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PRIME MINISTER

Financial arrangements for self-governing hospitals

HC 65

Paper by the Secretary of State for Health and the Chief Secretary, Treasury

DECISIONS

This paper has, subject to one important point, been agreed between Mr Clarke and Mr Major. It is the first time that detailed proposals for the financial arrangements for self-governing hospitals have been put before the group. Together with the proposals on pay, the paper represents important and useful progress.

2. The arrangements proposed appear to provide considerable freedom for self-governing hospitals. They would own their own assets and be free to dispose of them without limit, subject to a reserve power of the Secretary of State to intervene. They would be able to retain end-year surpluses and build up reserves. They would appear to have the power to raise private capital if they chose, although you may wish to put this beyond doubt. Subject to this and any other points raised in the discussion, and to resolution of an outstanding disagreement between Mr Clarke and Mr Major, you may wish to welcome the general approach of the paper.

3. The outstanding disagreement is whether an annual limit should be put on borrowing by the self-governing hospitals. Mr Major argues for one, Mr Clarke against. Since the hospitals' borrowing will be public expenditure, and in effect backed by the Government's credit, it seems hard to argue that it could be without limit. But you may wish to run over the arguments and resolve the point.

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4. For the rest, you may wish to raise some or all of the following, just to check that there are no points which have been overlooked or are unacceptable:

i. extent of control by Secretary of State;

ii. building of new hospitals;

iii. change of ownership of self-governing hospitals;

iv. taxation;

v. power of self-governing hospitals to pay dividends;

vi. audit arrangements.

ISSUES

5. The proposals in the paper represent considerable common ground beween Mr Clarke and the Chief Secretary. They would also appear to provide self-governing hospitals with a good deal of financial flexibility. Subject to the points which follow, and to resolution of the disagreement about external borrowing limits, you may wish to welcome the general approach of the paper.

Controls over borrowing

6. Two important issues arise in relation to borrowing.

7. First, there is the question whether self-governing hospitals should be free to decide whether to borrow from the public or the private sector. On this the paper says in paragraph 11, although without enthusiasm, that hospitals "could be allowed to borrow from the private sector and/or Government". This is the point to which the group attached the most importance at its last meeting. You may wish to put it beyond doubt, and in particular to check whether hospitals would need permission from the Secretary of State and the Treasury to raise private capital. There is an important difference between having the formal power to do something, subject to consents, and actually being free to do it if a board of management so decide.

8. Second, there is the question whether the Government should each year place a limit on each self-governing hospital's total borrowing from all sources. This is the point on which Mr Clarke and the Chief Secretary are in disagreement, as explained in paragraphs 8 to

10 of the paper. Mr Major believes that since all borrowings by the hospitals will count as public expenditure, there should be an annual limit on it fixed by the Government. Mr Clarke thinks this would be unduly restrictive. You will wish to resolve this disagreement. Earlier discussion in the group has already established the importance of having a clear financial framework for self-governing hospitals: this is the other side of the coin from the freedoms which the Government will be giving them to manage their own affairs. You may feel that it would be very hard to defend giving hospitals an open-ended ability in effect to commit the Government's credit, alone of all the bodies in the public sector. If Mr Clarke is worried that hospitals may be unduly restricted, one option might be for his Department to retain a reserve which they could allocate during the year to those hospitals which could make a case for exceeding their own limits.

Other controls

9. The paper emphasises the need for maximum freedom for the hospitals. But it mentions in several places the possible need for the Secretary of State to have special controls, and you may want to probe these. Examples are:

i. the Secretary of State is to have reserve power to intervene if a disposal of assets is against the public interest (paragraph 3);

ii. the Secretary of State is to have power in extremis to dismiss the board of a hospital and remove its self-governing status (paragraph 14);

iii. the Secretary of State will need some limited specific powers on the sale and purchase of assets and size and use of reserves (paragraph 14);

iv. Ministers will need to consider whether there should be specific powers over prices (paragraph 15);

v. there will need to be adequate monitoring arrangements to protect the position of the Department's Accounting Officer (paragraph 18).

10. You might also ask if there would be any control over the hospitals' investment programme, as there is for other public corporations.

New hospitals and joint ventures

11. You might ask Mr Clarke what his thinking is on the construction of new hospitals in the public sector. For instance, who would decide when and where they would be built? Could self-governing hospitals build new hospitals themselves, or in joint ventures with the private sector? If they were joint ventures, how far would the controls in the paper (e.g. of total borrowings) still apply?

Change of ownership

12. You might also ask whether and in what circumstances, self-governing hospitals could go into the private sector, for example by a management buy-out, or takeover by a charity or religious order.

Taxation

13. You may wish to probe the tax position of self-governing hospitals, which, according to paragraph 16, still needs to be considered. Is there any risk of difference of treatment between them and hospitals remaining under DHA control?

Dividends

14. Public corporations, on whom the treatment of self-governing hospitals is generally modelled, have on occasion paid dividends rather than interest on their capital. In their case, the arrangement was often artificial, but for self-governing hospitals it might have some advantage in bringing their financial structure closer to that of the private sector. You might ask whether the system now proposed would allow the future introduction of public dividend capital.

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Audit

15. Paragraph 18 says that self-governing hospitals will be subject to audit by the Audit Commission, like the rest of the NHS, but paragraph 19 that the NAO will have access to their papers and be able to include them in their VFM studies. You might ask if there is a risk of duplication and conflict between the two auditing bodies.

AJW.

R T J WILSON
Cabinet Office
13 December 1988

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