CIPFA BRIEFING

August 2015

the health of health finances

Does the Government have adequate plans to deal with the financial pressures on the health service? This paper reviews the evidence by looking at recent financial results and forecasts and the pressures they indicate, making comparisons with trends in spending levels and analysing the specific pressures likely in future years. Current plans are based on the NHS's Five Year Forward View's assessment that £30bn of pressures are faced over the five years to 2021, and that £8bn of that will be offset by additional funding.

CIPFA concludes that the key figures of £30bn pressures and £22bn savings are both optimistic, and – ahead of the forthcoming Comprehensive Spending Review – makes recommendations for how the Government can improve the realism of the plans, and what actions it should take to make any plan a more deliverable reality.

Those actions include continuing with the Better Care Fund (BCF), setting aside invest to save funding and recognising the fundamental need to add further to the NHS budget. Do you charge users more or reduce services? It is vital that those matters are addressed in the right way as part of the realistic long-term planning which should form the core of the Spending Review.

CIPFA The Chartered Institute of Public Finance & Accountancy

Summary

It is clear that the NHS faces severe financial challenges. Are the Government's plans to deal with them adequate? This paper reviews the evidence by looking at recent financial results and forecasts and the pressures they indicate; making comparisons with trends in spending levels; and analysing the specific pressures likely in future years.

Current plans are based on the Five Year Forward View's assessment that £30bn of pressures are faced over the five years to 2021, and that £8bn of that will be offset by additional funding. CIPFA concludes that the key figures of £30bn pressures and £22bn savings are both optimistic:

- More analysis is required to validate the extent of the pressures, and especially to build in the cost of the new Government's manifesto health promises (which postdate the £30bn assessment) and to ensure there is sufficient upfront investment in the preventative actions which will generate future savings. The effects on health of any changes in other parts of the whole system which supports people should be taken explicitly into account in making future funding decisions.
- It isn't likely that the NHS can react fast enough in the early years to achieve the productivity gains required: that £22bn implies that efficiency improves at double the historic rate, and a high proportion of the actions which might deliver such a step improvement require the sort of radical transformation which takes time.

Given that context:

- The BCF must continue in order to prevent the knock-on effects on health services of a failure to invest in social care.
- The Government should set aside invest to save funding in order to make the upfront investments which will save in the future without undermining the short-term position.
- It will be necessary either to add further to the NHS budget, charge users more, or reduce services. To choose none of those is not a realistic option.
- Whatever the direction, whole system leadership is critical.
- A clear answer is needed to perhaps the most fundamental question of all: what should the Government be providing in terms of public services, and should it prioritise health above others?

It is vital that those matters are addressed in the right way as part of the realistic long-term planning which should form the core of the Government's forthcoming Comprehensive Spending Review.

Context

There is widespread acknowledgement across political parties, media and professions that the health service faces unprecedented financial challenges, and a strong degree of consensus on what needs to be done. That could be seen in the party manifestos before the election, and it hasn't changed since.

This briefing sets out the context and nature of the problem and, building on that, considers the possible means of addressing the situation. It draws strongly on the NHS Five Year Forward View[1] and the work of independent commentators, notably the Health Foundation's Briefing on NHS Finances[2] and material from the King's Fund and the Nuffield Foundation.

There are two main questions one might ask of the health budget: is it sufficient? And is it providing the best possible value for money? The two are of course linked, as better value for money allows more to be done with a given budget. Yet they're not the same, as value can be improved by meeting previously unmet demand, which provides no help in delivering to budget.

CIPFA is closely involved in the agenda for improving value across public services, and has been supporting the Best Possible Value stream of the NHS's Future Focused Finance initiative, which concentrates on decision-making processes. However, this paper is focused on the first question: is the funding envelope sufficient?

