



Report

Scottish Budget 2025–26

Scottish Budget: the overall fiscal and spending outlook

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Funding and spending growth are set to slow. Without a top-up, health spending will be flat in 2025–26 and tricky trade-offs elsewhere loom too.

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This chapter of our third annual Budget Report looks at the outlook for the Scottish Government's finances and its public spending plans and trade-offs. The focus is the coming financial year, 2025–26. Significant boosts to UK government funding have eased the outlook for day-to-day and capital funding compared to expectations as of a year ago. This is despite downgraded forecasts for the contribution of devolved taxes to day-to-day funding. Looking further ahead, a planned slowdown in increases in UK government funding implies that real-terms increases in day-to-day spending would average just 0.5–1.4% a year on average between 2025–26 and 2028–29. Capital investment is set to fall by 4.1% in 2026–27 and remain at these lower levels in subsequent years.

Key findings

1. UK government funding for day-to-day spending in Scotland in 2024–25 through the block grant is £2.2 billion (or 5.8%) higher than was expected in December 2023, when the Budget for 2024–25 was first proposed. The UK block grant for 2025–26 is £2.6 billion (or 6.8%) higher than was expected in December 2023. That is largely driven by the top-ups to UK spending announced by the Chancellor, Rachel Reeves, in her first Budget last October, which fed through mechanically to increased funding for the Scottish Government via the Barnett formula.
2. In contrast, the net tax revenue position (the difference between devolved tax revenues and the block grant adjustments subtracted from UK government funding to account for tax devolution) has been downgraded significantly since December 2023. In December 2023, the net position was forecast to be £1.6 billion in 2024–25 and £1.9 billion in 2025–26. It is now expected to be £1.0 billion in 2024–25 and £1.2 billion in 2025–26. The rules of the Scottish Fiscal Framework insulate the Scottish Government from the in-year downgrade to forecasts in 2024–25 (instead it will have to make a reconciliation payment to the UK government to offset any forecast error in future once actual revenues are known). But its funding for the coming year, 2025–26, will be based on the new lower net revenue forecasts for that year.
3. Taking the Scottish Government's various sources of funding together, forecasts published alongside the 2025–26 Budget in December 2024 implied that after a 5.5% real-terms increase in day-to-day funding for public services in 2024–25 (or 4.7%, after adjusting for technical changes to how pension contribution costs are calculated), there would be virtually no real-terms change in 2025–26. Following the 2024–25 Spring Budget

Revision in January 2025, which confirmed that not all funding budgeted for use in 2024–25 will actually be used, the latest figures are for an increase of 4.8% (or 4.0%, adjusting for pension contribution costs) in 2024–25, and 0.4% in 2025–26.

4. Plans published in December 2024 implied that day-to-day spending on health and social care would grow by 3.4% in real terms between 2024–25 and 2025–26. After top-ups to this year’s health budget in the Spring Budget Revision, health spending is now planned to be essentially flat in real terms between 2024–25 and 2025–26, suggesting further top-ups to next year’s Budget are likely over coming months. The Finance and Local Government portfolio was set to grow by 2.6% in real terms; after top-ups to this year’s Budget, it is now set to grow 1.8% in real terms between 2024–25 and 2025–26.
5. Total capital spending is set to be boosted significantly next year, growing by 12% in real terms between 2024–25 and 2025–26. Investment in the Justice portfolio has been particularly prioritised, with spending set to almost double between this year and next. Other portfolios – for example, Education and Skills, and Transport – are seeing their capital budgets increase much less quickly, with a cut of 6% and growth of 6%, respectively, pencilled in. These differences will partly reflect the different priority placed on different types of investment by the Scottish Government, but also the volatility of capital investment as major investment projects start and end.
6. Funding in 2026–27 and beyond is uncertain and will depend on plans for UK government spending set out in the June Spending Review, as well as how Scottish tax forecasts evolve. Scottish Government projections assume that day-to-day funding will grow by 1.4% annually in real terms. Given current policy, our view is that funding might grow at less than half that speed – at about 0.5% in real terms – with assumptions made by the Scottish Government on funding from the UK government and forecasts for the net income tax revenue position a little on the optimistic side.
7. The outlook for capital funding is set to tighten after next year. A levelling-off of UK government funding, and a planned reduction in the Scottish Government’s borrowing and use of one-off sources, such as Scotwind income from offshore windfarm licences, means capital spending is currently projected to fall by 4.1% in real terms in 2026–27 and broadly remain at these lower levels in subsequent years.
8. There are set to be difficult trade-offs between spending in 2026–27 and beyond, given this relatively slow growth in funding. For example, if day-to-day spending on health and social care was increased by 3% a year in real terms and funding for councils via the main finance and local government portfolio increased by 1.5% a year in real terms, other areas

could face cuts to spending of between 1.7% and 5.6% in real terms each year from 2026–27 to 2028–29.

9. While it is the spending plans set out in the Scottish Budget that are most important, the way those plans are presented is also important for understanding and scrutiny. The Budget document now contains an annex table, which allows meaningful comparison of planned spending in the coming year with the most up-to-date plans for the current year as of the publication of the Budget in December 2024. This is an important and useful addition. But the main sections of the Budget document present figures in a different, less meaningful way, and Scottish Ministers have continued to compare planned spending in 2025–26 with the initial (rather than updated) plans for 2024–25. This risks confusing stakeholders, and the Scottish Government and Scottish Parliament should agree on a single approach to aid transparency.

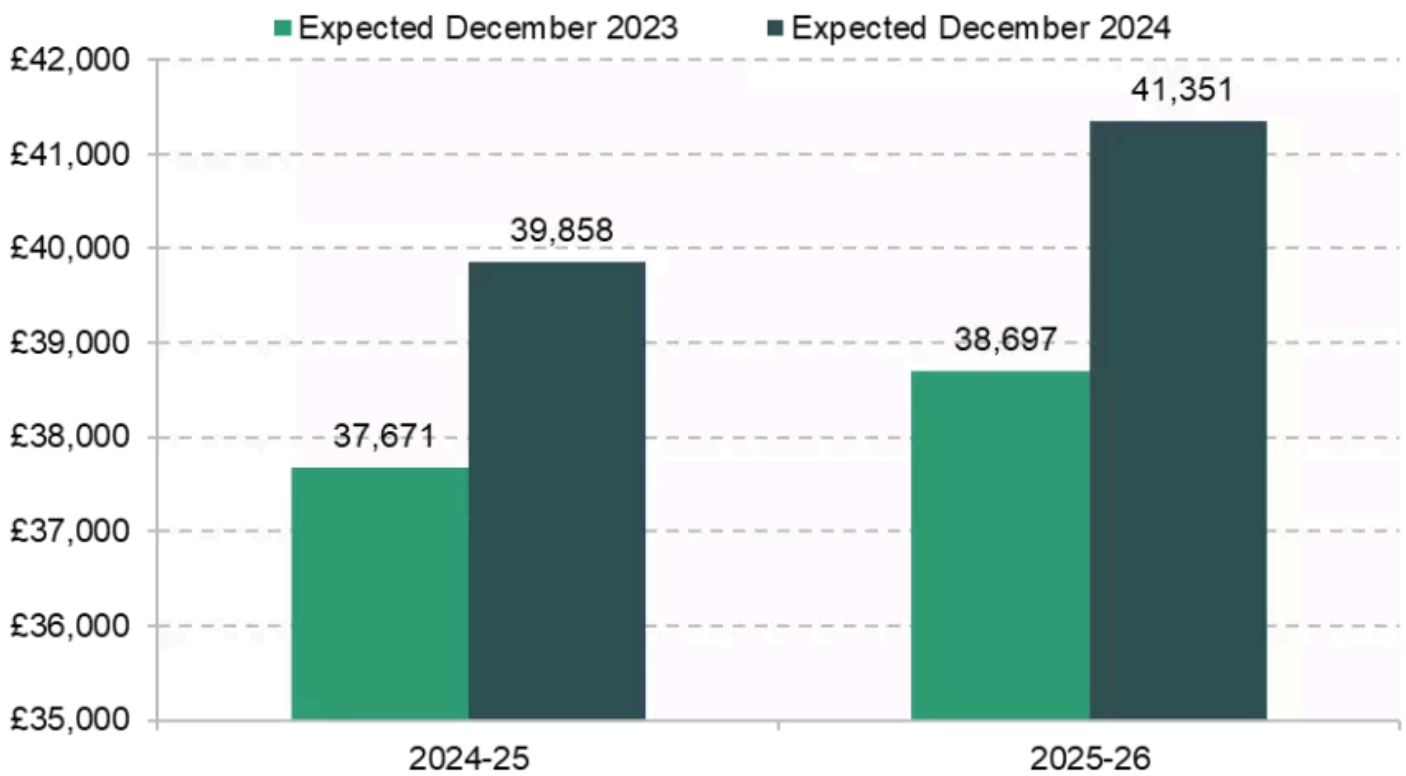
6.1 Funding position in 2024–25 and 2025–26

The Budget published in December and now working its way through the Scottish Parliament relates to the coming financial year, 2025–26. However, to understand its implications for Scottish public services and investment, it is also important to consider recent changes in funding and planned spending for the current financial year, 2024–25. We can then calculate how much more (or less) funding is available to be spent next year, compared to the latest plans for this year.

UK government resource funding

The single biggest source of Scottish Government funding for non-investment (resource) purposes is provided in the form of a block grant from the UK government. In the UK's Autumn Budget, the Chancellor, Ms Reeves, announced significant in-year top-ups to spending plans in 2024–25, and additional increases in spending in 2025–26 which were substantially larger than those inherited from the previous UK government. These top-ups fed through mechanically to devolved block grants. Figure 6.1 illustrates expectations in December 2023 and December 2024 for the block grant in 2024–25 and 2025–26.

Figure 6.1 UK block grant and migrant surcharge funding in 2024–25 and 2025–26, as expected in December 2023 and December 2024



Source: Authors' projections using Scottish Fiscal Commission (2024) and Scottish Government (2024d).

When the Scottish Budget for 2024–25 was proposed, in December 2023, block grant funding from the UK government for that year was set to be £37.5 billion.¹ An additional £0.2 billion was expected to be provided from the UK Home Office during the course of the year from the UK-levied migrant health surcharge, meaning total resource funding from the UK government of £37.7 billion before a block grant adjustments (BGAs) to account for tax and social security devolution.

Since then, UK government funding for 2024–25 has been boosted three times: at the March 2024 UK Budget, at the July UK Main Estimates and most significantly at the October 2024 UK Budget. The first two changes combined amounted to an increase of around £0.7 billion, although almost half of this was compensation for changes in rules that mechanically increase the recorded cost of unfunded pension schemes for a range of Scottish Government employees. In the October 2024 Budget, big funding top-ups for UK government departments largely serving England (or England and Wales) generated a further increase of £1.4 billion via the Barnett formula, with non-Barnett additions taking the total increase in UK government resource funding at the Budget to £1.5 billion.

Taken together, this means that UK government general-purpose resource funding for the Scottish Government in 2024–25 is now set to amount to £39.9 billion, £2.2 billion or 5.8% higher than planned back in December 2023. Stripping out the estimated £0.3 billion of funding provided to cover mechanically higher pension costs still means the latest plans for UK government funding represent an increase of £1.9 billion. At 4.9% of allocatable resource funding, this is a sizeable sum.

The October 2024 Budget also set UK government spending plans for 2025–26 for the first time – including its funding for the Scottish Government. A further increase of £1.5 billion in block grant funding was announced. Adding in assumed in-year transfers of £0.2 billion from the UK-levied migrant health surcharge takes the total UK government general-purpose resource funding for 2025–26 to £41.4 billion, 3.8% higher in cash terms and 1.4% higher in real terms than the latest plans for 2024–25. It also represents an increase of £2.6 billion or 6.8% compared to the Scottish Government’s assumptions as of December 2023 – or £2.3 billion (6.0%) stripping out the estimated £0.3 billion of funding provided to cover mechanically higher pension costs. The October 2024 UK Budget therefore transformed the funding position of the Scottish Government in both 2024–25 and 2025–26.

