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Institute for Fiscal Studies

IFS Report

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The IFS Scottish Budget Report – 2025–26



**Economic
and Social
Research Council**



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Preface

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1. Introduction

David Phillips

The Scottish Government's Budget for 2025–26 takes place after Chancellor Rachel Reeves's first UK Budget transformed the short-term funding outlook for public services nationwide, but the medium-term outlook still looks challenging. General purpose funding from the UK government for day-to-day public service spending is set to be £2.2 billion or 5.8% higher this financial year than when the 2024–25 Budget was initially set back in December 2023. Funding for 2025–26 is set to be £2.6 billion higher than expected at that point. The Scottish health service has been the biggest beneficiary of the funding increase so far, but current plans imply no further real-terms increase in day-to-day health spending in 2025–26. Health spending in the coming year will almost certainly have to be topped up as it was this year. But with a tricky fiscal situation meaning it highly unlikely that Ms Reeves will be able to top up overall funding significantly, boosting health spending in the coming year will require funding to be carried forward from this year via the Scotland Reserve and/or cuts to other areas of spending.

Capital spending is set for an even bigger boost in 2025–26 and then a fall in 2026–27. This lumpy path is unlikely to be optimal, and could increase the cost of key inputs, including labour costs. Indeed, history suggests projects may slip, leading to a slower-than-planned ramp up in investment spending. And, to the extent that investment is front loaded, it may make sense to invest in equipment and software that can boost the productivity and performance of the health service and other public services – such investments are less prone to demand-driven inflation (at least due to demand from a single small country) and could help make tight public service budgets in future years go further.

Alongside the Budget, the Scottish Government published its first Tax Strategy. This is best thought of as a framework for how a strategy for tax policy could be developed, rather than a strategy itself. But it is welcome nonetheless and sets many laudable aims for tax policymaking, and commits the Scottish Government to evaluating key policies, such as recent changes in income tax rates. Also welcome is a long overdue process to develop and consult upon reform of council tax – with council tax bands based on values over a third of a century old, at a bare minimum, plans for a revaluation should be made. Less welcome were the changes to land and buildings transactions (LBTT) tax on second and rental homes, which make arguably Scotland's most economically damaging tax even more damaging.

As well as income tax, policy in Scotland on school teacher numbers and public sector pay has increasingly diverged from that in the rest of the UK in recent years. Commitments to maintain teacher numbers in the face of falling pupil rolls and higher public sector pay are legitimate policy positions, but as with income tax it will be important to evaluate their effects given their implications for other areas of spending.

The rest of this report proceeds as follows.

Chapter 2 assesses the Scottish Government’s tax strategy and recent tax policy decisions. It first sets out the key elements of the tax strategy, before evaluating the strategy: is what it says sensible? And does it represent a coherent strategy for the tax system? It then describes and analyses recent reforms to income tax, business rates and LBTT.

Chapter 3 looks at council tax specifically. It sets out why revaluation and reform are needed, before considering how the effects of two example reforms – a simple revaluation and a system where tax rates for each band were proportional to the up-to-date average value of properties in those bands – on different types of households. In both cases, reforms are modelled to be revenue-neutral across Scotland as a whole, and we assume funding for individual councils is updated to account for changes in their tax bases. The chapter also discusses issues such as transitional arrangements and mitigation measures to ease the passage of reform, and legislation to keep council tax up to date in future.

Chapter 4 focuses on Scottish school spending, as well as teacher and pupil numbers. It first sets out the large increases in per-pupil spending in recent years, which now exceeds English levels by around 20%. It then looks at trends in teacher and pupil numbers. With pupil numbers set to fall, a commitment to maintain teacher numbers would see a significant reduction in class sizes, which may not be the best way to improve school attainment, or ensure the sustainability of Scottish councils’ finances.

Chapter 5 looks at Scottish public sector employment and pay. It begins by looking at the level and trends in public sector employment compared to the rest of the UK, before turning to look at public sector pay. Median public sector pay is now 5% higher than in the UK as a whole, whereas it was roughly in line with it during the 2010s. The chapter then looks at how retention of workers in the public sector in Scotland compares with England, finding little evidence that higher pay has improved retention, although it may have other benefits.

Finally, Chapter 6 looks at the overall Scottish Government funding and spending outlook. It shows how Rachel Reeves’s top-ups to public spending UK-wide have boosted Scottish Government funding, but that a downgrade in forecasts for devolved tax revenues in the short term will partially offset this next year. It then looks at how planned changes in both day-to-day

and investment spending vary across services, finding that health and local government are currently set to see increases broadly in line with the average over the period 2023–24 to 2025–26, with smaller service areas seeing a mix of larger increases and smaller increases (and even cuts). The chapter concludes by looking to the period 2026–27 to 2028–29, when a planned slowdown in UK government funding will mean tough trade-offs as the Scottish Government allocates its funding between services. The chapter also highlights scope for the Scottish Government to be much more transparent about what its plans really mean for year-on-year changes in spending by consistently comparing plans for the coming year with the latest plans for the current year. Continued comparisons with superseded budgets for the current year risk giving a misleading impression of how resources are really changing – and hence what the public can expect from different services.

2. Assessing Scottish tax strategy and policy

Stuart Adam and David Phillips

The Scottish Government has a range of tax powers at its disposal, which it has used in recent years to forge an increasingly distinct tax policy from the rest of the UK. In its 2025–26 Budget, the Scottish Government made a number of tax policy changes, including to income tax, business rates, and land and buildings transaction tax (LBTT). Alongside the Budget, the Scottish Government also published a Tax Strategy, setting out its approach to tax policymaking and evaluation and a number of priorities for tax policy and administration. Only the income tax changes were clearly linked to the new Tax Strategy.

This chapter of our report assesses the Scottish Government’s Tax Strategy and tax policy in turn; the next chapter looks in depth at one tax particularly ripe for reform – council tax.

Key findings

1. The Tax Strategy aims to set out the Scottish Government’s medium-term plans for tax policy, administration and the policymaking process. After setting out some context, it provides a mix of concrete plans and vaguer ambitions under five headings: priorities for the existing system; the economy and tax; tax administration; evidence and evaluation; and future priorities.
2. The publication of a Tax Strategy – not something the UK government has done – should be welcomed, and much of what it says is commendable. The aims set out for tax policy are good ones. There is a pleasing emphasis on evidence and engagement as central to future policymaking. The desire to improve administration of the tax system and public understanding of it is laudable.
3. But this Tax Strategy is not a strategy for tax policy. It is full of good intentions to engage with others to improve tax policy and delivery, but it says little about the long-term direction of tax policy itself. It does not tell us what kind of tax policy the Scottish Government thinks would best promote its objectives; it does not provide a vision of

what individual taxes or the tax system as a whole should look like in 5, 10 or 20 years' time. It is more of a framework for producing a strategy than a strategy in itself.

4. The Tax Strategy recommits the Scottish Government to complete the devolution of taxes already legislated for but not yet implemented – Scottish aggregates tax and air departure tax – but gives no guidance on the future direction of these taxes. No specific priorities for further significant tax devolution are identified, although in a separate submission to a UK parliamentary inquiry, the Scottish Finance Minister says that the current government's position is that all taxes should be devolved.
5. The 2025–26 Budget announced an above-inflation increase in Scotland's basic and intermediate income tax thresholds, and a two-year freeze in the higher-, advanced- and top-rate thresholds. This continues a pattern of (small) tax cuts for the lower-income half of Scottish income taxpayers and (bigger) tax rises for those on higher incomes. Following these changes, individuals with incomes below about £30,300 will pay up to £28 a year less income tax in Scotland than in the rest of the UK, while those with higher incomes will continue to pay significantly more: £1,528 more for someone with an income of £50,000, and £5,207 more for someone with an income of £125,000. The Tax Strategy commits the Scottish Government to evaluating responses to these tax differences, which could, for example, include people with higher incomes moving to the rest of the UK.
6. Business rates will be frozen in 2025–26 for properties with a rateable value of up to £51,000. This will likely benefit occupiers in the short term but landlords in the long term as rents adjust upwards, and will increase the cliff-edge in rates bills at that point (bills for larger properties will increase by 1.7%, in line with inflation). A new discount of up to 40% for small hospitality businesses will be put in place for 2025–26. This will benefit hospitality businesses, but if made permanent would hurt other types of businesses (such as retailers) as property rents would increase, with landlords again the beneficiaries.
7. The 2025–26 Budget further increased the top-up to LBTT paid on the purchase of second homes (including rental properties) from 6% to 8% of the purchase price. This means that a landlord buying a £500,000 property, for example, must now pay £63,350, or 12.7%, in LBTT on top of the purchase price (compared with £23,350, or 4.7%, if bought as an owner-occupier's main home). This makes Scotland's most ill-conceived tax even bigger and more damaging. The change will encourage owner-occupation, but will make it even more difficult and expensive for those who remain in the rental sector – tenants (who are likely to face higher rents as a result of the policy) as well as landlords.

2.1 Assessing the Scottish Government's new Tax Strategy

Chapter 1 of the Tax Strategy (Scottish Government, 2024a) says it sets out the Scottish Government's 'medium-term ambitions for how the tax system will develop to support the delivery of our four government priorities: eradicating child poverty, growing the economy, tackling the climate emergency, and ensuring high quality and sustainable public services'. Moreover, it aims to 'support the progression to a tax system which aligns policy aims with outcomes, is informed by robust evidence and engagement with others, and enables us to take a system wide and comprehensive approach to tax policy in Scotland'.

But what exactly does the strategy cover? Does it deliver what it sets out to do? And does it represent a meaningful, coherent strategy for the future of the Scottish tax system – including the Scottish Government's priorities for further tax devolution?

What does the Tax Strategy cover?

After setting out its high-level vision for the Tax Strategy, the remainder of chapter 1 describes the tax powers devolved to the Scottish Government and the institutional underpinnings for the collection of these taxes (by Revenue Scotland and HMRC) and forecasts of their revenues (by the Scottish Fiscal Commission). It highlights how policies enacted so far have increased the progressivity of the tax system and raised additional revenue to help fund devolved spending. It also recognises the trade-off between raising revenue and potential impacts on taxpayer behaviour and economic competitiveness. In addition, it references the potential role for taxation in 'encouraging positive behavioural change' (e.g. by accounting for the potential negative externalities from the use of land for landfill waste disposal and the extraction of sand, gravel and rock).

Chapter 2 of the strategy document sets out the economic and fiscal context in which the Tax Strategy has been made. This includes out-turns and forecasts for revenues, a range of facts and figures for each devolved tax, and demographic projections for an increasingly elderly population which will impact both revenues and public spending requirements. The chapter also highlights some of the key determinants of tax revenue, including employment, earnings and other income growth, property prices and transactions volumes, and the impact of both Scottish and UK government policy decisions (the latter impacting either directly, or indirectly via affecting the size of the block grant adjustments deducted from the Scottish Government's block grant funding to account for devolved revenues). It also discusses some of the factors underlying recent income tax revenue performance, and the downside risks associated with current income tax revenue forecasts.

All of that is context. The meat of the strategy is set out in chapter 3, and is organised into five main subsections:

- **Priorities for the existing system.** This includes plans for income tax in 2026–27, information on the Scottish Government’s approach to engaging on and exploring options for local taxation, and a restatement of its commitment to complete the devolution of several taxes already legislated for (we discuss what the strategy says about tax devolution in further detail below).
- **The economy and the tax system.** A number of actions outside the tax system to support economic and hence tax-base growth are highlighted, including the provision of employability support and the focus of Scotland’s Migration Service on helping employers recruit internationally. This subsection also commits the Scottish Government to review the evidence on how tax policy affects the economy, with an evidence review for income tax to be published this year, and to engage with business on cumulative impact assessments of UK, Scottish and local tax policies.
- **Administration of the existing tax system.** Priorities identified include improving the public’s understanding of tax, strengthened arrangements for ensuring tax compliance, lower administration and compliance costs, and consideration of making regular changes to devolved taxes via primary (rather than secondary) legislation via the equivalent of the UK’s Finance Bill process.
- **Evidence and evaluation.** This subsection commits the Scottish Government to a systematic programme of tax policy appraisal and evaluation, with a formal impact evaluation of recent income tax changes and a review of land and buildings transaction tax (LBTT) specifically identified. A set of ‘areas of research interest’ – essentially, questions or issues the Scottish Government is interested in research being undertaken on – is also published as an appendix to the Tax Strategy.
- **Future priorities.** These include further work to identify which additional tax powers the Scottish Government should prioritise for devolution, explore the potential role of wealth taxation, and consider the role that taxation could play in encouraging positive behavioural change (seemingly with an environmental context in mind).

How useful is it as a strategy?

There is much to welcome in the Tax Strategy. It is to the Scottish Government’s credit that it has published something on this topic at all – not something the UK government has done,

despite much urging.¹ And much of what it says is commendable. The aims set out for tax policy are good ones. There is a pleasing emphasis on evidence and engagement as central to future policymaking. The desire to improve administration of the tax system and public understanding of it is laudable. The document is full of worthy ambitions.

But it is not a strategy for tax policy.

A strategy for tax policy would set out the Scottish Government's vision of what a good tax system for Scotland would look like in 5, 10 or 20 years' time, and how we should expect tax policy to evolve towards that in the coming years. It would trace a path connecting first principles and the Scottish Government's overarching objectives to concrete policy.

More specifically, it would ideally address the following four groups of questions:

1 What tax powers should be devolved?

Which existing tax policies should be set at the UK level, which at the Scottish level and which by Scottish councils? What new taxes should Scotland be able to introduce unilaterally? If the Scottish Government would like more tax powers to be devolved, what would be its priorities and why? Considerations might include the mobility of different tax bases, the desire for Scotland to diverge from UK policy, and administrative practicality, among other things.

2 What ideal tax system is the Scottish Government aiming for?

Given Scotland's existing tax powers, how should each tax be designed (and administered) to best meet the Scottish Government's long-term objectives? How should the different taxes fit together and what is the appropriate balance between them? What is the role of tax (versus non-tax policies) in achieving those objectives? What should, or should not, be taxed at all?

How should devolved Scottish tax policy relate both to equivalent tax policies elsewhere in the UK and to reserved tax policies affecting Scotland, and how should the Scottish Government approach tax policymaking when only parts of the Scottish tax system are within its control? And what might tax policy look like if it had more of the tax powers it wanted? A tax strategy clearly could not describe what tax policy choices would be made under every possible scenario for devolution, but it could give a sense of the principles, priorities and considerations that would drive the Scottish Government's decisions.

¹ See, for example, Johnson (2011) and Rutter et al. (2017). UK governments have occasionally produced a strategy for a specific bit of the tax system or a specific aspect of tax policy – notably, corporate tax 'road maps' (HM Treasury, 2010 and 2024) and the consultation framework (HM Treasury and HMRC, 2011) – but these have been much narrower than a strategy for the tax system as a whole.

3 How should we get there?

What steps does the Scottish Government plan to take to move towards its ideal, and over what time frame? Should it pursue a ‘big bang’ reform or incremental improvements? How could dauntingly ambitious reforms be broken down into more manageable steps? Do some changes need to precede others, or are some higher priority, or can some be achieved more quickly? What process of evidence-gathering, consultation etc. will it undertake?

4 How might the destination change over time?

How should features of the system – from tax thresholds to property valuations – evolve over time by default in response to inflation and other changes in the economy? And in an uncertain world, where it is not feasible or sensible to say with certainty what every tax rate should be many years into the future, which features of tax policy should be kept stable and which should respond to changing circumstances and priorities? Again, a tax strategy cannot specify exact policy for every possible eventuality, but it can give principles and guidance which help to make its likely response to new developments more predictable.

These are difficult questions. It would be asking a lot for the Scottish Government, in the 18 months it has taken to produce this document, to have produced a tax strategy covering all of this and going from first principles to a fully mapped-out plan for tax policy over the medium-to-long term.

But it is not clear that the document provides much of an answer to any of these questions.

Chapters 1 and 3 both begin by setting out laudable aims for a tax strategy or tax policy. These include, for example, taking a system-wide and comprehensive approach, building on underlying principles, robust evidence and engagement with others; a tax system that supports the delivery of government priorities, aligning policy aims with outcomes; going beyond annual budget cycles; and recognising the risk of unintended consequences. These are all worthy ambitions; it is hard to argue with any of them.

But these are ambitions and criteria for how tax policy will be produced in future: the Tax Strategy does not actually undertake the task and reach conclusions. What combination of tax policies would best promote economic growth, or fairness, or simplicity, or environmental sustainability? We are not told.

Of the five subsections of chapter 3 listed above, only the first and last are concerned with what tax policy might actually look like.

The strategy for income tax policy

The only specific policy plans are for income tax rates and thresholds, setting out the following intentions for the remainder of this Parliament (i.e. up to May 2026):

- No new bands.
- No increase in rates.
- Uprate the starter- and basic-rate bands by at least inflation.²
- Freeze the higher-, advanced- and additional-rate thresholds (subject to annual review at the Budget).
- Keep over half of Scottish income tax payers paying less income tax than they would in the rest of the UK.

Refraining from adding any more bands to the already overcomplicated Scottish income tax schedule is unambiguously welcome. Adding ever more bands does nothing to the distribution of tax payments that could not be closely approximated by adjusting existing rates and thresholds; it complicates the tax schedule for little-to-no economic benefit.

The rest are reasonable policy choices. But it is hard to see them as part of a broad tax strategy.

There is no indication of *why* the lower bands should be uprated but the upper thresholds frozen, or why the aim is for more than half of taxpayers to pay less income tax than they would in the rest of the UK (apparently irrespective of *how much* less, or of how much more the remainder pay, or of how much people pay in other taxes). There is no sense of whether and how this income tax policy is joined up with other tax policies as part of an integrated plan for the Scottish tax system as a whole. If there is any such strategic thinking behind the announcement, the Tax Strategy would surely have been the place to spell it out.

It does differ from a typical Scottish Budget announcement in giving a statement of intent for the whole of the remainder of the Parliament. In practice, at this stage of the electoral cycle, that covers only one extra year. But the principle is worth considering. On the one hand, it helps to give individuals and businesses some forward guidance, reducing their uncertainty about likely future taxes; ‘signalling a period of stability’ is the rationale the Scottish Government gives. On the other hand, it ties the Scottish Government’s hands – or at least reduces its room for manoeuvre – if changing circumstances or policy preferences mean it looks to raise more revenue in future. The Tax Strategy gives no guidance on these pros and cons. When is making

² Note that, since UK government policy is to keep the tax-free personal allowance frozen in cash terms up to 2027–28, increasing the width of these *bands* by inflation would mean that the *thresholds* up to which the starter and basic rates apply (i.e. the personal allowance + the widths of the bands) would increase by much less than inflation. For the same reason, when the Scottish Budget announced that, as a one-off in 2025–26, the *thresholds* would increase by 3.5%, the bands had to be uprated by much more to achieve this: 22.6% for the starter-rate band and 6.6% for the basic-rate band. The commitment for subsequent years in the Tax Strategy is thus much less generous.

commitments a better/worse idea? Which features of tax policy should be kept flexible and used to respond to changing desires to raise revenue or redistribute, and which should be kept stable regardless of these?

The strategy for other devolved tax policies

On other existing taxes, there is little indication of the Scottish Government's long-term intentions.

For the two next biggest devolved taxes – business rates and council tax – there is an intention to engage with others to consider possible future directions for policy, but no indication of what such directions might be and why. It does not inspire confidence that much-needed reform will actually happen to taxes that are notoriously politically difficult to reform.

Policy on land and building transaction tax is not mentioned at all, except in the context of a review which seems to be focused on detailed technical issues and unusual cases, rather than the underlying rationale for, and design of, the tax. Outside income tax, the biggest tax policy change in the Budget was an increase in the additional LBTT that must be paid on the purchase of second or rental homes, discussed in Section 2.2 below. There is nothing in the Tax Strategy that would help us to assess the merits of this change and how it contributes to – or detracts from – the Scottish Government's ultimate aims for tax policy, or to judge whether we should expect, in five or ten years' time, LBTT overall to be higher or lower and the gap between LBTT on first and additional homes to be bigger or smaller.

The relationship with tax policy in the rest of the UK

Some of the tax policy announcements in the Budget mirror changes made by the UK government (on Scottish landfill tax rates, LBTT and business rates); in some places, the Budget refers to the competitiveness of Scottish tax rates vis-à-vis the rest of the UK (non-residential LBTT, business rates for all but the highest-value properties); while in other contexts, the Scottish Government also highlights the greater progressivity of Scottish tax policy than UK tax policy.

Yet there is nothing in the Tax Strategy about the trade-offs between the simplicity benefits of having a system aligned with that elsewhere in the UK, the benefits of diverging to reflect different preferences and circumstances in Scotland, and the benefits of being competitive, or about how those trade-offs might differ across different areas of tax policy. For example, the fact that property is immobile and its supply is relatively unresponsive to taxation means that there is much less economic imperative for the property tax regime to be competitive with that in the rest

of the UK (rUK) – or elsewhere – than for other taxes.³ Property taxation is an area where Scottish policy could easily and productively diverge from that in rUK if the Scottish Government wished to forge its own path.