Evidence of pressure

Health spending has grown steadily in real terms and as a proportion of gross domestic product (GDP) since the war, but as the Five Year Forward View puts it:

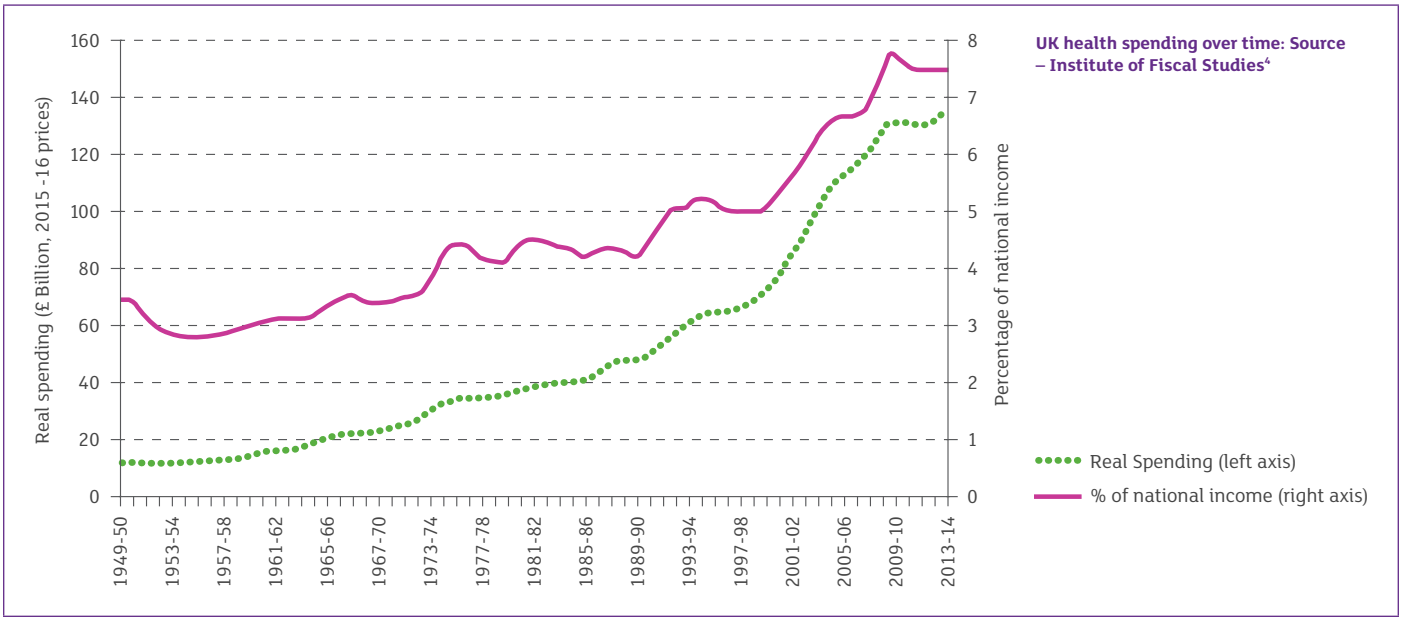
'Given the after-effects of the global recession, most western countries will continue to experience budget pressures over the next few years, and it is implausible to think that over this period NHS spending growth could return to the 6%-7% real annual increases seen in the first decade of this century'.

NHS spending was substantially protected in the previous parliament, such that it rose by an average of 0.9% per year over the five years. On the one hand this contrasts with the 40% reduction in central government support for local government[3], but on the other it does represent a much tougher position than the NHS has previously faced, especially given the backdrop of a growing and ageing population. Since 1950, annual growth has averaged 3.7% per year.

1 NHS Five Year Forward View: **www.england.nhs.uk/ourwork/futurenhs**

2 Briefing on NHS Finances, Health Foundation: **www.health.org.uk/publications/funding-briefing-collection**

3 See for example the Independent Commission on Local Government, Feb 2015 at: **www.cipfa.org/iclgf-home**



UK health spending over time: Source – Institute of Fiscal Studies[4]

Health spending in the UK accounts for a lower proportion of the gross domestic product (GDP) than in most countries of comparable wealth, and in contrast to the international picture the proportion of health spending funded through taxation stands at 98% compared to an average of 76% across the European Union. The central question therefore is how financially sustainable this is.

There are three ways of assessing extent of the financial challenge:

- Recent financial results and forecasts and the pressures they indicate.
- Comparison with trends in spending levels.
- Analysis of the specific pressures – extra population and new treatments etc – which are judged likely in future years.

These are considered in turn.

Recent results

Sixty six NHS trusts ended 2013-14 in the red – incurring overspends of more than £750m. This was up from 45 a year earlier and included 41 of the 147 foundation trusts – semi-independent of the Department of Health and NHS and meant to have the best-run finances.