The UK government has also said that additional funding will be provided on top of this to help fund the cost of higher employer National Insurance Contributions (NICs) bills for directly employed public sector workers from April 2025. The amount that will be provided has not yet been officially confirmed, but as discussed in Box 6.1 suggestions are that it may be around £200 million less than the actual cost of higher employer NICs bills for Scottish public sector employees. In addition, as in the rest of the UK, no funding is being provided to cover the costs for contracted-out workers and private or third sector providers funded by the Scottish Government or councils. This means over half of the real-terms increase in core UK government funding for the Scottish Government in 2025–26 may be required to cover higher employer NICs costs in the short term. The lack of clarity about the amount of funding that will be provided also makes it more difficult for the Scottish Government to budget.

Box 6.1. Employer National Insurance increases and Scottish Government funding

In order to help fund the substantial increases in spending announced in the October 2024 UK Budget, employer NICs bills will be increased from April 2025, with the annual salary threshold at which it becomes payable being reduced from £9,100 to £5,100, and the tax rate above the threshold increased from 13.8% to 15%. When the policy was announced, the UK government also announced that public sector employers would be compensated for the increase in their own employment costs as a result of increased NICs bills, although not for any increases in costs due to higher NICs bills for the outsourced services or private or third sector organisations they fund. £4.7 billion was set aside for this compensation UK-wide, but detailed information on how it will be allocated across public sector organisations has not yet been published.

For the Scottish Government, a key question is whether it is allocated via the Barnett formula, which would provide Scotland with a population-based share of compensation provided for England, or via a method that accounts for the relatively higher public sector pay bill in Scotland. As discussed in Chapter 5 of this report, this higher pay bill reflects both relatively high levels of employment and higher average levels of pay.

The Scottish Government has estimated that higher employer NICs for directly employed workers will cost £550 million in 2025–26, with over four-fifths of this being accounted for by the NHS and local government – including schools (Scottish Government, 2024a). Costs for outsourced service providers and private and third sector organisations funded by the Scottish Government are estimated to amount to over £200 million, with adult social care accounting for around 40%, and both universities and NHS contractors accounting for around 20% each. The Fraser of Allander Institute (2024) finds a similar distribution across services as the Scottish Government, but its estimate for workers directly employed by the Scottish public sector is slightly lower at around £510 million.

A population share of the overall compensation set aside by the UK government would provide the Scottish Government with around £380 million in funding. In reality, if the Barnett formula were used to allocate funding, the Scottish Government would receive somewhat less than this. That is because part of the compensation provided by the UK government has to go to departments providing services on behalf of the whole UK (such as the Ministry of Defence, the Foreign, Commonwealth and Development Office, and large parts of HMRC and the Department for Work and Pensions), which rightly would not generate funding for the Scottish Government under the Barnett formula.

Official figures for the amount of compensation that will be provided have not yet been published, but the BBC has reported that UK government officials have indicated a figure of around £300 million (BBC News, 2024). This would be more consistent with using the Barnett formula than Scotland's share of the public sector wage bill, although if anything a little on the low side given the relative sizes of the UK-wide and devolved public sectors. Such a figure would mean the Scottish Government needing to find £200–£250 million on top, to cover costs for directly employed workers, and £400–£450 million to also compensate outsourced, private and third sector providers, in the short term.

Whether allocating compensation based on the Barnett formula should be considered reasonable in this case is not clear-cut. On the one hand, the Barnett formula is how the vast majority of UK government funding for the Scottish Government is allocated, including for

increases in labour costs driven by higher pay. In addition, if the Scottish Government and councils have chosen to outsource services to a lesser extent than in England, and more provision is via directly employed workers, it is not clear that they should receive relatively more compensation – if they did, a bigger share of their total increased costs would be covered than in England. On the other hand, to the extent that higher public sector employment reflects higher needs for public services (for example, due to a slightly older, less healthy and more sparsely distributed population), it may be considered unfair to provide only a population-based share of compensation. Although, it is widely agreed Scotland's current relative funding levels exceed its relative level of needs, so a share of funding based on the existing public sector pay bill would exceed Scotland's underlying share of need for public service provision.

It is also worth noting that based on a review of evidence, the Office for Budget Responsibility (OBR) expects that after a few years, most (60%) of the burden of higher employer NICs bills will be transferred to employees in the form of lower wages (Office for Budget Responsibility, 2024). This means the extra employment costs faced by both public sector organisations and the outsourced, private and third sector service providers they fund will be lower in the long term than in 2025–26: instead, workers will bear more of the burden. This could ease the pressure on the Scottish Government's budget induced by the employer NICs increase in 2026–27 and beyond.

Ultimately, it is the Scottish Government's responsibility to determine how much, if anything, to allocate to specific services to help meet higher employer NICs bills. Shona Robison, the Scottish Finance Minister, has recently announced that she will aim to provide funding equivalent to an average of 60% of the costs for directly employed workers. In line with this, Scottish councils have been told that they will be provided with an additional £144 million (Scottish Parliament, 2025), equivalent to 54% of their own estimates of the direct costs they face, and 40% of the total costs they face including for outsourced and commissioned services such as social care and childcare. Figures for other service areas have not yet been announced.

One element of UK government resource funding that was reduced slightly between December 2023 and the latest plans following the October 2024 UK Budget was the overall BGA added to the block grant to account for social security devolution. This reflects the UK government's decision to means-test the Winter Fuel Payment for pensioners, which, by reducing expenditure in the rest of the UK, leads to a lower BGA for Scotland to help pay for any equivalent devolved benefit. While other social

security BGAs were revised upwards – largely as a result of higher-than-initially forecast caseloads for disability benefits in the rest of the UK in 2024–25 – the £146 million reduction resulting from means-testing the Winter Fuel Payment has more than offset that this year. And in 2025–26, lower-than-previously-expected inflation in September 2024 (the inflation rate typically used to index most social security benefits) will also reduce benefit spending (in cash terms) in the rest of the UK and hence the social security BGA, further offsetting the impact of higher caseloads for disability benefits.

Devolved resource funding sources

The second largest source of funding for the Scottish Government is its devolved tax revenues. By far the largest of these is revenue from the Scottish rates of income tax (a forecast £20.5 billion in 2025–26), followed by business rates (£3.1 billion), land and buildings transactions tax (LBTT; £1.0 billion) and Scottish landfill tax (£40 million).

What matters for the Scottish Government’s funding is not just the revenues from most of these taxes, but how those revenues compare to the BGAs subtracted from the Scottish Government’s UK government funding to account for the fact that it now retains devolved tax revenues.² In turn, the BGAs change each year in line with changes in revenues for the equivalent taxes in England and Northern Ireland.³ The net amount the Scottish Government receives is at first based on forecasts for both revenues and the BGAs. Forecasts for revenues are made by the Scottish Fiscal Commission (SFC) while forecasts for the BGAs are based on forecasts for England and Northern Ireland made by the OBR. Any deviations between forecasts and outturns for the fully devolved taxes (LBTT and Scottish landfill tax) are fully reconciled two years later, following a partial reconciliation when updated in-year forecasts become available (as they did for 2024–25 in December 2024). For income tax, any deviation between forecasts and outturns is reconciled in full three years later.

Table 6.1 shows two sets of forecasts for both revenues and the BGAs for LBTT, Scottish landfill tax and income tax in 2024–25 and 2025–26: the most recent forecasts published in December 2024 alongside the Scottish Budget for 2025–26; and the previous forecasts published in December 2023 alongside the Scottish Budget for 2024–25.

Table 6.1 Devolved tax revenue and BGA forecasts, £ million

	December 2023 forecasts		December 2024 forecasts	
	2024–25	2025–26	2024–25	2025–26
Income tax				
Revenues	18,844	19,731	19,099	20,477

BGA	17,432	18,125	18,389	19,639
Net position	1,412	1,749	711	838
LBTT				
Revenues	730	795	911	1,019
BGA	521	591	574	660
Net position	209	202	337	358
Landfill tax				
Revenues	58	42	54	40
BGA	84	76	75	57
Net position	-25	-34	-21	-16
Total				
Net position	1,596	1,917	1,027	1,180

Source: Scottish Fiscal Commission (2023, 2024).

The table shows that the net revenue position for these devolved taxes was downgraded significantly for both 2024–25 and 2025–26 as a result of changes in SFC and OBR forecasts between December 2023 and December 2024. For example, whereas the overall net revenue position as of December 2023, was forecast to be +£1.6 billion in 2024–25 and +£1.9 billion in 2025–26, this has been revised down to +£1.0 billion and +£1.2 billion, respectively.

This is not a result of tax policy changes – as discussed in Chapter 2 of this report, their net revenue effect is modest. Instead, the downwards revisions reflect the fact that underlying growth in the income tax base has been revised up by less for Scotland by the SFC than for England and Northern Ireland by the OBR. As a result, while forecast Scottish income tax revenues in 2024–25 have been revised up by approximately £0.25 billion (from £18.8 billion to just under £19.1 billion), the forecast BGA has been revised up by approximately £1 billion (from just over £17.4 billion to just under £18.4 billion); for 2025–26, the revisions are an increase of £0.7 billion and £1.5 billion, respectively, for forecast Scottish revenues and the BGA.

Two factors underlie this. First, the net income tax revenue position for 2022–23, while better than originally forecast as of December 2021, was less strong than forecast as of December 2023: the SFC assume that this persists. Second, the SFC has revised up its forecasts of earnings growth by less than the OBR for the period between 2022–23 and 2025–26 since December 2023, in turn reflecting the fact that it was more optimistic to begin with. The SFC has revised up its nominal earnings growth forecasts between 2022–23 and 2024–25 by a cumulative 0.6 percentage points (from 10.5% to 11.6%), compared to 2.3 percentage points (from 9.8% to 12.1%) for the OBR. For the period

between 2022–23 and 2025–26, the revisions are +1.5 percentage points and +3.6 percentage points, respectively, for the SFC and OBR.

A combination of a weaker starting position (due to outturns data for 2022–23), combined with earnings forecasts now slightly lower than the OBR's (rather than slightly higher), means that the previously forecast large and rapid increase in the net income tax revenue position between 2022–23 and 2025–26 is now much more muted. This was a risk recognised explicitly by the Scottish Fiscal Commission (2023), which highlighted that the differences in earnings forecasts between itself and the OBR may have reflected different views about the overall earnings outlook, rather than indicating that Scottish earnings were likely to outpace those in the rest of the UK. Either the OBR would be closer to the truth, and income tax revenues in Scotland would be revised down relative to the BGA, meaning a lower net income tax position. Or, as now looks to be the case, the SFC would be closer to the truth, and income tax revenues in Northern Ireland and England and hence the BGA would be revised up by more than Scottish revenues, again meaning a lower net revenue position than forecast in December 2023. In either case, the risks for the net income tax revenue position in December 2023 were weighted to the downside, and those risks are now forecast to have crystallised – although it is possible that future forecast revisions and outturn data may significantly change the picture again.

Partially offsetting the downwards revision in forecasts for the net position for income tax has been an upwards revision in the forecast net position for LBTT. This appears to reflect property values and transactions holding up better in Scotland than in England and Northern Ireland.

The design of Scotland's Fiscal Framework means that it benefits immediately from the upwards revision in the net position for LBTT – its funding for 2024–25 has been revised up as a result of the higher revenue that Revenue Scotland is collecting from this tax. But the downwards revision to forecasts in the net position for income tax in 2024–25 has not led to a reduction in funding in the current financial year – instead, if this downwards revision is borne out when outturn data become available, it will lead to a negative reconciliation payment of just over £0.7 billion being applied in 2027–28 (we discuss this further in Section 6.3). However, it is the (lower) December 2024 forecast for the net income tax position that determine the Scottish Government's funding in 2025–26.

