Executive summary:
We are developing planning guidance for the NHS for the next two years. This paper sets the context for that work. The government has increased funding significantly over the past three years as services dealt with the Covid-19 pandemic. In total we have committed to delivering £12bn of annualised savings by 2024/25 including reducing exceptional funding for covid. The impact of higher inflation this year and the potential recurrent effect of this year’s pay settlement and other responsibilities transferred to us could add substantially to this. In addition to this we could face a further £6-7bn depending on how inflation feeds through into pay and other prices next year. This is at the same time as the NHS seeks to deliver the NHS elective recovery programme, the most ambitious catch-up programme in health service history, and deal with Covid-19 and other operational priorities.

Action required:
The Board is asked to note the prospects for next year’s budget.
2023/24 POSITION AND THE FUTURE FINANCIAL OUTLOOK

NHS England budget 2022/23

1. The NHS England budget, which grew significantly in response to the Covid-19 pandemic, grows in nominal terms over the SR period but was planned to be 1.4% smaller in real terms in 2022/23 than it was in 2021/22.1 This required a total efficiency from NHS systems of around 5% (£5.6bn) taking account of managing elective recovery and other service demands. Of this £2.9bn is a reduction in covid funding on the basis that additional Infection Prevention and Control arrangements would be changed and that covid pressures would materially reduce. Similar challenges are being faced by health systems across the world.

<table>
<thead>
<tr>
<th>£m</th>
<th>2020-21</th>
<th>2021-22</th>
<th>2022-23</th>
<th>2023-24</th>
<th>2024-25</th>
</tr>
</thead>
<tbody>
<tr>
<td>NHSE RDEL (nominal)</td>
<td>149,473</td>
<td>150,614</td>
<td>152,595</td>
<td>157,403</td>
<td>162,641</td>
</tr>
<tr>
<td>Adjusted NHSE RDEL (nominal)</td>
<td>147,963</td>
<td>147,650</td>
<td>151,500</td>
<td>157,403</td>
<td>162,641</td>
</tr>
<tr>
<td>Adjusted RTG on prior year (%)</td>
<td>0.0%</td>
<td>-1.4%</td>
<td>1.5%</td>
<td>1.5%</td>
<td>1.5%</td>
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| % of PSCE (adjusted RDEL) | 15.1% | 15.7% | 15.6% | 16.2% | 16.3% |

2. On top of this the non-pay inflation experienced by the NHS in 2022/23 is resulting in extra costs in excess of the standard GDP deflator measure of inflation, worth another 1% of total budget (£1.5bn). There have also been over £1bn of other costs absorbed (including making a financial contribution to the Living with Covid testing strategy, part of the cost of the pay award above the planned level and other responsibilities transferred to us).

3. Whilst in 2023/24 and 2024/25 the table above suggests the budget will grow in real terms, this is based on inflation forecasts which have yet to be updated. Later in this paper we consider the prospects for additional costs due to inflation.

4. Since the creation of the NHS, revenue expenditure on health has grown on average by 3.7% a year in real terms.2 This is the result of population growth and demographic change, new technologies and treatments, and the choice made by developed countries to spend more on healthcare as the wealth of society grows. In the 10 years to 2019/20 NHS funding grew more slowly than the long run trend.

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1 The published budget based on Financial Directions to NHS England will be 2.6% smaller in real terms. The 1.4% figure shown here includes adjustments to make a like-for-like comparison by removing transfers from the DHSC for testing, Covid-19 vaccines and PPE in 2021/22 (not yet finalised for 2022/23).