Surpluses generated by other hospitals almost balanced out that £750m, but not quite, leaving the sector to post its first deficit – totalling £107m – since 2005-06.

The NAO report, The Financial Sustainability of NHS Bodies[5] concluded that headline measure of financial sustainability worsened between 2012 and 2014, mainly due to stress in trusts and foundation trusts, and that the trend was not sustainable.

In 2014-15 the overall outcome was similar, driven mainly by acute hospital deficits (£822m) partly offset by DH underspending (£503m, though that was largely reliant on a one-off £400m carried forward).

The NHS Trust Development Authority noted the 'wide span of financial positions planned by NHS Trusts across England and cited rising unplanned demand for care in a hospital setting as an important driver. This type of demand is often paid for by providers at a premium cost.

Monitor's Chief Executive David Bennett has concluded that the Foundation Trust sector, though accredited as a hallmark of excellence 'can no longer afford to operate on a business-as-usual basis and we all need to redouble our efforts to deliver substantial efficiency gains in order to ensure patients get the services they need'.

All the signs are that 2015-16 will be more difficult, with suggestions that last year's £822m trust overspend could at least double. 80% of trusts have forecast they will end up in the red, and the total year end deficit predicted is £2.1bn.

The Health Service Journal[6] was able to compare 2014 and 2015 forecasts at the end of quarter one for 137 of the 246 trusts: the increase between years was almost threefold.

4 NHS spending, to protect or not to protect, Institute of Fiscal Studies: **http://election2015.ifs.org.uk/nhs-spending**

5 The Financial Sustainability of NHS Bodies, NAO: **www.nao.org.uk/report/financial-sustainability-nhs-bodies-2**

6 HSJ 24 June 2015: Bailouts top £870m as trusts struggle to pay bills, Ben Clover

It's no surprise, then, that a survey of finance directors by the King's Fund[7] showed considerable concern amongst NHS trust finance directors:

- 70% are concerned about balancing their books in 2015-16.
- 60% said their trust relied on additional financial support or drawing down their reserves last year.
- 45% identified staff morale as one of their top concerns.

Commissioning bodies have historically found it easier to deliver, but the clinical commissioning groups (CCGs) are relatively new bodies which face some difficult challenges:

- The tariff system drives increases in provider activity such that, unless capacity is reduced, preventative action to reduce spend in one area is likely to lead only to additional demand being met in another area.
- CCGs are typically small, with less ability to spread risk than the predecessor PCTs.
- The BCF is principally funded from CCGs, which have effectively invested £1.9bn from national 2015-16 allocations with no guarantee of comparable savings in their own budgets, even if savings are achieved in the indicated timescales across the system as a whole.

The Health Foundation attributes this difficult position to two main factors:

- Increased staff costs in response to safety concerns – both for permanent (1% more nurses in 2013-14) and temporary staff (spending on temporary staff grew sharply from £3.6bn in 2012-13 to £4.6bn in 2013-14. In the provider sector alone, £3.3bn was spent in 2014-15, more than double the planned total.
- A focus on short-term cost savings and a lack of progress on more transformational change. Hospitals are finding it increasingly difficult to realise planned savings and the NHS has been over-reliant on pay restraint, administrative cost savings and reductions in the tariff payments to hospitals while 'progress on more fundamental change has been slower than planned – and required'.[8]

Comparison with trends

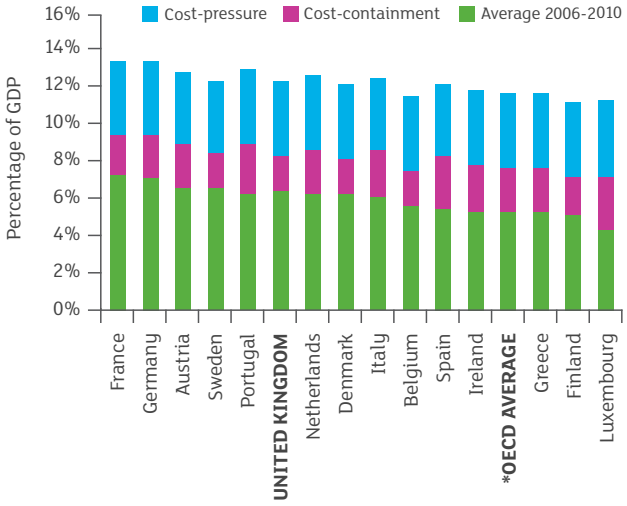
The NHS's Five Year Forward View judges that there will be £30bn new pressure on the health service over the coming five years, i.e. by 2020-21, and that £22bn of efficiency gains can be achieved – leading to the request for additional funding of £8bn in 2020-21.[9]

