Finance and Public Administration Committee
35th Meeting, 2025 (Session 6),
Tuesday 16 December 2025

Scrutiny of the Scottish Budget 2026-27: UK context

Purpose

1. The Committee is invited to take evidence from David Phillips, Associate Director at the Institute for Fiscal Studies (IFS) in relation to the UK context to the forthcoming Scottish Budget 2026-27.

2. This paper provides a summary of key announcements made in the UK Budget on 26 November 2025 as well as forecasts in the accompanying Office for Budget Responsibility's (OBR's) Economic and fiscal outlook. It also highlights issues raised in IFS analysis of the UK Budget, and in its immediate reaction to Scottish fiscal announcements made in June 2025.

UK Context

UK Budget 2025

3. The UK Government in its UK Budget 2025 document states that "this Budget takes the fair and necessary choices to deliver on the government's promise of change", by cutting the cost of living, reducing the NHS waiting list in England and decreasing debt and borrowing. It further highlights that "the government's plans are underpinned by its non-negotiable fiscal rules which provide credibility by ensuring day-to-day spending is met with revenues, while allowing the step change needed in investment to grow the economy".

4. Key spending announcements in the UK Budget 2025 include—

   Removing the two-child limit in universal credit from April 2026. The UK Government estimates that this measure will lift 450,000 children out of poverty. The Fraser of Allander Institute (FAI) in its reaction blog on the UK Budget noted that this decision allows the Scottish Government to spend the £155 million it had set aside for mitigation on other priorities, although it also highlighted knock-on effects[1] that would reduce the net savings to around £121 million. [2]

   Increasing the national living wage by 4.1% to £12.71 per hour for eligible workers aged 21 and over. For 18 to 20-year-olds, the increase will be 8.5%

[1] The FAI explained that scrapping of the two-child cap leads to additional costs to the Scottish Government "as it means more households are entitled to Universal Credit (and therefore for some Scottish benefits like the Scottish Child Payment) and moves more existing Universal Credit claimants onto the Benefit Cap (which is mitigated in Scotland through Discretionary Housing Payments)".
[2] FAI Budget 2025 reaction: meeting the (briefed) expectations.

to £10.85 per hour and for 16 to 17-year-olds and apprentices 6.0% to £8.00 per hour.

Introducing a cash limit of £12,000 within the overall annual limit of £20,000 for individual savings accounts (ISAs).[3]

Cancelling the planned uprating of fuel duty for 2026/27.

Maintaining the £35,000 taxable income threshold for winter fuel payment payable to eligible pensioners for the rest of the UK Parliament.

Reducing household energy bills by around £150 on average in Great Britain from April 2026 through changes to the renewables obligation and the energy company obligation.

5. The Budget document states that, as a result of the UK Budget 2025, the Scottish Government will receive an additional £510 million in resource funding over the next four years and an extra £310 million in capital funding over five years (£820 million in total).[4] The FAI suggested that this funding for the Scottish Government "is quite lumpy: there is a boost in the short-term, eroding away quickly and a small cut in day-to-day spending in 2028-29".[5]

6. Further specific direct investment in Scotland is also referred to in the UK Budget document, including £14.5 million in funding for the Grangemouth industrial cluster, £20 million from the Growth Mission Fund to upgrade Inchgreen Dry Dock, and a further £20 million for the redevelopment of Kirkcaldy town centre and seafront.

7. Key revenue-raising measures announced in the UK Budget include—

Freezing personal tax thresholds for both income tax and national insurance contributions (NICs) for employees and self-employed individuals for a further three years—from April 2028 through until April 2031. Prior to the UK Budget there was speculation that income tax rates in the UK would be increased. The FAI had estimated that a two-percentage point increase in the basic rate of UK income tax would have led to a cut of around £1 billion in Scotland's block grant in each of the next three financial years.[6]

Capping National Insurance Contributions (NICs) relief on salary sacrifice into pension schemes to the first £2,000 of pension contributions per person from 2029.

Increasing tax on dividend income by two percentage points at the ordinary and upper rate from April 2026.

[3] The limit will not apply to savers over the age of 65.
[4] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy
[5] FAI Budget 2025 reaction: meeting the (briefed) expectations.
[6] What would UK income tax changes mean for Scotland? | FAI

Increasing tax on property income and savings income by two percentage points at the basic, higher and additional rates from April 2027. The Budget states that the UK Government intends to "engage with the devolved governments of Scotland and Wales to provide them with the ability to set property income rates in line with their current income tax powers in their fiscal frameworks".[7] The Cabinet Secretary for Finance and Local Government wrote to the Committee on 9 December 2025 providing advance notice of a Legislative Consent Memorandum (LCM) relating to amendments to the UK Finance (No.2) Bill which would devolve this power to Scotland. The letter asks that the Committee considers and reports on the LCM by the end of January 2026 to fit in with the UK Bill's timetable.

