BRIEFING

The Health Foundation

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NHS Finances – The challenge all political parties need to face

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46%

of voters in the Ipsos MORI's January 2015 political monitor said that the NHS was a very important election issue.

The NHS is one of the key issues of public concern in the run up to the 2015 general election. Ipsos MORI's January 2015 political monitor found that 'health care and the NHS' was the most important issue for voters ahead of the election, with 46% saying it was a very important issue. This had increased from 26% shortly before the last general election.[1]

In part, this reflects the enduring public commitment to the principles of the NHS. But it also reflects the growing evidence and concern about the strains on the service.

The Health Foundation will be publishing a series of briefings and blogs in the run-up to the 2015 general election, to inform the ongoing public debate on health care policy. These materials will analyse and discuss key issues raised by political parties and others about health care policy and the NHS.

In this briefing we set out our analysis of the funding issues facing the NHS. The briefing covers:

- UK health funding in the context of past trends and international comparisons of health service spending
- English NHS finances over the current parliament
- The outlook for NHS finances over the next parliament and beyond.

All the financial figures in this briefing are expressed in real terms (adjusted for inflation) using 2014/15 prices based on the GDP deflator published by HM Treasury in December 2014.[2]

This briefing draws on four accompanying *Funding overviews* which contain more detailed figures and references. They are available at **www.health.org.uk/fundingoverview**

SEE ➲
Funding overview: Historical trends in the UK;
Funding overview: International comparisons
www.health.org.uk/fundingoverview

UK health funding in context

In 2012 the UK devoted 9.3% of gross domestic product (GDP) to health, matching the OECD average but below many of the UK's European partners.* Health spending as a share of GDP averaged 9.9% among the EU-15 nations.** Only five EU-15 countries spent a lower share of GDP on health (Greece, Italy, Finland, Ireland and Luxembourg), although the UK's relative position has risen since 2000 when it spent less than all but one (Ireland) of the other 14 countries. The UK also has a relatively low number of hospital beds and doctors and nurses per head of population.

Spending a high proportion of GDP on health care is not necessarily a good thing – the key is the efficiency and effectiveness of spending. Evidence on the relative efficiency and effectiveness of the UK health system varies. Recent work by the Commonwealth Fund ranked the UK as one of the highest performing health care systems of 11 countries studied,[3] but research by the OECD suggested there is significant scope for improvement.[4]

Although spending on health in the UK is relatively modest by international standards, the share of spending which is funded by taxation is comparatively high. In 2012 publicly funded health spending† accounted for 84.0% of UK spending on health compared to 72.0% across the OECD and 76.5% across the EU-15.

Government spending on health more than doubled from 3.6% of GDP in 1949/50 to 7.5% of GDP in 2013/14

Since the NHS was founded in 1948, government spending on health across the UK has outstripped inflation and economic growth, growing by an average of 3.7% a year in real terms between 1949/50 and 2013/14. As a result, government spending on health more than doubled from 3.6% of GDP in 1949/50 to 7.5% of GDP in 2013/14.‡ Within this overall rising trend, funding growth has varied substantially over different periods. The 2001/02 to 2004/2005 parliament saw the highest period of spending growth for the UK NHS at 8.7% a year in real terms. The current parliament will have had the lowest rate of growth in health spending across the UK since 1955 (0.6%). Figure 1 shows the increase in public health spending since 1949/50.