Is £30bn the right assessment of the pressures? That's an average of 5.2% per year on the 2015-16 budget of £115bn, and is based on the assumption of inflation being funded at the prevailing rate in addition. Comparison with past trends, international expectations and social care projections might be relevant:

Past: The 2001-02 to 2004-2005 parliament saw the highest period of spending growth for the NHS at 8.7% a year in real terms. That may indicate the 'unconstrained' rate of potential growth.

International: UK spend on health as a percentage of GDP remains relatively modest, and based on OECD projections, current UK plans would see that comparative position diverge slightly further from the norm. The Health Foundation's research shows the international consistency of pressures:

Source: OECD, Public spending on health and long-term care: a new set of projections.



OECD projections for average public spending on health for EU15 countries, as a percentage of GDP between 2006 and 2010, with projected spend in 2060 under both cont-containment and cost-pressure assumptions.

Social care: The Dilnot Report assessed the future real term pressures on social care at 3.3% annually under the current system (and 5.4% under the reformed system to be phased in from 2016-17).[10] Health services are subject to similar demographic pressures, plus the cost of new treatments and issues with the underlying health of the population, e.g. increased obesity-related conditions the expectation that new treatments will be provided. That is consistent with somewhat higher pressures in health.

7 King's Fund Quarterly Monitoring Report: **http://qmr.kingsfund.org.uk/2015/15**

8 Health Foundation – 'NHS Finances – The challenge all political parties need to face' at: **www.health.org.uk**

9 The July 2015 budget confirmed that this £8bn is additional to the £2bn injection made into the NHS in 2015-16, so it is fully available to offset the £30bn pressures.

10 See also the CIPFA Briefing Moving Ahead with Integration, April 2015, for a fuller account of social care issues

Analysis of factors

It would make sense to quantify the future pressures on the NHS, and hence to assess the reasonableness of the £30bn estimate for the five year 2016-21, by setting out a year-by-year estimate of the assumptions and impacts as follows:

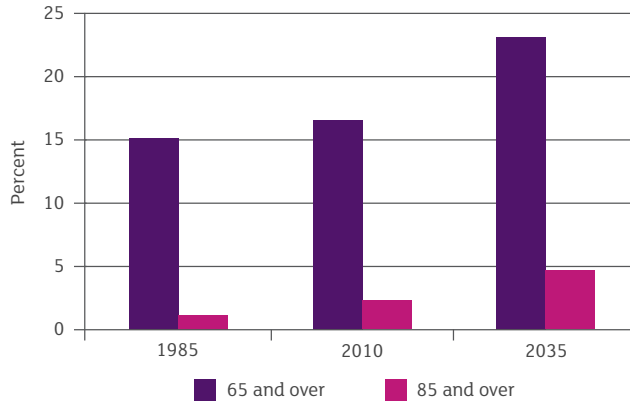
- Demographics - number and age of people.
- State of population's health, e.g. diabetes trends.
- Paying for/savings through new medical treatments.
- Any cost pressures beyond inflation assumption.

The Health Foundation runs an overall model which builds up projected costs from activity levels, as projected in line with the factors above, and incorporating an assumption of pay awards at 2%. The Foundation has stated that this yields a similar £30bn total estimate of pressures across the five year cycle.

The pay assumptions within the Government's £30bn modelling have not – understandably – been made public, but it seems likely that if the limit of 1% pay annual increases for four years (as announced in the Government's recent Budget) is delivered, that will help to make the projection more achievable.

On the other hand, that limit may be hard to maintain in practice; and if it is enforced successfully, could lead to recruitment difficulties and hence to additional pressure on agency budgets. On balance, it appears prudent not to adjust the £30bn headline for the Budget announcement.