As a result, the net tax revenue position for budgeting purposes will be lower in 2025–26 than in 2024–25. Taking the December 2023 forecasts for income tax with the December 2024 forecasts for LBTT and Scottish landfill tax means a net contribution of these devolved taxes of £1.7 billion to funding in 2024–25. Taking the December 2024 forecasts for all taxes means a net contribution of £1.2 billion to funding in 2025–26. This reduction in net contribution from devolved taxes of approximately £0.5 billion is equivalent to just over 1% of the Scottish Government's resource

funding, partially offsetting the aforementioned increases in UK government funding between this financial year and next.

The other impact of devolved tax revenues on the change in funding between 2024–25 and 2025–26 relates to reconciliations for past tax revenue forecast errors. The net reconciliation payment in 2024–25 is negative (–£0.4 billion), reflecting the fact that the outturn net income tax revenue position in 2021–22 was less positive (+£85 million) than initially forecast (+£475 million). In contrast, the net reconciliation payment in 2025–26 will be positive (+£0.5 billion), largely reflecting the fact that the outturn net income tax revenue position in 2022–23 was positive (+£260 million) rather than negative (–£190 million) as initially forecast.

This swing (–£0.4 billion to +£0.5 billion) is a boost to funding equivalent to around 2% of the Scottish Government’s resource funding. As discussed below, the Scottish Government no longer plans to borrow at all to spread the cost of the £0.4 billion negative reconciliation payment this year (it had originally planned to borrow to cover the full amount and as recently as December was planning to borrow almost £0.2 billion, as discussed below). This means the swing in reconciliation payments will fully feed through into the year-on-year change in Scottish Government funding.

Taking the decline in the in-year net revenue position and the increase in net revenues from reconciliation payments together shows that Scotland’s devolved tax powers and revenues are currently set to make a modest positive contribution to the change in funding between 2024–25 and 2025–26 of around £0.3–0.4 billion. In contrast, as of the SFC’s December 2023 forecasts, the equivalent contribution to the change in funding between 2024–25 and 2025–26 was forecast to be almost £1.2 billion. Scotland’s devolved tax powers and revenues are therefore boosting funding over the next year by far less than was expected a little over a year ago.

Borrowing, reserves and Scotwind drawdowns

In addition to tax revenues, the Scottish Government has limited powers to fund spending using borrowing and reserves, and the proceeds of auctions for offshore windfarm licences via the Scotwind programme.

It is this area where there have been changes to plans in both 2024–25 and 2025–26 since the Scottish Budget for 2024–25 was published in December 2024. At that stage, the Scottish Government was planning to borrow £187 million (to help cover aforementioned negative reconciliation payments for income tax), draw down £162 million from the Scotland Reserve and make use of £160 million of Scotwind drawdowns in 2024–25, meaning a total of £0.5 billion in funding from these sources. No borrowing or reserve drawdown was planned for 2025–26, and Scotwind drawdowns were set to fall

to £10 million, meaning just £10 million of funding from these sources in 2025–26 – a reduction equivalent to around 1% of the Scottish Government’s total resource budget.

In the January 2025 Spring Budget Revision (SBR), the Scottish Government confirmed it would no longer borrow any money to spread the cost of negative forecast reconciliations in 2024–25, and instead cover them from in-year funding. The planned drawdown of £162 million from Scotwind funding was also cancelled, meaning this money will be available for use in future years. This has been welcomed by various groups on the grounds that the money could now be used to support the energy transition.⁴ There is no need, in our view, to tie Scotwind money to costs associated with the energy transition in particular – but, because it is non-recurring funding, it seems sensible to spend it on investment (whether in the energy transition or on other investment priorities), rather than using it to cover day-to-day spending as was previously planned.

Offsetting these two changes, the Scottish Government now plans to draw down £265 million from its main Scotland Reserve to help cover the costs of day-to-day spending, rather than the £162 million planned back in December. This appears to reflect the fact that underspends in 2023–24 were greater than expected back in December, meaning that there is more money in the Scotland Reserve that can be drawn down.

This combination of changes will slightly reduce the amount of interest the Scottish Government will have to pay over the next few years (because it will no longer incur interest on new borrowing, and money held in the Scotland Reserve does not earn interest). However, it means less flexibility for the Scottish Government to distribute its funding over time and to respond to shocks. The rules of the Scottish Fiscal Framework mean it can only borrow to cover day-to-day spending when there is a negative forecast error or reconciliation payment – a condition satisfied in 2024–25 but not expected to be satisfied in 2025–26. In other words, it cannot borrow more next year if it has borrowed less this year. In contrast, it has flexibility over when and how much to draw down from any balance held in the Scotland Reserve. Forgoing borrowing and planning to draw down in full the Scotland Reserve this year therefore reduces financial flexibility in 2025–26 and beyond.

One interpretation of the Scottish Government’s actions is that it thinks this is a price worth paying for slightly lower future debt interest payments. Alternatively, it may think a significant underspend is again a real possibility again this year, and may want to reduce the risk that this exceeds the amount it can set aside in the Scotland Reserve: planning to draw down the Scotland Reserve in full, by definition, maximises the ‘headroom’ against its reserves limit if budgets are again underspent.

Overall resource (day-to-day) funding

The Scottish Government’s overall resource funding, for day-to-day spending on public services and social security benefits, is the sum of UK government funding, devolved revenues and net movement in reserves and borrowing.

Table 6.2 shows the total resource funding available to the Scottish Government in 2024–25 and 2025–26, broken down by major source of funding. Column 1 shows the plans for 2024–25 resource funding as of December 2024 when the Budget for 2025–26 was published. Column 2 accounts for the changes announced in the SBR for 2024–25. Column 3 shows the plans for 2025–26 resource funding, updated for changes officially made to the Budget bill for 2025–26 as it has progressed through the Scottish Parliament. Changes have not yet been made to reflect the employer NICs compensation discussed in Box 6.1, but as discussed this funding is expected to amount to £300 million in 2025–26.

Table 6.2 Scottish Government resource funding, £ million

	2024–25 plans		2025–26 plans
	December 2024	January 2025	January 2025
Block grant	39,635	39,646	41,141
Migrant surcharge	223	221	210
Net tax revenues	1,724	1,686	1,175
<i>Of which: BGA</i>	-18,110	-18,110	-20,386
<i>Of which: tax revenues</i>	19,834	19,797	21,561
Social security BGA	5,182	5,182	5,596
Reconciliations	-338	-338	500
Borrowing	187	0	0
Scotland Reserve	162	265	0
Other	3,038	2,886	2,820
Total funding	49,813	49,547	51,442
Social security spending	6,224	6,224	6,930
Funding available for public services	43,589	43,323	44,512

Note: Grey figures represent unchanged projections. Numbers are after making IFRS adjustments. ‘Other’ funding includes business rates revenues and reductions to account for debt servicing costs (interest and repayment of principal).

Source: Authors’ calculations using Scottish Fiscal Commission (2024) and Scottish Government (2025a).

Since December 2024, as Table 6.2 shows, the contribution of UK government funding to Scottish resource funding in 2024–25 has increased slightly. As described above, the Scottish Government is no longer expecting to borrow in this year, and no longer expecting to draw on Scotwind funding (reducing the ‘Other’ row of the table), while expected drawdowns from the Scottish Reserve have increased. The combined effect of these changes is to reduce the amount of funding available for public services in 2024–25 by around £300 million.

This decline, together with the £13 million of funding found for deals with the Scottish Greens and Scottish Lib Dems on the 2025–26 Budget bill means that, rather than decrease slightly in real terms (–0.3%) between 2024–25 and 2025–26, as was planned in December 2024, funding available for public services is instead set to grow slightly (0.4%) between the two years. The block grant from the UK government is set to grow by 1.4% in real terms between years – important in pushing down the overall funding growth rate is the decline in net tax revenues, which are set to fall 31.9% in real terms, as well as a more negative net social security position (just over –£1.3 billion as opposed to just over –£1.0 billion).

Overall capital (investment) funding

Scottish Government capital investment is funded via a mix of UK government funding, and devolved borrowing, reserves and Scotwind proceeds. Table 6.3 shows how these different sources of funding contribute to the overall capital funding in both 2024–25 and 2025–26.

Table 6.2 Scottish Government capital funding, £ million

	2024–25		2025–26
	December 2024	January 2025	January 2025
General capital funding			
Block grant	5,709	5,696	6,256
Borrowing	300	332	472
Scotland Reserve	130	141	0
Other	139	101	451
Total general capital funding	6,278	6,270	7,179
Total financial transactions funding	124	127	167
Total capital funding	6,402	6,397	7,347

Note: Numbers are after making IFRS adjustments.

In contrast to resource funding, there has been little change in overall capital funding in 2024–25 compared to initial plans set out in the December 2023 Budget for this financial year. Increases in UK government funding via the Barnett formula and an increase in planned capital drawdowns from the Scotland Reserve following underspends in 2023–24 have been offset by reductions and planned capital borrowing and the cancellation of a planned transfer from the Scottish Government's resource to capital funding. All told, general capital funding this year is set to be £20 million or 0.3% higher than initially budgeted for, although a little lower than expected in December.

A more significant change is for 'financial transactions capital' funding (which covers loans and equity schemes for the private sector), where a reduction in planned spending by the UK government has reduced the Scottish Government's funding for this type of spending from £176 million to £127 million this year, which although a relatively small change in the context of the Scottish Government's overall capital budget, represents an almost 30% reduction in planned funding for this particular element of capital funding.

The October 2024 UK Budget announced a large increase in capital funding for 2025–26 (£0.5 billion), which the December 2024 Scottish Budget added to via a planned increase in borrowing (an additional £0.1 billion) and the first planned drawdowns from Scotwind for investment purposes (£0.2 billion). This is partially offset by the fact that planned drawdowns in 2024–25 mean that there is not currently expected to be any remaining money to draw down from the Scotland Reserve next year (£0.1 billion). All told, overall general capital funding is set to increase by a substantial £0.9 billion, equivalent to a 14% cash-terms or 12% real-terms increase over 2024–25 levels. Overall capital funding, including financial transactions capital, is set to grow by 15% in cash terms or 12% in real terms.

The increase in planned borrowing from £332 million to £472 million means an increase in the aggregate amount of debt incurred, from 78% of the Scottish Government's capital debt limit this year to 87% of its limit next year. As discussed further in Section 6.3, capital borrowing is then planned to reduce to £300 million per year from 2026–27 onwards to leave some headroom against the debt limit, so that the Scottish Government can use borrowing to respond to urgent capital funding requirements, if necessary. And when combined with the fact that Scotwind drawdowns for capital purposes are not currently planned in subsequent years, capital funding is set to fall in real terms after 2025–26.

In this context, we may expect some slippage in capital spending plans in 2025–26. Indeed, to maximise the value-for-money of the funding provided, it might make more sense to ramp up spending a little more slowly by borrowing and drawing down less Scotwind funding in 2025–26, and

more in later years. This would allow more time to plan and select schemes, and might reduce costs by avoiding a temporary spike in demand for skilled labour and equipment used in construction. However, if bringing forward capital spending in this way helps boost public and private sector productivity more quickly, this might help improve the fiscal situation in later years. This might suggest a focus on new equipment and software for the delivery of public services – which might translate more directly into improvements in public sector productivity, and might be less at risk of demand-induced costs (given that the markets for such equipment and software are often more international than for construction services).

