King's Fund

Briefing

FEBRUARY 2006

Where's the money going?

In March 2005, the King's Fund published *An Independent Audit of the NHS Under Labour (1997–2005)*, which included an analysis of where extra NHS funding had been spent. This briefing provides an update to the question 'Where's the money going?' It analyses new data recently released by the Department of Health and reveals how much money is absorbed by higher pay and other cost pressures and how much is left over for other developments such as reducing waiting times and other government priorities.

The figures in the document refer to cash increases for English hospital and community health services (HCHS). These cover all hospitals and services such as district nursing and health visiting but exclude general practice, dentists, prescription drugs and other, centrally determined spending. The total budget for HCHS in 2005/6 is around £49.8 billion and in 2006/7 it is estimated to be around £54.3 billion.

Prospects for 2006/7

New data from the Department of Health and further analysis by the King's Fund[1] suggest that nearly 40 per cent of the £4.5 billion cash increase for HCHS will be absorbed by pay rises (see Figure 1).

Higher prices and increases in costs associated with NICE recommendations, clinical negligence and increased costs for capital are estimated to absorb a further 32 per cent of the increase.

This leaves 28 per cent of the increase – £1.26 billion – to be spent on other developments, in particular, meeting waiting times targets and other government priorities. We have assumed a cash increase of 9 per cent, though the exact amount will not be known until next year, and on this basis, around 2.5 per cent will be available for other developments.

If the increase turned out to be lower – for example, 8 per cent – the amount available for other developments would reduce to just 1.5 per cent.

However, the Department assumes that the HCHS will be able to make efficiency savings equivalent to 2.5 per cent of this year's spend – £1.2 billion – which would, if achieved, in part make more money available and in part ensure services were delivered more cheaply.

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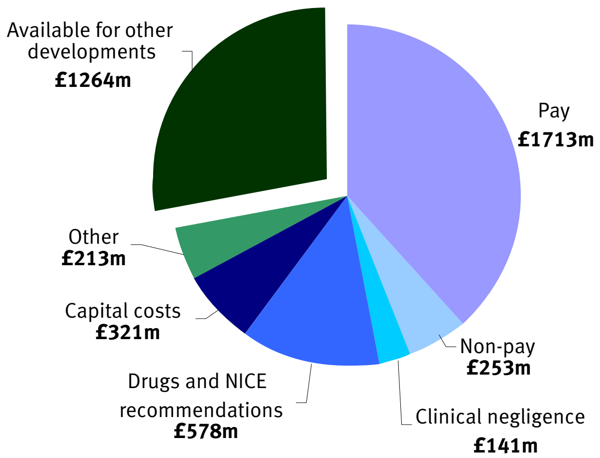
FIGURE 1: OF THE £4.5 BILLION CASH INCREASE IN 2006/7 FOR THE HOSPITAL AND COMMUNITY HEALTH SERVICES IN ENGLAND, 72% WILL BE ABSORBED BY HIGHER PAY AND OTHER COST PRESSURES

