

Briefing

THE KING'S FUND BUDGET BRIEFING 2010

With the Budget set to confirm that the NHS is facing the most significant financial challenge in its history, new analysis from The King's Fund shows the extent of the productivity gap it needs to address.

Key points

- After years of unprecedented growth, the English NHS budget for 2010/11 will increase by just 1.6 per cent in real terms.
- Additional demand arising from demographic changes will cost an additional £1.1–£1.4 billion a year over the next few years – equivalent to a real terms spending increase of around 1 per cent.
- With NHS spending set to be frozen in real terms from 2011/12, the NHS faces a productivity gap of £21 billion by 2013/14.
- New analysis from The King's Fund shows that this gap could be reduced to £14 billion by looking again at assumptions about future spending in three key areas – staff pay and pricing (eg, medicines), reducing waiting times and capital investment.
- Closing this gap would require productivity gains of 3–4 per cent a year – still a significant challenge given the NHS's past productivity record.
- Improving productivity must be the NHS's top priority if it is to maintain quality and avoid having to cut services but it must also look to manage cost and demand pressures.
- Politicians must be honest about the scale of the challenge ahead and help the public understand that some local services may need to change to deliver the productivity gains needed while maintaining quality.

Background

Health will once again be one of the key battlegrounds in the general election campaign. Polling shows that health care is second only to the economy in terms of the issues that will influence how people vote,ⁱ while over 80 per cent of people say the NHS should be protected from spending cuts, significantly more than any other area of public expenditure.ⁱⁱ

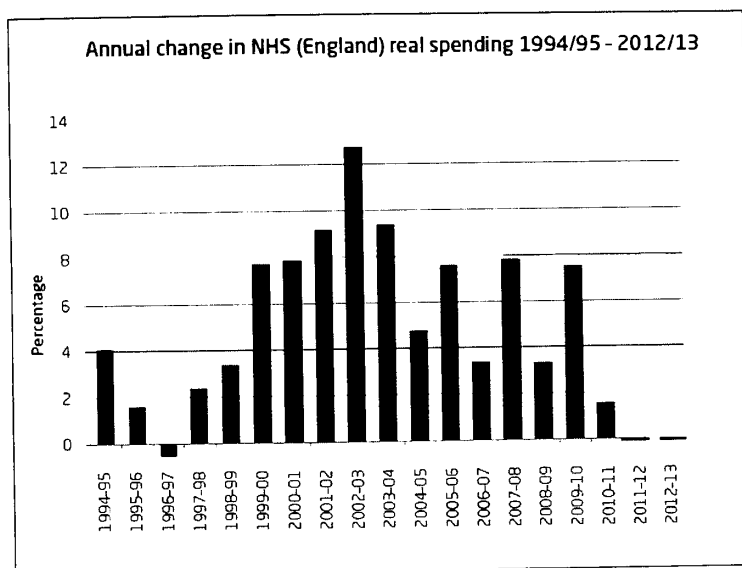
Against this backdrop, the main political parties have been anxious to reassure the public that the axe will not fall on the NHS budget. The government has pledged to increase 'frontline' NHS spending in line with inflation, while the Conservatives have promised to 'protect' health spending in real terms (the Liberal Democrats have not made any specific spending commitments on health).

Although detailed plans are unlikely to be published until a spending review later this year, the Budget is likely to confirm NHS expenditure for the next three years. A number of announcements about the NHS budget were made in the Pre-Budget Report.

- The government will stick to the previously announced increase in NHS spending in 2010/11, taking the total NHS budget in England to around £105 billion – this represents a real terms increase of 1.6 per cent.

- Frontline NHS spending (defined as 'the 95 per cent of spending that supports patient care') will rise in line with inflation in 2011/12 and 2012/13.
- Annual efficiency savings of £10 billion a year will be achieved by 2012/13, as a milestone on the way to delivering the £15-£20 billion in savings the NHS has been challenged to achieve by its Chief Executive.
- In line with other public sector workers, NHS staff pay increases will be capped at 1 per cent (in cash terms) in 2011/12 and 2012/13.
- The NHS will also be affected by a 1 per cent increase in employers' National Insurance contributions which will be introduced from 2011.