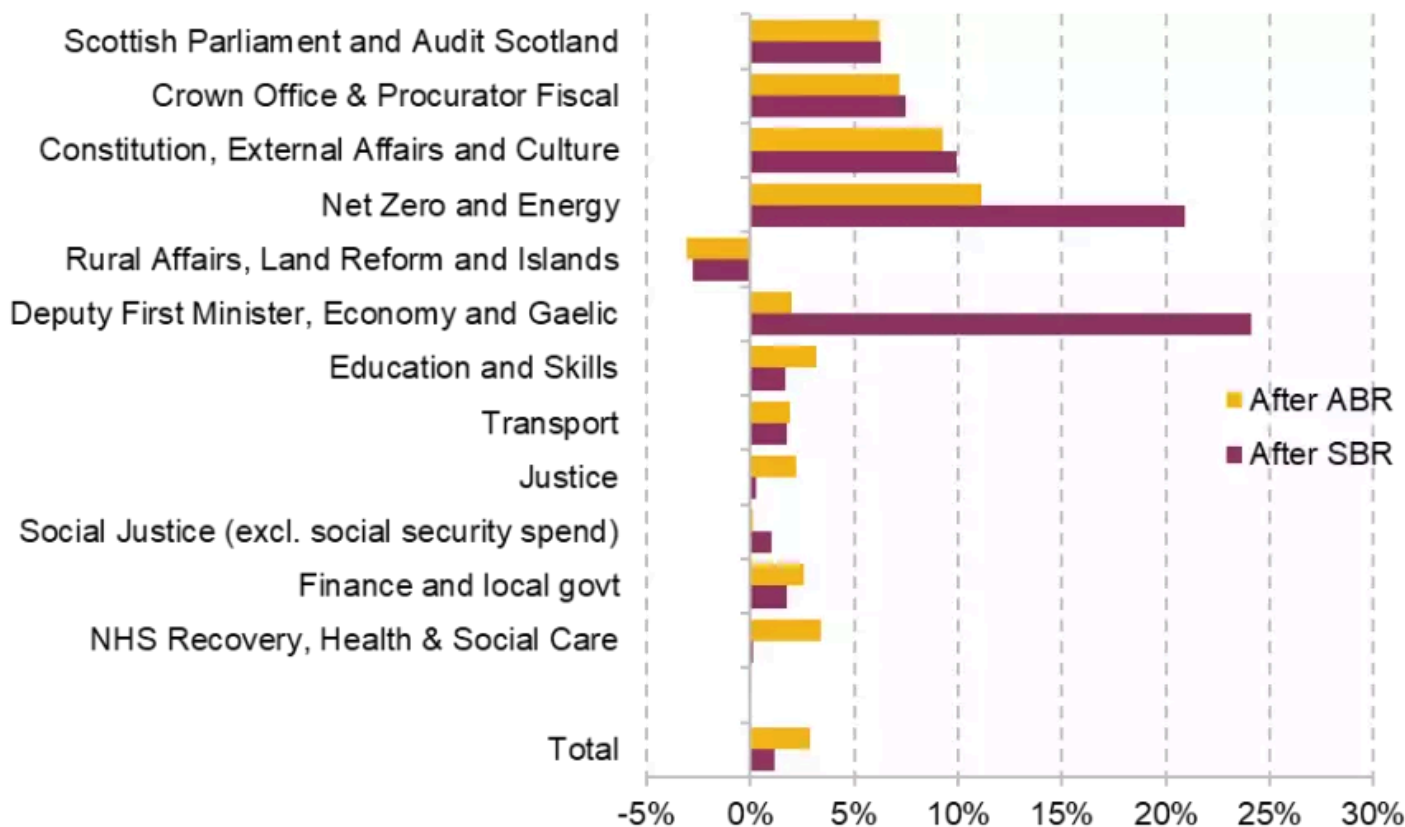
6.2 Public spending in 2025–26

Given its available funding, the Scottish Government has to choose how much to allocate to different types of services and investments based on the spending pressures faced and its policy priorities.

Resource spending decisions

Figure 6.2 shows real-terms changes in resource spending by Scottish Government portfolio. The yellow bars show the changes implied by comparing plans for 2025–26 with plans for 2024–25 following the Autumn Budget Revision (ABR), the basis for comparison in the Scottish Government’s Budget documentation. The purple bars show the changes implied following the SBR for 2024–25 and the latest negotiations over the Scottish Budget Bill for 2025–26.

Figure 6.2. Change in resource spending by portfolio, real terms, 2024–25 to 2025–26



Note: Finance and Local Government portfolio includes non-domestic rates (NDR), Social Justice portfolio strips out social security benefit spending and Deputy First Minister, Economy and Gaelic excludes employability. We strip out non-baselined internal transfers only. Changes in figures also reflect changes in IFRS funding cover between the ABR and SBR.

Source: Authors' calculations using Scottish Government (2024c, 2024d).

Changes between 2024–25 and 2025–26 as set out in the Budget

As explained in more detail in Box 6.2, the most meaningful information on the changes in planned spending in 2025–26 as of the time of the Budget was not in the main body of Budget documentation but an annex table. This table showed that compared to plans for 2024–25 following in-year top-ups to spending made at the ABR, just one area was set to see a real-terms fall in day-to-day spending in 2025–26: the Rural Affairs, Land Reform and Islands portfolio, which covers agricultural and fisheries support, forestry and land management, and a range of specialist services for rural areas.

Box 6.2. Spending baseline choices in the Scottish Budget documentation

In this report, when considering plans as set out in the Budget documentation, we use figures from an annex to the main document. Because of this, the year-to-year real-terms changes in spending we calculate differ from what one would calculate if one compared the spending figures for 2024–25 and 2025–26 set out in the main body of the Budget documentation. This is because the figures in the main body do not adjust for the fact that there are multiple

planned transfers of funding between spending portfolios at the time of the ABR, as funding is moved from the portfolio where ministerial responsibility for that spending lies to the portfolio implementing the associated activities. Figures for 2024–25 are presented after those transfers have been made, but figures for 2025–26 are presented before those transfers have been made, and so comparing the two provides an uninformative impression of the change in spending between these two years for portfolios affected by such transfers.

The effects are not insignificant. Transfers from the Health portfolio to the other portfolios (mostly to the Finance and Local Government portfolio to provide social care funding for councils) amount to £684 million. These are subtracted off the figures for 2024–25 but the transfers planned next year (amounting to a similar, if not slightly larger, amount) are not. This means that rather than increasing by the £1.8 billion set out in the main Health portfolio funding table in the Budget, at that point, the resource budget for the Health portfolio was actually set to increase by £1.1 billion in 2025–26. The total planned increase as of the time of the Budget in December including capital investment was not £2.0 billion as set out in that table and widely reported in the media and highlighted by Scottish Government ministers, but £1.3 billion.^a These are big differences.

As highlighted, the correct figures were published in an annex to the Scottish Budget documentation. In next year's Scottish Budget, the Scottish Government should go further and put these adjusted figures in the main body of the Budget document. And it should use these adjusted figures in communication with the Scottish Parliament, stakeholders and wider public. Continuing to use unadjusted figures and/or reverting to comparing Budgets to initial (rather than the latest) plans for the coming year risks confusing stakeholders and the wider public, and arguably risks being misleading about the actual changes in spending being planned.

^aNote that the increase for the Health portfolio in 2025–26 is also £2 billion when compared to the original portfolio budget for 2024–25. But again, this comparison provides a misleading picture of how the plans for 2025–26 set out in the Budget documentation compare to what was expected to be spent in 2024–25 even at the time the 2025–26 Budget was presented given the £1 billion top-up announced in the ABR. Moreover, it seems unlikely that 2025–26 will see scope for such significant top-ups, without cuts to other areas of spending.

The overall real-terms rate of growth in day-to-day spending on public services compared to the updated 2024–25 budgets set out in the ABR was set to be 2.9%. Several portfolios were set to grow at rates similar to this overall average – including, importantly, the Health and Social Care portfolio,

which was planned to increase by 3.4% in real terms next year compared to the then latest plans for 2024–25, and the Finance and Local Government portfolio (including spending funded by business rates), planned to grow by 2.6% in real terms. Areas seeing substantially larger than average increases were mostly relatively small areas of day-to-day spending, such as funding for Audit Scotland (which audits the Scottish Government and councils) and the Crown Office (Scotland’s public prosecution service and death investigation authority). The Net Zero and Energy portfolio was set to see the largest real-terms increase of 11.1%.

Changes between 2024–25 and 2025–26: the latest position

The SBR was published in January 2025, setting final budgets for 2024–25. This allocated a further £0.7 billion for day-to-day spending on specific services, as we described in our immediate response (Boileau and Phillips, 2025). There were significant shifts in the prioritisation of different areas: most notably, day-to-day spending by the Health and Social Care portfolio was topped up by around £0.6 billion in 2024–25. In contrast, expected underspends of previous budgets meant that the Net Zero portfolio’s day-to-day budget was reduced by £9 million for redeployment elsewhere.

These changes to funding also have implications for the implied growth rates in funding between this year (2024–25) and next (2025–26). Particularly notable, again, is the change to the Health and Social Care portfolio: as already mentioned, the Budget documentation implies a real-terms increase in day-to-day spending of 3.4% in 2025–26. However, the further in-year top-ups to spending plans in 2025 announced in the SBR now imply that funding will essentially be unchanged in real terms between 2024–25 and 2025–26. This may change during the course of 2025–26 if, as seems likely, some further funding becomes available (for example, due to underspends this year) or if funding is reallocated from other services: a real-terms freeze is almost certainly inconsistent with the Scottish Government’s ambitions to improve the performance of the NHS. However, the UK government’s finances mean top-ups of anywhere near the scale seen during the current year are unlikely without significant in-year cuts to some other areas of Scottish Government spending.

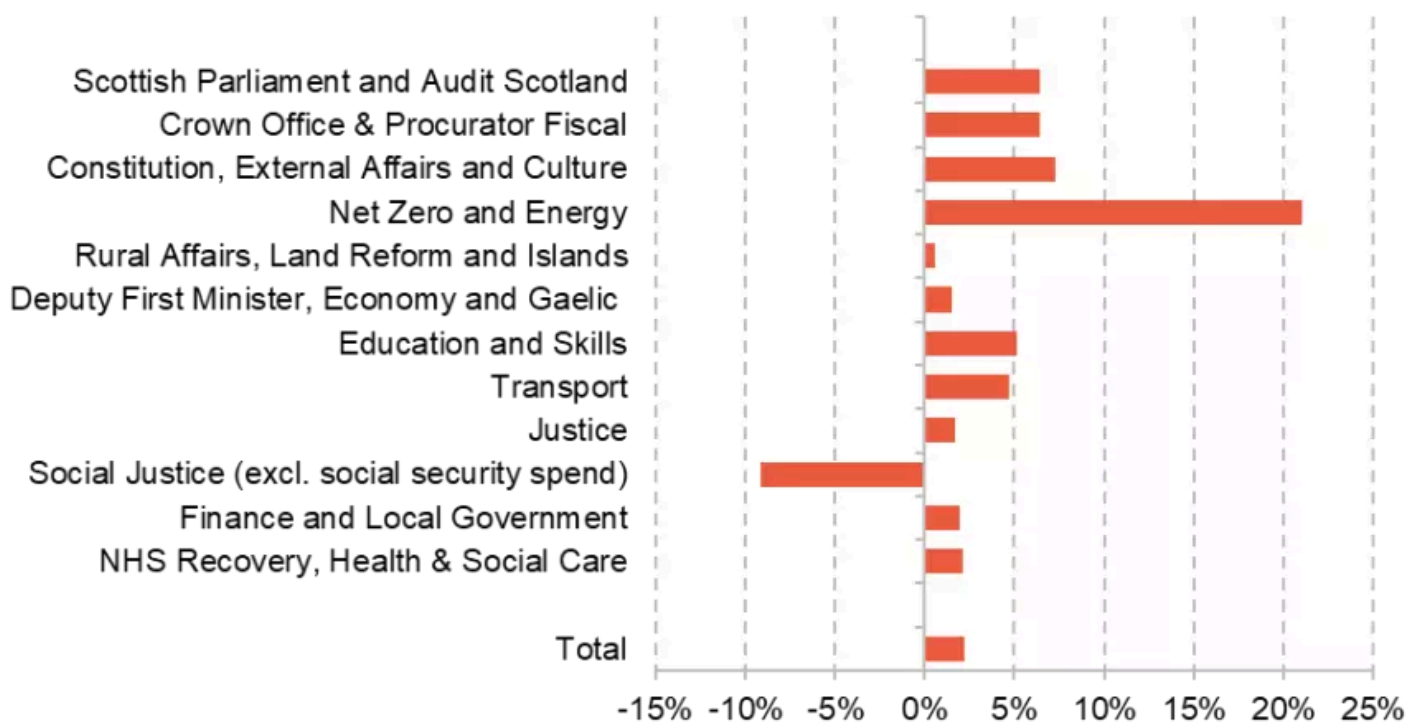
Other changes as a result of the SBR are not insignificant. Planned growth in spending on the Justice portfolio is also slower as a result of in-year top-ups to the in the SBR: 0.3% as opposed to 2.2%. Year-on-year growth in the Finance and Local Government portfolio is now set to be 1.8%, before considering the recently announced (but not yet officially budgeted for) £144 million compensation for employer NICs increases. The in-year reductions in the Net Zero budget also have a transformative effect on expected year-on-year real-terms growth in spending (although to a much smaller portfolio): this is now set to be 20.9% as opposed to the 11.1% set out in the Scottish Budget. In-year cuts this year to the Social Justice and Crown Office portfolios confirmed in the SBR mean a bigger implied increase next year.