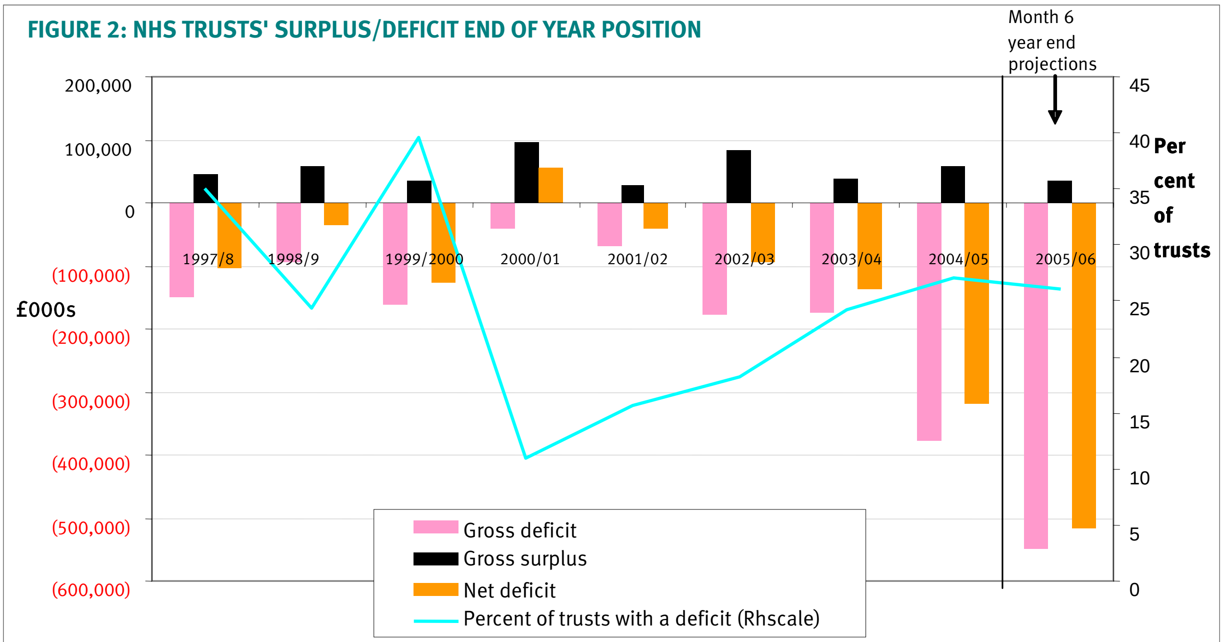


2005/6 situation

The new data from the Department of Health also revises the estimates of cost pressure and HCHS allocation for the current financial year – 2005/6 – and sheds more light on reasons for the difficult financial position of many NHS organisations this year.

Although deficits are not a new phenomenon, as Figure 2 shows, the projected year end deficit for 2005/6 will be the largest since 1997/8.

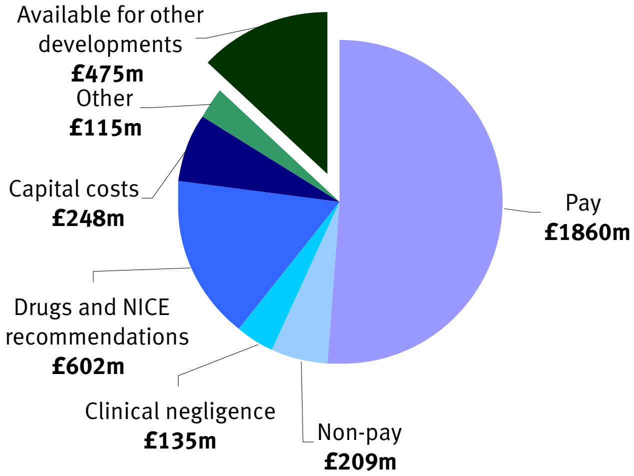
FIGURE 2: NHS TRUSTS' SURPLUS/DEFICIT END OF YEAR POSITION



Although this will be substantially reduced by the end of the year, estimates of the cash available in 2005/6 after taking account of cost pressures underlines how difficult the situation is.

Of the £3.6 billion cash increase (7.9 per cent more than 2004/5) this year, 50 per cent went on higher pay and a further 37 per cent on other cost pressures. This has left around £475 million (1.1 per cent over 2004/5) for other developments – such as meeting waiting time targets (see Figure 3).

FIGURE 3: OF THE £3.6 BILLION CASH INCREASE IN 2005/6 FOR THE HOSPITAL AND COMMUNITY HEALTH SERVICES IN ENGLAND, 87% WAS ABSORBED BY HIGHER PAY AND OTHER COST PRESSURES



As with next year, the Department assume that the HCHS will generate efficiency savings this year – around 1.7 per cent of last year's budget, or £769 million – which would increase resources available for development.

Commentary

- As in previous years, next year a significant proportion of the extra cash for the HCHS will go on higher pay. This is not in itself a bad thing – helping to retain and attract staff, for example. However, with consultant and nurse pay rates already near the top of the international league table, it raises questions about value for money.

- While the situation in 2006/7 looks better than in the current year, the Department of Health (ref) has decided to raise the tariff price for the work hospitals do by only 1.5 per cent[2] – well below the inflation rate for NHS costs. This will potentially leave hospitals with less cash than we estimate above to meet other development targets.

- Although the Department builds efficiency gains into their calculations of available resources, it is hard to ascertain evidence of previous efficiency targets being met. The target for next year of 2.5 per cent is high compared with previous years and there must be some uncertainty as to whether all hospitals will meet this, and whether attempts to cut costs also reduce quality and access.

For the current financial year, the revised figures from the Department emphasise a key reason underlying many hospital's deficit situation: while a lot of cash has flowed into the NHS, a lot has also flowed out again – on pay and other cost pressures – leaving relatively little for hospitals to fund increases in activity to meet waiting times targets and other must do priorities.

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[1] Notes: Data for this analysis is derived from the 2005/6 and 2006/7 'Implementing Payment by Results, Technical Guidance' issued by the Department of Health (http://www.dh.gov.uk/PublicationsAndStatistics/Publications/PublicationsPolicyAndGuidance/PublicationsPolicyAndGuidanceArticle/fs/en?CONTENT_ID=4127113&chk=ETLlj6).
This guidance includes estimates of the uplift needed to account for increases in unit costs in order to calculate national tariffs under payment by results.

[2] The NHS in England: the operating framework for 2006/7 (Department of Health: http://www.dh.gov.uk/PublicationsAndStatistics/Publications/PublicationsPolicyAndGuidance/PublicationsPolicyAndGuidanceArticle/fs/en?CONTENT_ID=4127117&chk=BgslVK)