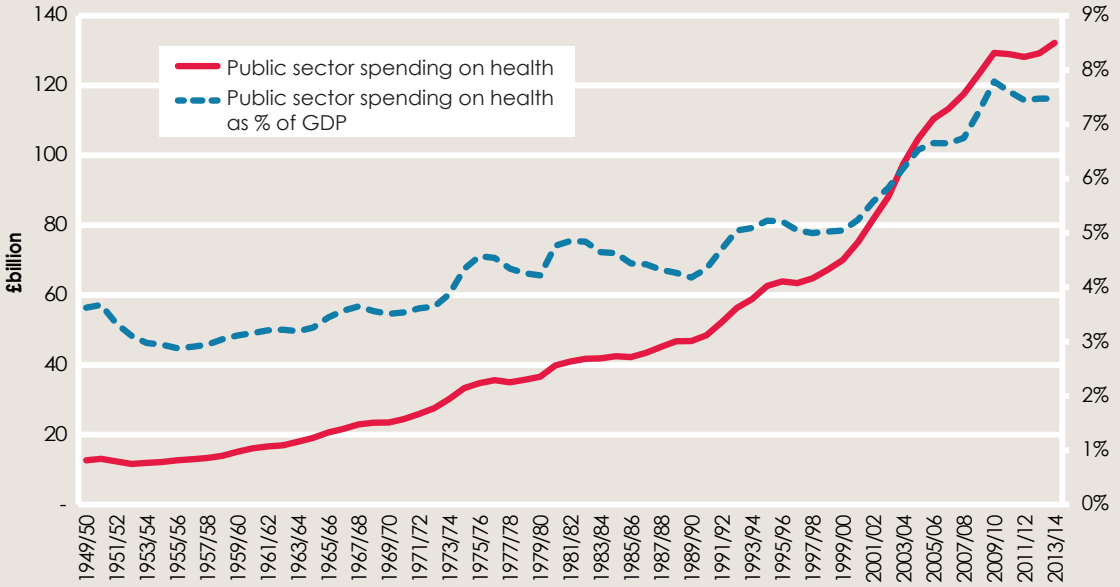
* 2012 is the most recent data for which international comparisons are available from the OECD. International data compares the UK as a whole with other countries.

** The EU-15 are the member countries of the European Union prior to the accession of ten candidate countries on 1 May 2004. The EU-15 comprised the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.

† Public expenditure on health care is made up of all governmental expenditure on health care including expenditure in prisons and defence. Research and development and education and training in health care are not included. Private health care expenditure is defined as private household spend on medical goods and services, private health care insurance, expenditure by not-for-profit institutions serving households (includes charities and other non-profit organisations) and private sector capital. Private household spending on medical goods and services include goods such as over the counter pharmaceuticals and services such as dental services and private hospital services. (Office for National Statistics: Expenditure on healthcare in the UK: 2012. www.ons.gov.uk/ons/rel/psa/expenditure-on-healthcare-in-the-uk/2012/art-expenditure-on-healthcare-in-the-uk--2012.html)

‡ These figures do not completely match the OECD estimates as data has been revised since 2012 by the Office for National Statistics.

Figure 1: Public spending on health in the UK, in real terms and as a percentage of gross domestic product (GDP) (2014/15 prices)



Source: Author's calculations, using data from: *Public Sector Statistical Analyses 2014* (HM Treasury), *Fiscal Facts: Spending by function* (Institute of Fiscal Studies), *OHE Guide to UK Health and Health Care Statistics 2013* (Hawe E and Cockcroft L), *UK National Accounts – The Blue Book* (Office for National Statistics), Quarterly National Accounts (Office for National Statistics), *GDP deflators at market prices, and money GDP* (HM Treasury).
Note: GDP deflators for 1949/50 to 1954/55 were estimated by using the GDP deflators available for the calendar years 1949 to 1954, calculating the yearly change in GDP deflator for these years and applying them to the fiscal years.

Private health spending includes goods such as over-the-counter pharmaceuticals and services such as dental and private hospital services

In 2012, private spending represented 16.0% of total UK health spending. Together with 2010, this was the lowest proportion since records began in 1997. This reflects the greater impact of the prolonged economic downturn on private health spending relative to public spending. Private health spending fell by an average of 2.8% a year in real terms between 2008 and 2012, a dramatic change from the annual average real terms growth of 5.1% a year in the decade before the 2008 downturn.

