

The Scottish Budget 2026: Memorandum by Professor David Heald¹ to the Finance and Public Administration Committee of the Scottish Parliament

Introduction

1. The timetable for the Scottish Budget 2026-27 (Scottish Government, 2026a) was delayed by the timing of the UK Autumn Budget 2025 which was held on 26 November 2025. The Westminster Parliament does not take *ex-ante* scrutiny of public expenditure seriously, unlike the devolved legislatures. The disruption caused to the budgetary procedures of the devolved legislatures clearly does not rank highly in the timing decisions of UK Governments. This is not just a matter of parliamentary convenience but also affects the communication of spending allocations for 2026-27 to the public organisations which deliver services to the public.
2. In the context of this timing, the most important consideration for the Scottish Parliament is to agree the Scottish Budget 2026-27 as quickly as possible while communicating to the UK Government that the situation is unsatisfactory. Moreover, the Scottish Government which emerges after the 7 May 2026 Holyrood election may wish to make some in-year changes, though too much change then would be disruptive.
3. This brief memorandum is divided into a section on structural budgetary weaknesses and a section on specific Scottish Budget 2026-27 issues. The limited attention in this memorandum to the detailed choices in the Scottish Budget 2026-27 is motivated by the urgency of securing Parliamentary approval in order to limit disruption to public service delivery.

Structural Budgetary Weaknesses

4. Notwithstanding repeated messages from the Scottish Fiscal Commission (for example, 2025), there is no recognition in public debate that the finances of the Scottish Government are fiscally unsustainable. Either public spending will have to be curtailed, or taxes will have to increase, or some combination of both. Making adjustments early would be less economically and socially damaging than making them in a fiscal crisis. After the Cabinet Secretary for Finance and Local Government presented the Scottish Budget 2026-27 on 13 January 2026, the debate was dominated by pleas for more spending on a wide range of topics. My interpretation is that members of this Committee

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have a good understanding of the long-term fiscal position but that this is not shared across the Parliament and is certainly not shared by the electorate.

5. Managing the Scottish Budget has become more difficult in recent years because of the frequency of UK Government fiscal events, particularly the lack of multi-year Spending Reviews. The situation should be better after the UK Government's Spending Review 2025 (Treasury, 2025a), covering the financial years 2026-27 to 2028-29. However, fiscal speculation before UK fiscal events is damaging confidence that UK Spending Review settlements will hold, and that allocations will neither be increased nor decreased. This communicates uncertainty to the Scottish Government's finances.
6. In addition to the demographic pressures facing Scotland's public spending, there are two technical issues that cause budgetary difficulties. First, Scotland's Fiscal Framework provides for Barnett-formula consequentials, up or down, when spending in England on comparable programmes changes. This adds to, or subtracts, from the block grant, without requirements to spend/save in the same way. Policy divergence is to be expected under devolution. However, if that divergence is always in the direction of more spending, then savings have to be found elsewhere in the Scottish Budget. Unlike for Northern Ireland (Northern Ireland Fiscal Council, 2021, pages 110-15), there are no systematic data for Scotland where there are many examples of 'above-parity' spending but where it is hard to find any of 'below-parity' spending. This gap has to be financed by spending less elsewhere. Strikingly, in 2007-08, per capita health expenditure in Scotland was 14% above the UK but only 1% above in 2024-25 (Treasury, 2008, Table 9.12; Treasury, 2025b, Table 9.6). The comparable figures for Total Expenditure on Public Services, which includes non-devolved expenditure, were 17% above and 14% above, respectively. In my view, every Scottish Budget should provide a multi-year table of above-parity and below-parity expenditure lines. Alternatively, the Committee could request that the Scottish Fiscal Commission prepare such data.
7. Second, the expansion of devolved expenditure responsibilities means that the Scottish Budget now includes significant items of expenditure that are 'demand-led'. Unlike other expenditure, once entitlement rules have been promulgated and benefit/grant levels have been set, outturn expenditure is not directly under government control as all eligible claimants must be paid. A central feature of UK public expenditure control since 1998 has been the distinction between Departmental Expenditure Limits (DEL) for which totals can be set and enforced and Annually Managed Expenditure (AME) for

which outturn expenditure cannot be controlled without policy changes. Devolved social security expenditure is now a significant item in the Scottish Budget, £7.23 billion in 2026-27. The Department for Work and Pensions benefit expenditure is treated as AME and overspends because of more eligible claims than forecast are met by the Treasury. In contrast, the Scottish Government's benefit expenditure is treated, not as AME, but as what might be called 'quasi-DEL'. Overspends on devolved social security benefits have to be accommodated within the Scottish Budget, creating another source of destabilising fiscal pressure on public services. The UK Government's experiences with Winter Fuel Allowance and Disability benefits are a telling reminder of how politically difficult it is to withdraw entitlements.