In addition to making the final official updates to planned spending on specific services, the SBR also set aside £350 million of funding that is being held centrally as a contingency in case service-specific budgets turn out to be overspent or devolved tax revenues come in under forecast. Recent history suggests underspends rather than overspends are more likely (with 2021–22, 2022–23 and 2023–24 seeing underspends compared to the final budgets set out in those years’ SBRs). It therefore seems highly likely that the Scottish Government will be able to carry this funding forward in the Scotland Reserve for future years. Indeed, the Scottish Government has earmarked £60 million of this £350 million pot as ‘funding to be carried forward for Health and Social Care to support 2025–26 costs’. It would arguably have been more transparent to have allocated this element of the contingency immediately to Reserves, making clear the intention to carry it forwards. If the remainder of the contingency and any underspends by specific services can be carried forward, then this would help top-up spending plans next year (including to provide the Health and Social Care portfolio with a real-terms increase) or beyond somewhat.

Comparison with 2023–24 outturns

The changes planned for next year follow substantial real-terms increases in funding and hence spending in the current financial year, 2024–25, compared to the amounts actually spent in 2023–24. Figure 6.3 shows that this means, taking 2024–25 and 2025–26 together, the average annual real-terms increases in resource spending look more generous. Growth in day-to-day spending is set to average 2.2% annually between the two years, after adjusting for technical changes in how pension costs are calculated for certain public services (termed SCAPE costs). Growth in the Net Zero portfolio looks particularly strong, at 21.0% in real terms on average each year. Day-to-day Education and Transport spending are set to increase significantly as well, averaging 5.1% and 4.7% in real terms each year, respectively.

Figure 6.3. Average annual change in resource spending by portfolio, real terms, 2023–24 to 2025–26



Note: Finance and Local Government portfolio includes non-domestic rates, Social Justice portfolio strips out social security spending and Deputy First Minister, Economy and Gaelic excludes employability. We here strip out non-baselined internal transfers only. We also add estimates of SCAPE-related funding in 2023–24, to make 2023–24 and 2025–26 comparable.

Source: Authors' calculations using Scottish Government (2024c, 2024d).

In contrast, day-to-day Health and Social Care spending is set to grow by 2.1% annually on average, roughly in line with the average for all day-to-day spending, but more slowly than in England (where planned growth averages 3.4% annually).⁵ The day-to-day budget of the Local Government and Finance portfolio is also set to grow close to the average rate of day-to-day spending growth, by 2.0% each year. As discussed below, councils receive funding from a range of portfolios, not just funding initially allocated to the Local Government and Finance portfolio. Day-to-day spending on the non-benefits elements of the Social Justice portfolio is set to be cut by around 9.1% each year. This appears to partly reflect a reduction in spending on the administration of social security benefits, reflecting the fact that set-up costs do not have to be incurred again. It also reflects a reduction in funding allocated to supporting Ukrainians living in Scotland, likely reflecting the need for less support as Ukrainian refugees become more integrated.

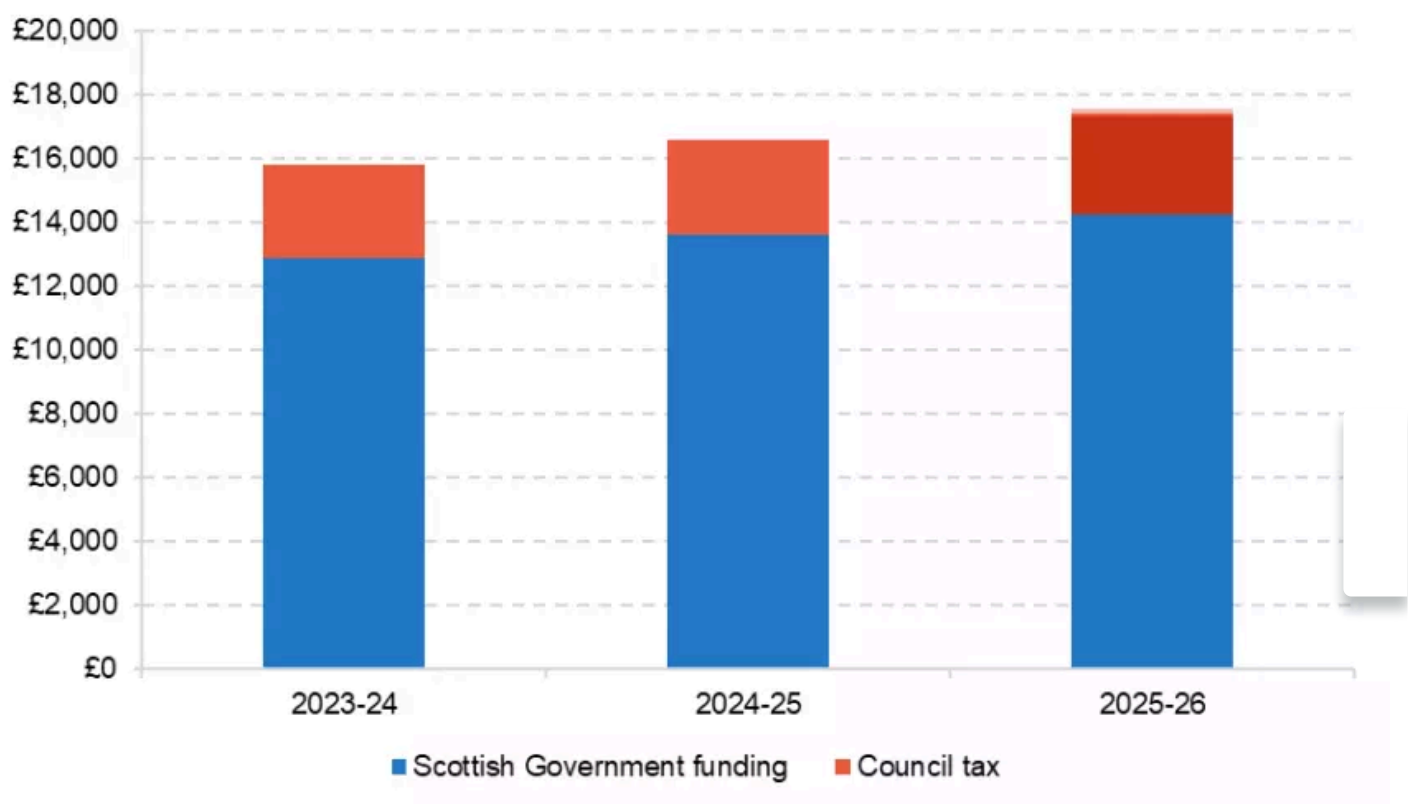
Zooming in on local government

Working out what the Scottish Budget means for council funding is tricky because of the complex way in which their funding is organised and presented. Significant amounts are first allocated to other portfolios (such as Health and Social Care or Education) before being transferred to the Finance and Local Government portfolio and, in turn, councils during the course of the year. The presentation of the figures can change over time, for example, because of previously ring-fenced funding being rolled into general funding, as has been the case recently as a result of the Verity House Agreement. And the

government has in some years provided councils with additional capital funding that has implicitly supported their resource spending needs (by using less of their resource funding to help fund capital investments, as they usually do), such as for pay costs in 2022–23 and 2023–24.

The Budget document includes a table which adjusts for most of these changes, except for the capital funding issue. Adjusting also for this change, and accounting for in-year top-ups to council funding made at ABRs and SBRs, Figure 6.4 shows how council funding is set to change between 2023–24 and 2025–26.

Figure 6.4. Scottish council funding (including in-year transfers from other Scottish Government portfolios), 2023–24 to 2025–26, £ million



Source: Scottish Government (2024c) and various ABRs and SBRs for Scottish Government funding, and Scottish Government (2023, 2024b, 2025b) for council tax revenues.

The blue portion of each bar shows Scottish Government grant funding, while the red portions show council tax revenues. The council tax figures for 2023–24 and 2024–25 are taken from councils’ provisional outturns and budget plans (see Scottish Government, 2024b). Councils have yet to set their council tax rates for 2025–26 so we instead show three scenarios, all based on an assumption of underlying tax base growth of 1%: dark red (2%, roughly in line with inflation); mid red (5%, in line with the maximum allowed in most of England without a local referendum); and light red (10%, roughly in line with the maximum allowed in England over two years without a local referendum).

The figure shows that Scottish Government funding for councils' day-to-day spending (including transfers from other portfolios) is set to increase from £12.9 billion in 2023–24 to £13.6 billion this year and £14.3 billion in 2025–26. Council tax revenues are forecast to increase from £2.9 billion in 2023–24 to £3.0 billion in 2024–25. With council tax increases of 2% or 5% that would grow to just under and just over £3.1 billion, respectively, in 2025–26. With council tax increases of 10%, it would instead increase to £3.3 billion.

Adjusting for inflation, we estimate that funding will have increased by 2.5% in real terms in 2024–25. Funding would increase by approximately 1.9% in real terms in 2025–26 if council tax bills are increased by 2%, 2.5% if they are increased by 5% and 3.4% if they are increased by 10%. This means a two-year real-terms increase in funding of between 4.4% and 5.9% for Scottish Councils on the basis of these three scenarios for council tax.

In England, the combined figure for 'core spending power' for local government and schools (the most comparable measure to Scottish councils' funding including council tax) is set to increase by 7.4% in real terms between 2023–24 and 2025–26. To match this, Scottish councils would need to increase their council tax by an average of 18–19% in 2024–25.