SEE ➲
Funding overview: Current NHS spending
www.health.org.uk/fundingoverview

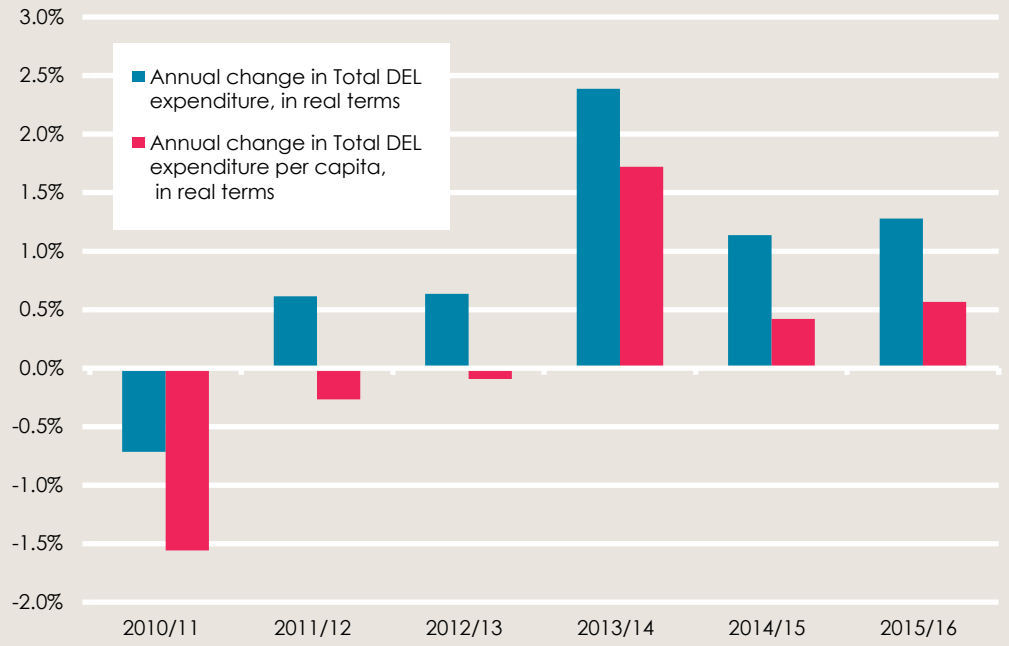
English NHS finances in the current parliament

Decisions about the funding and management of health services are devolved to the different nations of the UK. The remainder of this briefing focuses on the NHS in England. The English NHS is the responsibility of the Department of Health and, as such, will be the focus of the health policy proposals of the main political parties in the run-up to the general election.

Following the last general election in May 2010, the incoming coalition government committed to protect health spending in England from the cuts to public spending which were introduced to tackle a fiscal deficit that had reached a post-war high of 10.2% of GDP in 2009/10.[5] This commitment was expressed in terms of the Department of Health's capital and resource Departmental Expenditure Limit (TDEL excluding depreciation).

Over this parliament as a whole, the government will have met this commitment. By 2015/16 spending on the NHS in England will have risen by an average of 0.9% a year since the last election. As figure 2 shows, spending fell in real terms at the beginning of the parliament but it has since increased and in the last financial year (2013/14) spending grew by 2.4% in real terms.

Figure 2: The annual change in English NHS spending since 2009/10



Source: *Public Sector Statistical Analyses 2014* (HM Treasury); *Autumn Statement 2014* (HM Treasury); ONS population estimates.

Since the last election spending on the NHS in England will have risen by an annual average of

0.9%

Overall public spending on health has been protected, but this is against a backdrop of a growing population. Over the current parliament the population of England will have increased by 1.65m people (3%). As a result, spending per person actually actually fell in real terms over the first three years of the parliment and only increased in 2013/14. Over the parliment as a whole, spending per person will have fallen by 0.05% a year on average. However, this almost certainly underestimates the impact on the resources available to treat patient demand as the population has also aged. Average NHS spending for retired households is nearly double that for non-retired households. There is also much variation within this age group: the average cost of providing hospital and community health services for a person aged 85 years or over has been estimated by the Department of Health to be around three times higher than for a person aged 65-74 years. During the current parliament the population aged 65 and over will have increased by 10.7% and the population aged 85 and over increased by 9.0%.[6]

The modest real terms increase in health spending is in the context of a reduction in spending on other public services in England. Over the five years from 2010/11 to 2015/16, the real terms cut to unprotected departments is expected to average 19.9%.[7] Social care services are the responsibility of local government. Social care spending in 2013/14 was 6.5% lower than in 2009/10. This is equivalent to an annual average fall in social care spending of 1.7% a year in real terms.

Despite its relative protection, the NHS is showing increasing signs of financial distress

Despite its relative protection, the NHS is showing increasing signs of financial distress. The number of NHS providers (acute and specialist hospitals, community services organisations and mental health trusts) reporting a deficit doubled between 2012/13 and 2013/14, with 66 trusts in deficit in 2013/14. Halfway through the current year, six out of 10 NHS providers could not balance their books. In 2013/14 the overall combined deficits of NHS providers exceeded the combined surpluses by just over £100m. The problems have largely been concentrated in the acute sector. At the end of September 2014, 81% of all NHS acute hospitals in England were in deficit and acute hospitals (both foundation and NHS trusts) reported a net deficit amounting to just over £700m.

