FPAC/S7/26/12/3

Finance and Public Administration Committee
Wednesday 25 November 2026
12th Meeting, 2026 (Session 7)

Scotland's fiscal framework: review

Background

1. At today's meeting, the Committee will take evidence to inform a response to the Scottish Government on the scope of the next review of Scotland's fiscal framework planned for 2028.

2. Scotland's fiscal framework between the Scottish and UK Governments (2023) sets out the funding arrangements, borrowing limits, and budget management flexibilities in relation to the Scottish Budget.

3. First agreed in 2016, the fiscal framework was first reviewed[1] in 2023, when some flexibilities were updated and uprated for inflation. The framework provides resource borrowing powers for in-year cash management and forecast error and capital borrowing powers to invest in infrastructure, both within specified annual limits and cumulative caps. It also includes a Scotland Reserve to enable the Scottish Government to carry forward underspends or revenue surpluses between financial years to smooth out tax or spending volatility.

4. The 2023 review was informed by a report by independent experts, with a remit to look at various block grant adjustment (BGA) arrangements and to assess how they best meet the Smith Commission principles for the fiscal framework[2]. The report was jointly commissioned by the Scottish and UK Governments and co-authored[3] by Professor David Bell (University of Stirling) and David Phillips (Institute for Fiscal Studies), who are both giving evidence to the Committee today, alongside Dr Eleanor Ryan, Commissioner at the Scottish Fiscal Commission (SFC).

5. The authors of the independent report recommended granting the Scottish Government powers to be able to borrow a small sum of money to cover shocks other than tax and social security forecast errors, including shocks to public service spending, falls in tax revenues, or increases in social security spending forecast in advance. They also suggested that, rather than link the borrowing and reserve limits to inflation, "it would make more sense to link

[1] Reviews of the fiscal framework are intended to occur roughly every five years, aligning with a parliament's worth of practical experience. A review cannot happen more than once during a single UK or Scottish electoral cycle. Both the Scottish and UK Governments can agree to hold a review earlier than scheduled. These review arrangements are set out in the fiscal framework itself.
[2] Annex A of the fiscal framework contains the Smith Commission Principles for Scotland's Fiscal Framework.
[3] Former Deputy Director of the Fraser of Allander Institute, David Eiser, also co-authored report. He has since moved into a different field of work.

them to the amount of revenue and social security spending at risk, which will typically grow faster than inflation".[4]

6. A Scottish Government factsheet published in September 2025 compares the 2016 fiscal framework with the changes made in the 2023 review.

7. As noted above, a further review of the fiscal framework is due in 2028.

Committee scrutiny

8. The Cabinet Secretary for Finance and Local Government's letter to the Committee of 23 September 2026 confirmed that the Scottish Government is currently working with the UK Government to develop the scope of this review. She also said she would "welcome any further views that the new Committee may wish to provide" and repeated this invitation during evidence to the Committee on 30 September 2026.

9. The Committee agreed to explore with the panel of witnesses at today's meeting whether the Session 6 Finance and Public Administration Committee's priority areas for the next fiscal framework remain relevant and if any additional matters should be included as part of the next review in 2028. This letter is provided as an Annexe for information.

10. The Committee's pre-budget 2027-28 report on the affordability and sustainability of the Scottish Government's tax and spending plans, highlighted evidence from witnesses welcoming the changes made to the fiscal framework as part of the 2023 review. Many of them now consider that some additional fiscal flexibilities are needed for the Scottish Government to manage its Budget effectively, given its increasing size and the risk of forecast errors and subsequent reconciliations.

11. The SFC, for example, told the Committee during evidence on 2 September 2026 that, "as the Government takes on more risk and as revenues rise, there is a genuine question about whether the Government's flexibilities to manage that are still as robust as they need to be". The SFC also suggested "it is worth looking again at whether the annual borrowing limits make sense". Other suggestions from the SFC included giving the Scottish Government some flexibility to overspend slightly, which the SFC noted was "just good budget management" for a Budget of £60 billion.

12. Professor Bell wrote in his written submission to the Committee that there is "a good case for a larger Reserve", adding "it would not itself increase the public expenditure over time: it would simply allow the Scottish Government to smooth receipts and spending more effectively across years". He also called for "more flexibility over the timing of forecast-error borrowing, continued indexation of borrowing limits, [… and] potentially greater capital borrowing capacity where projects satisfy robust investment criteria". He further

[4] An immediate response to the Scottish Fiscal Framework review | Institute for Fiscal Studies. August 2023.

indicated he would not support general borrowing to finance recurrent spending.

13. The written submission from David Phillips at the Institute for Fiscal Studies suggested that "there is a case for indexing borrowing and reserves limits not by inflation, but in line with the revenues and spending at risk", and that annual borrowing limits could be removed entirely for forecast error while retaining a cumulative cap.

14. Many witnesses also highlighted the £720 million negative reconciliation to be applied to the 2027-28 Scottish Budget which exceeds the amount that can be borrowed for forecast error under the fiscal framework and therefore questioned whether these borrowing limits are sufficient.

15. The Cabinet Secretary suggested to the Committee that that the fiscal framework review should seek to create a more balanced approach that recognises the differing strengths and circumstances of economies across the UK.

Next steps

16. Drawing on evidence gathered at this evidence session, the Committee will respond to the Cabinet Secretary's invitation to share its views on the scope of the fiscal framework review. The Committee has also indicated its intention to continue to engage in the review process as it progresses.[5]

Committee Clerking Team
November 2026

[5] Agreed at Business Planning Day, 31 August 2026.

Annexe

Letter from the Session 6 Finance and Public Administration Committee to the Cabinet Secretary for Finance and Local Government on the fiscal framework review, dated 19 December 2025

Dear Shona

Thank you for your letter of 25 November 2025 in which you seek the Finance and Public Administration Committee's views prior to Christmas recess in relation to the scope of the next review of the fiscal framework between the Scottish and UK governments.