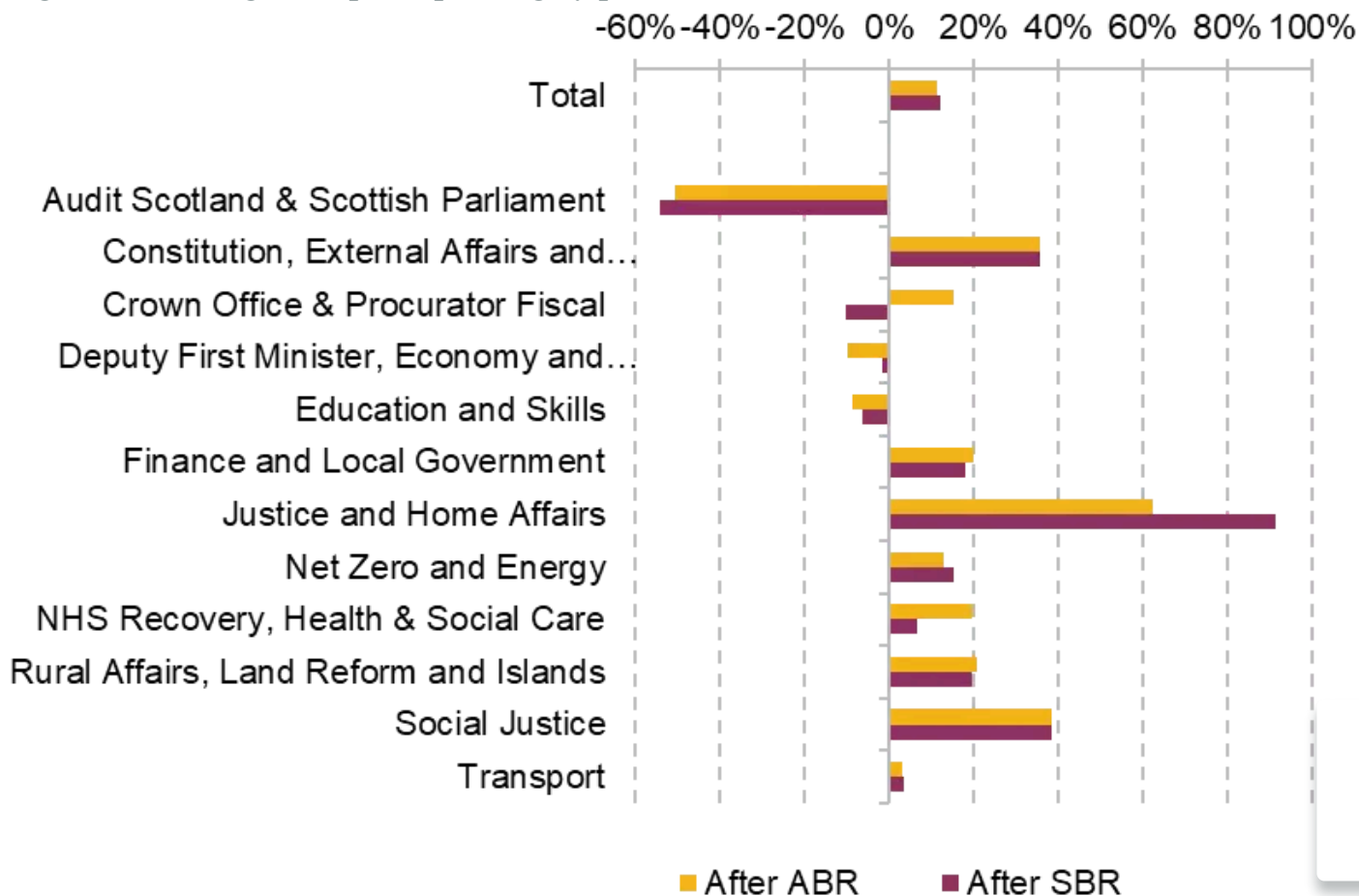
One thing not accounted for in either the Scottish or English figures is additional income councils are set to receive as a result of new fees paid by businesses making use of packaging for goods to be sold to households – so-called Extended Producer Responsibilities. The UK Department for Environment, Food and Rural Affairs will allocate the proceeds of these fees to councils across the UK, including Scotland, based on a formula taking account of existing waste packaging volumes, deprivation and sparsity of population. Provisional figures show Scottish councils receiving a total of £171 million in 2025–26, equivalent to an additional 1.0% in funding.⁶ English councils are set to receive £1.05 billion, equivalent to an additional 0.8% in funding. In England, this funding has been guaranteed for one year by the Ministry for Housing, Communities and Local Government, even if a fall in packaging use means fee income falls short of this. The Scottish Government has not yet made a similar commitment.

Another source of funding not accounted for is compensation for increases in employer NICs bills. As discussed in Box 6.1, the Scottish Government has announced £144 million in additional funding to help Scottish councils meet these costs, although this falls short of the £265 million in direct costs and £93 million in indirect costs for outsourced and commissioned services that councils have estimated they will face. The UK government has announced compensation for English councils' non-education budgets but has yet to announce how much will be provided to meet the costs facing council-run schools and early years facilities.

Capital investment decisions

The big boost to capital investment next year is not being spread equally across different investments. Instead, as shown in Figure 6.5, planned growth differs considerably between portfolios.

Figure 6.5. Change in capital spending by portfolio, real-terms, 2024–25 to 2025–26



Note: We here split out all internal transfers, for consistency in our treatment of spending in different financial years. The change between the ABR and SBR includes swings in the IFRS accounting adjustments.

Source: Authors' calculations using Scottish Government (2024c, 2024d, 2025a).

Growth planned at the time of the ABR was 11.6% in real terms. Investment in Justice was most strongly prioritised, with Justice investment set to grow by 62.3% between 2024–25 and 2025–26, mostly for investment in the Prisons estate. Investment in the Social Justice portfolio was also planned to grow fast, at 38.6% between 2024–25 and 2025–26, and investment in the Finance and Local Government portfolio was set to grow 20.1%.

Other areas' growth looks considerably weaker. Transport investment was set to grow only 3.0% in real terms between 2024–25 and 2025–26, and investment in education, as well as in the Deputy First Minister and Economy and the Scottish Parliament and Audit Scotland portfolios, was set to fall.

Changes in funding at the time of the SBR alter the specifics here slightly, but do not change the overall picture in terms of the prioritised areas of investment. Capital spending totals were cut back on net by around £30 million in the SBR, particularly for the Deputy First Minister and Economy and the Justice portfolios, which has the result of pushing up expected growth between this year and next (to 12.1% in real terms), as Figure 6.5 shows.⁷ The cuts to the Justice portfolio this year in particular push up planned growth even further, with investment expected to almost double in real terms between this year and next.

6.3 Outlook for 2026–27 and beyond

The Scottish Budget set plans for 2025–26 only but it is worth considering the longer-term fiscal context facing the Scottish Government, and how this will shape the trade-offs it faces when allocating funding between different services and investments.

Funding position

UK government funding

Like the Scottish Government, the UK government has set firm plans for public spending only until 2025–26, with plans for the period 2026–27 to 2028–29 set to be announced as part of a multi-year Spending Review due to be published on 11 June 2025. However, the October 2024 UK Budget did set out indicative overall spending envelopes for subsequent years. These were for overall departmental resource funding to increase by 1.3% a year in real terms in each of these years (and 2029–30) – a significant slowdown from the 4.3% increase for 2024–25 and 2.6% increase for 2025–26 implied by the October 2024 UK Budget’s detailed plans. It was, however, slightly up on the 1.0% a year spending growth implied in the plans bequeathed to Ms Reeves by the previous Chancellor, Jeremy Hunt.

What this means for the Scottish Government’s funding will depend on how this funding is allocated between UK government departments. Only allocations to those departments that provide services for which the Scottish Government is responsible in Scotland generate additional funding for the Scottish Government via the Barnett formula – allocations to departments that provide services which cover Scotland too do not (for obvious reasons). The more the UK government allocates to the first kind of department (such as Education, and Health and Social Care), and the less it allocates to the second kind of department (such as Defence, and the Foreign, Commonwealth and Development Office), the bigger the increase the Scottish Government would receive.

Based on assumptions by the Scottish Government, the medium-term projections for UK government funding included in the SFC's December 2024 forecasts assume that UK government funding for the Scottish Government increases in line with the average for overall UK government departmental resource funding: 1.3% a year in real terms (or around 3.3% a year in cash terms).

This would require those UK government departments responsible for services that are devolved to the Scottish Government to see an increase a fair bit higher than 1.3% a year in real terms though. This is because the Barnett formula allocates the Scottish Government a population-share of any planned increases in funding for departments serving England (or England and Wales). And because the Scottish Government starts with a higher level of funding per person, that equivalent per-person increase represents a smaller percentage increase in funding for the Scottish Government than for England (or England and Wales) – the so-called Barnett Squeeze.⁸ Given current inflation forecasts, it would require UK government funding for departments providing services that are devolved to Scotland to increase by an average of 1.7% in real terms to generate a 1.3% real-terms increase in Scottish block grant funding. So that overall departmental spending increased by 1.3% a year in real terms, and so that commitments on defence and overseas aid spending were still met, many other departments providing services UK-wide (such as the non-devolved functions of the Department of Work and Pensions and HMRC) would need to see cuts under such a scenario.

We have also modelled an alternative scenario for how the UK government may allocate funding, based on those defence and overseas aid commitments, the cost of rolling out expanded childcare provision in England and estimates of the cost of delivering the long-term plan for the English NHS. This would see defence and aid funding increase by 1.6% a year in real terms, childcare funding rise by an average of 7.2% a year in real terms and NHS England funding increase by 3.6% a year in real terms. On average, other areas would need to see cuts of 1.4% a year, in real terms, so that overall spending increases by 1.3% a year in real terms. Assuming those cuts were spread equally, application of the Barnett formula would imply an increase in UK government resource funding for the Scottish Government that averages 0.9% a year in real terms, substantially slower than the 1.3% being assumed by the Scottish Government.

Of course, there is significant uncertainty around these projections, which will be partially resolved by the UK Spending Review (although only partially as plans could still be changed in subsequent UK fiscal events). This could see the planned rate of overall spending growth changed. On the one hand, if the overall real-terms rate of growth is increased from 1.3%, it would increase the likelihood of funding increases for the Scottish Government reaching 1.3% or higher. On the other hand, decreases in the overall real-terms rate of growth would increase the likelihood of funding for the Scottish Government growing by 0.9% or less, per year. Over the last 10 years, Spending Reviews have seen

top-ups to previous spending plans – often quite sizeable (Atkins and Lanskey, 2023). However, the UK government’s fiscal room for manoeuvre is currently extremely limited, given high debt and borrowing, and both the Prime Minister and Chancellor saying that no further tax rises are planned. Without either abandoning its fiscal rules, or an improvement in economic and hence tax revenue forecasts, it is difficult to see how the UK government would substantially top-up its spending plans. It therefore seems likely that the Scottish Government will see smaller real-terms increases in UK government funding over the next few years than it has seen over the last few years. A major upturn in the UK economy will be needed to change this picture.

As with resource spending, detailed capital spending plans have not been announced for 2026–27 onwards. Indicative overall capital spending figures have been published which show further real-terms increases in 2026–27 and 2027–28, but a small real-terms cut in 2028–29 (and 2029–30). The Scottish Government has again assumed UK government capital funding for the Scottish Government would change by the same percentage rate as has been pencilled in overall. However, capital funding per person in Scotland exceeds that in England by even more than resource funding does. This means that, for this scenario to be borne out, either overall UK government capital spending plans would need to be topped up, or spending needs to be particularly strongly targeted at departments responsible for investments which in Scotland are devolved responsibilities (such as new hospitals, schools, roads and railways), rather than those responsible for UK-wide investments (such as new defence equipment and most research and development funding).

Devolved funding sources

Forecasts by the SFC and OBR for devolved tax revenues, social security spending and the associated BGAs are published for the period 2026–27 to 2029–30.

Forecasts for income tax imply a significant improvement in the net revenue position from 2026–27 onwards, with an increase from £0.8 billion in 2025–26 to £1.3 billion in 2026–27, £1.8 billion in 2027–28, £2.1 billion in 2028–29 and £2.3 billion in 2029–30. Slightly offsetting this is a reduction in the net revenue position for LBTT from £358 million in 2025–26 to £298 million in 2026–27 and £176 million in 2029–30.

For income tax, some increase in the net revenue position over time would not be unexpected given the increased marginal tax rates applied to incomes over approximately £27,500: a higher proportion of any increase in taxpayers’ gross income is therefore paid over in tax. However, a large part of the improvement implied by current forecasts reflects the fact that the SFC forecasts for earnings are higher for future years than the OBR’s. For example, in 2026–27, the SFC forecasts growth in average earnings of 2.8%, 0.7 percentage points higher than the 2.1% forecast by the OBR. This difference

would account for an increase of around £0.2 billion in the net revenue position between 2025–26 and 2026–27, roughly half of the £0.4 billion increase forecast. The difference in forecasts for average earnings growth increases to 0.9 percentage points in 2027–28, which on its own would mean an increase of around £0.3 billion in the net revenue position, before falling back to 0.6 percentage points (£0.2 billion increase) and 0.3 percentage points (£0.1 billion increase).

As with previous forecasts though, the SFC highlights that it is not necessarily the case that its greater optimism about earnings growth compared with the OBR relates to Scotland-specific factors. Instead, it may reflect differences in their optimism about UK-wide factors affecting earnings growth, such as the extent to which, and the speed with which, higher employer NICs bills depress earnings growth. If the SFC is closer to the truth, the BGA would likely be revised up relative to Scottish income tax revenues in future years, whereas if the OBR is closer to the truth, then Scottish revenues would likely be revised down relative to the BGA. This means that the risks for the net income tax revenue position are weighted to the downside – there is more risk that the net revenue position is weaker than currently forecast, rather than stronger than currently forecast.