Aging trend – source: Office for National Statistics[11]



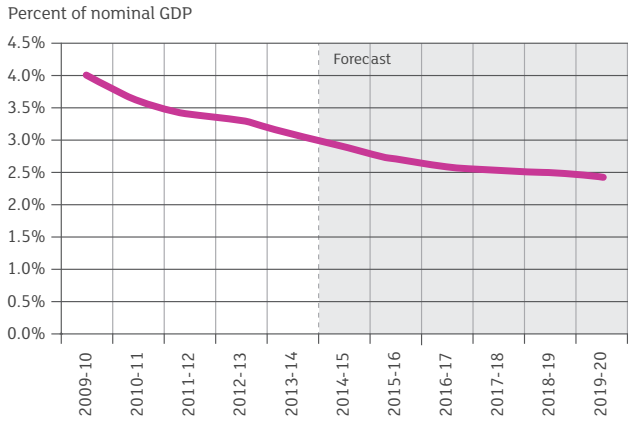
There are other factors not explicitly built in to those assessments:

- Any additional policy pressures: the Government's electoral pledges included providing access to a GP from 08:00 to 22:00, seven days a week, guaranteeing same day appointments to over-75's and training 5,000 more GPs by 2020.

  There were also more general aspirations such as making the UK a 'world leader' in fighting cancer and dementia, increasing funding for mental health and reviewing how best to support people with a condition such as obesity, or drug or alcohol addiction to remain in or return to work.

- Any knock-ons assumed from problems elsewhere in the system, e.g. underfunded social care or housing, or the effect of reductions in benefits.
- CIPFA analysis shows that, since 2009-10, local authorities' per capita spending will have decreased by 17.2% in cash terms. Adjusted for inflation, this represents a drop of 32%.[12] And all the indications are that local government (and social care, housing and public health budgets in particular) and benefits budgets will be severely restricted in the coming years.

Local Government Spending as a Proportion of National GDP[13]



Consequently, there is considerable burden on the BCF to deliver in order to ensure that health has the social care support it needs. Certainly were the BCF funding stream to cease after 2015-16, an indirect impact on health pressures would be inevitable.

11 **www.ons.gov.uk/ons/rel/mortality-ageing/focus-on-older-people/population-ageing-in-the-united-kingdom-and-europe/rpt-age-uk-eu.html**

12 See article July 2015 at: **www.publicfinance.co.uk/news/2015/07/council-spending-down-third-2010-cipfa-research-finds**

13 Final Report: Financing Devolution, Independent Commission on Local Government Finance

Assumed additional spend up front on prevention/ transformation. Far from acting consistently with the whole system actions required to cover those two factors – as flagged by the Five Year Forward View – the Government has announced further cuts in local government as a whole, and an in-year 2016-17 reduction of £200m (7%) in the ring-fenced budget for public health specifically.

That is the opposite of what is needed if pressures are to be offset by savings in the medium term. Public health reductions are particularly short-sighted and inconsistent with the Government's own stated strategy. In that context, the Wanless Review (2002) makes salutary reading as the Five Year Forward View admits:

'Twelve years ago Derek Wanless' health review warned that unless the country took prevention seriously we would be faced with a sharply rising burden of avoidable illness. That warning has not been heeded – and the NHS is on the hook for the consequences'.

Unless a way is found to make investments[14] up front and cover transitional costs (such as double running) as well as dealing with the immediate financial challenges, the same problem will be identified in 2020. In that longer term, the position will grow worse unless transformative change is initiated now for long-term advantage.[15]

Are £22bn of efficiency savings achievable in the necessary timescale?

Against that background of pressures, the key question is what savings can be realised. Annual productivity growth was 1.5% on average in 2004-12, but if only that is achieved, then there will be a shortfall of £16m.

The Forward View assumes 2% annual productivity gains in 2016-19, rising to 3% in 2019-21. If the £30bn assessment of pressures is correct, then that is an optimistic position as:

- it preceded the Government's manifesto pledge to increase seven day working in the NHS
- the comparatively high productivity gains in recent years (compared with a long-term average of 0.8% annual gain) have relied significantly on pay restraint, and that is likely to become harder to deliver, even with the recent budget announcements of a 1% cap on annual pay increases
- regardless of the merits of the concrete plans, practical problems are likely to arise: historic achievement has always tended to be less than the forward assumptions
- savings on this scale require radical action. A proportion of that is likely to be on unproven initiatives, which carry a big risk of delay or underachievement. That is, indeed, the approach of the Five Year Forward View, which is about transformational change through experimenting with different models of care.