Future priorities

More informative than the discussion of priorities for most existing devolved taxes is the discussion of future priorities. While the desire to seek further devolution of tax powers from the UK government is vague and unsurprising (see below), the other parts – ‘reviewing how tax is balanced across labour, income and wealth, and considering how tax can be used to encourage positive behavioural change’ – signal the direction of travel that interests the Scottish Government: towards more taxation of wealth and more environmental taxation. The Scottish Government did not have to pick out those two particular areas: that it did so provides genuine insight into its thinking. The Tax Strategy gives little by way of rationale or detail – it does not itself provide the promised review or consideration – but promises ‘we will set out our detailed programme of work on future priorities alongside the next MTFS [Medium-Term Financial Strategy] in [May] 2025’. We await that with interest.

The Tax Strategy and future tax policymaking

Beyond the design of tax policy itself, much of the rest of the Tax Strategy sets worthwhile goals that are easy to endorse.

The Tax Strategy is peppered with sensible-sounding promises to engage (or continue engaging) with others: with local government on the future of council tax, with business and other stakeholders on the operation of business rates, with HMRC on improving tax administration, with researchers on the evidence on the effects of taxation, and so on – including ‘reaching out to groups who may not often contribute to the conversation on tax’. This is all welcome.

Likewise, policymaking should of course be informed by robust evidence, so the emphasis on gathering that, including by publishing a review of the evidence on income tax this year and more broadly by developing ‘a systematic and regular programme of appraisal and evaluation across the Scottish tax system’, is welcome. From a researcher’s point of view, the appendix that lists the Scottish Government’s ‘areas of research interest’ (ARIs) – research questions on which it would value external input – is particularly helpful, so that future research can be focused where it will be most valuable to policymakers. The promise of ‘exploratory funding available to

³ While property is immobile, people and businesses can of course choose where to locate, and tax will sometimes be one factor affecting that choice. But to the extent that the supply of property is unaffected by taxation, higher property taxes will be reflected in lower property values and rents, so higher property taxes in one place will be offset almost one-for-one by cheaper property there, leaving the overall cost of property (rent / purchase price plus tax) and therefore the attractiveness of the location unaffected. There are some nuances and complexities to this argument in practice, but it will nonetheless be a good approximation.

support the development of these ARIs’ makes it more likely that such research will actually happen.

The aims to work with others to improve public understanding, tax compliance, tax collection mechanisms and the legislative process are all laudable. The steps mentioned, such as publishing ‘externally commissioned research on international best practice on tax communications and engagement’ and ‘an updated compliance plan for Scottish Income Tax, increased communication with taxpayers to promote good compliance, and risk-based analysis of compliance risk’ all sound useful. But these are still just about how the Scottish Government will engage and produce plans in future – not actual plans now with concrete proposals. It remains to be seen what will be achieved in practice.

So, the Tax Strategy is full of ambitions and promises for tax policymaking in future, but says little about the long-term direction of tax policy itself.

It is more of a framework for producing a strategy than a strategy in itself.

What does the Tax Strategy say about further tax devolution?

In contrast with the sections on tax policy in previously published financial strategies, the Tax Strategy says little directly about the Scottish Government’s priorities for further tax devolution.

It restates its intention to enact taxes already agreed for devolution and legislated for, but yet to be enacted: the Scottish aggregates tax (which will replace the existing UK-wide aggregates levy) by April 2026, and the air departure tax (which will replace the existing UK-wide air passenger duty) once subsidy control rules related to exemptions for flights to the Highlands and Islands are resolved. The increase in the number of taxes managed by Revenue Scotland and the (small) increase in revenues that would be devolved to the Scottish Government are highlighted. However, the opportunity to provide information on the direction of tax policy for these two taxes is missed: even if the plan, at least initially, is to mirror existing UK policy to provide certainty and stability to taxpayers, that is worth stating.⁴

The strategy highlights a request made to the UK government for powers to create a Scottish building safety levy payable by the developers of residential properties, to replicate a policy

⁴ The Scottish aggregates tax will mirror the structure of the existing aggregates levy but decisions on the rates will be taken in the Scottish Budget preceding its implementation (<https://www.gov.scot/publications/aggregates-tax-devolved-taxes-administration-scotland-bill-stage-1-debate-minister-employment-investment/>). The latest information (from 2019) on planned policy for air departure tax is that initial plans to halve and eventually abolish the tax compared with existing air passenger duty rates have been shelved due to concerns about the increased carbon emissions such a policy would entail; see <https://www.bbc.co.uk/news/uk-scotland-scotland-politics-48191110>.

legislated for in England and to be enacted this autumn.⁵ However, it does not reference plans to consult on proposals for councils to be able to charge a levy on cruise ships.⁶

The unsuitability of the method – based largely on a household survey with a small sample size – initially proposed for assigning half of estimated VAT revenues raised in Scotland to the Scottish Government is recognised. Instead, alternative options are to be explored, although what these may be is left unsaid. Do they, for example, include options that would require additional reporting by businesses (e.g. on the location of their sales and customers within the UK)?

Beyond this, any proposals on wealth taxation or tax policies to influence behaviour towards the environment coming out of the aforementioned exploration of these issues would likely require further devolution (unless implemented via local taxation powers). However, there is no reference to the devolution of VAT, National Insurance contributions or full powers over income tax, which was highlighted in the most recent Medium-Term Financial Strategy as desirable (Scottish Government, 2023). It appears that remains the position of the Scottish Government, though, with a recent submission to a House of Commons Scottish Affairs Committee Inquiry going even further and calling for the devolution of all taxes under ‘full fiscal autonomy’.⁷

Thus, while it is welcome that the Tax Strategy shifts the focus onto priorities for the use of powers and reform of tax policy processes already under the Scottish Government’s control, there was a missed opportunity to at least bring together what the Scottish Government has said before about further tax devolution and explain how additional powers could help achieve tax policy objectives.

2.2 Assessing the Scottish Government’s tax policy decisions

The 2025–26 Budget itself (Scottish Government, 2024b) made several changes to Scotland’s tax policy, including to income tax thresholds, rates and reliefs in business rates, LBTT rates for the purchase of second and rental homes, and Scottish landfill tax rates. As shown in Table 2.1, this mix of revenue-reducing and revenue-raising measures is forecast by the Scottish Fiscal

⁵ The intended implementation date for the (English) building safety levy was announced in December 2024: <https://www.gov.uk/government/publications/accelerating-remediation-a-plan-for-increasing-the-pace-of-remediation-of-buildings-with-unsafe-cladding-in-england/remediation-acceleration-plan>.

⁶ See <https://www.gov.scot/policies/taxes/cruise-ship-levy/>.

⁷ See the letter from the Scottish Finance and Local Government Secretary, Shona Robison, MSP, to the Chair of the House of Commons Scottish Affairs Committee, Patricia Ferguson, MP: <https://committees.parliament.uk/publications/46344/documents/233832/default/>.

Commission (SFC) to raise a net £54 million in 2025–26, rising to £207 million in 2026–27 and £241 million in 2029–30. These amounts are small in the context of forecast revenue of £25 billion in 2025–26 and £30 billion in 2029–30.

Table 2.1. Tax policy changes announced in the 2025–26 Scottish Budget (£ million)

Tax policy change	2025–26	2026–27	2029–30
Income tax			
Increase basic- and intermediate-rate thresholds by 3.5% in 2025–26	–24	–25	–28
Freeze higher-, advanced- and top-rate thresholds in 2025–26 and 2026–27	+76	+211	+244
Business rates			
Freeze basic poundage rate for 2025–26	–9	–11	–12
Continue Islands and Remote Areas Hospitality Relief for 2025–26	–5	0	0
Introduce partial mainland hospitality relief for 2025–26	–22	0	0
LBTT			
Increase additional dwelling supplement from 6% to 8%	+32	+29	+33
Scottish landfill tax			
Increase rates to match UK landfill tax rates	+6	+4	+4
Total	+54	+207	+241

Source: Scottish Fiscal Commission, 2024.

Income tax

Unlike the last two years, there will be no changes to Scottish income tax rates in 2025–26 (with the Tax Strategy stating an intention to keep them the same in 2026–27 as well, as discussed above). Changes were made to thresholds, though, slightly reducing the income tax paid by low- and middle-income taxpayers and increasing the tax paid by high-income taxpayers relative to indexing tax bands in line with inflation.

- The threshold above which the basic (20%) rate becomes payable will increase by 3.5% from £14,876 to £15,397 in 2025–26, with the threshold at which the intermediate (21%) rate becomes payable also increasing by 3.5% from £26,561 to £27,491. Compared with indexing the starter- and basic-rate *bands* by inflation (the SFC’s default forecasting

assumption),⁸ which would have seen the thresholds increase to £14,915 and £26,799 respectively, this saves basic-rate taxpayers £5 per year and intermediate-rate taxpayers £12 per year.

- The thresholds at which the higher, advanced and top rates of income tax become payable will be frozen at £43,662, £75,000 and £125,140, respectively, in 2025–26 and 2026–27. Compared with indexing the relevant tax bands in line with inflation (the SFC’s default forecasting assumption), which would have seen these thresholds increase to £44,191, £76,061 and £127,267 respectively, in 2025–26 this will cost higher-rate taxpayers £98 per year, advanced-rate taxpayers £136 per year and top-rate taxpayers £199 per year. The further freeze planned for 2026–27 will increase these losses to approximately £280, £360 and £530 per year respectively.

Taken together, these changes raise income tax revenue in a broadly progressive manner, continuing the long-standing pattern of Scottish income tax policy. With all income tax thresholds frozen in the rest of the UK, these changes increase the extent to which low- and middle-income taxpayers pay less tax in Scotland: they will pay up to £28 per year less in Scotland, as opposed to £23 this year. The changes will slightly reduce the extent to which higher-income taxpayers pay more in Scotland: for example, someone on £50,000 will pay £1,528 more, down from £1,542 more in the current financial year.

Figure 2.1 shows the marginal rate structure for Scotland’s income tax in 2025–26, while Figure 2.2 compares income tax liabilities in Scotland and rUK.

In 2025–26, the marginal rate of income tax will be higher in Scotland than in rUK on incomes above £27,492 (the intermediate-rate threshold), with particularly large differences of 22 percentage points (42% as opposed to 20%) for incomes between £43,662 and £50,270 as a result of Scotland’s lower higher-rate tax threshold, and of 7.5 percentage points (67.5% as opposed to 60%) for incomes between £100,000 and £125,140 as a result of the interaction of the UK government’s tapering of the tax-free personal allowance and Scotland’s 45% ‘advanced’ rate of income tax.

The marginal rate structure is significantly more complex in Scotland than in rUK, with six official tax rates (in addition to the 0% up to the personal allowance) and a seventh created by the tapering of the personal allowance above £100,000. As discussed in Adam and Phillips (2021), this proliferation of rates, and especially having separate 19%, 20% and 21% rates, is hard to justify economically: a small 0% band on top of the UK government’s tax-free personal allowance followed by a 21% rate would be both simpler and more progressive, taxing the lowest-paid income tax payers less than the system currently in place.

⁸ See footnote 2 on the difference between uprating the bands and uprating the thresholds.

Figure 2.1. Income tax marginal rate structure, Scotland and rUK, 2025–26

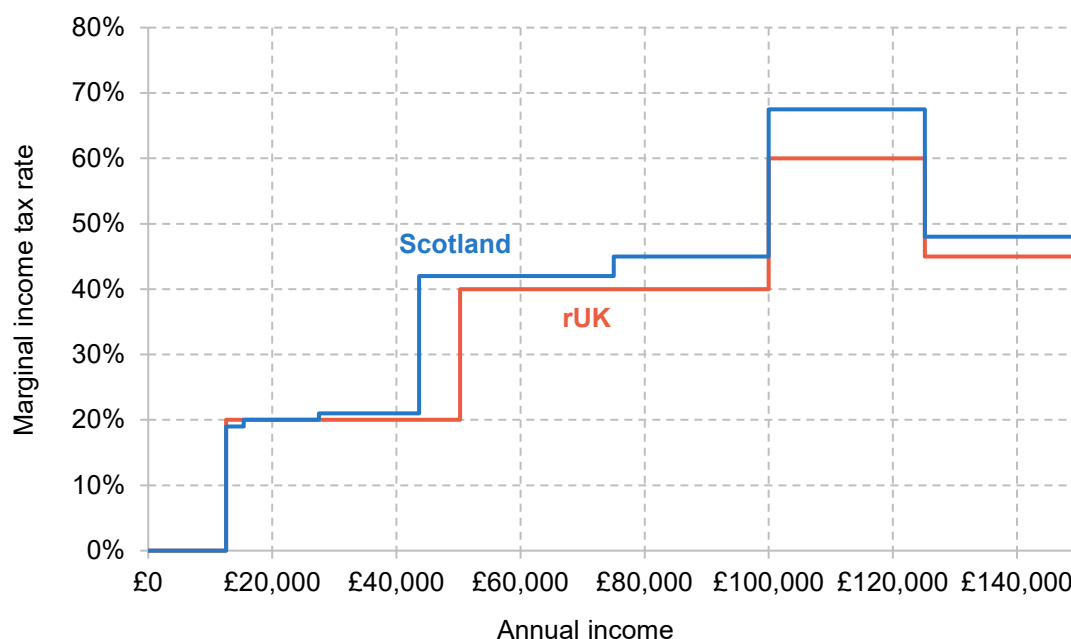
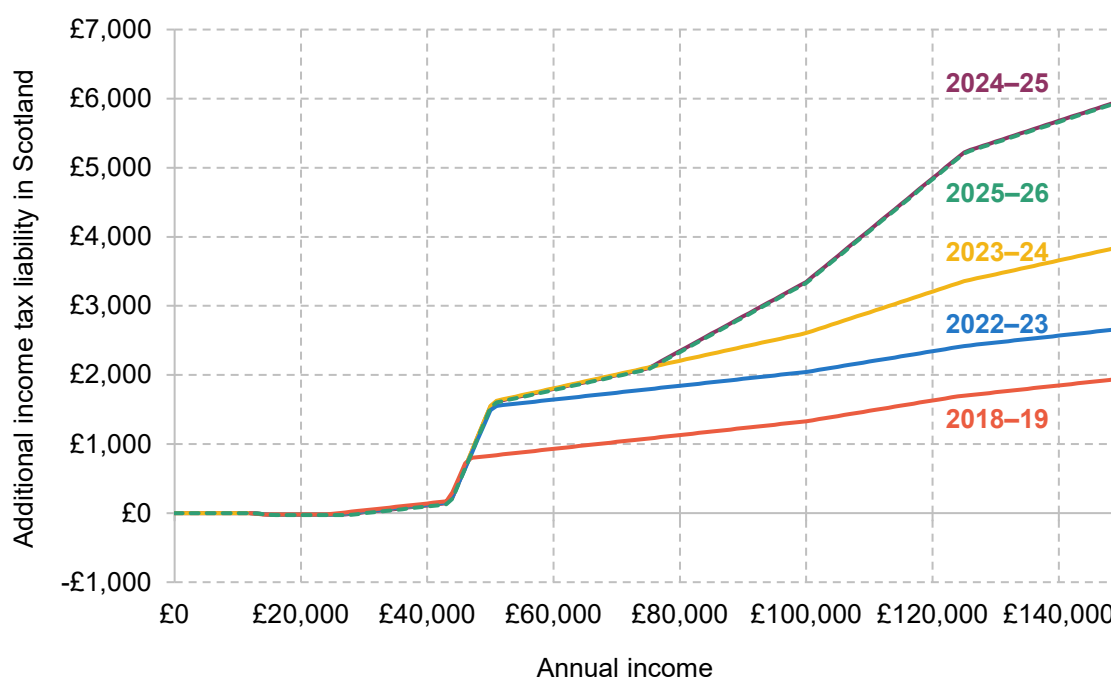


Figure 2.2. Difference in income tax liability between Scotland and rUK



Note: Assumes all income is non-savings, non-dividends income.

Figure 2.2 shows how the slightly lower bills in Scotland than in rUK for the majority of taxpayers are dwarfed by the much higher bills for those on higher incomes. It also shows how the additional tax paid by higher-income taxpayers in Scotland has built up over time. The amount paid by someone with an income of £125,000 is around £5,200 higher in Scotland than in rUK in both 2024–25 and 2025–26 (the changes in the Scottish Budget are relatively small),

up from around £3,360 in 2023–24 and £1,700 in 2018–19. As discussed in Phillips (2024), evidence from both Scotland and other countries suggests that the additional tax due on high incomes will have affected taxpayers' decisions over work, migration and the avoidance and evasion of taxes, potentially to the extent that the increases in the top rate of tax could have reduced rather than raised revenues (although the overall set of changes made to income tax by the Scottish Government since devolution is still almost certainly revenue-raising).

In its costings of the most recent reforms, the SFC assumes that such behavioural responses will reduce the yield from freezing the higher-rate threshold by 8%, the yield from freezing the advanced-rate threshold by around a quarter, and the yield from freezing the top-rate threshold by almost two-thirds (Scottish Fiscal Commission, 2024). These assumptions are plausible and draw on a wide range of evidence about how responsive taxpayers are to changes in tax policy.

Moreover, the SFC estimates that in the absence of behavioural responses to Scotland's income tax policy changes, and if the underlying income tax base in Scotland had grown in line with that in rUK, the Scottish Government's tax policies would mean its net income tax revenue position would be £1.7 billion in 2025–26, approximately 40% more than the actual forecast of £1.2 billion.⁹ To a large extent, this will reflect other factors depressing Scotland's income tax base (such as slower private sector earnings growth in the late 2010s and early 2020s, in part linked to the declining high-paid oil and gas industry), but the impact of behavioural responses to Scotland's higher tax on high incomes is also likely to have played a role.

Business rates

The 2025–26 Budget reduced business rates for two groups: permanently, for the occupiers of properties with a rateable value (i.e. estimated annual market rental value) of up to £51,000; and for 2025–26 only, for hospitality businesses and grass-roots music venues with a capacity of up to 1,500.

The tax rate on properties with a rateable value up to £51,000 (the 'basic poundage rate') will be frozen at 49.8% for the second year in a row,¹⁰ rather than increasing in line with inflation to 50.6%. This represents a permanent cut in business rate bills.

⁹ The net income tax revenue position is the difference between Scottish income tax revenue and the associated block grant adjustment subtracted from the UK government funding provided to the Scottish Government to account for the devolution of income tax. It measures how much net additional funding devolved income tax is generating for the Scottish Government's budget, relative to if rUK rates applied. And it reflects both the impact of Scottish income tax policy decisions and any other factors affecting the relative change in income tax revenue per person in Scotland compared with England and Northern Ireland since prior to the devolution of income tax to Scotland.

¹⁰ While the basic poundage rate was frozen at this rate in 2023–24 too, that freeze accompanied a revaluation that, on average, increased rateable values from those that applied in 2022–23. Hence, the average business bill increased. As the basic poundage rate freezes in 2024–25 and 2025–26 are not accompanied by a revaluation (the next revaluation is due in 2026–27), they do freeze bills for affected businesses too.

In the short term, this freeze will likely benefit the occupiers of properties up to £51,000 that pay business rates, although this will include large businesses occupying multiple small properties as well as the small businesses the Scottish Government says it is targeting for support. In the longer term, though, both theoretical and empirical evidence suggest that the main beneficiaries are likely to be commercial landlords, as rents and property prices rise (or fall less) relative to what they would otherwise have done.¹¹ Some businesses could lose out: for example, those benefiting from the ‘small business bonus scheme’ which do not pay business rates could face slightly higher rents as a result of increased competition from those benefiting from lower rates bills. The freeze in the basic rate poundage while the intermediate poundage is increased in line with inflation to 55.4% will also increase the size of the jump in business rates at the £51,000 threshold to just over £2,850 (up from £2,400). This is equivalent to an 11% jump in business rates bill and an approximately 4% jump in combined rent plus rates bill at the £51,000 threshold. Charging £2,850 extra tax for a property that costs £1 more to rent is absurd – unfair and potentially distortionary – and it would be better for the Scottish Government to remove this cliff-edge, as it did elsewhere in the property tax system when it introduced LBTT (which has no such jumps) in place of stamp duty land tax (which did have at the time).

The extension of a relief of up to 100% for hospitality businesses in the Scottish islands and three remote mainland areas (Cape Wrath, Knoydart and Scoraig), and the introduction of a relief of up to 40% for hospitality businesses elsewhere in Scotland, apply in 2025–26 only. Reliefs will be capped at £110,000 per business (matching a cap in place for a broader relief for the retail and leisure sectors, in addition to the hospitality sector, in both England and Wales), and will be available only on properties with a rateable value up to £51,000 under the mainland Scotland scheme.

These schemes likely will help hospitality businesses, especially in the short term. If the reliefs were made a permanent feature of Scotland’s business rates system, we would expect the higher demand for properties suitable for hospitality usage to lead to much of the benefit being passed on to landlords (and hospitality businesses that own their own properties). Hospitality businesses themselves would still likely gain somewhat because increased demand from them for property would likely push up rents by less than they gain from lower rates bills. But other potential users of the properties (such as retail or leisure businesses, or residential renters if the properties are convertible) would likely lose out, as they too would face increased rents due to the higher demand from hospitality businesses but would not benefit from reduced rates bills.