8. I have long supported the Scottish Parliament having devolved tax powers. However, I am concerned about two issues. First, there seems to be a widespread view that more devolved tax powers results in the Parliament having more money to spend, whereas this depends on the relationship between devolved tax revenues and Block Grant Adjustments, which can be either positive or negative. My interpretation is that the Scottish Parliament has secured more fiscal legitimacy at the expense of more fiscal risk. Although there are strong arguments for doing this, the consequences of the change must be understood. The paradox of more tax devolution is that Scotland's public finances are now more vulnerable to UK fiscal events, in terms of both timing and substance.²
9. Second, although the 2023 review of Scotland's Fiscal Framework (UK Government and Scottish Government, 2023) produced some marginal gains and avoided damaging changes,³ the fiscal flexibility of the Scottish Government does not match its exposure to fiscal risk. Unlike the UK Government, it must in practice run a balanced budget in each year which leads to disruptive in-year searches for savings. In an uncertain economic climate and depending on forecasts of tax revenue and prior-year tax reconciliations, attention is diverted from running public services efficiently. This could be resolved by the UK Government granting the Scottish Government higher resource

² When the Scottish Government was mainly dependent on Barnett formula funding, there were relatively few variables for it to watch, particularly the degree of comparability of English programmes that might be increased or decreased. With Scottish Income Tax contributing £21.508 billion in 2026-27, UK Government income tax decisions for England could have large effects on Block Grant Adjustments. When the media was briefed prior to the UK Autumn Budget 2025 that this would increase the UK income tax basic rate and reduce employee National Insurance Contributions, it was reported that this could lead to a £1 billion increase in Scotland's negative Block Grant Adjustment.

³ The key win for Scotland was that the Per Capita Indexation method of Block Grant Adjustment was made permanent, thereby protecting the Scottish Budget from the effects of divergence in population growth.

borrowing limits and making it easier for the Scottish Government to hold reserves. The main reason why this is difficult to secure is that, rightly or wrongly, UK Governments do not believe that the Scottish Government would be fiscally responsible if such extended powers were granted.

10. The Scottish Government (2024) published its tax strategy in December 2024. A tax strategy should set out where the Government would like the tax structure to be, say ten years ahead. If it were a tax strategy in a meaningful sense, it would be possible for the Parliament to assess annual changes as taking the tax structure closer or further away from the desired destination. Although there is useful material in that document, it is not a tax strategy because ministers do not wish to constrain their annual budget decisions on tax.

Specific Scottish Budget 2026-27 Issues

11. The Scottish Budget 2026-27 (Scottish Government, 2026a) is polished in presentation and contains useful description and data. Even allowing for the proximity of the 2026 Holyrood election, there are two reasons why this Committee should be concerned about the text. First, there is so much use of the words 'investment' and 'investing' that it would be difficult to find items in the Scottish Budget which could not be so described on that usage. Although there are rough edges, the distinction between resource and capital is an important one. Second, there is hardly any recognition of the stresses that Scottish public sector organisations are facing, except where the UK Government is blamed, or of widespread concerns about public sector performance, or about the fiscal unsustainability of the Scottish public sector given weak economic performance and adverse demographic trends. Per capita spending on devolved public services in Scotland is substantially higher than on equivalent services in England. Regrettably, at both the Scottish and UK levels, the texts of budgetary documents now read more like campaigning material than as instruments for public accountability.

12. The main tax policy instrument of both the UK and Scottish Governments is fiscal drag, seeking to exploit the lack of taxpayer understanding of the interaction between tax bands and tax rates. The UK Government controls the Personal Allowance which is frozen at £12,570 until the end of tax year 2030-31. The Scottish Government has frozen higher rate, advanced rate and top rate thresholds until 2028-29. If it had not done so, negative Block Grant Adjustments would be higher. Fiscal drag is perceived to be less politically costly than increasing rates, but it aggravates the efficiency and equity problems arising from the two peaks in combined income tax and National Insurance

Contribution marginal rates.⁴ It would be possible to achieve the objective of the Scottish Government to make Scotland's tax system more progressive than the UK's, without inviting as many adverse behavioural responses.

13. The Scottish Government's increase to the Starter Rate and Intermediate Rate thresholds is designed to substantiate the claim that 55% of Scottish income taxpayers will pay lower income tax in 2026-27 than if they lived in England. This leads to the following arithmetic: 32.3% of Scottish adults will not pay Scottish Income Tax (Scottish Government, 2026c), meaning that 67.7% will do. Therefore 30% of Scottish adults will pay the same or more income tax than if they lived in England, the others either paying less or none. Whether this is desirable or not is a political judgement, but there is a practical danger that increases in income tax may be seen as something other people will pay.

14. A supporting document (Scottish Government, 2026b) reports survey data on attitudes to taxation. The Scottish Government is to be commended for commissioning such research, but I have two worries. The first relates to the level of public understanding of the UK and Scottish tax systems:

"54% of respondents felt they understood the UK tax system and the UK taxes paid. This compares to 41% of respondents who felt they understood tax devolution in Scotland and the devolved taxes they paid. This is broadly in line with the last three years." (page 3).

If this were true, then why do the UK and Scottish Governments engage in so much subterfuge? The second relates to how one should interpret the 2025 result that 35% of respondents report that "I am prepared to pay more taxes myself in order to fund public services", a percentage which is down from 43% in 2024 (Figure 3 on page 4). The prominence of election promises not to increase tax rates suggests that political parties do not believe this to be true.

References

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⁴ These arise because of (a) different UK and Scottish thresholds for higher rate and the interaction with National Insurance Contributions and (b) the phased withdrawal of Personal Allowance for incomes over £100,000.

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