracting out, self governing hospitals, consultants and medical audit; and a minute dated 28 June from the Chancellor of the Exchequer on Supply and Demand.

The group first considered tax relief and contracting out. The Chancellor of the Exchequer said that since the last meeting he had reconsidered, in the light of the points made at that meeting, the scope for tax relief for private insurance premiums. He started from the view, set out in his minute of 28 June, that the problems in health were on the supply side, to be solved mainly by supply side measures. There was no shortage of demand, and indeed demand exceeded supply. To increase demand by extensive measures of tax relief would therefore run a substantial risk of simply putting up prices. Despite this, there was a political case for tax relief on premiums paid by the elderly, as he had suggested earlier. He now proposed a modest extension of this to provide relief from the benefits in kind charge on premiums paid in respect of the elderly by employers.

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But he was convinced that, against the supply and demand background he had described, it would be a mistake to go further. There were also more specific arguments against the possible extension of relief which had been mentioned at the last meeting. Relief at the higher rate for premiums paid by or for the elderly would complicate the administration of the relief, increase the cost and substantially reduce the political attractions of the change. The other proposal was that the income limit above which benefits in kind were taxed should, for private health premiums paid by employers, be raised substantially above £8,500. Such a change did not seem necessary to promote the expansion of company schemes, which were now growing at the rate of 7 per cent a year. But it could prove highly repercussive, especially in encouraging pressure, which was already considerable, to raise the income limit for benefits in kind generally.

In discussion the main points made were as follows:

- a. The acceleration in the growth of company schemes was very recent, and perhaps only a response to the current controversy over the NHS. If the other changes being discussed succeeded in improving the NHS, the relative attraction of the private sector would be reduced. It could not be assumed therefore that the recent spurt in the growth of company schemes would be sustained.
- b. The fundamental question for the Government was whether it wanted the great bulk of the population to continue to be dependent on the NHS for all their medical treatment. Such a situation would mean high and growing calls on public expenditure and inadequate freedom of choice for the patient. Procuring a substantial shift to the private sector in the longer term was a very high priority of policy.
- c. Company schemes had the great advantage that they gave employers an incentive to hold down the costs of private medical treatment.
- d. It was not clear that there was a real shortage in the supply of medical services. There was evidence of a surplus of medically trained people, both in this country and abroad.
- e. Another method of encouraging growth of private insurance among the working population would be the contracting out scheme, limited to cold elective surgery, suggested by the Secretary of State for Social Services. Growth of individual insurance would not have the advantage of growth of company schemes in giving employers an interest in holding down medical costs. It might therefore not be as attractive as tax relief, but it should certainly be considered if tax relief going beyond the elderly were rejected.

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The group then considered the papers by the Chief Secretary on the financing of hospitals and by the Secretary of State for Social Services on self-governing hospitals.

The main points made in discussion were:

- a. The group had earlier identified a major defect in the present arrangements for funding hospitals. This was that they did not get more money if they attracted more patients. The proposal put forward by the Chief Secretary was designed to improve this situation by holding back the money provided each year for real growth in the health budget - typically about 2 per cent - and allocating it separately to reward performance.
- b. This proposal would however have an effect only at the margin. The great bulk of funding for hospitals would continue to be provided under the present procedures. It would be better to make a more fundamental change under which all the money for a hospital was paid under contract in payment for services provided by it. The need for the hospital to win contracts, and perform them satisfactorily, across the whole range of its activities would be a powerful incentive towards greater efficiency.
- c. On the other hand, the proposal by the Chief Secretary should be seen as providing only the first steps in a long-term programme of change. It was certainly desirable to move towards making hospitals dependent on performance under contract for the whole of their revenue. This would be achieved when self-governing hospitals were fully developed, and the papers on financing hospitals and self-governing hospitals therefore needed to be considered together. But here as elsewhere the difficult question was how to manage change and to move gradually and without upheaval to the right long-term position.

The group then proceeded to the papers by the Secretary of State for Social Services on consultants' contracts and medical audit.

The following were the main points made in discussion:

- a. There was no doubt that the consultants' present practices made the proper management of NHS resources more difficult, and that action was needed. But it was important to attack the right target. The question of where the consultants' contracts were held was not for example of great practical importance. The objective was to ensure more flexibility in the use of consultants, especially through the power to transfer them between hospitals, and to get their participation in management.

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- b. It should not be assumed that the necessary changes would require changes in the contracts. Pressing for changes in the contracts might lead to a confrontation with the profession, and be expensive if the existing contracts had to be bought out. In practice some improvements had already been made in working practices within the terms of existing contracts. The first step for the Government should be to see how far it could achieve its objectives for the profession without changes in these terms.
- c. Proper arrangements for medical audit were most important and the objective was to make participation in them obligatory for consultants. How this could best be achieved required further consideration. The profession itself seemed anxious to move in this direction. It might well be that this was a change which could be made without a formal change in the contracts, which indeed already implied participation in audit arrangements.
- d. The fundamental solution to the problem of consultants would be to make them independent and self-employed, selling their services to the hospitals under contract.

The Prime Minister, summing up the discussion, said that the group had not yet made a definite decision about the extent of tax relief, or about contracting out. These issues would require further consideration.

As to consultants' contracts, it would be helpful if Sir Roy Griffiths could circulate a note to the group setting out in particular the changes which in his view could be accomplished without changing the contracts.

More generally, it was important that the changes proposed by the Government should be coherent and have a clear direction. Recent discussions had perhaps been too concerned with detail and had lost sight of the overall strategy. It was clear that more must be done to encourage the growth of the private sector and to move towards a situation in the NHS in which suppliers of health care were paid according to the services they provided. There was much to be said for a solution broadly along the lines proposed by Lord Trafford and his colleagues. Under this the district health authorities would become buyers of services from hospitals. Family Practitioner Committees would be abolished and their work absorbed into that of the district health authorities, as in Northern Ireland. The regional health authorities might also be abolished. Hospitals would depend for their income entirely on winning and retaining contracts from the buyers, and this would put them under effective pressure to be efficient. The problem of the consultants might also be dealt with by making them self-employed contractors selling their services to the hospitals. This solution needed to be considered further.

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In public presentation it would be important to bear in mind the distinction between the changes that would be made quickly, and the longer term objectives. One solution might be to have a White Paper with green 'fringes', setting out firm proposals for the present and more tentative thinking about how longer term objectives could be achieved.

N At the next meeting arranged for 8 July, Ministers would want to assess the overall package and in particular consider whether it was sufficiently comprehensive and coherent. For that meeting, the Cabinet Office should circulate a note summarising what the package would look like on the basis of the discussions so far.

I am sending copies of this letter to the Private Secretaries of the Ministers attending the meeting, and to the others present.

Yours,
Paul

PAUL GRAY

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