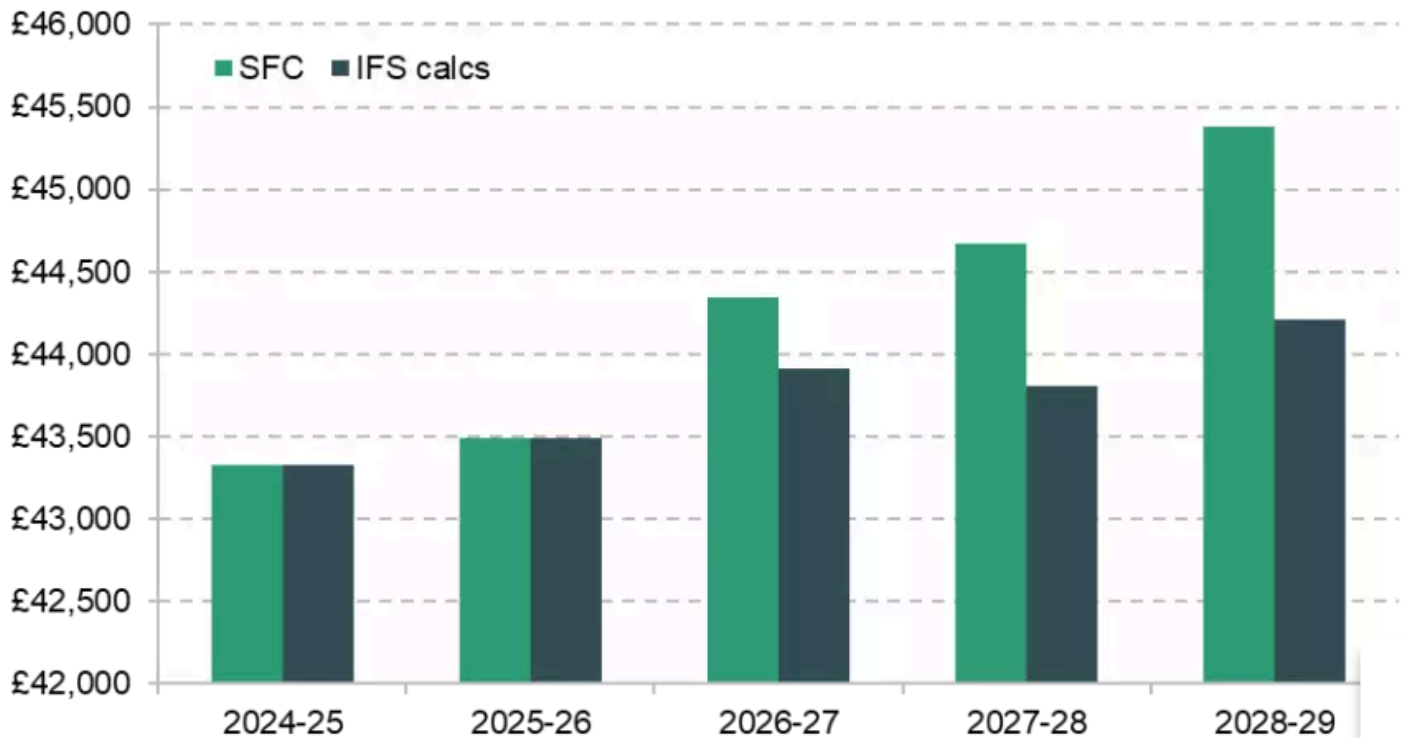
For LBTT, the main factor seems to be that after a period during which Scottish property prices and transactions have held up better than in the UK as a whole (boosting the net revenue position), SFC and OBR forecasts imply slightly weaker growth in prices and much weaker growth in transactions volumes from 2026–27 onwards in Scotland compared with the UK as a whole. To the extent that there is more room to ‘bounce back’ in England and Northern Ireland following a bigger slowdown period where prices and transactions grow less quickly in Scotland than England and Northern Ireland may be expected. But risks for the forecast net LBTT revenue position may be weighted to the upside, given how much more optimistic the OBR is for the long-term trajectory of transactions than the SFC is.

As well as changes to the in-year net tax revenue position, the future funding outlook will also be affected by reconciliation payments for past forecast errors. Current forecasts imply positive net reconciliation payments of around £0.5 billion in 2026–27, largely due to the fact that the latest forecast for the net income tax revenue position for 2023–24 (£0.8 billion) is substantially higher than what was assumed when the 2023–24 Budget was set (£0.3 billion). In contrast, current forecasts imply a large negative reconciliation payment of –£0.7 billion in 2027–28, due to an aforementioned downgrade in the net income tax revenue position for 2024–25 from £1.4 billion to £0.7 billion. If this is borne out, the Scottish Government would be able to borrow to cover most but not all of this reconciliation payment, spreading its cost over multiple years.

Overall funding outlook

Taking all sources of funding together, Figure 6.6 sets out two scenarios for how the Scottish Government’s resource funding may evolve from 2026–27 onwards. Both scenarios subtract forecast social security spending (including the SFC’s supplementary forecasts of the cost of mitigating the two-child limit), and debt servicing costs, to focus on the amount available for public services.

Figure 6.6. Resource funding available for public services between 2024–25 and 2028–29, £ million, 2024–25 prices



Note: The IFS calcs scenario assumes that block grant funding grows more slowly and that the income tax net position is adjusted downwards. Both projections strip out projected social security spending in this period, including the forecast cost of mitigating the two-child limit after 2026–27.

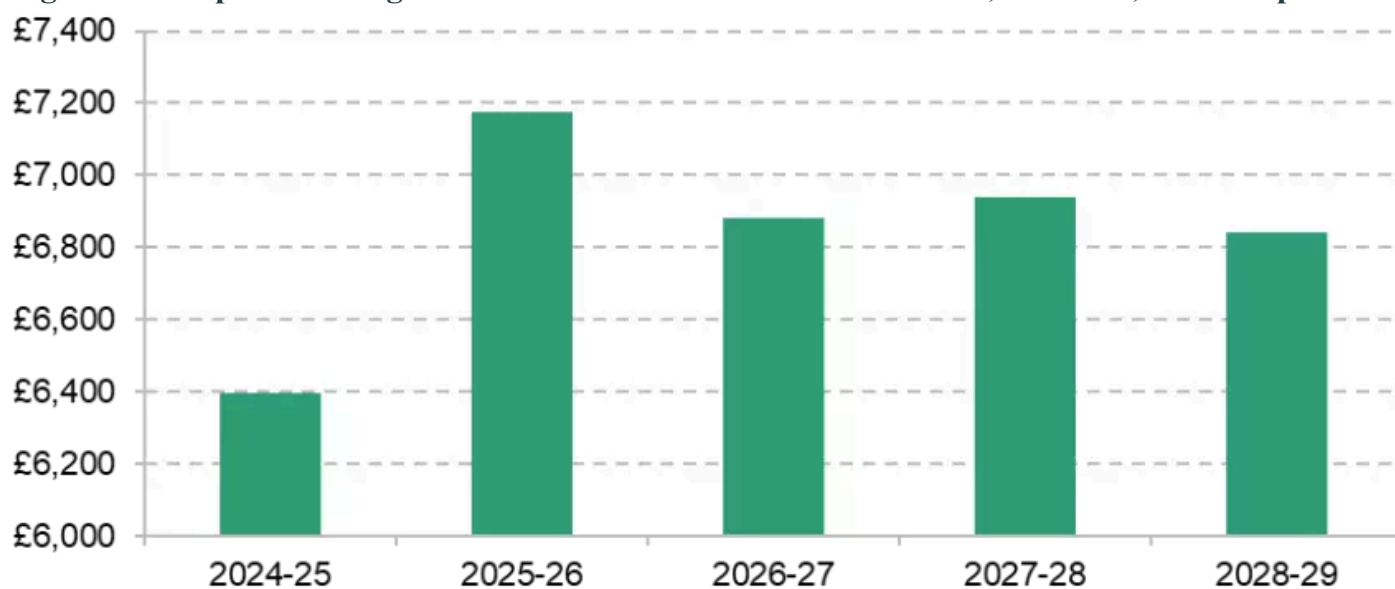
Source: Authors’ projections using Office for Budget Responsibility (2024), Scottish Fiscal Commission (2024) and Scottish Government (2024d, 2025a).

The SFC scenario illustrated in the figure reflects the SFC’s long-term resource funding projections: under this scenario, resource funding would grow by 1.4% in real terms each year on average between 2025–26 and 2028–29. The IFS calcs scenario reflects our alternative scenario for the UK government’s allocation of funding after next year, under which the block grant grows more slowly, as well as the downside risk associated with the OBR and SFC’s projections of income tax revenues. We assume that from 2026–27 onwards, average earnings grow identically in Scotland and in the rest of the UK, implying downwards revisions to the net position. Under this scenario, resource funding would grow by just 0.5% in real terms each year on average between 2025–26 and 2028–29.

Figure 6.7 sets out how capital funding is likely to evolve from 2024–25 onwards. After experiencing a significant initial boost, with funding growing 12.2% in real terms between 2024–25 and 2025–26,

funding is then set to fall in real terms by 4.1% between 2025–26 and 2026–27, and remain at lower levels thereafter. This volatility is unlikely to be optimal, particularly in the case of investment spending. We know that investment spending is hard to ramp up fast: under the Labour governments of the 2000s, capital spending tended to increase less fast than was planned.⁹ It may be sensible for the Scottish Government therefore to carry some funding forward, both to ensure money is spent (well) and to cushion or avoid a sharp fall in funding in 2026–27.

Figure 6.7. Capital funding available between 2024–25 and 2028–29, £ million, 2024–25 prices



Note: Figure includes both general capital and financial transaction funding.

Source: Authors' projections using Office for Budget Responsibility (2024) and Scottish Fiscal Commission (2024).