The deterioration in NHS finances despite the protection given to the health service budget reflects a series of factors. In the early years of this parliament the NHS performed well against finance targets. Administrative costs fell sharply and pay pressures were significantly reduced as the government's policy of pay restraint held down wages. Spending on some services actually fell (most notably GP services and prescribing). But spending on other services, principally acute and specialist services, grew at a much faster rate. Between 2009/10 and 2012/13, funding for general practice fell at an average annual rate of 1.3% in real terms while funding for hospital services increased at a rate of 2.0% in real terms.

The NHS also delivered headline savings from its Quality, Innovation, Productivity, Prevention (QIPP) programme of more than £11 billion in the first two years of this programme (in 2014/15 prices). System productivity also appeared to increase above the historic trend, at around 2.13%–2.38% a year* in 2010/11 to 2011/12.

* depending on the choice of mixed or indirect input index used

In 2013/14 spending on temporary staff grew by

28%

Since 2013, NHS financial performance has become an increasing challenge. There are two key reasons for this:

- **Increased staff costs** – specifically nursing in response to concerns about the quality of care following the scandal at Mid Staffordshire and the subsequent review by Sir Robert Francis QC,[8] which led to new NICE guidance on safe staffing levels and a requirement to publish ward staffing levels. In 2011/12 and 2012/13 the number of nurses employed by the NHS fell, but in 2013/14 the overall number of nurses increased by 1%, with acute, elderly and general nurses increasing by 2% in that year alone. In addition, as the NHS struggled to recruit permanent skilled staff, spending on temporary staff grew sharply from £3.6bn in 2012/13 to £4.6bn in 2013/14 (2014/15 prices) – a 28% increase in just one year.
- **A focus on short-term cost savings and a lack of progress on more transformational change**. The level of cost savings across the NHS has fallen since 2012/13 and hospitals are finding it increasingly difficult to realise planned savings. As the Health Select Committee has commented in several reports, the NHS has been over-reliant on the one-off effects of pay restraint and administrative cost savings and on reductions in the tariff payments to hospitals for the care they provide. Progress on more fundamental change has been slower than planned – and required.[9]

As a result of the growing pressures on health service finances, in December 2014 the government stepped in with significant additional funding for the NHS

As a result of the growing pressures on health service finances, in December 2014 the government stepped in with significant additional funding for the NHS. In the current year (2014/15) the Treasury is increasing the Department of Health's budget by £250m, and is allowing money to be shifted from the capital budget to fund higher running costs (£490m). In 2015/16 the Department of Health's DEL budget has been increased by a further £1.25bn. Without this additional funding the NHS would have almost certainly overspent its budget for the first time since 2005/06.

SEE ➲
Funding overview: NHS funding projections
www.health.org.uk/fundingoverview

The outlook for NHS finances over the next parliament and beyond

In their October 2014 *Five year forward view*, NHS England published updated estimates of the funding pressures facing the NHS in England for the next five years (2015/16 to 2020/21).[10] They estimate that NHS funding pressures will be £30bn higher at the end of the decade, over and above inflation. These pressures result from the impact of a growing and ageing population, rising expectations of care, new technologies and increasing input costs (staff, drugs, etc). The report goes on to estimate the additional funding requirement above inflation under three scenarios for productivity. These are shown in Table 1.

Table 1: NHS England estimates of funding pressures facing the NHS in England by the end of the decade

Annual productivity growth assumption	Funding requirement in 2020/21 above inflation
0.8%	£21bn
1.5%	£16bn
2-3%	£8bn

Note: NHS England's projections of total spending are in cash terms, allowing them to explore the impact of cost pressures (such as pay) separately to assumptions for GDP deflators. The budget for NHS England is then assumed to rise with inflation

Between 2004/05 and 2011/12 annual productivity growth in the English NHS was

1.5%

NHS England argue that, by implementing the ambitious programme of service redesign set out in the *Five year forward view*, the NHS could deliver productivity improvements in the range of 2-3% a year and thereby reduce the additional funding requirement to £8bn in 2020/21 over and above inflation. Although the NHS in England delivered productivity improvements of just over 2% a year for the first two years of the current parliament, maintaining productivity growth at this rate to 2020/21 would represent an unprecedented level of health service productivity improvement for such a long period. Research by the University of York found that between 2004/05 and 2011/12 productivity in the NHS grew by an average of 1.5% a year – higher than the longer run UK average for health care of 1% a year.