In its reaction blog on the UK Budget, SPICe noted that "once the Scottish Parliament has the powers to set income tax rates to property, it will presumably face a choice between at least matching the rates for England, or accepting a block grant adjustment which will reduce funding for the Scottish Budget".[8]

Reducing capital gains tax relief on qualifying disposals to employee ownership trusts from 100% to 50% from 26 November 2025.

Increasing gambling levies, including remote gaming duty to 40% from April 2026.

Introducing electric vehicle excise duty, a new mileage-based charge for electric vehicles and plug-in hybrid cars, from April 2028.

Introducing a council tax surcharge in England from April 2028 on residential properties valued at or over £2 million (a so-called 'mansions tax').

Implementing permanent lower business rates for retail, hospitality and leisure properties. SPICe commented in its blog that "it is certain that industry [in Scotland] will advocate for the Scottish Government to implement similar changes for retail, hospitality and leisure properties in Scotland".[9] The Scotsman newspaper reported on 11 December 2025 that 12 Scottish retail organisations have jointly written to the Cabinet Secretary for Finance and Local Government calling for a permanent business rate discount for all retailers at the Scottish Budget which is "at least as competitive" as the situation in England.[10]

8. Despite concerns raised by the oil and gas industry in advance of the UK Budget, the UK Government confirms in the Budget document that the temporary Energy Profits Levy (EPL) will continue until 2030 (unless it concludes earlier if the EPL price floor triggers). The UK Government then plans to replace the Levy with a permanent Oil and Gas Profits Mechanism, "a revenue-based mechanism which only operates in times of high prices".

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[7] Change to tax rates for property, savings and dividend income — technical note - GOV.UK
[8] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy
[9] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy
[10] Scotsman article, 11 December 2025

9. The Budget document also states that "to support the economy with greater policy certainty, the government is delivering on its commitment to hold one fiscal event a year, by legislating to ensure that the fiscal rules are only assessed at future Budgets".

10. SPICe observed in its blog that the new forecasts for the GDP deflator will mean the Scottish Government is able to borrow up to £491 million in capital in 2026-27, while the cumulative capital borrowing limit rises to £3,275 million. The annual limit on resource borrowing increases to £655 million, with the cumulative cap rising to £1,910 million, and the limit on the Scotland Reserve increases to £764 million[11].

Economic and fiscal outlook

11. In its [Economic and fiscal outlook – November 2025] published alongside the UK Autumn Budget 2025, the OBR forecasts real GDP growth of 1.5% in 2025, increasing its March forecast figure of 0.5%. This, the OBR explains, is "because output growth was revised up in the second half of 2024 and growth was stronger than expected in the first quarter of 2025, at 0.7%".

12. The OBR has reduced its central forecast for the underlying rate of productivity growth in the medium term to 1%, 0.3 percentage points slower than in its March forecasts. It explains that "the UK's productivity performance has undershot our forecasts, despite several substantial downgrades since 2010, as a significant rebound from recent negative shocks has not materialised".

13. It goes on to say that this decision "is based on our latest assessment of the UK's productivity performance in historical and international context; what the latest output and labour force data tell us about the impact of shocks and underlying productivity of the economy; and how developments in global trade policy, the sectoral composition of output, the emergence of new technologies like artificial intelligence, and other structural trends are likely to affect the productive potential of the UK economy in the future".

14. According to the OBR, policies in the UK Autumn Budget "increase spending in every year and by £11 billion in 2029-30, primarily to pay for the summer reversals to welfare cuts and lift the two-child limit in universal credit". The Budget also raises taxes "by amounts rising to £26 billion in 2029-30, through freezing personal tax thresholds and a host of smaller measures and brings the tax take to an all-time high of 38% of GDP in 2030-31". The OBR states that the tax increases expected to raise £0.7 billion next year and £26 billion in 2029-30 more than offset the increase in spending by the final years of the forecast.

15. Borrowing is projected to fall from 4.5% of GDP in 2025-26 to 1.9% in 2030-31. Debt rises as a share of GDP from 95% of GDP this year and ends the decade at 96% of GDP. This, the OBR highlights, is 2 percentage points higher than projected in March and "twice the debt level of the average advanced economy".

[11] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy

16. The OBR has revised up its near-term forecast for earnings growth and inflation. Cumulative real wage growth over the next two years is just under ¾ percentage points higher than in its March forecasts and CPI inflation just over ½% higher "as surveys of wage settlement expectations have held up more than we expected, and there is more momentum in domestically generated inflation than we anticipated". It goes on to say that "greater domestically generated inflation, alongside higher food prices, mean we also expect inflation to stay higher for longer than in March".