Even if the £22bn efficiency improvements are achieved as planned, this would lead to a need to frontload the additional £8bn support as follows:

Cumulative	Pressures £bn	Efficiency £bn	Difference £bn*
2016-17	6.0	3.6	(2.4)
2017-18	12.0	7.3	(4.7)
2018-19	18.0	11.0	(7.0)
2019-20	24.0	16.5	(7.5)
2020-21	30.0	22.0	(8.0)

*Before additional £8bn support – CIPFA's assessment

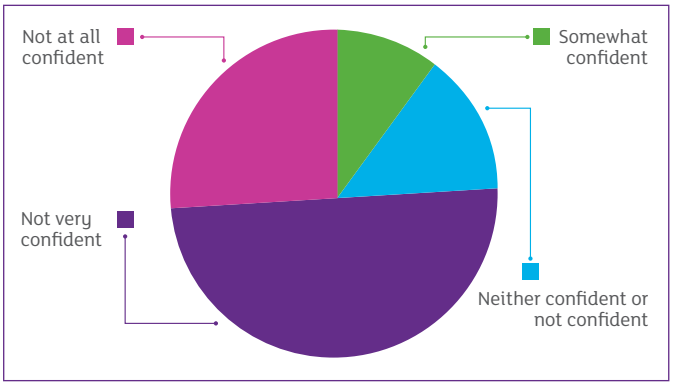
However, the deliverability of that £22bn efficiency programme in the timescale set out above must be subject to significant doubt. For example, the Nuffield Trust's survey[16] of a panel of 100 health leaders in February-March 2015 showed that they are confident that the Five Year Forward View identifies the challenges they face, but they are not convinced about its ability to help them generate the significant savings required.

14 As also called for recently by The Health Foundation and The King's Fund – see: **www.publicfinance.co.uk/news/2015/07/nhs-%E2%80%98needs-transformation-fund-addition-%C2%A38bn-spending-pledge%E2%80%99**

15 See also Prevention better than the cure: public health and the future of healthcare funding, CIPFA (2014): **www.cipfa.org/cipfa-thinks/health**

16 **www.nuffieldtrust.org.uk/our-work/projects/health-leaders-survey-results-1**

How confident are you that the NHS can meet the £22bn efficiency?



Three quarters of respondents (76%) said they are either not very or not at all confident that the NHS can meet the £22bn efficiency challenge. No respondents said they were very confident that the NHS could meet the efficiency challenge.

Consistent with that, Former NHS Chief Executive David Nicolson opined recently that the NHS faced "serious short-term financial problems" such that the £8bn boost needs to be "frontloaded" by being brought into effect from this year rather than merely made an ambition for five years' time[17].

Lord Carter's recent interim report[18] is also consistent with that assessment. It acknowledges that 'the NHS' long-run efficiency performance has been 0.8% annually. This has risen to 1.5-2% in recent years largely due to pay restraint, but the NHS needs to repeatedly achieve 2% net savings for the rest of the decade (perhaps rising to 3% by the end of the period)'. Examining providers, which spend the majority of the NHS budget, it identifies the potential for up to £5bn savings per year by 2019-20.

That's a significant contribution towards the £22bn, but much more is needed. Moreover the £5bn is based on relatively well-established ideas for improving efficiency – £2bn by improving workflow and containing workforce costs; £1bn each from improved hospital pharmacy and medicines optimisation; improved estate management; procurement management. Lord Carter acknowledges that further work is needed to deliver the more transformative change. It may be that the proposals for better comparative measurement of hospital efficiency will provide that driver, but that will take time to take effect.

This all suggests that, while Lord Carter's proposals may help substantially, they will need to be supplemented by the more radical transformational changes for which uncertainties of a different order come into play. Those include the importance – which CIPFA has set out elsewhere[19] – of generating a whole system leadership which prioritises total population outcomes over organisational goals.

The Health Foundation's analysis[20] of the implementation challenge of the Five Year Forward View recognises the challenges. It proposes that five layers of action are needed, focusing on scientific discovery, technology and skills; population health; new ways of delivering care; process improvement for quality and productivity; and active cost management. 'Shaping the Future' sets these out as actions likely to spread over more than a decade, underlining the reality that the pressures of 2016-21 are unlikely to be fundable within the current plans. It also fits with the King's Fund report[21] on Better Value Healthcare which spells out what some of those longer term changes are likely to be. It also emphasises that such changes will take time, citing the evidence of impressive achievements in the NHS since the 1970's in increasing the use of generic prescriptions, switching inpatient activity to day-case admissions and reducing the average length of stay in hospitals.