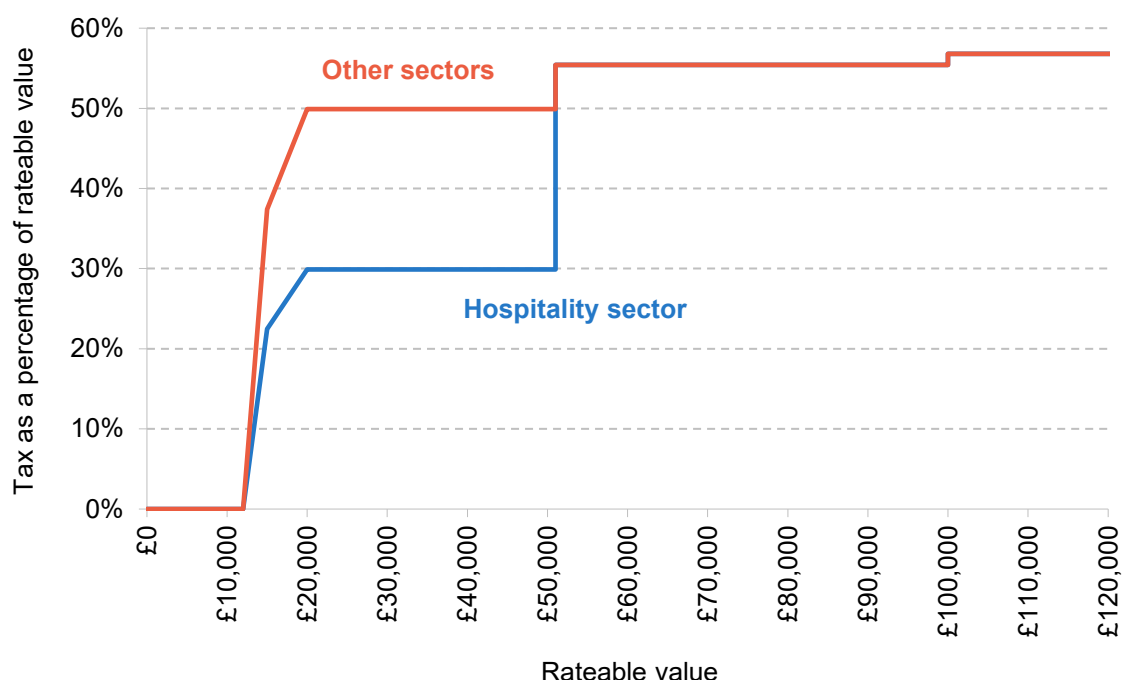
The Scottish Government should make clear as soon as possible whether these new reliefs will be temporary, as announced, or made permanent (or at least long-term) features of the business

¹¹ See, for example, Bond et al. (1996) and Cambridge Econometrics (2008).

rates system. It should avoid following policy in England where multiple one-year extensions to a broader relief for the retail, hospitality and leisure sectors increased uncertainty for businesses, landlords and the government's finances. In contrast, the decisiveness with which the Scottish Government ended reliefs for the retail, hospitality and leisure sectors in place during the COVID-19 pandemic was welcome from a policymaking perspective.

These two new policies continue a Scottish trend – and wider UK trend – of increasing differentiation of business rates tax rates by property value and type of occupier. Figure 2.3 shows the rates bill as a percentage of rateable value for businesses in the hospitality sector (in blue) and other sectors (in red) in mainland Scotland assuming they occupy one property.

Figure 2.3. Scottish business rates as a percentage of rateable value, 2025–26



Note: Assumes a business occupies one property.

No rates are payable on properties with a rateable value up to £12,000 (provided the combined rateable value of all properties a business occupies is no more than £35,000) as a result of the Small Business Bonus Scheme for rates relief. For a business occupying a single property, the reduction in bill as a result of this relief is tapered from 100% for rateable values up to £12,000 to 25% for a rateable value of £15,000, above which the discount is reduced more gradually, finally being removed for properties with a rateable value of £20,000. This means, for sectors other than hospitality, business rates bills increase from 0% of rateable value for properties up to £12,000, to 37.4% for properties with a rateable value of £15,000, to the basic poundage of 49.9% for properties above £20,000. For properties in the hospitality sector on the mainland of Scotland, the 40% relief in 2025–26 means the equivalent tax rates will be 0%, 22.5% and

29.9%, respectively. Tax rates (and bills) jump up at a rateable value of £51,000, particularly for businesses in the hospitality sector as they will no longer be entitled to 40% relief at that point. There is a further small jump at £100,000, where the higher rate of business rates kicks in.

It is tempting to think of levying lower tax rates on low-value properties as akin to levying lower tax rates on low-income individuals, but the analogy is flawed. The people who ultimately bear the burden of a tax on business property – a combination of the taxpaying firms' owners, employees, customers, suppliers or (most likely) landlords – are not necessarily any worse off for low-value properties than for high-value properties. Taxing lower-value business properties less heavily is not necessarily progressive with respect to household income.

The £35,000 cap on the total rateable value a business can occupy to receive the small business bonus relief means the relief does reduce the cost of property for small businesses relative to large businesses (which are likely to occupy multiple properties with a total rateable value of more than £35,000, or larger individual properties).¹² This will mean more properties occupied by small businesses and fewer properties occupied by large businesses. The hospitality relief will also reduce the cost of property for relatively small hospitality businesses relative to other types of relatively small businesses (such as retailers, or small professional services businesses), affecting the size of these business sectors. These may be the intended effects of the reliefs, but by distorting business size and sector relative to what would otherwise pertain, the reliefs are not economically costless.

Land and buildings transaction tax

Purchases of second or rental properties in Scotland – around a fifth of housing transactions – are subject to an additional dwelling supplement (ADS) payable on top of the main rates of residential LBTT shown in Table 2.2.¹³ The 2025–26 Scottish Budget increased the ADS from 6% to 8% from 5 December 2024.

This increase in the ADS continues a trend. Before April 2016, there was no ADS. It was first brought in at that point at a rate of 3%, and has been gradually increased since then to its current rate of 8%.

¹² Similarly, large hospitality businesses will benefit less than smaller ones from hospitality relief due to the £110,000 cap.

¹³ Non-residential LBTT, which accounts for 20–25% of LBTT revenue, has not been changed since 2019 and we do not discuss it further here. See Adam and Phillips (2021) for a brief analysis.

Table 2.2. Rates and thresholds of LBTT for residential property, 2025–26

Band	Rate	Proportion of transactions, 2023–24
£0–£145,000 ^a	0%	36%
£145,000 ^a –£250,000	2%	33%
£250,000–£325,000	5%	14%
£325,000–£750,000	10%	16%
£750,000+	12%	1.2%

^a £175,000 for first-time buyers.

Note: Rates apply to the part of the value in each band. Additional 8% of the full purchase price payable on transactions above £40,000 if the buyer owns another residential property.

Source: Proportions of transactions calculated by the authors from Revenue Scotland, LBTT monthly statistics, December 2024, <https://revenue.scot/news-publications/publications/statistics/monthly-lbtt-statistics>.

Figure 2.4. Land and buildings transaction tax on residential property transactions, 2025–26

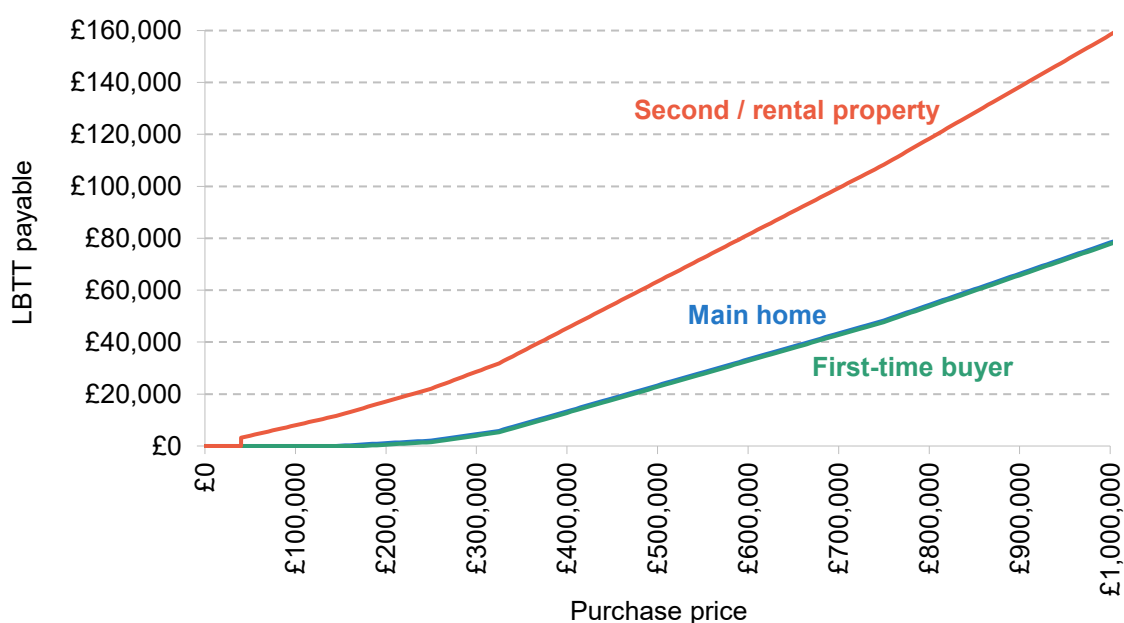


Figure 2.4 shows what the new rate of ADS implies for tax bills. A landlord buying a £500,000 property, for example, must now pay an eye-watering £63,350, or 12.7%, in LBTT on top of the purchase price (compared with £23,350, or 4.7%, if bought as an owner-occupier's main home). Many will be put off by that. (On that scale, the LBTT discount for first-time buyers – worth £600 for any purchase above £175,000 – is barely discernible on the graph.)

Taxing property transactions is an exceptionally damaging way to raise revenue. It discourages mutually beneficial transactions, so properties are not owned by the people who value them most. That misallocation of property makes everyone worse off. The increase in the ADS makes a bad tax bigger and even more harmful.

The rationale given in the Budget was that it would raise revenue and that ‘the increased rate also supports the Scottish Government’s commitment to protect opportunities for first-time buyers in Scotland’. The SFC estimates that it will indeed raise revenue, around £30 million a year, though that is less than half of what it would have raised if people were not put off making such purchases by the tax increase (Scottish Fiscal Commission, 2024). And penalising the rental sector will indeed make it cheaper and easier for people to move into owner-occupation. What the Scottish Government did not mention is that it will also make it even more difficult and expensive for those who remain in the rental sector – tenants (who are likely to face higher rents as a result of the policy) as well as landlords.

The case for tilting the playing field even further towards owner-occupation and away from rental is doubtful: bear in mind that landlords must also pay income tax on their rental income and capital gains tax on any increase in the property’s value, neither of which applies to owner-occupiers. But in any case, an LBTT supplement is a bad way to do it. The ADS does not just penalise the rental sector; it penalises transactions within the rental sector. Preventing a landlord who wants to sell their property to another landlord from doing so is bad for both landlords and tenants.

This is even more pointed as it comes alongside a new power for councils to ask ministers to designate areas for rent controls. The combination of rent controls and high LBTT could lead to a withering of the rental market in some areas, and while some tenants could benefit, others would lose.

Unlike the ADS, the main rates and thresholds of residential LBTT have not changed (apart from a temporary COVID-related relief) since it replaced the UK-wide stamp duty land tax in Scotland in 2015–16. But freezing thresholds for a decade is a big real-terms reduction, again making the tax bigger (and therefore more damaging) over time: the resultant fiscal drag means that 64% of housing purchases were above the £145,000 threshold for paying the tax in 2023–24, up from 47% in 2015–16, and the number subject to the 12% top rate trebled in that time – still to only 1.2% of transactions, but accounting for 23% of revenue from residential LBTT (excluding the ADS).¹⁴

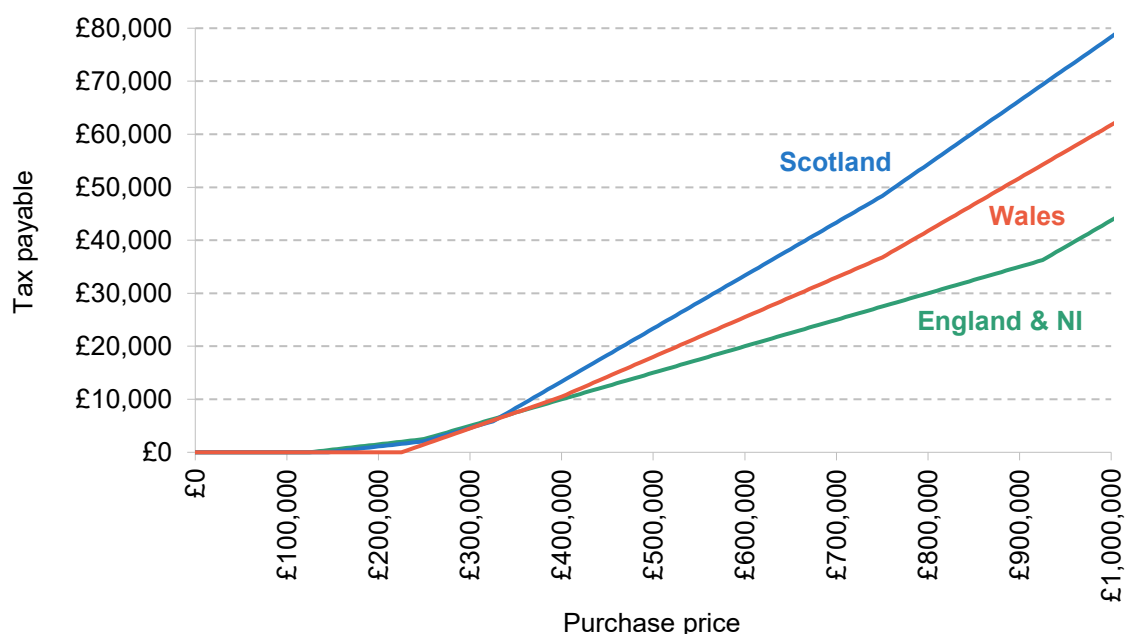
As with other taxes, Scotland’s tax on housing transactions is more progressive than that in England and Northern Ireland.¹⁵ Purchases above £333,000 are taxed more heavily in Scotland than in England or Northern Ireland (see Figure 2.5), and purchases below that level are taxed less – unless they are first-time purchases (since Scotland’s discount for first-time buyers is less

¹⁴ Source: Revenue Scotland, LBTT monthly statistics, December 2024, <https://revenue.scot/news-publications/publications/statistics/monthly-lbtt-statistics>.

¹⁵ Wales’s equivalent tax, land transaction tax, is lower than Scotland’s for both low-value and high-value properties, as shown in Figure 2.5.

generous than that in England and Northern Ireland) or second/rental properties (since Scotland’s supplementary tax on such purchases is higher).

Figure 2.5. Tax on residential property transactions, 2025–26



Note: Rates shown apply where the buyer is not a first-time buyer and does not have another residential property.

2.3 Conclusion

The Scottish Government’s Tax Strategy makes the right noises on a range of issues – notably on policy appraisal and evaluation, and the consideration of tax policy in the round – and should be welcomed in the context of the lack of such a document covering taxation as a whole at the UK level. It goes beyond the usual refrain of ‘more devolution, please’ to say something at least about policymaking for taxes already devolved to the Scottish Government.

However, as explained in this chapter, the published Tax Strategy is more of a framework and plan for the tax policymaking process, building in worthy commitments to engagement and evidence-gathering, rather than a strategy for tax policy or administration. With little over a year until the next Scottish election, the current Scottish Government may feel unable to set out more concrete medium-term plans. Whoever is in government in Scotland following the 2026 election should publish a strategy early in its term of office that does set a clear direction for policy for the rest of the next Parliament.

It is also notable that, with the exception of changes to income tax bands, the policies officially announced in the 2025–26 Budget seem somewhat divorced from the Tax Strategy. There is

nothing in the Tax Strategy that helps us to understand and evaluate the increase in LBTT, for example. Indeed, it is not clear that that policy is consistent with any economically rational tax strategy.

Tax policy in the 2025–26 Budget did, though, largely follow the patterns of recent years, with increases in income tax for high-income taxpayers, further differentiation of business rates bills for different types of ratepayers and another rise in LBTT on purchases of second and rental homes. The Tax Strategy unfortunately does not provide much clarity on the extent to which this will continue to be this Scottish Government’s approach in 2026–27 and – if it wins the 2026 Scottish election – beyond.

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3. Scottish council tax: ripe for reform

Stuart Adam, David Phillips and Sam Ray-Chaudhuri

Council tax is levied on the occupiers of residential property to help fund the provision of local services. Individual Scottish councils set the tax rates for their area, but it is the Scottish Government that determines the tax base to which the tax rates apply. With properties still assigned to tax bands based on an assessment of how much they were (or would have been) worth in April 1991, this tax base is now over a third of a century out of date. The tax rates are a lower share of property value for high-value properties: the tax is regressive with respect to property value. And a range of discounts and exemptions distort the usage of residential property, in particular contributing to both the overcrowding and the underoccupation of property. Revaluation and reform of council tax could improve the fairness and efficiency of Scotland's tax system, especially if combined with reforms to Scotland's other property taxes. With a process of stakeholder engagement on reform of council tax set to take place this year, it is an opportune time to consider the options and potential impacts on different types of Scottish households.

This chapter of our Budget Report sets out the case for revaluing and reforming Scotland's council tax, analyses the potential impact of two example reforms on different types of households, and discusses a number of practical considerations for a successful reform, such as transitional arrangements and legislation for regular future revaluation.

Key findings

1. The Scottish Government reformed council tax in 2017 to make it less regressive, but failed to tackle the most obvious problem with the tax: the lack of a property revaluation since its introduction over 30 years ago. In the intervening years, the values of different properties have increased by vastly different amounts. Properties now worth similar amounts can face bills that differ by hundreds of pounds because they used to be worth different amounts in 1991; conversely, those now differing in value by hundreds of thousands of pounds can face the same tax bill. This is unfair and we estimate that over half of properties are now effectively in the 'wrong band', in the sense that if the

same number of properties were in each band but based on current rather than 1991 values, over half would be in a different band. Revaluation would address this.

2. Wider reform could further improve the fairness and efficiency of the tax. Despite the 2017 reform, council tax is still highly regressive with respect to property value. If the Scottish Government wanted to continue to make the overall tax system more progressive, doing so through council tax would have less-damaging effects on work incentives, tax avoidance and migration than doing so through income tax. Reforming the single person discount could also remove a distortion that currently makes it cheaper for single-adult households, and more expensive for multi-adult households, to live in higher-band properties – which contributes to both underoccupation and overcrowding.
3. Updating the allocation of grant funding to councils would be vital alongside council tax revaluation and reform if tax bills across Scotland were to fully reflect the reformed system. In the absence of any redistribution of grant funding, if councils wanted to maintain their spending they would each need to raise as much council tax as now, and so levy the same average tax bill. In that case, revaluation and reform would redistribute bills between households within council areas (e.g. within Edinburgh) but not across council areas (e.g. between Edinburgh and Glasgow).
4. If properties were revalued for council tax on a revenue-neutral basis and grant funding redistributed accordingly, we estimate that around 60% of households would see little change to their net bill – those whose band did not change and/or whose bill was covered by the means-tested council tax reduction scheme (CTRS). Roughly equal numbers would see increases and decreases, with an estimated 11% seeing a cut of over £200 per year and 11% seeing an increase of over £200. The average change in bill would be close to zero at all income levels, although a higher share of low-income households would see no change to their net bill due to the CTRS.
5. Making council tax less regressive with respect to property value would, on average, reduce bills for lower- and middle-income households and increase them for higher-income households. Under a system where tax rates were proportional to the (up-to-date) median property value in each band, for example, households in the poorest four-fifths of the income distribution would see their bills fall by £56 a year on average (with the biggest reductions for the second-poorest fifth). The top fifth would see an increase of £227, on average. More households would see their bills cut than increased, but there would be more very large increases than cuts: for example, while 6% would see a cut of at least £500, 10% would see an increase of at least £500.

6. We would expect changes in a property's annual council tax bill to be reflected to a large extent in changes in the property's value. The winners (losers) from falls (rises) in council tax bills would therefore primarily be the existing owners of properties at the time any reform is introduced, rather than whoever is living in them and actually paying the council tax bills in subsequent years (who would face lower (higher) tax bills but have to pay correspondingly more (less) for the property).
7. The Scottish Government could phase in any changes – particularly more radical ones – using a transitional relief scheme. It could also consider a scheme to allow the 'asset-rich, cash-poor' to defer the payment of part of their bills (with interest) until they sell their property or die, or some other time limit (e.g. 10 years). Such schemes operate in Ireland, and British Columbia in Canada, and have been used in the UK to help people defer the cost of residential care home fees.
8. The Scottish Government should follow Wales's lead and legislate for regular future council tax revaluations to reduce the risk of another third of a century (or more) passing before the issue is tackled again. Advances in computing mean it is now quicker and cheaper to revalue properties than it used to be, making regular revaluations more practical.