2 IFS/Health Foundation
5. The NHS’s agreed Spending Review settlement in 2021 provided additional funding for elective recovery but also set out stretching requirements to increase efficiency and reduce other costs. This assumed:
   - typical levels of inflation of c2% per year
   - Covid-19 demand and additional costs would reduce significantly. Direct funding to systems for Covid-19 costs falls 57% from the equivalent of 5.1bn in 2021/22 to £2.2bn in 2022/23, and to £0.5bn in 2023/24.
   - no significant reduction in capacity of the social care system

6. The impact of higher inflation and other costs is set out above. Covid-19 remains a significant draw on NHS resources; on average in 2022 so far 9,743 beds have been occupied each day by Covid-19 patients compared to 7,691 in 2021 and 7,313 in 2020. The domiciliary care workforce has reduced over the past year and as a result the ability to discharge to people’s homes is highly challenged. The number of patients in hospital for more than a week is around 7,000 higher than it was before the pandemic, largely because of difficulties in discharging patients from hospital, leading to increased length of stay and associated problems in urgent and emergency care and ambulance services, as well as reduced capacity for inpatient elective care. The Government is providing an additional £500m for this winter to support discharge and social care to improve this position.
2023/24 inflation prospects and implications

7. SR21 funding assumed inflation of around 2% over the next two years and 2% pay settlements. The NHS will be asked to plan for significant efficiency requirements for local health systems of 2.9% (£3.6bn) and 2.2% (£2.8bn) in each of the next two years. These annual efficiency requirements – agreed by the NHS as part of the SR - are higher than the NHS has historically delivered (c1%/year) as we seek to recover the lost productivity experienced because of Covid-19. We are planning that we will have to absorb recurrently the £1.5bn of additional inflation costs from this year and around £1bn of other new pressures and transferred responsibilities.

8. Current forecasts are that further inflation will be experienced in the remainder of 2022/23 and into 2023/24; CPI inflation is currently at 9.9%, and the Bank of England’s latest Monetary Policy Report says that inflation is expected to rise further before falling back, as shown in the chart below.

Figure 2: Bank of England inflation forecast


9. This will affect the NHS through decisions on pay settlements (based on independent advice from the NHS Pay Review Body and Doctors’ and Dentists’ Pay Review Body) and through the inflationary impact on the price of the goods and services that the NHS buys from the wider economy, including medicines, energy costs for businesses, estates costs, and services from other providers and contractors such as care homes, GPs and pharmacists.
10. If headline pay awards in 2023/24 were to track this year in response to higher inflation and similar to private sector earnings, and non-pay non-drugs inflation is at 9%, then the further cost increase next year (above the level assumed in current financial plans and above the recurrent impact of 2022/23’s additional costs) could be up to c£6-7bn. If this were to materialise clearly decisions would have to be made about how this pressure would be managed in the period covered by the planning guidance.

**Capital**

11. Investment in capital is key to driving productivity and efficiency as well as improved patient and staff experience. The NHS uses its capital assets and infrastructure more intensively than most other western countries, and over the past decade has invested less in health capital than other countries. There has been a reduction of 17% in the value of capital per worker between 2010/11 and 2017/18.

12. The current Spending Review settlement provides a significant growth in capital and digital investment, particularly compared to 2010-2019. NHS provider capital investment is forecast to be around £8bn a year over the SR period, up from around £3bn a year on average over 2010-2019. Other things equal, these increased budgets allow for investment to begin to address some of the challenges noted above. For example, we are increasing capacity in diagnostics, protected elective capacity, and electronic patient records systems for trusts without these critical systems. This will enable reform and higher productivity over the next two years, which is already factored into the significantly higher efficiency levels agreed in the 2021 Spending Review.

13. However, there is also significant inflation in the construction and materials markets, with further volatility expected. This inflationary impact has materially eroded the value of the NHS capital budget and will increase the cost of delivering key capital priorities. Construction economists at Arcadis have forecast 2022 inflation of 10% for buildings and 12% for infrastructure, driven by energy and material prices, general inflation and scarcity and disruption risks around materials.³

14. Longer term, continued investment in digital transformation, equipment (e.g. diagnostics) and fit for purpose estate will be critical to enable more radical reform to transform the NHS to provide high quality, responsive patient care at an affordable cost to the taxpayer for the long term. Nonetheless, as technology costs move increasingly to revenue, our ability to use investment in technology to increase efficiency and productivity will depend on total revenue affordability.

³ Arcadis, UK Autumn Market View, 2022