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cc G Grumse (B'ham)

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

7 June 1988

Dear Geoffrey,

NHS REVIEW

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

I should be grateful if you and copy recipients would ensure that this record of the 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 minutes dated 3 June from the Chancellor of the Exchequer, 'NHS Review: Tax Relief', and from the Secretary of State for Social Services, 'A Mixed Economy of Health Care'.

In discussion the following were the main points made:

a. It was essential to achieve substantial growth of the private sector. Otherwise the growing demands for health care meant the costs of the NHS would continue to escalate. The rate of growth in private health care had been relatively slow over the past few years, and this suggested that a major boost was now needed. Action on the supply side, for example on the restrictive practices of the professions, would be important, but by itself was unlikely to be enough. Action to stimulate demand for private care would also be necessary.

b. There was a very strong case for tax relief for private medical insurance premiums paid by the elderly. Although contrary to the general thrust of tax policy in recent years, it stood a good chance of being cost-effective in encouraging more private provision and should not be unduly repercussive. It would also be politically attractive, especially if

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it were extended, as described in the Chancellor's minute, to premiums paid in respect of the elderly by younger members of their families.

c. The mechanism for tax relief for the elderly described in the Chancellor's minute had many advantages. It would be right for the relief to start at age 60 and a MIRAS-type arrangement would have the attraction of providing the same relief for non-taxpayers as taxpayers, even though relief for non-taxpayers would score as public expenditure. It was doubtful however whether it would be right to restrict the relief to the basic rate. The argument against extension to the higher rate was that it would make the relief much more complicated for the sake of a small minority of taxpayers (a higher proportion of whom were likely already to have private health cover). On the other hand, premiums for the elderly were so substantial that relief at the higher rate might be necessary to provide them with enough incentive to take out private insurance. This aspect of the scheme should therefore be looked at further.

d. It was argued that exemption from tax as a benefit in kind of premiums paid by employers under company schemes raised much more difficult issues of tax policy. The deadweight cost of this relief would be high (about £80 million), and it was unlikely to be good value for money in promoting an expansion of private insurance. It was also likely to be repercussive. On the other hand, it was argued that tax relief going beyond the elderly was required to give the necessary boost to the private sector, and that relief for company schemes would respond to the growing pressure from employees for the introduction of such schemes.

e. The relief for company schemes might be better targeted, and therefore more cost-effective, if it did not apply to premiums paid in respect of people at the highest levels of income, who were the group most likely to have taken out private medical insurance already. A way of achieving this would be to raise from £8,500, for health insurance premiums only, the level of income above which benefits in kind were taxed. This option should be further considered.

f. The option of some form of contracting out should also be considered further. It could be restricted to cold elective surgery and would then make a contribution to cutting queues, which were largely made up of people awaiting treatment of that sort. There would be dead-weight costs, but in assessing the balance of costs and benefits it was important to take account of the behavioural consequences of introducing the scheme.

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The Prime Minister, summing up the discussion, said that the group were agreed that a substantial boost to the growth of the private sector was required, through action on demand as well as supply. The group saw considerable attraction in tax relief for health insurance paid by or for the elderly, along the lines set out by the Chancellor of the Exchequer. They saw some objection however to the restriction of the relief to the basic rate. This aspect should be looked at further, and the Chancellor of the Exchequer should arrange for a paper to be circulated to the group accordingly. The main question however was whether tax relief should extend more widely than the elderly. One possibility was the exemption from tax as a benefit in kind of premiums paid by employers under company schemes. The group saw arguments for such a concession, in view of the need to make a big impact on the growth of the private sector. But it also raised difficulties from the point of view of cost and tax policy. Before taking a final decision the group wanted to consider whether there were ways of improving the targeting. One way which had been suggested was that the relief should apply only to those with earnings up to a specified level, which would have to be much higher than the level of £8,500 above which benefits in kind generally were taxable. The Chancellor of the Exchequer should arrange for this option to be considered further, and a paper prepared for the group.

On a separate matter, the Chancellor of the Exchequer had agreed to send her a note on the tax treatment of employees in relation to provision of workplace nurseries.

The Secretary of State for Social Services had suggested that another option was the introduction of a system of contracting out for cold elective surgery. It was unlikely that it would be right to have both contracting out and extensive tax reliefs. But the group agreed that the contracting out option should be considered further and the Secretary of State should prepare a paper on it, in consultation with the Chancellor of the Exchequer.

It had already been agreed that for the next meeting of the group papers should be prepared on a number of practical aspects of change: on financing hospitals, self-governing hospitals and capital allocation, issues to do with the professions, and audits. These papers should be discussed between Departments in the Cabinet Office group before circulation to the Ministerial group. Thereafter the group would need to have a more extensive discussion of the whole package as it was now developing. The further papers which had been commissioned at this meeting on tax relief for the elderly, tax relief for company schemes, and contracting out should be ready for that discussion. In looking at the whole package, the group would need to consider whether it was sufficiently radical. Radical change would be necessary if the growth of public expenditure on health was to be contained. The option of major changes in structure was still open. In particular, the method of financing hospitals would need to be radically changed so that they receive their income under contract; and the future of the health authorities

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needed to be reassessed.

I am copying this letter to the Private Secretaries of the Ministers at the meeting, and to the others present.

Yours,
Paul

PAUL GRAY

Geoffrey Podger, Esq.,
Department of Health and Social Security