As you are aware, the Committee was disappointed that the previous review in August 2023 was so narrowly focused, lacked transparency and provided no opportunity to feed in views. We have since therefore continued to call for a more comprehensive review. Indeed, the Committee restated our view that there would be merit in carrying out a wider review of how the fiscal framework is operating in our latest report on the Scottish Budget process in practice published in June 2025. The Committee further heard from Professor Graeme Roy, Chair of the Scottish Fiscal Commission (SFC) on 2 September 2025 that the "constant reviewing of the fiscal framework to see how it is operating and working entirely makes sense".

The Committee therefore welcomes the recent agreement between the two Governments that preliminary work should "begin to establish the scope for the next review" and we share the Scottish Government's position that the scope of that review "should be broader than the last".

The Committee is keen to understand the UK's appetite for a more comprehensive and open review given the limitations around the previous exercise. We also urge both Governments to learn the lessons of the 2023 review to ensure that discussions on the scope/terms of reference are not unnecessarily protracted and that the time available can therefore be spent on negotiations regarding key improvements that can be made.

As you are aware, the Committee has taken a keen interest in how the fiscal framework has operated during this session, including during times of uncertainty and volatility in the UK economy, as well as extraordinary global events such as the Covid pandemic. We have therefore made recommendations in various Committee reports over the course of the session on the issues we consider should be included as part of a future fiscal framework review.

Given the tight timescale for submitting views, the Committee has drawn on our previous recommendations, to request that the issues set out below should be prioritised when developing the scope of the next review.

Borrowing and the Scotland Reserve

- The adequacy of resource borrowing limits for forecast error and in-year cash management. In this context, the Committee notes recent evidence from the SFC1 suggesting that larger negative reconciliations can be expected in future years which could, as with indicative figures for 2027-28, exceed borrowing limits. This is likely to have a corresponding impact on the level of funding available for other areas of the Scottish Budget.

- The merits of a prudential borrowing scheme for capital borrowing.

- The effectiveness of the Scotland Reserve in enabling the Scottish Government "to smooth all types of spending and manage tax volatility and determine the timing of expenditure", as envisaged in the fiscal framework, and whether annual inflationary uprating of the Reserve limits is adequate.

Block grant adjustments and forecasting

- The impact of block grant adjustments (BGAs) for income tax being based on relative growth with the rest of the UK on income tax revenues in Scotland, and the merits of alternative approaches, including that of the Welsh model. In this regard, the Committee notes that the independent report on BGA arrangements commissioned by Scottish Government and HM Treasury in June 2022 did not appear to be considered as part of the previous review and we therefore seek assurances that the report will inform the upcoming review.

- Ensuring that data being used to forecast block grant adjustments is sufficiently robust and comprehensive. In this context, the Committee notes that the OBR currently uses the Office for National Statistics Labour Force Survey (LFS) to inform its forecasts, while the SFC uses real-time information given concerns regarding the reduced sample size and reliability of the LFS.2 The review should seek to implement any improvements identified as quickly as possible to ensure this data does not create unnecessary forecast error or impacts on the Scottish Budget.

- Whether mechanisms relating to comparative median wage are appropriately sensitive to exogenous shocks and trends in the shape of the Scottish economy.

Devolution of taxes

- The issues that have held back the implementation of Air Departure Duty in Scotland.

- A formal decision not to progress the policy of VAT assignment included in the Smith Commission, given serious concerns around how this would work in practice. The Committee notes a recent conclusion of the House of Commons Scottish Affairs Committee that it is "highly unlikely…that the assignment of VAT revenues will ever come into force" and has asked the UK government

"to explain why it thinks the policy is still possible, despite robust views to the contrary".

Timing of fiscal events and forecasts

- The need for greater co-ordination between the two Governments regarding the timing of UK and Scottish fiscal events, which have tended to follow a different timeline than envisioned in the original fiscal framework, creating additional volatility and uncertainty for the Scottish budget process.

- The extent to which the risks arising from differences in forecast timings are reasonable and appropriate given the size of the Scottish Budget and whether the OBR and SFC forecasts could be better timed to minimise this risk.

- How the fiscal framework can be strengthened to withstand the risk from any future health or economic shocks that could disproportionately affect one part of the UK.

Transparency and public understanding

- How the workings of the fiscal framework can be simplified and clarified where possible, to improve public understanding and accountability.

- How best to ensure that the next review is as open and transparent as possible, including publishing expected timelines for decisions and providing opportunities for the Scottish Parliament at key stages of the process to submit views to inform decision-making and to enable robust scrutiny.

Improved engagement between the two Governments

- Where improvements to communication and transparency around decision making between the UK and Scottish governments can be made, to support more effective management of public finances in Scotland.

Presentation of data

- How transparency and stakeholder understanding can be improved, including through routinely providing details of Barnett consequentials at the time of UK fiscal events.

- Ensuring publication of comprehensive budget data showing in-year changes and final outturn on a consistent basis (as per the "Additional Disclosure" data that was published before).

Structural challenges

- How the current fiscal framework could be strengthened to reflect structural challenges such as climate change, which requires a co-ordinated response across the two governments, and demographic trends which are more pronounced in Scotland.

The Committee trusts that our views set out above, which are based on the experience and knowledge of how the fiscal framework has operated throughout this parliamentary session, will be useful in informing the scope of the next review.

We look forward to receiving regular updates on how this work is progressing in the weeks and months ahead.

Yours sincerely

Kenneth Gibson MSP
Convener

The Annexe setting out the recommendations from previous reports that informed this letter can be found at the end of the web version of the letter.