3.1 Council tax and the case for reform

The Scottish Government shares control of council tax policy with Scottish councils. Broadly speaking, the Scottish Government determines the structure of the tax, while councils set the overall tax rate in each of their areas. As will become clear below, there is significant room for improving the design of this tax. But while the current Scottish Government committed to reforming council tax in its 2021 election manifesto (Scottish National Party, 2021), no concrete proposals for reform currently exist. Hopefully that may change soon: in line with a commitment in the Tax Strategy published alongside the 2025–26 Scottish Budget (Scottish Government, 2024a), on 11 February the Scottish Government announced a programme of engagement aimed at 'building consensus on council tax reform' (Scottish Government, 2024b). Expert independent analysis will be commissioned (including modelling of alternative reform options), followed by a formal public consultation, public events and stakeholder discussions later this year, and finally 'a Scottish Parliament debate on the findings and proposed policy reforms'. This is a promising development, and we hope that the analysis presented in this chapter is a useful contribution to the process. But it will fall to whoever is in office after the 2026 Scottish election to decide whether to go ahead with any reform.

How is council tax currently structured? And what types of reforms should be made?

What is council tax?

Council tax is levied on the occupiers of residential property and is collected and retained by councils to help fund the services they provide (although Scottish Government grants provide the majority of funding for these services). It is set to raise £3.0 billion in 2024–25, roughly equal to the amount raised by business rates, and approximately 19% of councils' general funding for day-to-day (resource) spending (Scottish Government, 2024c).

The amount of tax due on a property depends on:

- the tax band a property is placed in (from A to H), which in turn depends on its assessed value as of April 1991, which is determined by regional valuation boards;
- the tax rate set by the council covering the area it is located in; and
- whether the occupier is entitled to an exemption or discount or must pay a premium over the standard rate as a result of rules set by the Scottish Government or local council.

Table 3.1 shows each band's 1991 property value thresholds, share of properties across Scotland as a whole, and associated tax bill based on the average tax level set by Scottish councils. The bill for a property in band A is 67% of the bill for a band D property, while the charge for a property in band H is 245% of the bill for a band D property. A majority of properties (58%) are in the bottom three bands, A to C, while only a relatively small fraction are in the top three bands, F to H (14%).

Table 3.1. Scottish council tax bands and bills, 2024–25

Band	1991 value range	Share of properties	Tax rate relative to band D	Standard gross tax bill, Scotland average
A	Up to £27,000	19.1%	0.667	£945
B	£27,001 to £35,000	22.3%	0.778	£1,103
C	£35,001 to £45,000	16.3%	0.889	£1,261
D	£45,001 to £58,000	14.0%	1.000	£1,418
E	£58,001 to £80,000	13.9%	1.314	£1,863
F	£80,001 to £106,000	8.4%	1.625	£2,304
G	£106,001 to £212,000	5.4%	1.958	£2,777
H	Above £212,000	0.6%	2.450	£3,474

Source: Share of dwellings in each band and average bills calculated using data from <https://www.gov.scot/publications/council-tax-datasets/>.

Exemptions are provided for, among other things, properties solely occupied by students and care leavers aged 18–26, properties that have been repossessed, and properties usually occupied solely by someone currently receiving care in a hospital or care home or living elsewhere to provide care to another person. Discounts are provided for properties with only one taxable adult in residence ('taxable adults' excludes, for example, students, care leavers, and certain care givers and recipients) and those whose home has been adapted to meet needs due to a disability. Discounts generally take the form of a percentage discount off the standard bill applicable to a property in a given tax band, but the disabled person discount reduces the bill on a property to that applicable to the next tax band down. Means-tested reductions in bills are also provided to those with low incomes and savings.

Why revaluation and reform of council tax are needed

There are a number of significant shortcomings with the current design of council tax.

First is the use of outdated 1991 property values – now over a third of a century old – to assign properties to tax bands. This poses practical difficulties for the valuation of new properties by regional valuation boards, who must assess what they would have been worth in 1991. That may be particularly difficult in residential areas that did not exist in 1991: how do you value properties in what was a polluted industrial estate back in 1991, but is now a landscaped and leafy housing estate?

More fundamentally, the use of out-of-date valuations creates unfairness across households. The unfairness is not because property values have increased so much nationally over the last 34 years: if properties were revalued, the property value thresholds between bands could be reset to account for this. Instead, it is because the values of different properties have changed so differently over the last third of a century – some increasing by much more, and others much less, than average. As a result, two households living in equally valuable properties, receiving the same services from the same council, can have different tax bills because one property was worth more than the other 34 years ago. We would not calculate people's income tax based on the relative salaries of their jobs 34 years ago: salaries for different jobs have changed in different ways over the intervening period. The values of different properties have also changed in different ways over the last 34 years, yet Scottish council tax is still based on relative values 34 years ago.

Second, the banded structure of council tax means that two properties on either side of a band cut-off can attract very different tax liabilities: 31%, or almost £450 on average a year, higher at the bottom of band E than at the top of band D, for example. Again, this means households living in very similar properties can face very different tax bills. Conversely, two properties at opposite ends of the same band attract the same tax liability. This is particularly acute in extreme cases: all band H properties in a council area attract the same tax regardless of whether they

were worth £212,000 (in 1991) or were multi-million-pound mansions. There may be practical arguments in favour of a banded system, but it has undoubted drawbacks.

Third, council tax is regressive with respect to property value, by design. The tax levied on a band H property is 3.675 times higher than that levied on a band A property in the same council area, despite band H properties' being worth (in 1991) at least 7.85 times more than band A properties, and in many cases much more than that.

Regressivity of an individual tax is not necessarily a problem: while most people would agree that the tax and benefit system as a whole should be progressive, that does not mean every individual tax needs to be. For example, tobacco duties are highly regressive (because poorer households spend a bigger share of their budgets on cigarettes, on average), but they are widely regarded as fair. Their purpose is to discourage smoking by raising its price, rather than to redistribute between richer and poorer households.

Council tax is not trying to encourage behaviour change like tobacco taxation (or alcohol or fuel taxation). It is simply attempting to reflect one aspect of households' ability to pay – the value of their housing wealth or consumption – and if we want to levy higher tax rates on those with more resources in general then it seems odd to levy lower tax rates on those with more of one particular resource (housing) as the current regressive structure does.¹⁶ Moreover, the fact it is harder to hide or move housing than it is to hide or move incomes means that combining a regressive council tax with a progressive income tax is likely to increase the economic distortions and costs of redistribution. Even if one did not want to increase the progressivity of the overall tax system, there is a case for making council tax less regressive (and other parts of the tax system, such as income tax, less progressive) to redistribute more efficiently.

The Scottish Government has already made its council tax less regressive than the system it inherited from the UK government, as discussed in Box 3.1. However, a further reduction in regressivity consulted upon in 2023 was shelved, and no other specific proposals have yet been forthcoming from the Scottish Government. It remains to be seen whether the newly announced process of engagement described above will be followed by further reforms.

¹⁶ On the argument that council tax should be seen as a 'benefit tax' related to households' use of council services, see section 2.3 of Adam et al. (2020a).

Box 3.1. 2017 and aborted 2023 reforms to council tax in Scotland

Prior to April 2017, the relative rates of tax applied to different council tax bands in Scotland were the same as in England, with band A properties facing two-thirds of the tax of band D properties and band H properties twice the tax of band D properties. At that point, the Scottish Government increased the relative tax rates for band E properties by 7.5%, band F properties by 12.5%, band G properties by 17.5% and band H properties by 22.5%, to the relative rates shown in Table 3.1. The aim of this was to raise revenue in a progressive manner. To avoid increasing bills on asset-rich, cash-poor households, those living in affected properties whose income was below certain thresholds were – and still are – able to claim council tax reductions to reduce bills to what would apply under the old tax relativities. These thresholds are currently £16,750 of net income for single adults without children and £25,000 of net income for all other households.

In 2023, the Scottish Government consulted on going further in this direction in 2024–25, with further increases of 7.5–22.5% in the relative tax rates applied to band E–H properties, capping increases in any one year at 7.5% (Scottish Government, 2023). This would have increased the relative tax rate on a band H property to 3 times that on a band D property and 4.5 times that on a band A property. It was estimated that this would raise an addition £176 million, before accounting for any increase in the cost of the special means-tested support for asset-rich, cash-poor households.

An analysis of consultation responses published by the Scottish Government (2024d) found that only 4% of respondents approved of the plans, which may reflect the fact that around 90% of respondents listing a council tax band were in bands E–H, compared with 28% of all households in Scotland. In the end, the potential reforms were shelved, with the Scottish Government instead providing councils with additional grant funding conditional upon them agreeing a council tax freeze.

Finally, a less commented-upon issue with the current design of council tax is that it distorts who lives in which properties. Sometimes this is deliberate, such as recently-granted powers to levy premiums of up to 100% on second homes, which are designed to limit the number of properties being used as second homes to increase the supply of properties for use as primary residences. In other cases it may be unintended and potentially contradictory to wider policy aims.

For example, the single person discount, which operates as a 25% discount on the council tax bill, is worth more in cash terms for higher-band properties. This makes it cheaper for single-adult households, and more expensive for multi-adult households, to live in higher-band (typically larger) properties than would otherwise be the case. Thus the single person discount contributes to both the underoccupation of homes (by single-adult households) and the overcrowding of homes (by larger households). Alternative policy designs (such as discounts that do not depend on the band a property is in) would avoid this problem.

3.2 What impact would revaluation and reform have on households?

Modelled reforms and key modelling assumptions

Revaluing properties should be part of any reform to council tax. How far to go in making council tax less regressive, and how to reform exemptions, discounts and premiums, is more debatable. It is beyond the scope of this chapter to consider the impact of multiple options, depending, for example, on the Scottish Government’s distributional aims. To illustrate the potential pattern and scale of changes in bills, we consider the impact of two reforms that might be considered minimal and major reforms:

- A **pure revaluation**, whereby properties are revalued and placed in eight bands (A to H) based on these revised values, with band thresholds set so that, across Scotland, the same shares of properties are in each band as now.
- An **eight-band proportional system**: as above, but with the tax rates applied to each band then adjusted so that the tax is proportional to the median value of a property in the band.

We have previously undertaken similar analysis for England and Wales, looking at how impacts vary across neighbourhoods and council areas and across households with different characteristics (Adam et al., 2020a and 2020b; Adam, Phillips and Ray-Chaudhuri, 2023). The geographical analysis there used data on property transactions and characteristics which are freely available for England and Wales but not Scotland, so we do not replicate that geographical analysis for Scotland. The household-level analysis used household survey data which are available for Scotland, allowing us to replicate that type of analysis. Methodological information on how we do this is provided in Appendix 3A.

We model the effect of our two example reforms under the assumptions that councils keep spending on local services, and the Scottish Government keeps aggregate grant funding to councils, the same as they would be in the absence of reform. To keep total revenue and spending the same, this implies that the council tax reforms are revenue-neutral across Scotland as a whole – meaning that the average council tax bill across Scotland as a whole does not change either. The reforms need not be revenue-neutral for individual councils, which might see different numbers of properties moving up and down bands, and so increases or decreases in average bills compared with pre-reform for a given tax rate.

In addition, broadly speaking, our modelling assumes that the Scottish Government would redistribute grant funding between councils to account for the fact that the amounts they could raise under the reformed systems for a given tax rate (their ‘tax base’) would change

differently.¹⁷ This redistribution of grant funding would be vital for ensuring that any council tax revaluation and reform redistributes from council areas where values are higher and/or have increased by more than average since 1991, to council areas where values are lower and/or have increased by less than average. If grant funding were not adjusted, and if councils wanted to maintain their spending following reform, they would each have to raise the same amount of council tax revenue as presently. This would mean charging their residents the same average council tax bill after revaluation and reform as before. Thus a council seeing a fall in its tax base would have to set a higher band D rate to offset this fall and leave average tax bills unchanged, and vice versa. In that case, revaluation and reform would still lead to a big redistribution of tax bills across individual households within a council area (e.g. within Edinburgh), but it would not redistribute tax bills across council areas (e.g. between Edinburgh and Glasgow). The grant funding the Scottish Government provides to councils currently takes account of their existing council tax bases, so it would be natural to account for changes in tax bases as a result of any reforms to council tax.

Impacts on household bills

Figure 3.1 shows the proportions of households that would see their net council tax bill rise or fall by different amounts under the two reforms. A pure revaluation would see net bills change by less than £50 per year for 59% of households in Scotland. This reflects the fact that we estimate 43% of properties would remain in the same band¹⁸ (and see little or no change in their gross bill) and the fact that low-income households often have their bills covered in full or part by the means-tested council tax reduction scheme (CTRS) (and see little or no change in their net bill even if their gross bill changes). Similar numbers of households would see their bills go up and go down, with the changes for the vast majority being less than £500 per year. A small group of households, either moving more than one band or in one of the higher bands (where even moving one band can see an increase or decrease of at least £500), would see their bills change more significantly.

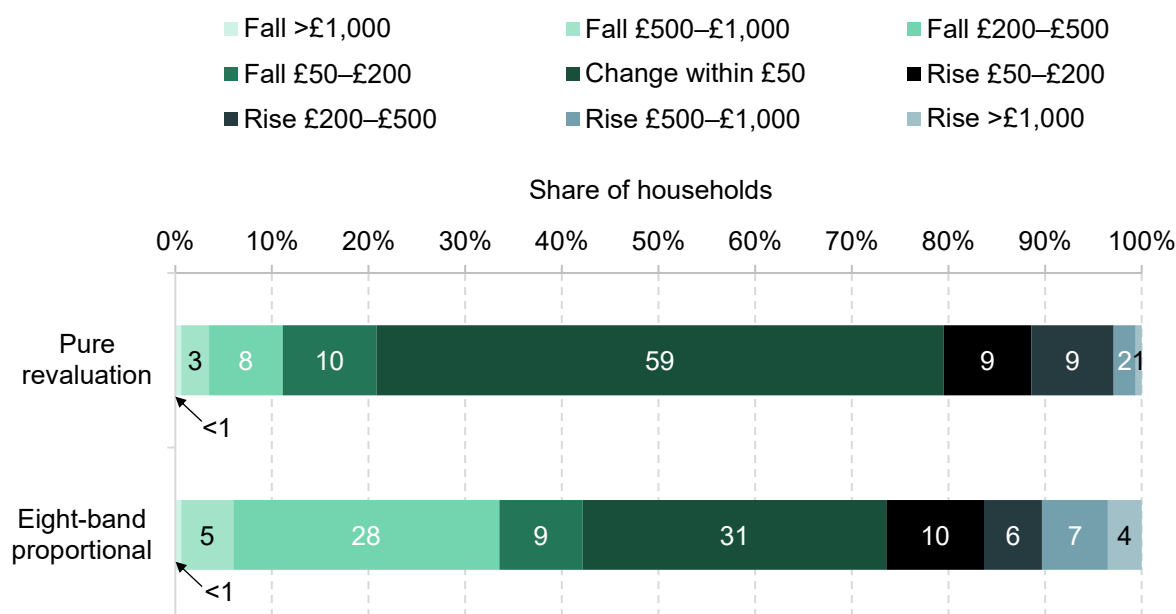
Under a system with proportional tax rates, 42% of households' bills would fall by at least £50 per year, with the majority of these seeing much bigger falls (at least £200 per year), compared with 26% seeing an increase of at least £50 a year. But more households would face very large increases in their net bills than very large reductions: 10% of households would see bill increases of £500 per year or more, versus 6% seeing reductions of that size. For comparison, only 3% of households would see bill increases of £500 or more under a pure revaluation. Thus while

¹⁷ See the methodology appendix for why our modelling is broadly but not precisely consistent with this assumption.

¹⁸ Since the total number of properties in each band would stay the same, roughly equal numbers would move up and down bands – just under 30% of properties in each direction.

moving to a proportional system would mean lower bills for a larger number of households, this would be paid for by bigger increases on a relatively small number of high-value properties.

Figure 3.1. Distribution of changes in net council tax bill



Note: Assumes full take-up of CTRS. Incomes are measured after taxes and benefits but before housing costs are deducted, and are adjusted for household size and composition using the modified OECD equivalence scale.

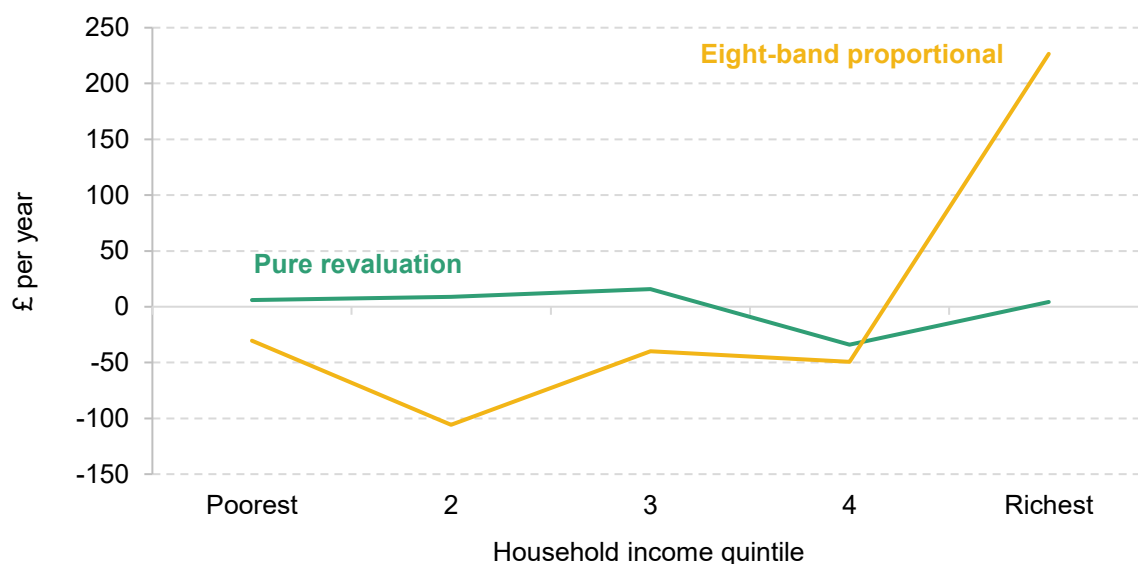
Source: Authors' calculations using Understanding Society waves 7–10 and TAXBEN, the IFS tax and benefit microsimulation model.

While council tax is a property tax, property wealth is correlated with income, and so adjustments to regressivity with respect to property values lead to changes in regressivity of the tax with respect to income. Figure 3.2 shows the average impact of our two example reforms on net council tax bills by household income quintile (i.e. for each fifth of the household income distribution).

A pure revaluation, which updates property valuations and band thresholds but does not alter tax rates, would have little systematic effect on households at different income levels. Figure 3.1 showed that many households would see their bill change under such a reform, but at each income level there would be similar numbers of households moving up and down bands – meaning little effect on overall (income) regressivity of the tax. That said, there are significant differences across income quintiles in the proportion of households that would see substantial changes in their bill. Just 5% of households in the poorest income quintile would face a change (rise or fall) in their net bill of £200 or more per year, compared with 42% of households in the richest income quintile. In general, the proportion of households whose bill would change by at least £50 per year is higher among richer sections of the population. One reason for this is that

poorer households are more likely to have their bill covered by the means-tested CTRS and therefore pay no council tax regardless of whether they move band.

Figure 3.2. Average change in net council tax bill, by quintile of household income



Note: Assumes full take-up of CTRS. Households are allocated to quintiles based on income measured after taxes and benefits but before housing costs are deducted, and are adjusted for household size and composition using the modified OECD equivalence scale.

Source: Authors' calculations using Understanding Society waves 7–10 and TAXBEN, the IFS tax and benefit microsimulation model.

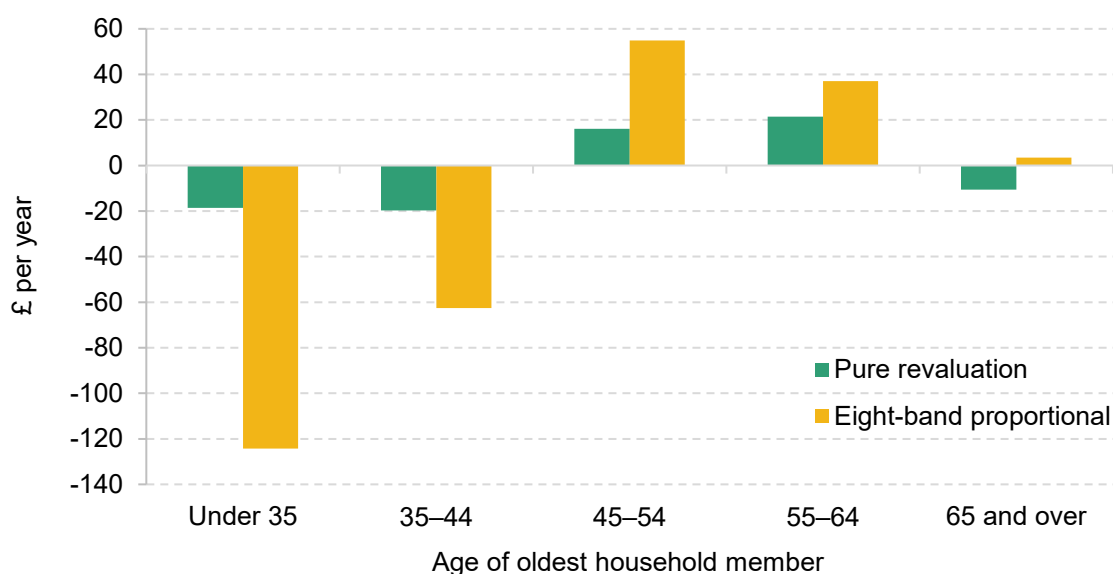
Under an eight-band proportional system, the tax rates on bands A–C would be lowered relative to band D whereas the tax rates on bands E and above would be increased. This would lead to falls in average bills for households in the bottom four-fifths of the income distribution, but much bigger increases for the richest fifth. Low- and middle-income households tend to live in lower-value (and hence lower-band) properties and so would benefit most from the reduction in relative tax rates. Despite this, the poorest income quintile would see smaller average reductions in net council tax bills than the second-poorest income quintile. As discussed above, this is because many of these households already have their council tax bill fully or partly covered by CTRS.