We have used the methodology developed by Roberts and others when at the Nuffield Trust[11] to extend the funding projections to 2030/31. Our analysis looks at the pressures on the English health budget from trends in the demand for care and the cost of inputs (staff, drugs etc). Under our central projection, the NHS in England will continue to achieve annual productivity growth close to 1.5% a year between 2015/16 and 2030/31, in line with recent trends. Under these assumptions, if a high-quality comprehensive service is to be maintained, **funding will need to rise by around 2.9% a year in real terms, which is above the expected rate of economic growth of 2.3% a year**. The results of our analysis are shown in table 2 and figure 3 overleaf.

If NHS productivity matched the estimate of the whole-economy trend rate of productivity growth (2.2% a year), public spending on health as a share of GDP could remain broadly constant and meet projected pressures. However, there is no evidence that productivity at this rate could be sustained in the medium term. Health care provision is relatively labour intensive and it is therefore likely that productivity growth will be slower in this sector than in the economy as a whole. Over the medium term, wages in the health sector would still need to rise in line with those in the whole economy. This would lead to what is known as 'Baumol's cost disease', where the cost of health

services rise relative to other sectors of the economy that are less human labour intensive. To maintain an increase in the level of service provided that is in line with increases in real output across the rest of the economy, government spending on health would have to increase more rapidly than GDP growth.

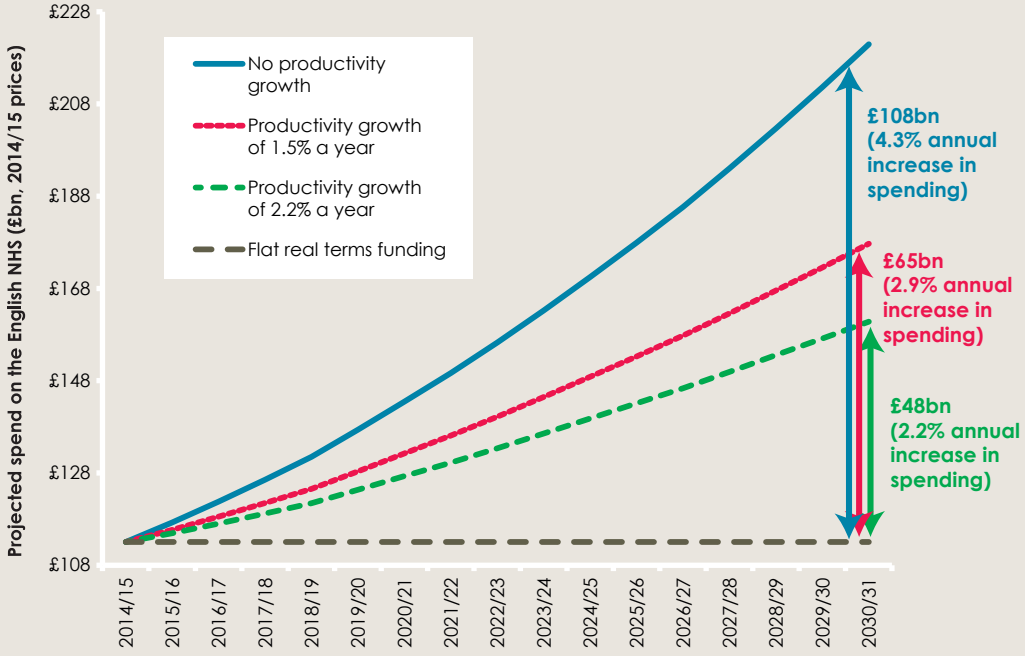
Table 2: Health Foundation projected funding gap for English NHS in 2030/31 under three assumptions for productivity

			Health Foundation estimated funding gap in 2030/31 (2014/15 prices):		
Annual rate of productivity growth	**Average annual increase in English NHS spending pressures**	**NHS England estimate of funding gap in 2020/21**	**Budget stays flat in real terms**	**Budget rises by 1.5% a year in real terms**	**Budget rises by 2.3% a year in real terms**
0.0%	4.3%	£30bn	£108bn	£78bn	£58bn
1.5%	**2.9%**	**£16bn**	**£65bn**	**£34bn**	**£15bn**
2.2%	2.2%	*	£48bn	£17bn	£2bn surplus

Source: *Roberts A. Funding overview: NHS funding projections.* London: The Health Foundation, 2015.