The graph below illustrates the impact of the planned 1.6 per cent real terms increase in the NHS budget for 2010/11 and the anticipated real terms freeze in spending in 2011/12 and 2012/13 (this assumes a small cut in the 5 per cent of NHS spending not described as supporting patient care).



The NHS productivity gap

In July 2009, The King's Fund and Institute for Fiscal Studies published *How Cold Will It Be? Prospects for NHS funding: 2011-17*. This included new analysis assessing the potential impact of the economic downturn on future NHS spending by modelling anticipated funding levels against the projections of future funding needs estimated by Sir Derek Wanless in his report to the Treasury in 2002, which remains the best assessment of future health funding requirements.ⁱⁱⁱ

This analysis suggested that demographic pressures are likely to cost the NHS an additional £1.1-£1.4 billion a year in the period up to 2017. Other things being equal, this would require annual real terms increases in spending of around 1 per cent in order to keep pace with demand and maintain the quality of services.

Overall, the analysis suggested that NHS expenditure would need to rise to £126 billion by 2013/14 to meet the Wanless projections.^{iv} If, as currently seems likely, there is no real rise in health spending from 2011/12, this would leave a shortfall of **£21 billion** a year, unless

productivity is improved. Closing this gap would require annual productivity gains across the NHS of around **6 per cent**. To put this into context, productivity in the NHS has fallen by an average of 0.4 per cent a year over the last decade.

New analysis

New analysis from The King's Fund looks again at the assumptions underpinning the funding projections set out by Wanless in his report and assesses them against progress made since 2002 and in the context of the pressure on the public finances. This analysis suggests that the productivity gap could be reduced by looking again at assumptions about future spending in three key areas.

- **Pay and prices:** Wanless assumed year-on-year pay increases for NHS staff of 2.5 per cent above inflation. In the current economic circumstances, a real terms pay freeze could be implemented (indeed the Pre-Budget Report has already announced a 1 per cent cap on pay increases in 2011/12 and 2012/13). Together with more aggressive procurement of, for example, medicines, we estimate this could reduce the productivity gap by around **£3.5 billion** by 2014.
- **Waiting times:** given the progress made in reducing waiting times – for example, in delivering maximum waiting times of 18 weeks between referral and treatment and four hour waits for A&E – it can be argued that the further reductions in waiting times assumed by Wanless should not be a priority. Not pursuing further reductions in waiting times could reduce the productivity gap by around **£1.4 billion** by 2014.
- **Capital investment:** Wanless assumed strong progress in increasing the number of single en-suite hospital rooms and continued investment in new buildings. Given the unprecedented levels of investment in the NHS estate in recent years and strong arguments that better use of existing facilities should be the priority, it could be argued that growth in capital investment should be reduced. Assuming much lower growth in capital expenditure could reduce the gap by **£1.6 billion** by 2014.

Revising previous assumptions about future spending in these three areas would lessen the productivity gap by around £6.5 billion a year by 2014, reducing it to around **£14 billion**. This would reduce the productivity improvements required from 6 per cent to **3-4 per cent** – still a significant challenge to the NHS given its past productivity record.

Conclusion

Although detailed spending plans will not be set out until later in the year, the Budget is likely to confirm NHS expenditure for the next three years. In doing so, it will underline the scale of the challenge the NHS faces and frame the terms of the health debate for the foreseeable future. Our analysis begins to highlight the key decisions that will need to be made to minimise cost pressures and the remaining productivity improvements the NHS will need to deliver. Politicians must be honest about the scale of the challenge ahead and help the public to understand that some local services may need to change in order to improve efficiency and maintain the quality of services.

¹ Ipsos Mori Political Monitor, September 2009

² Ipsos Mori Public Spending Index, June 2009

³ Wanless D(2002). *Securing Our Future Health: Taking a long term view*. London: HM Treasury.

⁴ The Wanless report modelled three different scenarios, each of which made different assumptions and estimates about the demand for and supply of health care including the impact of factors such as demographic change, NHS productivity and developments in health technologies. This analysis is based on the middle scenario – 'solid progress' – which The King's Fund's analysis suggests the NHS is on course to meet and seems the most appropriate in the current economic circumstances.

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