Figure 3.3 shows the impact of our two indicative reforms by the age of the oldest household member.¹⁹ A pure revaluation would have little effect on the average bills of each group,

¹⁹ The Understanding Society survey we use for this analysis underweights younger households compared with other data sources such as the Labour Force Survey and the Family Resources Survey. This may affect our estimates of the average increases and decreases in bill by age group (and other characteristics strongly correlated with age), but the overall patterns above will be robust to this issue. In future work, we will explore methods to address this underweighting.

reflecting the fact that within each age group, similar numbers of households would move up and down bands. By contrast, an eight-band proportional system would lead to falls in average bills of £124 per year for households where all adults are under 35 years old and of £63 per year for households where the oldest adult is aged between 35 and 44. Older working-age households tend to live in more valuable properties, and so would see their bills increase on average. For households with a pensioner, though, the average bill would remain approximately unchanged.

Figure 3.3. Average change in net council tax bill, by age of oldest household member



Note: Assumes full take-up of CTRS. Incomes are measured after taxes and benefits but before housing costs are deducted, and are adjusted for household size and composition using the modified OECD equivalence scale.

Source: Authors' calculations using Understanding Society waves 7–10 and TAXBEN, the IFS tax and benefit microsimulation model.

Likely impacts on property values

Because property prices are determined by the supply of and demand for housing, changes in council tax bills would be expected to be reflected over time in properties' market values. Properties that see a fall in their council tax bills would be expected to rise in value, whilst those that see a rise in their bills would be expected to fall in value, in a process called capitalisation.

Economic theory suggests that tax changes will be highly capitalised into property prices where housing supply is relatively unresponsive to property prices (Oates, 1969), as it is in the UK (Caldera Sánchez and Johansson, 2011; Drayton, Levell and Sturrock, 2024). Studies also find that local public goods provision – the corollary to local taxes – is highly capitalised into property prices in the UK; see, for example, Hilber, Lyytikäinen and Vermeulen (2011) on grant funding and Gibbons and Machin (2008) on school quality. Many studies on other countries have also found nearly full capitalisation of property taxes (Capozza, Green and Hendershott,

1996; Palmon and Smith, 1998; Høj, Jørgensen and Schou, 2018).²⁰ There is therefore strong empirical backing for the theoretical prediction that property prices would be affected by changes to property taxes such as council tax.

It is important to note that people whose bill rises (falls) do not lose (gain) twice over, from both the increase (fall) in their tax bill and the fall (increase) in the value of their property. On the one hand, if they continue living in the property indefinitely, they lose or gain as a result of the change in their tax bill; on the other, if they sell and move, they lose or gain as a result of the change in their property value. However, capitalisation does mean that it is the owner of a property at the time of revaluation and reform who loses or gains: future purchasers will pay less (more) for the property if the tax bill associated with it is higher (lower).

Bearing this in mind, our analysis of potential changes in bills suggests that a pure revaluation would have little effect on average property values across the property value distribution. This is because, for properties of a given value, a revaluation would lead similar numbers to move up and down bands, with little effect on average bills and therefore average property values²¹ – though individual properties could still change a lot in value (as we saw that many would see substantial changes in bills). In contrast, under the introduction of a proportional system, the lower (higher) tax bills on lower- (higher-) value properties would lead to rises in the value of lower-valued properties and falls in the value of higher-valued properties, on average. The scale of these changes is uncertain, though, and would depend on how potential property buyers value changes in council tax bills in future years (technically, their ‘discount rate’).

3.3 Wider policy considerations

As well as consideration of the impact of different reform options on household bills and property values, reforming council tax will also require consideration of a number of other practical and legislative issues.

Choice of number of bands

Adding more bands would allow for a more fine-grained relationship between property value and tax liability. It would also reduce the width of bands and the scale of jumps in bills at tax band thresholds, which cause unfairness. Indeed, in principle, it would be best to move away from a banded system altogether, levying the tax as a percentage of the exact property valuation, as many other jurisdictions (including Northern Ireland) do.

²⁰ For a literature review, see Hilber (2015).

²¹ We did not show changes in average bills by property value above, but the patterns are similar to those for the changes in average bills by income shown in Figure 3.2. Details available from the authors on request.

In its consultation on reform in Wales, the Welsh Government claimed that having a relatively small number of wide bands would make valuation easier (ultimately, all that would matter is which one of a few bands a property is in) and reduce the number of appeals. But when it comes to appeals, in principle the effect is ambiguous, as giving properties more precise valuations might leave more people believing their valuation was wrong but would also avoid such big jumps in tax liabilities across bands and leave appellants more exposed to being moved up rather than down, reducing the incentive to appeal.

At the very least, the Scottish Government should consider adding a couple more bands at the bottom and the top if it wanted to make council tax meaningfully less regressive.

Transitional arrangements and mitigation measures

As shown above, any reform of council tax would mean losers as well as winners. Particularly if council tax were made substantially less regressive, some losers (in high-value properties) would see large increases in their bills. And while substantially more would see reductions in bills than would see increases, especially among low- and middle-income households, there would be some low- and middle-income households in high-value properties (or properties moving up multiple bands) seeing large increases in bills.

Transitional arrangements – phasing in large changes in bills over several years – could help provide time for households to adjust to higher bills. An expanded CTRS could also provide support to those with low-to-middle incomes and low financial assets. The Scottish Government’s 2023 consultation proposed both such measures if further increases in band E–H bills were implemented.

Perhaps a better option to support those above standard CTRS income thresholds who own their own homes (and are therefore ‘asset-rich’) would be to allow them to defer their council tax for a period of time – for example, until sale of the property, death or 10 years, whichever is soonest. This would, in effect, be a loan of the tax liability from the Scottish Government or councils to households. Crucially, any deferral should apply with (at least) a market interest rate on the deferred liability – as happens in Ireland and in British Columbia, both of which operate such a scheme – so that households are not encouraged to defer payment unless they need to, and the Scottish Government and councils do not lose out financially from deferring the bill.²²

Legislate for subsequent revaluations

To avoid finding itself in a similar situation another 34 years down the line, the Scottish Government should also bring forward legislation for regular revaluations in future, as the

²² See box 7.1 of Adam et al. (2020a) for further discussion of the design of such a deferral scheme.

Welsh Government did in the Local Government Finance (Wales) Act 2024.²³ After setting out an initial revaluation in April 2028 in primary legislation, this Act sets a default period between subsequent revaluations of five years, but allows Ministers to bring forward or push back revaluations. There would be a case to change both these elements in Scotland (and indeed Wales). For example, three-yearly revaluations and/or updating valuations in line with local property price indices in between full revaluations would not only ensure council tax more accurately reflected contemporaneous property values, but probably also lead to smaller changes in valuations and hence bills, and help make the process be seen as routine rather than a potentially controversial special event. The administrative costs of more frequent revaluations should be lower now that they are mostly based on computer modelling rather than manual assessments. Putting the revaluation cycle into primary legislation would also give households, councils and valuation boards more certainty, and reduce the temptation for Ministers to delay revaluations for reasons of short-run political expediency, which can become a bad habit.

3.4 Conclusion

Scottish council tax is ripe for revaluation and reform. Revaluation would not reduce the regressivity of council tax overall, but would mean that the tax rates applied to different properties reflected their current relative values, not those from over a third of a century ago. Wider reform could, if the Scottish Government chose, reduce the regressivity of the tax, and help to make it more efficient by, for example, reforming the single person discount. And packaging reforms to council tax with reforms to Scotland's other property taxes – business rates and especially land and buildings transaction tax (LBTT) – could improve the fairness and efficiency of the overall tax system. Raising less from high-value properties via LBTT and more from a revalued-and-reformed council tax would be fairer and better for growth and well-being: fairer because the tax system would no longer penalise people who move more (via LBTT), or whose property's value has not kept pace with the rest of the country (via council tax); and better for growth and well-being because it would no longer hinder people from moving for work or to better suit their circumstances.

After aborting previous plans for council tax reform consulted on in 2023 (which in any case ducked the vital issue of revaluation), the Scottish Government has now announced a new programme of engagement on reform this year. It should use that engagement to make the case for revaluation, reform and legislation to keep council tax up to date in future.

²³ See <https://law.gov.wales/local-government-finance-wales-act-2024>.

Appendix 3A. Council tax analysis methodology

To undertake our analysis, we use data from four consecutive waves (waves 7–10) of Understanding Society, a representative household panel survey. This covers households interviewed between 2015 and 2019. Since it is a panel, there are some households that appear more than once, although we treat each household–wave observation individually. This gives us an initial sample of 7,440 household observations in Scotland.

In order to model reforms to council tax at the household level, we need (a) up-to-date property values, (b) current council tax bands and (c) council tax liabilities, taking into account council-specific tax rates, eligibility for discounts and exemptions (such as the single-person discount and student exemptions) and the CTRS. We abstract from empty home discounts, as our data only capture information on primary residences, and from disability-related discounts, which cannot be identified in the data. We are unable to model whether households meet asset requirements for CTRS due to a lack of information on assets in the Understanding Society data.

The process for deriving up-to-date property values is described in detail at the end of this appendix.

We use linked administrative data to determine households' current council tax bands. The Understanding Society data also contain self-reported council tax bands. However, we consider these to be less reliable than the council tax bands from the administrative data: they differ from the administrative data in around a third of all cases, and the distribution of self-reported council tax bands differs from the administrative data on all properties in Scotland. (Specifically, self-reports tend to overstate the share of properties in band D, which may reflect the fact that band D is the reference band and the band D rate is therefore often listed at the top of council tax bills.)

Administrative data are not available for 22% of the households in our data. In these cases, we use the households' self-reported council tax band. If we have no linked band or self-reported band, we impute their council tax band using their reported house value or rent, council and property characteristics. This is done using an ordered logistic regression, run separately for homeowners, private renters and social renters. For each tenure type, we regress administrative-linked council tax band on (log) self-reported house price or monthly rent (whichever is relevant), housing characteristics (house type interacted with number of rooms), location characteristics (rurality and Index of Multiple Deprivation (IMD) decile) and council dummies. We then randomly select a council tax band for those with missing values from the predicted probability distribution.

Because of the small sample size in Scotland, the imputation is done jointly for all of Great Britain, controlling for country and upper-tier council and allowing the effects of IMD deciles to differ by country (because they are separately defined). The results are robust to alternative imputation methods, including an ordered probit regression and nearest-neighbour matching based on reported house value or rent, dwelling type, upper-tier council (in England, where some areas have two tiers of local government) and the number of rooms.

Table 3A.1 shows the distribution of council tax bands using different data sources. It shows that the distribution of council tax bands in Understanding Society (USoc), using linked administrative data and including imputations (row 4), closely matches the distribution of council tax bands in Scotland as a whole (row 1). We then further reweight our data so that they match exactly the distribution of council tax bands in the full administrative data. The final sample closely matches the (representative) overall USoc sample in terms of the distributions of income, local area deprivation (IMD), age of oldest household member and household size. That said, the distribution by age of oldest household member differs from the distribution in other data sources (Labour Force Survey and Family Resources Survey), with fewer younger households.

Table 3A.1. Distribution of council tax bands in different data sources (%)

Data source	Council tax band							
	A	B	C	D	E	F	G	H
1. All Scotland	20.8	22.8	16.1	13.5	13.5	7.8	5.0	0.5
2. USoc: self-reported	14.4	24.0	13.8	18.4	11.6	8.4	6.7	2.6
3. USoc: admin	17.9	23.2	16.3	12.3	14.5	9.4	6.0	0.3
4. USoc: admin with imputations	18.6	22.7	15.5	13.8	13.4	9.1	5.9	0.9
5. USoc: final, reweighted	20.8	22.8	16.1	13.5	13.5	7.8	5.0	0.5

Note: All Scotland figures are for 2019. USoc figures are weighted using sample weights.

Source: Scottish Government (via statistics.gov.scot) and Understanding Society waves 7–10.

To calculate council tax liabilities, the impacts of reforms are modelled using the IFS tax and benefit microsimulation model, TAXBEN. This contains council tax rates for each council, as well as information on the Scottish CTRS. We model reforms under the 2024–25 tax and benefit system, assuming that changes being phased in, such as the roll-out of universal credit, are fully in place.²⁴ This allows us to capture the long-run effect of revaluation and reform. We drop 1,608 households with incomplete information on incomes and household characteristics. We

²⁴ An exception is the two-child limit on benefit entitlements, for which we model the policy as it is in 2024–25.

drop a further 15 households for which we are unable to impute council tax bands. This leaves us with a final sample of 5,817 household observations in Scotland.

Assumptions on grant adjustment

As discussed in Section 3.2, the impact of revaluation and reform of council tax will depend crucially on whether grant funding from the Scottish Government to local councils is adjusted to reflect changes in the tax bases of different councils. We are unable to explicitly account for this as samples at the council level are too small to be properly representative. Instead, we adjust the council tax rates that all households in Scotland face by the same proportion so that reforms are revenue-neutral across Scotland as a whole. When tax rates are fairly similar across council areas, as is the case in Scotland, this approach will lead to estimates closer to what we would obtain if we were able to model full grant adjustment, rather than no grant adjustment.

Hedonic regressions for property values

The Understanding Society data contain self-reported property values for homeowners, which we uprate to 2024 Q3 using the council-level House Price Index for the appropriate dwelling type (detached, semi-detached, terraced, etc.). This leaves us needing to estimate property values for renters.

To do this, we regress property values for homeowners on property characteristics (dwelling type, number of bedrooms and other rooms, existing council tax band), location characteristics (council, rurality, population density, Data Zone deprivation levels²⁵) and household characteristics (income, household composition and demographics²⁶). The estimated coefficients from this regression are then used to predict property values for renters. Note that the aim of this exercise is to predict property prices as closely as possible, not to model the price of specific housing amenities – it is not a ‘hedonic regression’ in the traditional sense of the term. As such, characteristics that do not directly affect property values but are nonetheless predictive of property values, such as household income and the number of children in the household, are included in the regression.

²⁵ Based on deciles of specific components of the IMD: income, employment, housing, education and health.

²⁶ These include whether the household contains a couple, the number of adults, the number of children in different age groups, the highest qualification in the household, the age of the oldest household member and whether anyone in the household is in receipt of disability benefits or reports having a long-standing illness or disability.

Table 3A.2. Regression of log property prices: selected coefficients

Variable	Coefficient	Standard error
Dwelling type (ref: detached)		
Semi-detached	−0.0825***	(0.0176)
Terraced	−0.0877***	(0.0198)
Flats/Maisonettes	−0.259***	(0.0283)
Other dwelling type	−0.857***	(0.331)
Dwelling type unknown	−0.0185	(0.0249)
Number of bedrooms (ref: 1)		
2	0.222***	(0.0470)
3	0.344***	(0.0467)
4	0.433***	(0.0505)
5	0.569***	(0.0544)
6	0.948***	(0.0710)
7 or more	0.834***	(0.117)
Number of other rooms (ref: 1)		
2	0.101***	(0.0147)
3	0.195***	(0.0223)
4	0.255***	(0.0324)
5	0.350***	(0.0438)
6	0.183**	(0.0919)
7 or more	0.453**	(0.192)
Council tax band (ref: band D)		
A	−0.448***	(0.0382)
B	−0.304***	(0.0249)
C	−0.188***	(0.0224)
E	0.0772***	(0.0193)
F	0.170***	(0.0291)
G	0.353***	(0.0307)
H	0.488***	(0.0644)

Continues

Table 3A.2 continued

Variable	
Interview quarter	Yes
Household composition (couple; number of adults; number of children aged 0–2, 3–4, 5–11, 12–15)	Yes
Net household income	Yes
Demographics (highest qualification; age of oldest household member; self-reported disability or long-standing illness; disability-related benefits)	Yes
Location (rurality; upper-tier council dummies; population density and squared; Data-Zone-level deprivation deciles)	Yes

Note: *** and ** indicate statistical significance at the 1% and 5% levels respectively.

Source: Understanding Society waves 7–10.

The regression explains 75% of the variation in property values for homeowners in Scotland. Regression coefficients for the main characteristics are listed in Table 3A.2. Property prices are regressed in log form. To impute values for rental properties, a random error (drawn from the distribution of prediction errors among homeowners) is added to the predicted log property price, which is then converted back into pound values. This ensures we have an appropriate degree of variation in property values conditional on observed characteristics. To ensure that our results are robust to these random draws, we impute 20 property values for each household based on 20 randomly drawn error terms. The results we present are averages over all 20 imputations for each household.

It is possible that the approach of imputing property values for renters based on a regression for owner-occupiers could lead us to overstate (understate) the values of rented properties, if they are systematically less (more) desirable than owner-occupied properties with the same observed characteristics. This would in turn lead us to overestimate (underestimate) the council tax liabilities of households that rent after revaluation and reform. However, controlling for unobserved differences is difficult and beyond the scope of this chapter.

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4. Scottish school spending, teachers and pupil numbers

Luke Sibieta and Darcey Snape

At just under £8 billion, spending on schools and childcare is the second-largest area of public service spending in Scotland, behind spending on health. While councils rather than the Scottish Government itself determine how much to spend on schools, they do so in the context of a funding and policy environment shaped by the Scottish Budget.

Policymakers in Scotland face a number of major challenges. As a result of demographic change, the number of pupils is declining over the long run, which might make some schools uneconomical in the future. These trends appear even more challenging in rural and island areas. Recently, the Scottish Government has been seeking to maintain teacher numbers. In the long run, however, it might become increasingly expensive, and even unsustainable, to maintain teacher and school numbers as they are. Scotland's performance on international PISA tests has also been in decline, particularly in maths and science, and this has been ascribed to the introduction of the Curriculum for Excellence from 2010 onwards (Paterson, 2023).

With this context in mind, this chapter starts in Section 4.1 by describing trends in spending and spending per pupil, including comparisons with England. It then details trends in teacher and pupil numbers in Section 4.2. Section 4.3 describes the overall challenges and trade-offs facing policymakers in Scotland over the next few years, including for this and future Budget cycles. Section 4.4 provides a brief conclusion.

Key findings

1. Total spending on schools and early years education in Scotland increased by £1.7 billion or 27% in real terms between 2015–16 and 2023–24. Current plans for 2024–25 imply an effective real-terms freeze in total spending of just over £7.8 billion.
2. Spending per pupil in Scotland is about £10,100 in 2024–25, which is about 20% higher than the £8,400 per pupil level seen in England. This gap has widened from a difference of about 4% in 2009–10. Partly as a result of this higher spending, class

sizes tend to be smaller in Scotland, with a pupil–teacher ratio of about 13 in 2024 compared with 17–19 in the rest of the UK.

3. Whilst spending per pupil has risen much faster in Scotland (21%) than in England (5%) since 2009–10, the real-terms growth in total schools and early years spending has been remarkably similar at 20–21%. All of the faster growth in spending per pupil in Scotland reflects slower growth in pupil numbers (1%) compared with England (13%).
4. The Scottish Government has set out the goal of increasing teacher numbers by 3,500 to 57,100 by the end of this parliament. In reality, teacher numbers have fallen very slightly and the Scottish Government is currently 3,700 short of this goal. More recently, it has instead emphasised the importance of restoring teacher numbers to 2023 levels after they fell further in 2024.
5. Pupil numbers have fallen in recent years and are projected to fall by a further 12.5% from 2024 to 2040. As a result, pupil–teacher ratios have remained stable despite recent cuts to teacher numbers. If policymakers chose to freeze teacher numbers over the long run, then the pupil–teacher ratio in mainstream schools would fall from 14 to 12 by 2040, lower than at any point in recent history.
6. Alternatively, the fall in pupil numbers could offer councils a chance to make savings. If policymakers chose to freeze pupil–teacher ratios at 2024 levels, then teacher numbers could drop by 1,000, which would generate in-year savings of about £65–120 million by 2027. Cutting teacher numbers can be challenging in practical terms, however, as it requires reducing the number of classes or schools.