17. In the OBR's central forecast, "the Government's fiscal mandate for the current budget to be in balance in 2029-30 is met by a margin of £22 billion (0.6% of GDP), which is £12 billion (0.3% of GDP) more than in March".

IFS response to the Autumn Budget 2025

18. In introductory remarks to an IFS event on 27 November, IFS Director Helen Miller described the Budget as a "borrow-to-spend budget in the short term, and a combination of a tax-and-spend and tax-and-bank-it budget in the medium term".

19. The IFS Autumn Budget 2025: initial response published on 26 November 2025 suggested that creating 'headroom' of around £22 billion was "a sensible move for which the Chancellor deserves credit", adding "by providing greater insulation against economic turbulence, the additional buffer will reduce the risk of playing out this year on repeat in 2026". It also acknowledged however that "relative to the uncertainties involved, it's still not that large a buffer".

20. On taxes, the IFS suggested that "the Chancellor found a way to cobble together a sizeable package without increasing the main rates of national insurance contributions, VAT or income tax", mainly targeting those on high incomes. The IFS further observed that "a range of […] tax increases – on pension contributions, unearned income, business investments and capital gains – weaken incentives to save and invest", adding "the Chancellor continues to show no real appetite for using tax reform to boost growth". It further highlights "there's a reasonable case for levying more on high-value homes, but the design of this [property] tax [on high value homes] leaves much to be desired."

21. The IFS also noted "one bright spot was the decision to do *something* on the taxation of electric cars, for which the government does deserve credit, though levying a motoring tax which bears no relation to congestion is far from ideal."

22. The blog goes on to argue that "the additional spending and borrowing in the short term is readily believable [but] the future restraint, just before the next election? - one could be forgiven for treating that with a healthy dose of scepticism".

23. The IFS also noted that the UK Government plans to make further efficiency savings between 2028-29 and 2030-31, aiming to save £4.9 billion from day-to-

day spending in 2030-31. It suggests, "this follows ambitious plans to improve productivity already set out at the Spending Review that already implied historically high productivity growth", adding "whether savings on this scale can be delivered remains to be seen".

24. Noting the Chancellor's decision to remove the formal assessment of the fiscal rules in the Spring, the IFS suggested the Chancellor is hoping to reduce policy volatility. However, "with the OBR forecast still in place each spring, the question remains how the government (and the wider world) will react if that forecast shows that they are on course to miss their fiscal rules".

IFS response to Scottish fiscal announcements (June 2025)

25. The IFS also published an immediate response to fiscal announcements made by the Scottish Government in the Medium-Term Financial Strategy (MTFS) and Fiscal Sustainability Delivery Plan (FSDP) published on 25 June 2025. In that blog, the IFS highlighted that—

> "As the MTFS and SFC make clear, current forecasts for the contribution of devolved tax revenues to the Scottish Budget are likely optimistic, as they assume earnings grow significantly faster in Scotland than in the rest of the UK from 2026–27 onwards. All else equal, if earnings instead grew at the same rate as in the rest of the UK, the 'funding gap' for day-to-day spending would be closer to £3.5 billion."

26. The IFS described the FSDP as "a welcome move by the current government to begin setting out its approach to tackling [the fiscal gap] – information that's previously been lacking". It highlighted "the most concrete part of the plan is […] an aim of cutting £1 billion per year, or roughly one-fifth, from administration costs by 2029–30". It further notes the Scottish Government's target of reducing the size of the devolved public sector workforce by 0.5% a year – which, given increases in front-line NHS staffing to tackle backlogs and to cope with an ageing population, will require substantially larger workforce reductions across the rest of the public sector".

27. The IFS blog also looks ahead to the Scottish Spending Review (SSR) to be published alongside the Scottish Budget 2026-27 on 13 January 2025. It suggests that the SSR will "have to say which services will be cut back in order to protect spending on the Scottish Government's key priorities – poverty, climate change, economic growth and effective public services – and to shift resources to prevention and early intervention". This, it argues, "will likely require steep cuts to some other 'non-priority' areas, and a laser-like focus on how effective spending actually is – not all spending on the government's priorities can and should survive the chop". The IFS adds "indeed, the scale of the fiscal challenge could necessitate the Scottish Government making trade-offs between its four priorities".

Next steps

28. The Committee is due to hear from the Office for Budget Responsibility on the UK context to the Scottish Budget on 13 January 2026. Following publication of the Scottish Budget 2026-27 also on 13 January, the Committee will take evidence on 20 and 27 January 2026, before reporting in early February.

Committee Clerking Team
December 2025