Conclusion and possible solutions

On balance:

- It seems likely that £30bn is a fair assessment of the pressures faced over the coming five years
- It seems unlikely that the £22bn of savings planned for by the Five Year Forward View will be delivered at a pace to match the developing pressures

Further work is recommended in order to better validate the position, but that is likely to show both that more than £8bn of additional support will be needed, and that support will need to be front-loaded. Once fully evaluated, that should become a central matter for the forthcoming spending review. The default solutions available are to:

- Reduce the level of service: no parties have shown any appetite for this.
- Increase Government funding: the problem here, of course, is the trade-off involved between spending on the Department of Health and other departments.

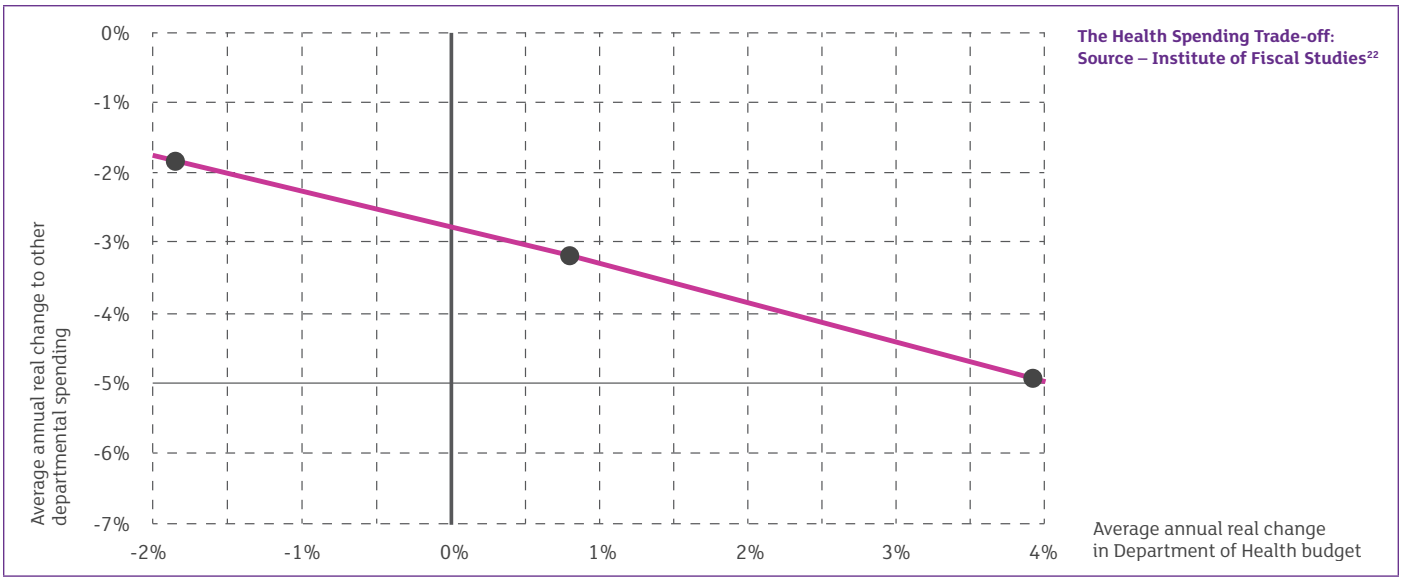
17 Interview on Today programme, 15 April 2015

18 Review of Operational Productivity in NHS providers. An independent report for the Department of Health by Lord Carter of Coles, Interim Report – June 2015 at: **www.gov.uk/government/publications/productivity-in-nhs-hospitals**

19 See: **www.cipfa.org/cipfa-thinks/aligning-local-public-services**

20 Shaping the Future: A strategic framework for a successful NHS – Health Foundation, June 2015 at: **www.health.org.uk/publication/shaping-future**

21 Better value in the NHS The role of changes in clinical practice: **www.kingsfund.org.uk/publications/better-value-nhs/summary?gclid=CM3DqIjr4cYCFRQatAod4TgDSQ**



The Health Spending Trade-off: Source – Institute of Fiscal Studies[22]

- Increase income: building on the Care Act, which aims to provide a more equitable approach to the balance between individual and state contributions to social care cost, there would be logic to extending some of its principles to health – perhaps as part of the pre-implementation review process now that the Dilnot changes in the Care Act have been deferred to 2020. That could mean, for example, charging for 'hotel costs' in health. Alternative charges might include flat rate contributions towards visits to the doctor or A&E; paying a proportion of treatment costs (as in France); or insurance appraoches.