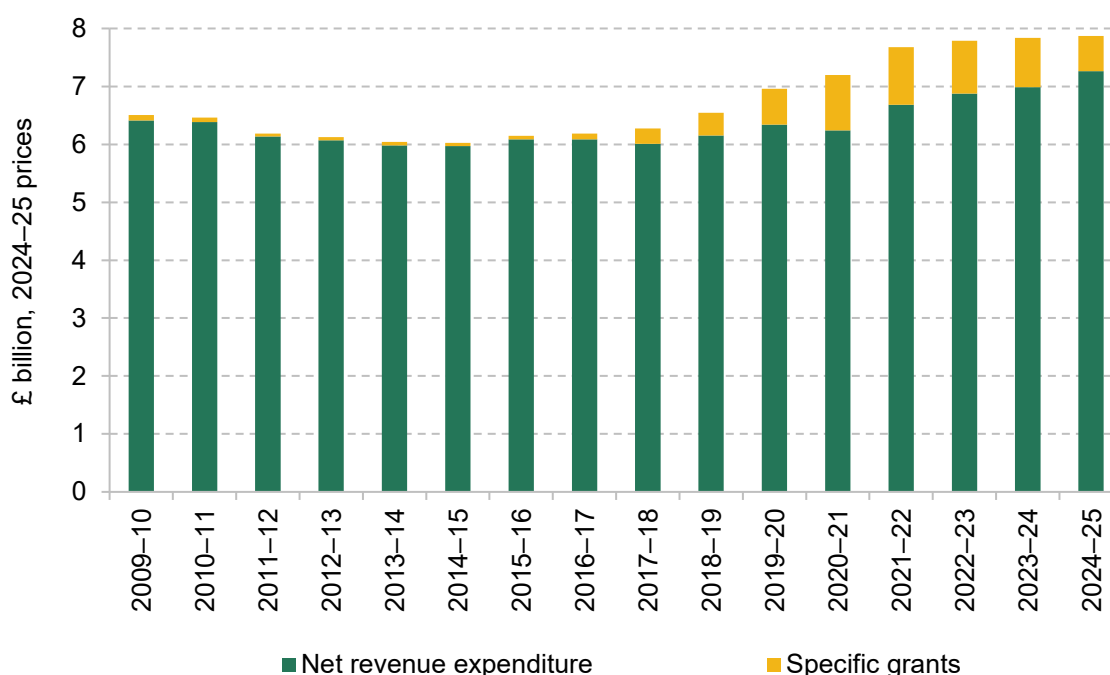
4.1 Schools spending

Spending on schools in Scotland is predominantly the responsibility of local councils. Indeed, it is the largest single area of council spending, comprising nearly half of net revenue expenditure by councils in Scotland. Councils also have a large amount of control over both the level and allocation of education budgets, with about one-third of expenditure centrally managed by councils and two-thirds devolved to individual schools. This contrasts with England, where over 90% of funding is devolved to schools, and Wales, where about 84% is devolved to schools (Jerrim and Sibieta, 2021).

Total spending

Figure 4.1 shows total school spending in Scotland between 2009–10 and 2024–25, including early learning and childcare to ensure consistency over time. Data for 2024–25 relate to planned spending, which could be changed before the end of the year. Spending is broken down into general spending by councils (net revenue expenditure) and specific grants. Between 2009–10 and 2015–16, total spending fell by 6% in real terms or by about £360 million. Over this period, specific grants represented a tiny share of total spending (about 1%).

Figure 4.1. Total spending on schools in Scotland (2024–25 planned)



Source: Total school spending for Scotland is based on net revenue spending on early learning and childcare, schools and all education-related specific grants from central government (specific grant figures relate to schools in 2009–10 and 2010–11, but also include the relatively small number of non-schools education specific grants from 2011–12 onwards). These figures were kindly supplied by the Scottish Government on a consistent basis from the underlying data for the [Scottish 'Local government finance statistics'](#) for 2009–10 to 2019–20. Figures for net revenue expenditure on schools and education specific grants for later years were taken from 'Scottish local government finance statistics' for [2020–21](#), [2021–22](#), [2022–23](#) and [2023–24](#). Net revenue expenditure on schools in 2024–25 is taken from '[Local government 2023–24 provisional outturn and 2024–25 budget estimates](#)'. Ring-fenced specific grants for 2024–25 are based on '[Local government finance circular no. 2/2024: settlement for 2024–2025](#)'. We calculate school-related reconciliation revenue grants for 2024–25 from '[Local government finance circular 10/2024: settlement for 2025 to 2026](#)'. We also assume a cash-terms freeze in other central government grants for 2024–25. [HM Treasury GDP deflators](#), January 2025.

Between 2015–16 and 2023–24, spending grew by 27% in real terms or by £1.7 billion. Most of this growth occurred between 2017–18 and 2021–22, during which time spending grew by 22% in real terms. A large part of this growth reflects large increases in teacher pay, with 7% increases in teacher salaries agreed in 2019, 2022 and 2023. Specific grants also grew substantially, from about £60 million in 2015–16 up to over £850 million in 2023–24. This included about £530 million for the expansion of early learning and childcare, with all 3- and 4-year-olds (and eligible 2-year-olds) now entitled to the equivalent of 30 hours a week free early learning and childcare during term time. (This only applies for working parents in England and Wales. Provision in England also now extends to parents of younger children.) This spending has now been rolled into net revenue expenditure. Specific grants also include £130 million for Pupil Equity Funding, which is a specific grant aimed at improving attainment amongst pupils from poorer backgrounds (much like the Pupil Premium in England).

Plans for 2024–25 imply a real-terms increase of just over 0.5%. These spending plans could be topped up before the end of the year. Notably, they include £145.5 million in funding for councils to maintain teacher numbers, which was initially the subject of a stand-off between the Scottish Government and councils, but which has now been agreed.²⁷ We discuss commitments and trends in teacher numbers in more detail in Section 4.2. Spending plans for 2024–25 notably also include £86 million to cover the cost of higher employer teacher pension contributions. Without this funding, there would be a small real-terms fall in planned spending.

Per-pupil spending

Figure 4.2 compares the level of spending per pupil in Scotland with that seen in England. To ensure comparability and consistency, we take a comprehensive measure of spending on schools and the early years, which includes COVID-related spending, grants to cover higher employer pension contributions and sixth form funding. Between 2009–10 and 2015–16, there were similar cuts in spending per pupil across both nations, with a real-terms fall of 5% in Scotland and a 6% fall in England.

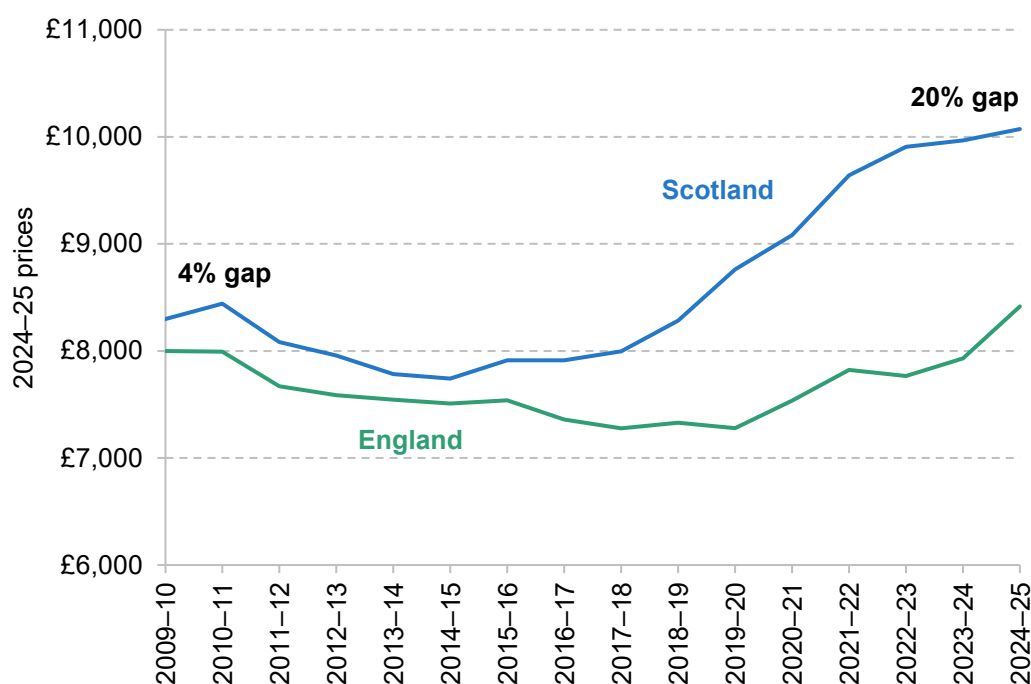
After 2015–16, spending per pupil in Scotland began to increase, with a particularly large real-terms increase of 25% between 2015–16 and 2022–23. Since then, spending plans imply a smaller real-terms rise of about 2% in total between 2022–23 and 2024–25. In England, by contrast, spending per pupil continued to fall in real terms up to 2019–20. This has been followed by a 16% real-terms rise in spending per pupil between 2019–20 and 2024–25.

²⁷ <https://www.parliament.scot/chamber-and-committees/official-report/search-what-was-said-in-parliament/meeting-of-parliament-10-12-2024?meeting=16153&iob=137965>.

Considering the full 15-year period, we observe a 21% real-terms rise in spending per pupil in Scotland and a 5% rise in England between 2009–10 and 2024–25. As a result, the gap in spending per pupil between Scotland and England has grown significantly. In 2009–10, spending per pupil in Scotland was around £8,300 in today's prices, which is about 4% higher than the £8,000 seen in England at the time. By 2024–25, spending per pupil is expected to be £10,100 in Scotland, approximately 20% higher than in England (£8,400 per pupil).

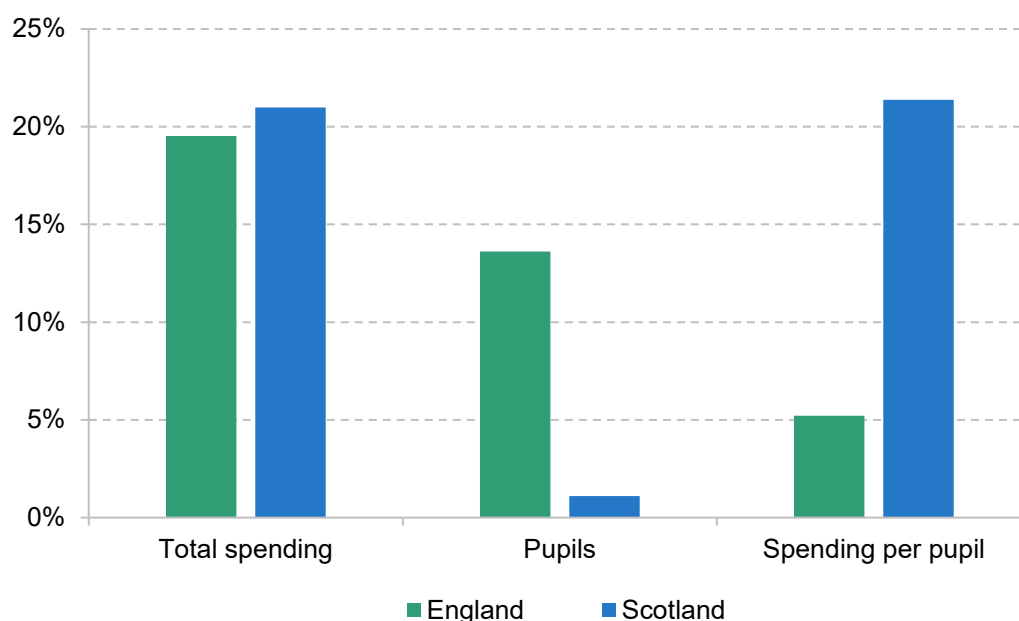
Interestingly, this differing picture on spending per pupil all seems to be driven by contrasting trends in pupil numbers. As shown in Figure 4.3, total spending on schools has grown by similar amounts between 2009–10 and 2024–25, with real-terms growth of 20% in England and 21% in Scotland. However, pupil numbers grew by more than 13% in England, whilst they only rose by 1% in Scotland. As a result, we see much faster growth in spending per pupil in Scotland than in England.

Figure 4.2. Schools and early years spending per pupil for Scotland and England (2024–25 planned)



Source: Spending on schools in Scotland taken from Figure 4.1. Full-time-equivalent pupil numbers in Scotland calculated as the sum of pupils in state-funded schools and early education centres (<https://www.gov.scot/collections/school-education-statistics/>). Spending per pupil in England is taken from Drayton et al. (2025). For consistency with figures for Scotland, we include grants to cover higher employer contributions to teachers' pensions in England and COVID-related grants for 2020, 2021 and 2022. COVID-related spending for England is taken from 'Department for Education consolidated annual report and accounts 2021 to 2022' and 'School funding statistics' for 2022–23. HM Treasury GDP deflators, January 2025.

Figure 4.3. Changes in total spending, pupil numbers and spending per pupil for England and Scotland between 2009–10 and 2024–25



Source: See Figures 4.1 and 4.2.

4.2 Teacher and pupil numbers

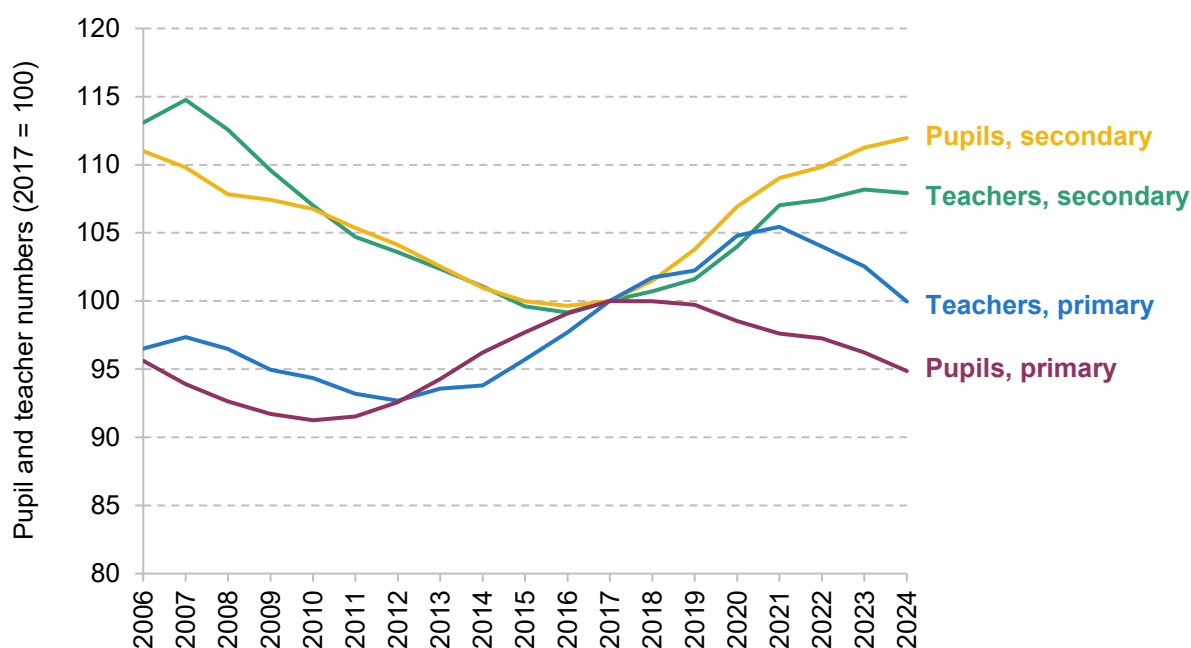
Pupil–teacher ratios remain stable

In recent years, councils have maintained teacher numbers roughly in line with pupil numbers, which has included small cuts in teacher numbers since 2021 (see Figure 4.4). As a result, pupil–teacher ratios (PTRs) have remained relatively stable over time, ranging between 12.9 in 2008 to 13.7 in 2015, and sitting at 13.3 in 2024 (15.5 in primary schools and 12.6 in secondaries).

As shown in Figure 4.4, we saw contrasting trends in primary and secondary numbers up to about 2016/2017. For primary schools, there were similar increases in teacher and pupil numbers. For secondary schools, we see declines in pupil and teacher numbers, again each of a similar magnitude.

From 2017 onwards, the pattern is more complicated. For secondary schools, we see a 12% increase in pupil numbers, which is not quite matched by an 8% increase in teacher numbers. For primary schools between 2017 and 2021, there was a significant spike in teacher numbers despite falling pupil rolls – a gap that has not (yet) been closed. As a result, PTRs have fallen in primary schools since 2017, whilst they have increased slightly in secondary schools.

Figure 4.4. Teacher and pupil numbers by mainstream school type, 2017 = 100



Source: Pupil and teacher numbers for 2006 to 2018 come from [School pupil, school and teacher historical time series](#). Pupil numbers up to 2023 come from [School level summary statistics](#) and for 2024 from [Pupil census supplementary statistics](#). Teacher numbers up to 2024 come from [Teacher census supplementary statistics](#).

Naturally, PTRs vary across councils, with island areas seeing PTRs as low as 9.8 and more urban areas having PTRs of up to 15. Notably, all of these ratios are significantly lower than in the other UK nations, where they range between 17.4 and 18.6. This gap has existed between Scotland and other nations since at least the 1990s (Jerrim and Sibieta, 2021).

The 2021 SNP manifesto promised to recruit 3,500 additional teachers by the end of the parliamentary term (May 2026 at the latest) in order to bring total numbers to 57,100 and reduce class contact hours for teachers from 22.5 to 21 hours per week. However, the most recent figures for 2024 show total teacher numbers to be almost 3,700 short of the initial goal. More recently, the Scottish Government appears less focused on these initial aims and has instead set out joint plans with councils to bring teacher numbers back up to 2023 levels by the end of this year (Learning Directorate, 2024). Further increases would be required in order to meet the reduction in class contact time target (WPI Economics, 2024).

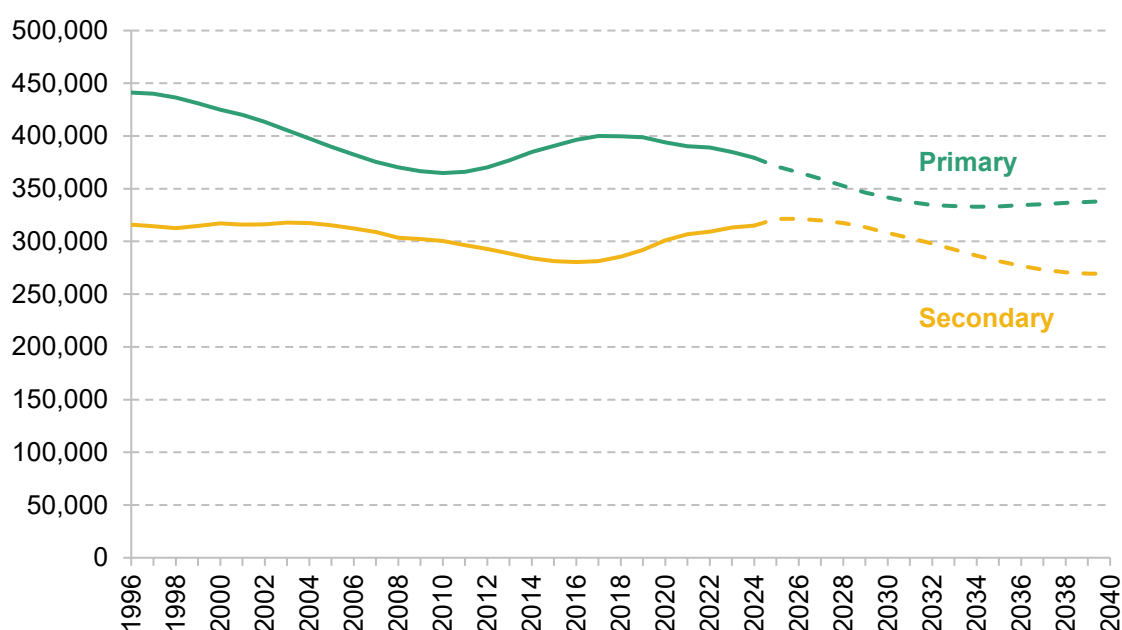
Since 2022–23, these plans have been backed by an annual grant to councils of £145.5 million, increased to £186.5 million for 2025–26, and theoretically ring-fenced for protecting teacher numbers. Despite this, many councils have still opted to cut teacher numbers to make savings on local government spending (and grant funding was not withdrawn from these councils despite threats to the contrary). These cuts, as well as the failure to reduce class contact hours, have

prompted some threats of strike action.²⁸ There are also some worrying signs of the impact of this government and council misalignment on newly-qualified teachers in Scotland. From 2016–17 to 2023–24, the share of newly-qualified (in their first year post-probation) primary school teachers who had permanent contracts in state schools has fallen from a recorded high of 57.6% to 12.8%, and the share with either permanent or temporary contracts has fallen from 88.4% to 54.7%.²⁹

Pupil numbers are falling

Scotland faces a future of declining pupil numbers: the number of pupils is likely to have peaked in 2017 for primary schools, and is projected to peak within the next two years for secondary schools (WPI Economics, 2024).³⁰ Indeed, this has been a key motivating factor behind decisions to cut teacher numbers. Population projections suggest that these declines are expected to continue over the next 15 years (Figure 4.5), with pupil numbers in mainstream schools projected to be 12.5% lower in 2040 than in 2024, largely due to lower birth rates. Additionally,

Figure 4.5. Actual and forecast pupil numbers by school type



Source: Pupil numbers up to 2023 are taken from [School level summary statistics](#) and for 2024 from [Summary statistics for schools in Scotland 2024](#). National-level projections are constructed using [Principal projection - Scotland summary](#), where we estimate the number of 4.5-year-olds in 2022 to correspond to the number of children eligible to be P1 pupils in the 2023 school census. Participation rates for each year group are constructed based on this and used to scale the estimated population by age group that would be enrolled in that school year.