* The *Five year forward view* does not include a for figure for 2.2% productivity growth, the closest comparable figure is £8bn which assumes productivity growth of 2%, rising to 3% by the end of the five years.

Figure 3: Funding pressures on English NHS in 2030/31 (2014/15 prices)



Source: *Roberts A. Funding overview: NHS funding projections.* London: The Health Foundation, 2015.

After the election, all the main political parties are committed to reducing the fiscal deficit

Conclusions

The NHS has been protected from the full impact of the government's austerity drive to tackle the fiscal deficit. Despite this, the service is showing growing signs of financial distress and in December 2014, the government found itself having to inject significant additional resources into the service for both 2014/15 and 2015/16.

After the election, all the main political parties are committed to reducing the fiscal deficit, which will involve cuts to public spending. Health care now accounts for almost £1 in every £5 of government spending – just sustaining, let alone improving, the quality of care while delivering fiscal balance will be one of the major challenges facing any incoming government.

If NHS productivity continues to rise in line with recent trends, over the next 15 years, annual above inflation increases in NHS funding will need to be

2.9%

NHS England has set out an ambitious programme of reform for the NHS in the recent *Five year forward view*. This is designed to improve the system's productivity and modernise care to ensure that it meets the needs of an ageing population with growing rates of chronic disease. There is no doubt that change on this scale is required. The key question is: can it be delivered quickly enough to unlock the required productivity savings? Under NHS England's most demanding productivity assumption (2-3% productivity growth a year), they recognise that the NHS will still need an additional 1.5% a year real terms funding growth which amounts to £8bn over and above inflation by 2020/21.

Our analysis suggests that £8bn is likely to be the minimum amount needed to maintain the quality and range of NHS services over the next parliament. If this is to be achieved we would argue that any incoming government needs to do the following:

- Provide support for rapid progress on the new models of care set out in the *Five year forward view*. A key part of this support will be to resource a 'transformation fund' to provide the financial assistance necessary to underpin change. At least part of the financing for the fund might come from selling surplus assets in the NHS but it is additional to the ongoing NHS funding requirement.
- Commit to the additional annual funding for the NHS specified by NHS England. This rises to £8bn of additional funding over and above inflation in 2020/21, but the government should recognise that this is a low estimate and if pay pressures turn out to be higher than anticipated, the NHS will need further resources to maintain quality and access.

Our work also shows that the funding challenge facing the NHS doesn't disappear beyond the current parliament even if the NHS succeeds in implementing the vision set out in the *Five year forward view*. Our new estimates of the pressures on the NHS budget project that, even with unprecedented productivity improvements of over 2% a year, by 2030/31 these pressures would be £48bn more than inflation. Our central estimates, using the recent trend of 1.5% productivity improvements, see funding pressures increasing to £65bn over and above inflation in 2030/31. If successive governments are to meet these pressures NHS funding needs to grow slightly faster than GDP (2.9% a year compared to 2.3% a year forecast increase in GDP).

Beyond the current parliament, our analysis shows health funding pressures will continue to grow beyond the rate of inflation and economic growth

The task facing the next government is therefore not just to secure the resources and deliver service change for the coming five years but also to ensure the longer term sustainability of the health service. To do this we need to establish a public and political consensus on the longer-term funding levels for the NHS.

Beyond the current parliament, our analysis shows health funding pressures will continue to grow beyond the rate of inflation and economic growth. Over recent decades this has been possible as spending on other public services has reduced as a share of GDP, creating headroom for the health service without the need to increase taxes. It is difficult to see how this can continue indefinitely.

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About the author

Before joining the Health Foundation in May 2014, Anita was Chief Economist at the Nuffield Trust for four years where she led the Trust's work on health care financing and market mechanisms.

Anita was Chief Analyst and Chief Scientific Advisor at the Department of Culture, Media and Sport from 2007 to 2010 and, prior to this, she was Director of Public Spending at the Treasury from 1998-2007, where she led the team working with Sir Derek Wanless on his reform of NHS funding in 2002. Anita has a Masters in Health Economics from York University and has worked as an Economic Advisor in the Department of Health and for SmithKline Beecham pharmaceuticals in the UK and USA.

Anita is Vice-Chair of the Whittington Hospital NHS Trust and a Trustee of Tommy's, the baby charity.

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