Trade-offs between spending priorities

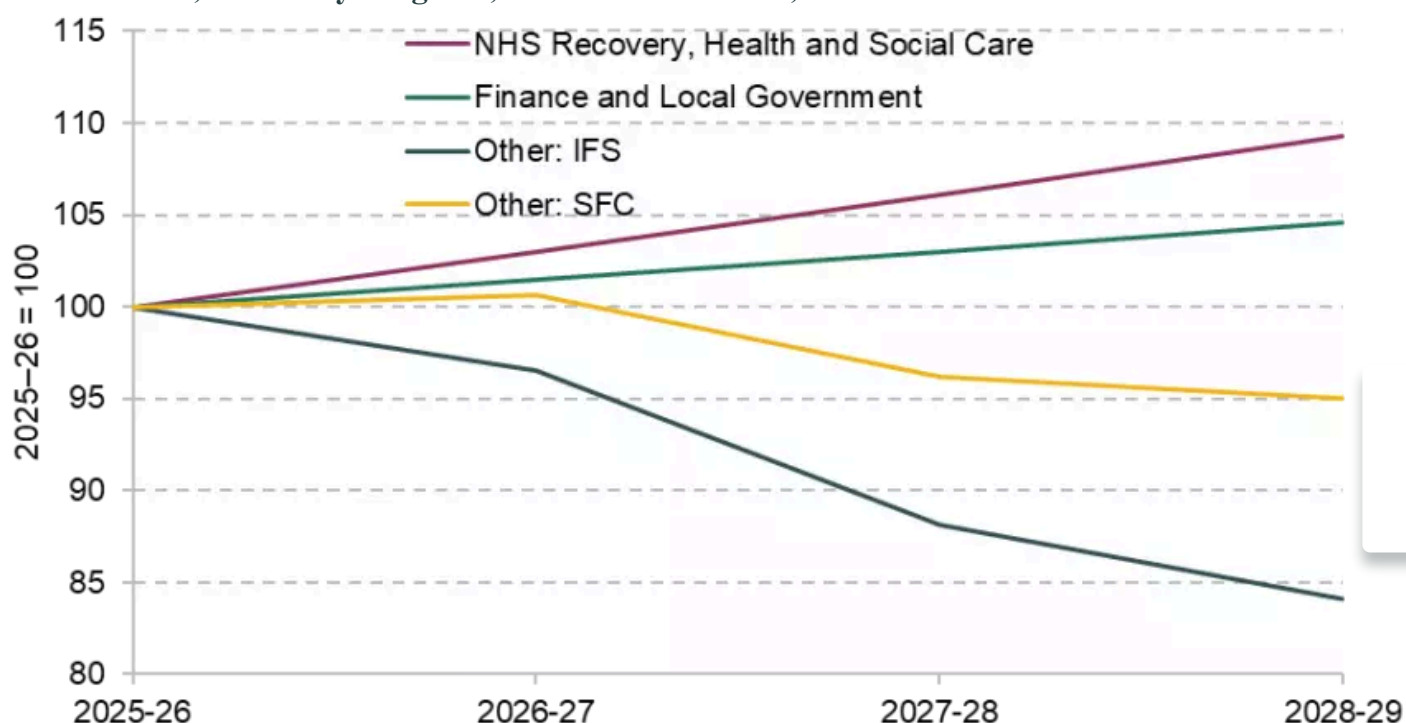
The Scottish Government should set its own multi-year spending plans once it has had time to take proper account of the UK government's Spending Review. This may be possible after the Scottish summer parliamentary recess, but may not be possible until the 2026–27 Budget. Provided the UK government does not make major changes to the plans set out in its own Spending Review in the Autumn 2025 UK Budget, the Scottish Government may be able to bring its Budget forward somewhat though (for example, to November), to give both more time for scrutiny and longer for service portfolio teams to plan.

Until the Scottish Government sets its plans, we do not know how different spending areas will fare from 2026–27 onwards. However, given the funding scenarios set out above, we can look at what plausible allocations for certain portfolios may mean for the amount available for other services.

Figure 6.8 shows resource funding for the Health and Social Care, Finance and Local Government and all other portfolios (excluding social security benefits) over the period 2025–26 to 2028–29 under one

such set of assumptions. In particular, we assume that resource funding for the Health and Social Care portfolio is increased by 3% in real terms per year from 2026–27 to 2028–29, while funding for the Finance and Local Government portfolio is increased by 1.5% a year in real terms each year. This is somewhat faster than in recent years but is broadly consistent with the amounts that would be needed to match the English NHS’s long-term workforce plan (Warner and Zaranko, 2023), after adjusting for the lower projected growth in the overall population in Scotland than England. The local government figures are somewhat slower than in recent years, but are designed to be consistent with increases in social care spending of 3% a year in real terms, while allowing modest increases to other areas of local government spending.

Figure 6.8. Real-terms spending on NHS Recovery, Health and Social Care, Finance and Local Government, and everything else, 2025–26 to 2028–29, indexed to 2025–26



Note: The IFS calcs scenario assumes that block grant funding grows more slowly and that the income tax net position is adjusted downwards. Both projections strip out projected social security spending in this period, including the forecast cost of mitigating the two-child limit after 2026–27. Spending is indexed to 100 in 2025–26.

Source: Authors’ projections using Office for Budget Responsibility (2024), Scottish Fiscal Commission (2024) and Scottish Government (2024d, 2025a).

We show the implications for other portfolios: both under the resource funding projections set out in the SFC’s forecast report published alongside the 2025–26 Scottish Budget document, and under our alternative scenario for resource funding, using the Barnett formula to project changes in funding and stripping out the effects of differential earnings forecasts and changes in higher rate income threshold from the net income tax revenue position. The two projections are illustrated in Figure 6.8.

As shown, when health and local government are prioritised, given the tight overall funding envelope, other areas are set to fall in real terms. The figures imply average annual cuts of 1.7% each year according to the SFC funding projections, and 5.6% each year according to the IFS funding projections, to all other portfolios. These cuts are large, and would be difficult to make while maintaining the quality of public services without a significant paring back of the range of services provided. Perhaps more likely than such large cuts to ‘unprotected services’ if overall funding changes in line with our alternative scenario is slower growth in spending on the Health and Social Care and Finance and Local Government portfolio: paring back growth to 2% and 1% in real terms per year would halve the required cuts to day-to-day spending on other services to 2.8%. The Scottish Government could seek to raise revenues.

Of course, these are projections not forecasts and there is significant uncertainty about the various moving parts of the Scottish Government’s finances – both on the funding and spending side of its budget.

One factor contributing to the projected squeeze on funding for day-to-day public service spending – and a source of some uncertainty – is the announcement of the Scottish Government’s intention to mitigate the two-child limit in universal credit. As we will discuss in further detail in a forthcoming publication, this policy is particularly well targeted at reducing child poverty (especially given the Scottish Government already mitigates the overall ‘benefits cap’). However, the forecast medium-term cost (approximately £180 million per year) does have an impact on the amount available for spending elsewhere.

If the Scottish Government did not go ahead with this policy – for example, if the UK government decided to remove the two-child limit UK-wide – then the £180 million a year freed up would be sufficient to reduce the scale of cuts to unprotected services by an average of 0.6 percentage points a year in the period 2026–27 to 2028–29. For example, under our main SFC and alternative scenarios the cuts would be reduced to 1.2% per year (from 1.7%) and to 5.0% per year (from 5.6%), respectively. Thus, forgoing this policy (or the UK implementing it nationwide) would ease the squeeze elsewhere in the Scottish Government’s budget – but only modestly.

6.4 Conclusion

This chapter has shown how the Scottish Government’s short-term funding position has improved substantially compared to expectations a year ago as a result of a big boost to UK government funding, announced in the UK Autumn 2024 Budget. This has been partially offset though by a

downgrade in the forecast net income tax revenue position, which will act as a drag on funding in 2025–26 compared with the current financial year.

The outlook for 2026–27 will become much clearer after the UK government’s multi-year Spending Review due on 11 June. The Scottish Government should then carry out its own multi-year Spending Review, although the combination of residual uncertainty about UK government funding (it could still be changed in subsequent UK fiscal events), uncertainty about devolved tax revenues and limited borrowing powers mean that any Scottish multi-year plans will be far from set in stone. Top-ups or cutbacks to UK government spending, and increases or decreases in the forecast net tax revenue position and subsequent outturn positions mean the total amount available to spend in future years *will* differ from what is assumed at the time of a Scottish Spending Review – potentially significantly. But a Spending Review still provides an opportunity to identify priorities for future service provision and investment, based on a review of existing performance and needs. And setting out baseline budgets and a set of principles for how those budgets will be updated, as it becomes clear how much they can be topped up in total, can help different service areas and providers (such as councils) with their own medium-term planning.

Bearing in mind the uncertainty, it seems highly likely that overall funding increases will be smaller for at least several years from 2026–27 onwards than over the last few years. This reflects a slowdown in planned growth in overall spending by the UK government as it seeks to reduce borrowing in the context of much elevated debt and high debt servicing costs, and an already-large increase in the tax GDP ratio since pre-pandemic levels. The projections included in the SFC’s forecast report, if anything, understate the likely slowdown in the overall growth in Scottish Government funding from 2026–27 onwards that is implied by current UK government plans and central expectations about the net tax revenue position. Without sizeable top-ups to UK government spending plans – which might only follow if growth forecasts are revised upwards – and/or a substantial improvement in the net tax revenue position, it seems likely that a range of services and capital investment will face cuts from 2026–27 onwards in order to meet NHS and social care spending pressures.

In this context, it is particularly important that the front-loaded increases in investment and public service spending planned are undertaken effectively (or smoothed out over more years). In the case of capital investment, this may mean focusing more on equipment and information technology rather than new buildings and infrastructure, and tolerating delays to planned spending if inputs (such as skilled labour) are in short supply and/or it takes time to identify the most cost-effective schemes. Well spent, investment may help boost public and private sector productivity, making the slowdown in UK government funding likely from 2026–27 onwards less painful. Without an improvement in productivity, the trade-offs facing the Scottish Government in future years will be more unpalatable.

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Endnotes

- 1 These and other figures in the following paragraphs are taken largely from Scottish Fiscal Commission (2024). The exception is figures for the amount of additional funding provided in 2024–25 onwards to cover mechanically higher pension costs, which are based on figures in HM Treasury (2024).
- 2 The exception is business rates, where there is no explicit BGA. Instead, the underlying block grant itself is reduced to account for the change in UK government funding for local government in England that is funded by the proportion of business rates revenues collected by English councils that are pooled at a national level.
- 3 More specifically, the BGA for a given tax in year t is equal to the BGA in year $t - 1$, increased in line with the percentage increase in revenues per person from the equivalent tax in England and Northern Ireland, and the growth in the Scottish population. Bell, Eiser and Phillips (2023) provide more information.
- 4 See, for example, Fraser of Allander Institute (2025).
- 5 Note, this is a lower rate of growth than implied by our analysis of the 2024–25 SBR. That is because part of the increase in funding between 2023–24 and 2024–25 for the Health and Social Care portfolio relates to funding that is transferred during the course of the year to councils. From 2025–26, this funding will be baselined into councils' core funding rather than transferred over during the year. For consistency reasons, like the Scottish Government, we also adjust 2024–25 spending plans to account for this. This means a lower rate of growth for the Health and Social Care portfolio in 2024–25 and a higher rate for the Finance and Local Government portfolio than when using the portfolio definitions in place historically.
- 6 See Department for Environment, Food and Rural Affairs (2024).
- 7 At the SBR, it became clear that the IFRS budget cover would be larger than expected, and some of this was absorbed by core capital budgets, which were cut back further.
- 8 The Barnett Squeeze was discussed in detail in chapter 2 of our 2023–24 Scottish Budget report (Boileau and Phillips, 2023).
- 9 See Box 3.2, [Capital spending plans: how much will actually be spent?](#) in Office for Budget Responsibility (2020).

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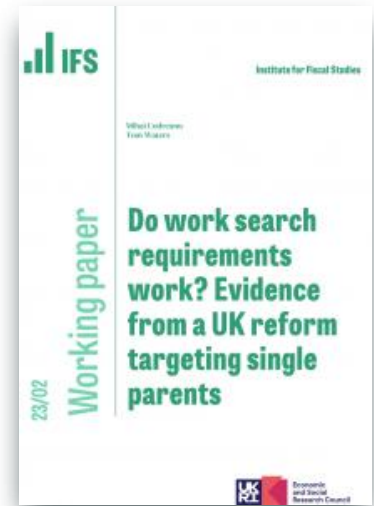


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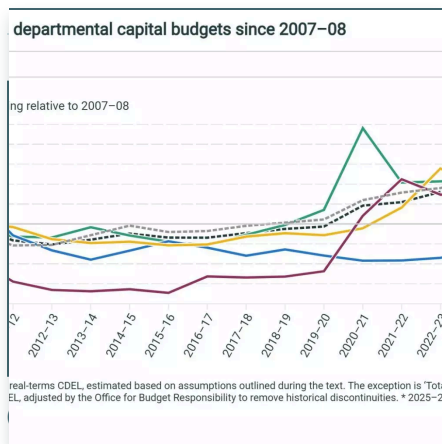
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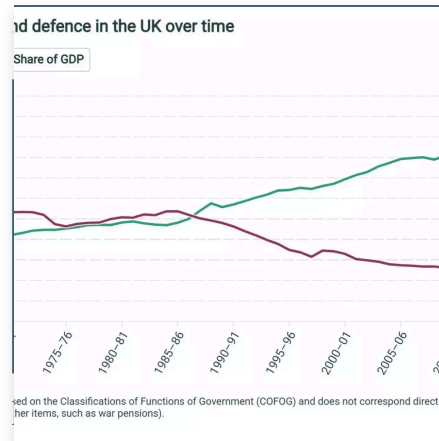
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