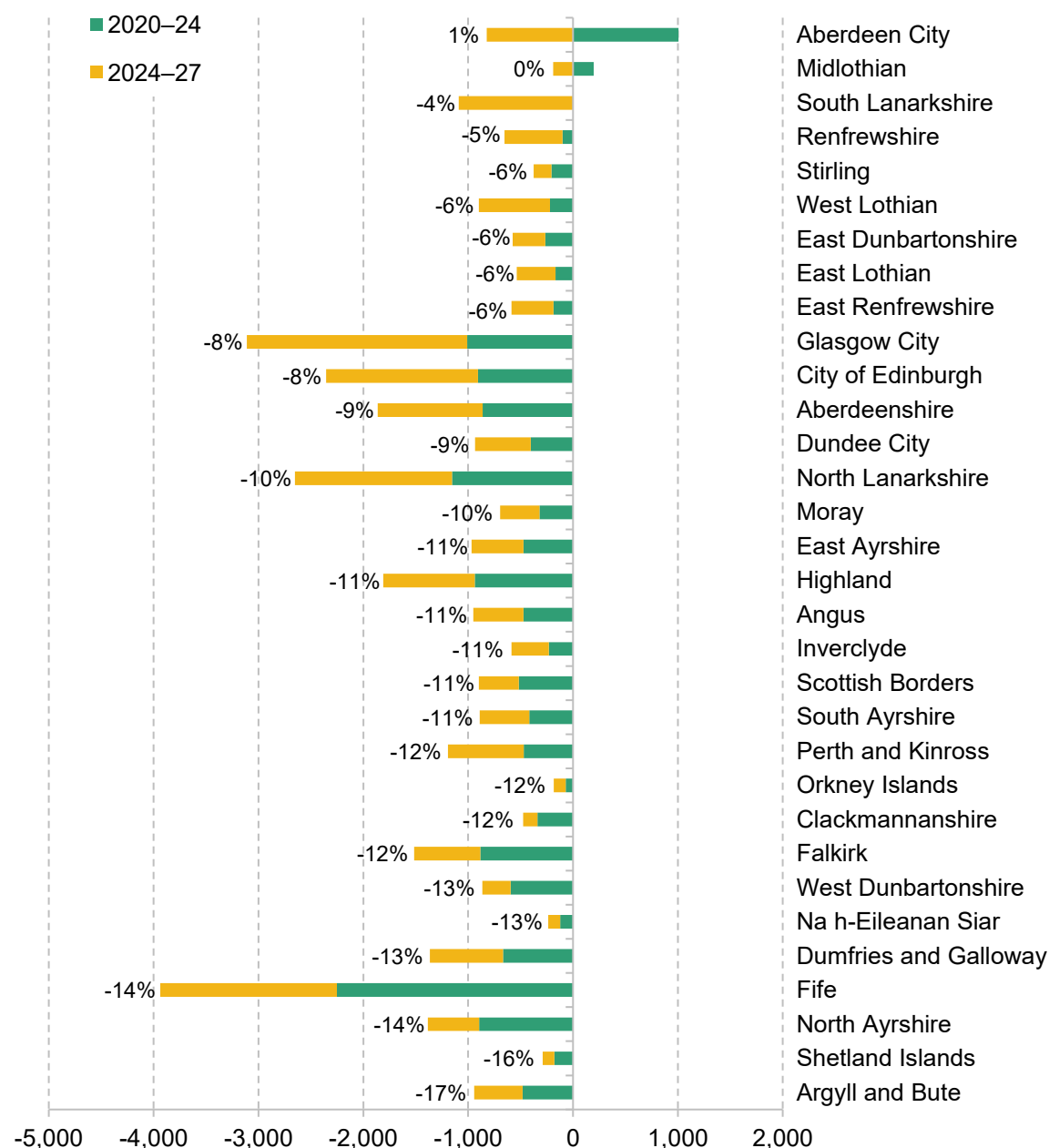
²⁸ [Glasgow teachers vote to strike in cuts protest - BBC News](#) and [SNCT Declare Dispute](#).

²⁹ <https://www.gov.scot/publications/post-probationer-teacher-employment-dashboard/>.

³⁰ Figures are only for state schools throughout.

these changes are not spread evenly (see Figure 4.6). Typically, more remote and rural areas are forecast to see the greatest proportional falls. These falls have occurred since government plans were formulated to increase teacher numbers, and are also projected to steadily continue.

Figure 4.6. Absolute and percentage change in primary school pupils by council, 2020–24 and 2024–27 (projected)



Source: 2020–2024 pupil figures sourced as in Figure 4.5. Council-level projections are constructed using year-on-year growth rates from 2024 to 2027 for each council in [Pupil projections - 2018 2020](#), applied to true pupil levels in 2024 to estimate up to 2027.

4.3 Future challenges and choices

The next few years will see a number of challenges and choices for the Scottish Government and Scottish councils on school funding and policy.

On the funding side, the Scottish Government's Budget for 2025–26 suggested a 4.3% real-terms increase in day-to-day funding for councils compared with the current financial year. However, this comparison omitted in-year top-ups to council funding in 2024–25 that amount to £238 million to help meet the cost of pay deals, pension costs and a council tax freeze. It also omits an additional £147 million in funding (including £144 million to help cover the costs of higher employer National Insurance contributions (NICs) bills) for 2025–26 announced since the Budget. But councils have estimated the increase in employer NICs will cost closer to £265 million for their own directly employed staff, with a further £93 million for social care and childcare providers.³¹ Taking this altogether suggests an underlying real-terms increase in funding of closer to 3.5% before subtracting the estimated cost of meeting higher employer NICs bills and 1.0% after. With social care spending likely to need to rise faster than this, councils may be seeking ways to hold down increases in other areas of spending, including schools.

The latter half of the 2020s is likely to involve yet more fiscal headaches, as set out in pre-Scottish-Budget analysis from IFS (Boileau and Phillips, 2024) – which will be updated shortly. Real-terms increases in funding for councils of even 1% a year may be difficult to deliver given expectations for overall funding levels and upwards pressures on the largest component of Scottish Government spending – funding for the Scottish NHS. In this context, maximising value for money in the schools budget will become increasingly important.

Choices on pupil–teacher ratios

In a period when pupil numbers are declining, freezing the current pupil–teacher ratios and thus allowing councils to cut teacher numbers could provide one opportunity to make savings on school spending. However, policymakers will need to consider the practical, educational and financial consequences when making these decisions.

From a practical perspective, it can be difficult to cut teacher or staff numbers in the short run as there is a need to maintain provision levels. In the medium term, teacher numbers can be decreased by reducing the number of classes and/or by reducing the number of schools. Of course, there may be difficulties associated with this – as shown, some of the largest proportional falls in pupil numbers are projected to be in remote and rural areas where it may be more difficult to consolidate pupils across classes or schools by more than is already done. There

³¹ See <https://www.gov.scot/publications/national-insurance-contributions-public-sector-costs/>.

may be more scope in urban areas, which are generally forecast to see the largest *absolute* falls in pupil numbers. Furthermore, as we saw earlier, secondary school teacher numbers did fall as secondary pupil numbers fell up to the mid 2010s. However, we have seen less evidence of falling primary school teacher numbers as primary school pupil numbers have fallen in more recent years, suggesting it may be less appealing to amalgamate primary school classes or close schools.

Clearly, it is crucial to consider the educational consequences of resource choices too. Here, we see evidence that lowering PTRs can improve outcomes, but is not generally the most cost-effective way of improving educational outcomes (Filges, Sonne-Schmidt and Nielsen, 2018; Britton and Sibieta, 2024). However, this should be considered amid some evidence of high teacher workload (Hulme et al., 2024), under-recruitment of teachers in shortage subjects such as maths and science,³² and rising pupil needs, which we discuss later.

Figure 4.7 shows the projected trade-off between teacher numbers and PTRs that Scotland faces over the next 15 years. In particular, it shows the change in teacher numbers relative to 2024 and the PTR for three selected years (2027, 2030 and 2040) based on projected pupil numbers. If PTRs were frozen for mainstream schools at 2024 levels (about 14 pupils per teacher³³) then primary and secondary school teacher numbers could fall by more than 1,000 over the next three years. Based on current employee spending, this could generate in-year savings of £65–120 million for 2027.³⁴ Alternatively, if teacher numbers were maintained at 2023 levels over this period (as is the current target), PTRs in mainstream schools could fall from 13.9 in 2023 to 13.5.

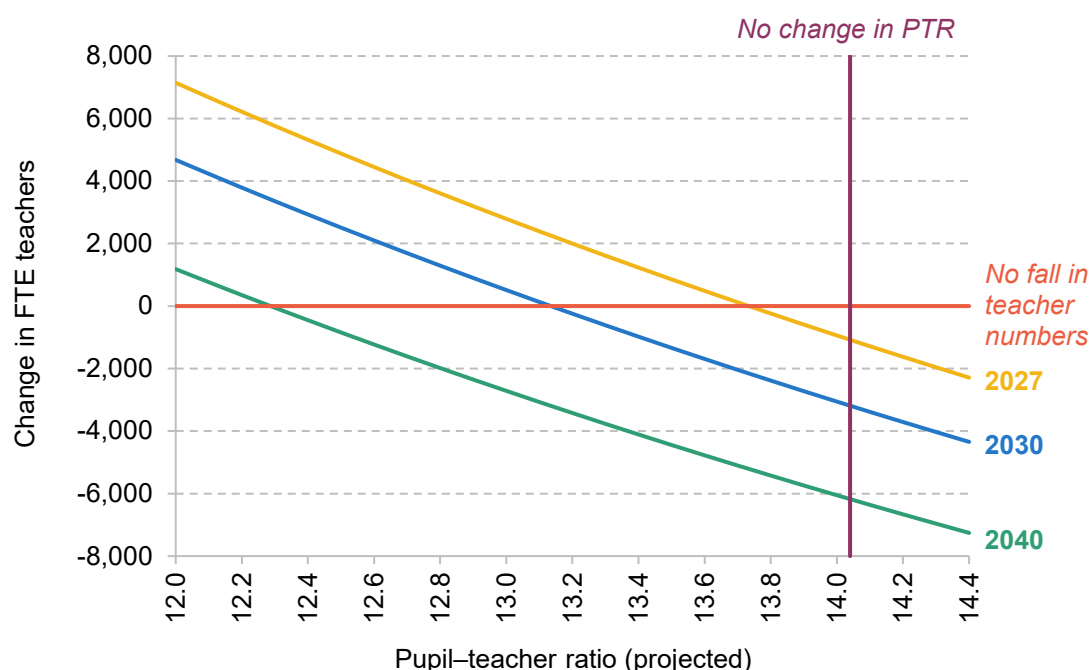
These numbers become starker further in the future. Under our pupil projections, mainstream teacher numbers could be cut by 6,200 or 12.5% by 2040 to maintain 2024 PTRs, whereas maintaining teacher numbers at 2023 levels would see the PTR for mainstream schools fall to 12.1. The financial consequences are naturally much larger too. A 12.5% reduction in 2024 employee expenditure would produce in-year savings of about £500 million by 2040, though this is naturally subject to high levels of uncertainty. The big question is whether it is worth £500 million to not cut teacher numbers and to reduce class sizes, or whether it would be better to release some of that funding to spend on other priorities (within or outside schools).

³² <https://www.gov.scot/publications/teacher-workforce-planning-advisory-group-initial-teacher-education-intake-figures-2023/>.

³³ This is higher than the previously quoted figures for PTRs as previous figures included special schools (for which we do not project pupil numbers) and centrally employed teachers.

³⁴ Lower bound calculated by applying employer costs of hiring post-probationary teachers to proposed cuts in numbers for each year up to 2027; upper bound calculated by applying a 2% reduction to 2024 total employee spending.

Figure 4.7. Projected PTRs given change in teacher numbers from 2024: 2027, 2030 and 2040 based on projected pupil numbers



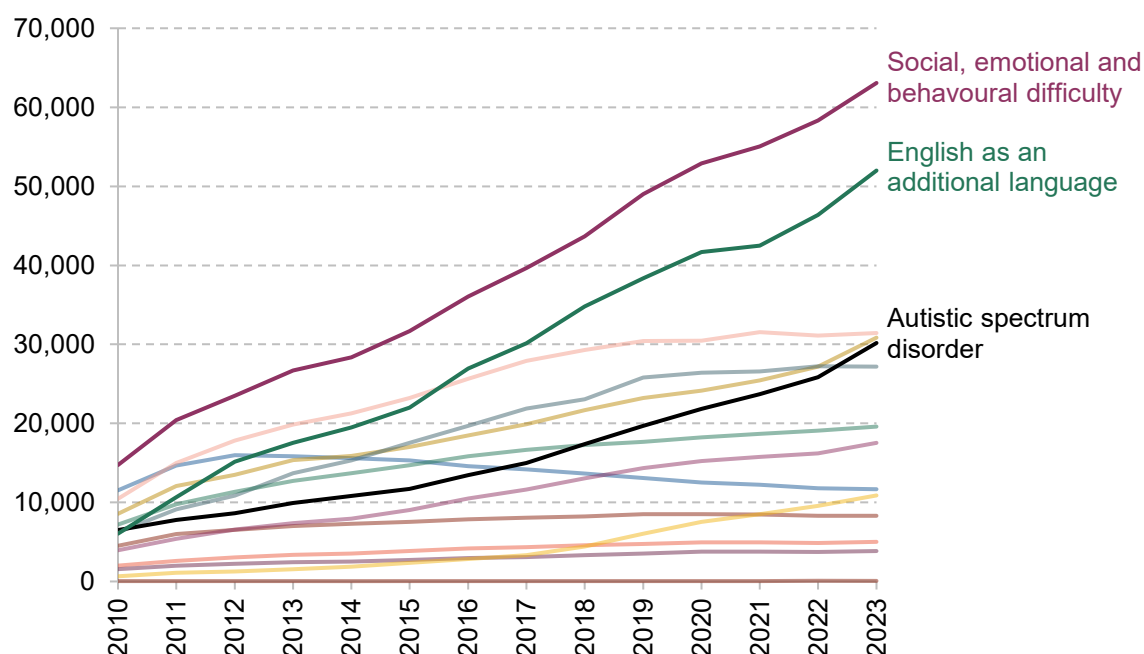
Note: FTE = full-time equivalent.

In the short run, one can naturally see the attractions of maintaining teacher numbers, with relatively small costs to avoid practical difficulties. However, the long-run picture is a consistent decline in pupil numbers over the next 15 years. A decision not to cut teacher numbers over a series of short runs could dramatically change the nature of schooling in Scotland. Policymakers should confront these long-run trade-offs.

Broader challenges

An additional factor shaping the trade-offs in school spending is the rise in pupils with additional support needs (ASN). Scotland has seen a more than fourfold increase in pupils classed as having ASN since 2010, with more than 40% of all pupils having ASN in 2024. This has mainly been driven by increases in pupils with social, emotional and behavioural difficulties or having English as an additional language (Figure 4.8). We also see a more than fourfold increase in the number of pupils with autistic spectrum disorder, from 6,500 in 2010 to more than 30,000 in 2023. A similar trend among pupils with special educational needs has also been seen in England (Sibieta and Snape, 2024), although the definition of ASN in Scotland encompasses a broader range of needs.

Figure 4.8. Number of pupils with selected additional support needs



Note: Only selected needs are shown, for clarity; those with significant increases are highlighted. Figures will sum to more than the total number of pupils with ASN as some pupils have multiple needs.

Source: <https://www.gov.scot/publications/pupil-census-supplementary-statistics/>.

The impact that this rise in ASN will have on spending pressures is unclear, however. Despite the dramatic increase in identified need, spending has not increased at the same rate; between 2017–18 and 2023–24, spending increased by 26% (from £788 million to £993 million) while ASN pupil numbers increased by over 40%.³⁵ Equally, while the number of support staff has risen since 2018, the number of ASN teachers has remained relatively constant since 2017 and indeed has fallen since 2010.³⁶ Scotland has a much greater tendency towards ‘inclusion’ in mainstream education for pupils with additional needs than England (Education, Children and Young People Committee, 2024): the share of pupils with legally binding support in the form of coordinated support plans has fallen, and the share of pupils in special schools has hovered around 1% for the last two decades.³⁷ While this has no doubt kept a lid on costs, it suggests that there has not been a dramatic change in the level of support available for pupils with additional needs, despite the increase in identified need. What this means for future spending pressures, and indeed staff numbers, will depend on whether this level of support has been sufficient to meet those needs.

³⁵ 2023–24 prices, calculated using January 2025 GDP deflators. Pupil statistics from <https://www.gov.scot/publications/pupil-census-supplementary-statistics/>. Spending figures from <https://www.gov.scot/publications/scottish-local-government-finance-statistics-slgfs-2023-24-workbooks/> and <https://www.gov.scot/publications/scottish-local-government-finance-statistics-2017-18-workbooks/>.

³⁶ <https://www.gov.scot/publications/school-support-staff-statistics/> and <https://www.gov.scot/publications/teacher-census-supplementary-statistics/>.

³⁷ <https://www.gov.scot/publications/pupil-census-supplementary-statistics/>.

4.4 Conclusion

Scotland has significantly increased spending on schools and early years education over the last six years. It spends 20% more per pupil than England and has substantially lower pupil–teacher ratios. The Scottish Government has also made repeated commitments to increase teacher numbers, which having not been met were subsequently revised to maintaining teacher numbers.

This is in the context of falls in pupil numbers across Scotland, which seem to be more pronounced in rural and island areas. There is also continued concern about the declining educational performance of Scottish pupils. The evidence suggests there are unlikely to be strong benefits from lower class sizes. Maintaining teacher numbers is also likely to get more expensive over time, just as the trade-offs facing the Scottish Government and local councils become even more challenging. Cutting teacher numbers is not without practical challenge, however, as it would likely involve amalgamating classes or closing schools.

Whilst there may be some clear attractions to avoiding cuts to teacher numbers in the short run, the Scottish Government’s one-size-fits-all approach to maintaining teacher numbers is unlikely to represent value for money over the long run. Instead, it would be better for local councils to make resource choices that reflect their specific circumstances, challenges and the best ways to deliver schooling locally. The Scottish Government should focus on how to distribute funding across different public services and areas. For instance, it could target greater resources at rural areas if it wanted to avoid pupils having to travel even further to school.

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5. Scottish public sector employment and pay

Jonathan Cribb, Magdalena Domínguez and Laurence O'Brien

Hospitals, schools, councils and other parts of the public sector are a major employer in Scotland. The public sector paybill is also a substantial part of government spending. Recent years have seen larger-than-expected increases in both public sector employment and pay, the latter driven by high rates of inflation following the COVID-19 pandemic and Russia's invasion of Ukraine. A rising paybill is particularly challenging in a Scottish context because while the increases in funding it receives from the UK government via the Barnett formula are population-based, its share of the increase in paybill costs is likely to be higher, due to higher current levels of pay in Scotland compared with the UK as a whole. The same is true of forthcoming increases in employers' National Insurance contributions.

This chapter of our Scottish Budget report sets out the facts and figures for Scottish public sector employment and pay, and considers the implications for Scottish Government policy.

Key findings

1. There are around 590,000 public sector workers in Scotland in 2024, representing 22% of the workforce. This fraction is lower than in Wales (24%) and Northern Ireland (26%), but considerably higher than in England (17%), and indeed is higher than in any English region. The cost of remunerating those employed by the Scottish Government and councils – who make up 92% of all public sector workers in Scotland – is around £27 billion this year, more than half of all devolved day-to-day public spending.
2. Public sector employment in Scotland has been growing significantly since 2017: it grew by 56,000 (11%) from 2017 to 2024. As a share of the workforce, public sector employment in Scotland has grown by a larger fraction since 2017 (by 2.5 percentage points, from 19.6% to 22.1%) than in any other part of the UK with the exception of Wales (where it grew by 2.6 percentage points).