None of those positions are popular, so what is to be done? If the answer were easy, of course, action would be under way already. There is probably a measure of agreement on the right course, but the difficulties lie in finding the funding and mechanisms to take those actions forward successfully.

For example:

- put the incentives in place to reward the right behaviours
- ensure that analytically grounded distribution/allocative assessments are carried through into action
- plan for the long-term, moving away from annuality
- invest up front to save in the future
- strengthen the other parts of the public service system which support health – not just social care, but benefits, housing, transport and leisure are important. The more they can be strengthened or at least maintained, and the more a one-place approach can be adopted to planning for the whole system with an eye to mutual advantage, the better.

The way forward

Of course NHS finances cannot be viewed in isolation from the whole plethora of public services delivered by the government[23], nor can it be isolated from the overall state of the public finances and the performance of the economy as a whole.

As NHS Chief Executive Simon Stevens said recently 'when the economy sneezes, the NHS catches a cold'. Moreover, the June OBR Fiscal Sustainability Report[24] highlights how critical it is for overall long-term financial projections that the NHS makes its efficiency targets. To illustrate the context:

- If interest rates increase by 1%, it will cost the public purse an extra £8bn to service debts. This is equivalent to the gap the government has pledged to fill.
- If the economy grows at a slower pace than projected, again this puts pressure on the overall public finances. The Budget was based on a growth rate of 2.4%: if that were only 1.4%, that would reduce annual tax receipts by some £5bn. Will the NHS be protected if that happens? What if there are unforeseen or unplanned-for pressures in the NHS and indeed any other public services?

The key point here is that the estimates of the funding gaps in the NHS are based on a whole raft of assumptions that may or may not hold and our health service will be affected by any economic, fiscal and demographic uncertainties facing the UK – just as any other centrally funded public service will be.

22 Institute of Fiscal Studies: **http://election2015.ifs.org.uk/nhs-spending**

23 CIPFA has emphasised the importance of an informed place-based view across these services: see aligning local public services at: **www.cipfa.org/cipfa-thinks/aligning-local-public-services**

24 **http://budgetresponsibility.org.uk/fiscal-sustainability-report-june-2015**

CIPFA's position on the health of health finances[25]:

- More analysis is needed to validate the assumption of 5.2% annual real terms pressures on which the Five Year Forward View is predicated, including the comparative phasing of pressures and planned savings.
- Adjustment is required to build in the cost of the new Government's health promises, notably an increase in seven day working, and to ensure sufficient investment in prevention.
- The effects on health of any changes in other parts of the whole system which supports people should be taken explicitly into account in making future funding decisions.
- Assuming that the 5.2% assessment is correct, it is unlikely that the NHS can react fast enough in the early years to achieve the productivity gains assumed by the Five Year Forward View.
- The BCF must continue in order to prevent the knock-on effects on health services of a failure to invest in social care.
- It will be necessary, to underpin that agenda, either to add further to the NHS budget, charge users more, or reduce services. To choose none of those is not a realistic option.
- In addition, the Government should set aside invest to save funding which can be bid for in order to make the upfront investments (including covering for double running costs) which will save in the future without undermining the short-term position.

  Given that this would be 'virtuous spending' to future advantage, it would make sense to allow this investment to be funded by borrowing or a bespoke tax.
- Whatever the direction, whole system leadership is critical.
- Perhaps the most fundamental question of all should be: what should the Government be providing in terms of public services, and should it prioritise health above others?

It is vital that those matters are addressed in the right way as part of the realistic long term planning which should form the core of the Government's forthcoming Comprehensive Spending Review.

25 This is consistent with the wider context and proposals in CIPFA's Manifesto 2015, see: **www.cipfa.org/cipfa-thinks/manifesto2015**

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