3. Average pay for public sector workers is notably higher in Scotland than in the UK as a whole. Median hourly pay in the public sector in Scotland was almost 5% higher than that for the UK as a whole in 2024. Back in 2019, median public sector pay was very similar in Scotland to that in the UK as a whole. Since then, median pay has risen by 5% in Scotland but is unchanged in the UK on average.
4. Consistent with this, comparing the current pay scales of selected public sector occupations in Scotland and England, we find pay in Scotland is 4½–6½% higher than the main scales in England. Pay for these newly qualified teachers and NHS ‘Agenda for Change’ workers in Bands 2, 5 and 7 in Scotland is similar to their pay in the ‘London fringe’ councils surrounding the UK capital. Staff in these ‘fringe areas’ have their pay boosted to reflect the considerably higher cost of living in areas close to London. Public sector pay scales in Scotland are lower than in London itself.
5. The gaps in public sector pay between Scotland and the rest of the UK have opened up in particular since 2019 (when median public sector pay in Scotland was the same as in the UK as a whole). This is consistent with the relative generosity of public sector pay deals in recent years in Scotland compared with England. The Scottish Fiscal Commission has also noted that the pay deals agreed in 2023 and 2024 were considerably higher than those implied by the Scottish Government’s public sector pay policy, which is the framework that guides the negotiations with trade unions. The higher public sector pay in Scotland is problematic for the Scottish Government’s budget if it aims to (at least) match the increases in public sector pay in the rest of the UK, because of the higher baseline level and number of staff covered.
6. We do not find any evidence that larger increases in public sector pay in Scotland in recent years have boosted the retention of public sector workers. There may well be other benefits to public service delivery or quality from the higher pay rises, such as improvements to recruitment and/or motivation. This is difficult for analysts external to government to observe, but should be evaluated by the Scottish Government. Nevertheless, given the cost of across-the-board increases in pay scales, the Scottish Government (and councils) should consider targeting public sector pay rises at occupations and/or areas where those pay rises are likely to be most impactful for public service delivery, such as roles where there are noted recruitment or retention issues.

5.1 Introduction

Public sector pay is one of the Scottish Government’s key items of expenditure and crucial in delivering public services in Scotland. Remunerating workers employed by the Scottish Government and councils (hereafter the ‘devolved public sector’) cost £25 billion in 2023–24 (Scottish Fiscal Commission, 2024). Given recent rates of public sector pay growth, this is likely to have risen to close to £27 billion this year (2024–25), accounting for over half of devolved day-to-day (resource) public spending.

Devolved public sector pay in Scotland is set following negotiations between the Scottish Government (or the Convention of Scottish Local Authorities – COSLA – for councils), employers of public sector workers (such as NHS Scotland), and trade unions which represent their members. These negotiations take place in light of the Scottish Government’s stated public sector pay policy, which sets a framework for negotiations but which does not actually determine the pay rises. Recent public sector pay policies have included sections that encourage employers to consider progressive approaches to public sector pay, i.e. prioritising lower earners. This implies public sector pay in Scotland plays a role in social policy (as it does elsewhere) – such as to undertake some redistribution towards lower-paid workers – though there are different perspectives on how appropriate this is relative to prioritising public service delivery and quality.³⁸

The system in Scotland is in contrast to the system of Pay Review Bodies which cover workforces in England and Wales, in which independent review bodies present a recommendation to the UK or Welsh government, which can then choose whether or not to accept these recommendations when beginning negotiations with trade unions. In Scotland, there are no such independent recommendations.

In recent years, there has been considerable upward pressure on public sector pay, not least due to elevated rates of inflation, and this has in turn put pressure on Scottish Government spending. The Scottish Government in 2023–24 agreed increases in public sector pay that averaged cash-terms increases of 6.5%, 3 percentage points higher than the Scottish Government’s plans contained in its public sector pay policy published in March 2023 (Audit Scotland, 2023). The Scottish Fiscal Commission (2024) has highlighted how pay deals agreed for 2024–25 for the

³⁸ In recent years, different public sector pay deals in both England and Scotland have prioritised lower earners within the public sector to different extents. For example, in 2023, increases in NHS pay both in Scotland and in England were higher for people on lower bands (see [NHS pay rise delivered in April](#) and [NHS pay deal in England - frequently asked questions](#)). For teachers, the pattern is different, with pay deals in Scotland being the same in percentage terms across the board (except the very top; see [Pay Agreement April 2022 – July 2024](#)), whereas in England there were higher increases for less experienced teachers (Sibieta, 2023).

NHS (5.5%) and local government (4.27%) also exceeded the policy of 3% rises in 2024–25 set out in May 2024.

The Scottish Government’s current public sector pay policy, published in December 2024, highlights a planned 9% cash-terms rise in public sector pay over the three years up to 2027–28 (Scottish Government, 2024). The fact that – as we detail in this chapter – public sector workers are both relatively more numerous and higher paid in Scotland than in the rest of the UK has important consequences for the Scottish Government’s finances. Because of higher baseline employment and pay, the same percentage increase in public sector pay in Scotland leads to a higher increase in spending in Scotland than the equivalent increase in pay scales would generate in England. And, importantly, this is not reflected in the increases in funding the Scottish Government receives from the UK government via the Barnett formula, which are based on Scotland’s share of the UK population.

In this context, Section 5.2 presents key facts about public sector employment in Scotland compared with the rest of the UK. Using various metrics, Section 5.3 sets out how different Scottish public sector pay is, while Section 5.4 examines whether higher public sector pay is associated with higher rates of retention in the public sector in Scotland. Section 5.5 provides a brief conclusion.

5.2 Public sector employment in Scotland

The latest data, from September 2024, show that there were 585,000 public sector workers in Scotland. Most of these are employed by either the Scottish Government or councils, but there are around 50,000 employed directly by the UK government, most of whom work for HM Forces or the UK civil service.³⁹ Figure 5.1 shows the recent history of falls, and then subsequent rises, in public sector employment in Scotland. From a peak of 586,000 in early 2009, public sector employment fell rapidly between 2009 and 2013, reaching 536,000 in early 2013 (a fall of 9%). Since the end of 2017, public sector employment has grown significantly (including throughout the COVID-19 pandemic), by 56,000 (11%), to reach its current level, which is almost identical to the previous peak in 2009.

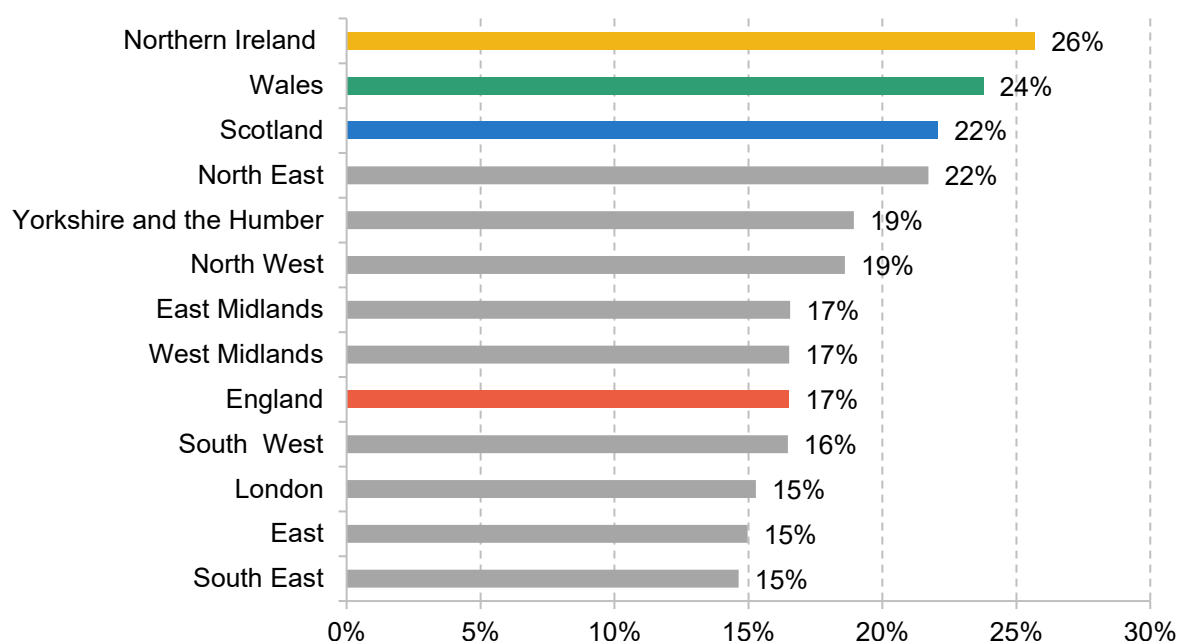
³⁹ See <https://www.gov.scot/publications/public-sector-employment-in-scotland-statistics-for-3rd-quarter-2024/>. There are various figures on the level of public sector employment in Scotland. To facilitate comparisons over time, we cite those published by the Office for National Statistics (ONS) ‘excluding effects of major reclassifications’. If we do not exclude the effects of these reclassifications, ONS statistics show public sector employment of 595,000 in September 2024. Notably, the consistent series cited in the text counts employees of the train operating companies in Scotland as private sector even though they have been reclassified into the public sector since June 2020.

Figure 5.1. Public sector employment in Scotland (headcount)

Note: Excludes the effects of major public sector reclassifications.

Source: ONS '[Public sector employment statistics](#)', table 6a.

Despite this lack of growth in total over a 15-year period, public sector employment makes up a larger fraction of employment in Scotland than in England. As shown in Figure 5.2, 22% of the workforce were employed in the public sector in Scotland in 2024, lower than the 24% in Wales and 26% in Northern Ireland, but higher than in England (17%) and indeed higher than in any English region.

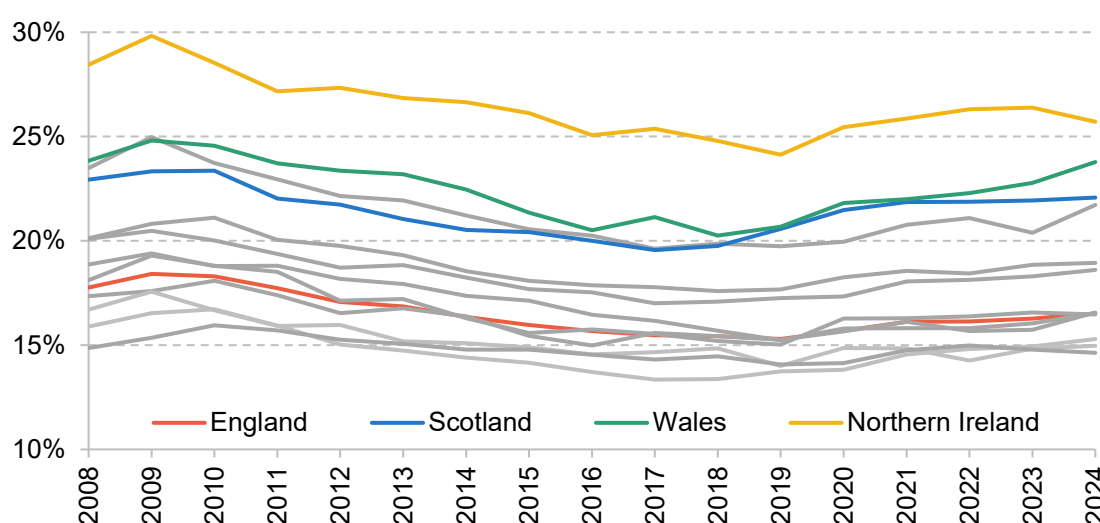
Figure 5.2. Public sector employment as a fraction of overall employment, 2024

Note: Excludes the effects of major public sector reclassifications.

Source: Authors' calculations using ONS '[Public sector employment statistics](#)', tables 6a and 7a.

Figure 5.3 shows how the fraction of the workforce employed in the public sector has changed in each nation and region of the UK, with the fractions for England, Scotland, Wales and Northern Ireland shown in red, blue, green and yellow respectively, and the English regions shown in grey. The graph shows that all parts of the UK have experienced the fall and then rise of public sector employment over the last 15 years. Scotland has remained – like Wales and Northern Ireland – near the top of this particular ranking. It is noticeable that the rise in the fraction of the workforce employed in the public sector between 2017 and 2024 (the period over which public sector employment has been rising) is larger in Scotland (+2.5 percentage points of the workforce) than in any part of the UK except for Wales (+2.6 percentage points over the same period).

Figure 5.3. Public sector employment as fraction of overall employment, by nation and region of the UK (English regions shown in grey)



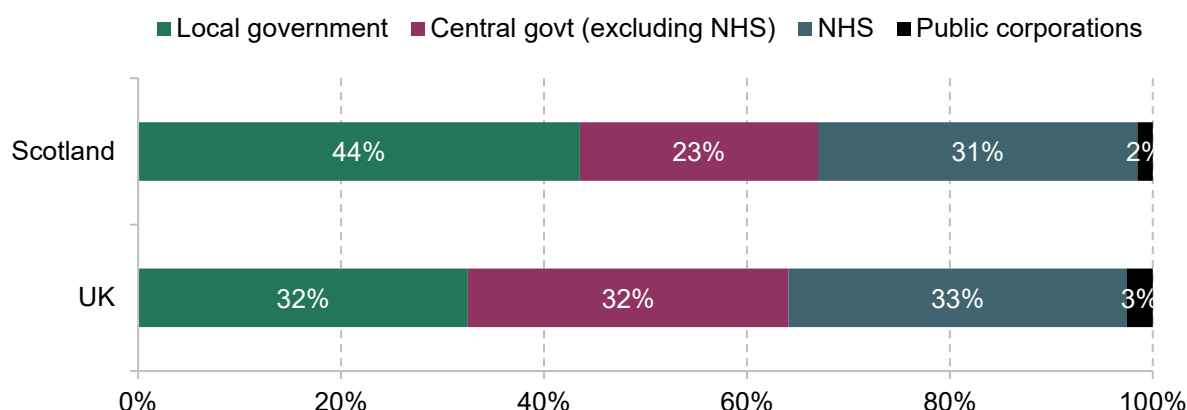
Note: Excludes the effects of major public sector reclassifications.

Source: Authors' calculations using ONS '[Public sector employment statistics](#)', tables 6a and 7a.

Finally, Figure 5.4 shows the composition of the public sector workforce in Scotland compared with the UK. The figures for Scotland include the almost 50,000 public sector workers who are employed by the UK government in Scotland, as well as those employed by the Scottish Government, councils and public corporations.⁴⁰ In both the UK as a whole and in Scotland, the NHS makes up around a third of public sector employment, though the fraction is slightly smaller in Scotland (31%) than in the UK (33%). The key difference in Scotland is that a much higher fraction of public sector workers are employed by local authorities (44%), compared with 32% in the UK as a whole. This is likely to reflect the fact that there are no academy schools or free schools in Scotland – and workers in academy schools and free schools in England are considered to be working for central government as they are not controlled by councils.

⁴⁰ 92% of the public sector in Scotland are employed by the Scottish Government or councils, rather than the UK government.

Figure 5.4. Composition of public sector employment, UK and Scotland, 2024Q3



Note: Excludes the effects of major public sector reclassifications.

Source: Authors' calculations using ONS '[Public sector employment statistics](#)' (tables 1 and 2) and Scottish Government '[Public sector employment in Scotland statistics](#)'.

5.3 Comparing public sector pay in Scotland and the rest of the UK

Comparing public sector pay in different parts of a country can be surprisingly difficult without registers of workers' earnings of the kind that exist in Scandinavia but not in the UK. This section compares public sector workers' earnings in Scotland with the rest of the UK in three ways. First, we compare pay scales for public sector workers in England and Scotland, though only for a small number of high-profile occupations. Second, we use statistics from an employer-reported survey to compare hourly pay for public sector workers in the UK and Scotland, though there is some variability due to relatively small sample sizes in Scotland. Finally, we use widely used Labour Force Survey data on public sector workers to estimate how different public and private sector pay are from each other in different parts of the country, including Scotland. This set of evidence allows us to draw a comprehensive picture of patterns and trends in public sector pay in Scotland.

Although pay scales can often be hard to compare across jurisdictions, NHS pay scales tend to be regimented and operate on a similar system (known as 'Agenda for Change') in England and Scotland. In addition, in teaching there is a clear 'bottom rung' in both nations – newly qualified teachers in England and probationers in Scotland. Table 5.1 therefore compares pay at the entry point to several NHS pay bands, and newly qualified teachers in England and Scotland, as well as showing the levels for the 'London fringe' – council areas surrounding London that are notable for having a relatively high cost of living.

Table 5.1. Annual full-time salaries for specific points on public sector pay scales, 2024–25, in England, Scotland and the London fringe

	England	London fringe	Scotland	Scotland as a share of England
	(£ per year)			
NHS (Agenda for Change)				
Band 2 (healthcare assistant)	23,615	24,873	24,647	104.4%
Band 5 (newly qualified nurse)	29,970	31,469	31,892	106.4%
Band 7 (ward manager)	46,148	48,270	48,788	105.7%
School teachers				
Newly qualified teacher	31,650	33,075	33,594	106.1%

Note: Pay scales for Agenda for Change staff show the entry point to each band. Newly qualified teacher salary compares probationer scale point in Scotland with M1 on the main teacher scale. 'England' refers to England outside London and its 'fringe'.

Source: Agenda for Change – <https://www.nhsemployers.org/articles/pay-scales-202425> and <https://www.msg.scot.nhs.uk/wp-content/uploads/PCSAFC2024-5-Pay-for-Agenda-for-Change-Staff.pdf>. School teachers – <https://www.nasuwt.org.uk/advice/pay-pensions/pay-scales/pay-scales-england.html>, <https://www.nasuwt.org.uk/advice/pay-pensions/pay-scales/pay-scales-scotland.html> and <https://www.nasuwt.org.uk/advice/pay-pensions/pay-scales/pay-scales-fringe-outer-london-and-inner-london.html>.

The table shows that entry points to NHS pay bands, and pay for newly qualified / probationer teachers, are around 4½–6½% higher in Scotland than the main scales in England. In the selected occupations at least, NHS pay in Scotland is very similar to that in the (high-cost-of-living) areas of the London fringe. Pay scales are, unsurprisingly, higher in London where the cost of living (in particular housing) is considerably higher, even compared with the 'London fringe'.

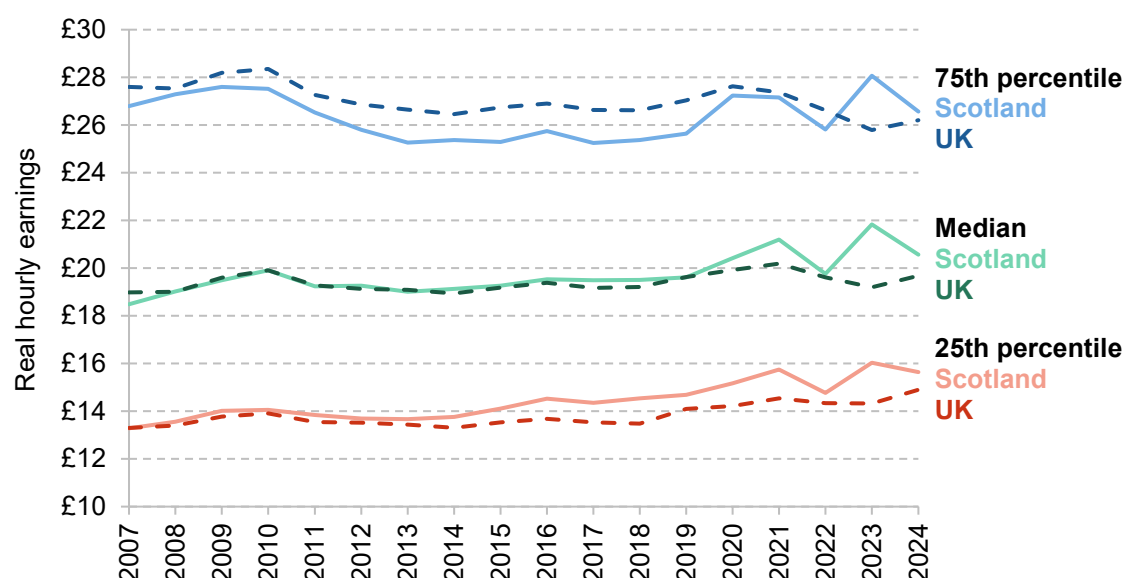
Figure 5.5 goes beyond a small number of occupations and shows changes in the distribution of hourly public sector pay in Scotland, and the UK as a whole, based on data from the Annual Survey of Hours and Earnings, an annual survey completed by employers.

The first takeaway from Figure 5.5 is that hourly public sector pay was higher in Scotland than in the UK at all three points of the distribution we analyse in 2024 (the 25th percentile – relatively low-paid employees; the median (middle); and the 75th percentile – relatively well-paid employees). For both low-paid workers (25th percentile) and at the median, public sector pay in Scotland was 4½–5% higher in Scotland than in the UK as a whole. The gap higher up the

distribution was smaller (1½% at the 75th percentile).⁴¹ Looking at the trends over time, median hourly public sector pay was fairly similar in Scotland and the UK as a whole until around 2019, after which a gap emerged. At the 25th percentile, public sector pay in Scotland overtook that in the UK much earlier; in fact, it has been higher in all years since 2008, though the gap has widened in recent years. Hourly public sector pay at the 75th percentile was higher in the UK than in Scotland in all years until 2023. All these are consistent with the prioritisation of increases in public sector pay scales in Scotland in recent years compared with the rest of the UK.

Figure 5.6 shows growth in real median hourly earnings since 2007. In both Scotland and the UK as a whole, private sector pay fell sharply following the 2008 financial crisis, while public sector pay performed better (particularly in Scotland). From 2013, private sector pay started to recover, with this recovery somewhat stronger in Scotland.

Figure 5.5. Median, 25th percentile and 75th percentile of real hourly earnings for public sector employees in Scotland and the UK

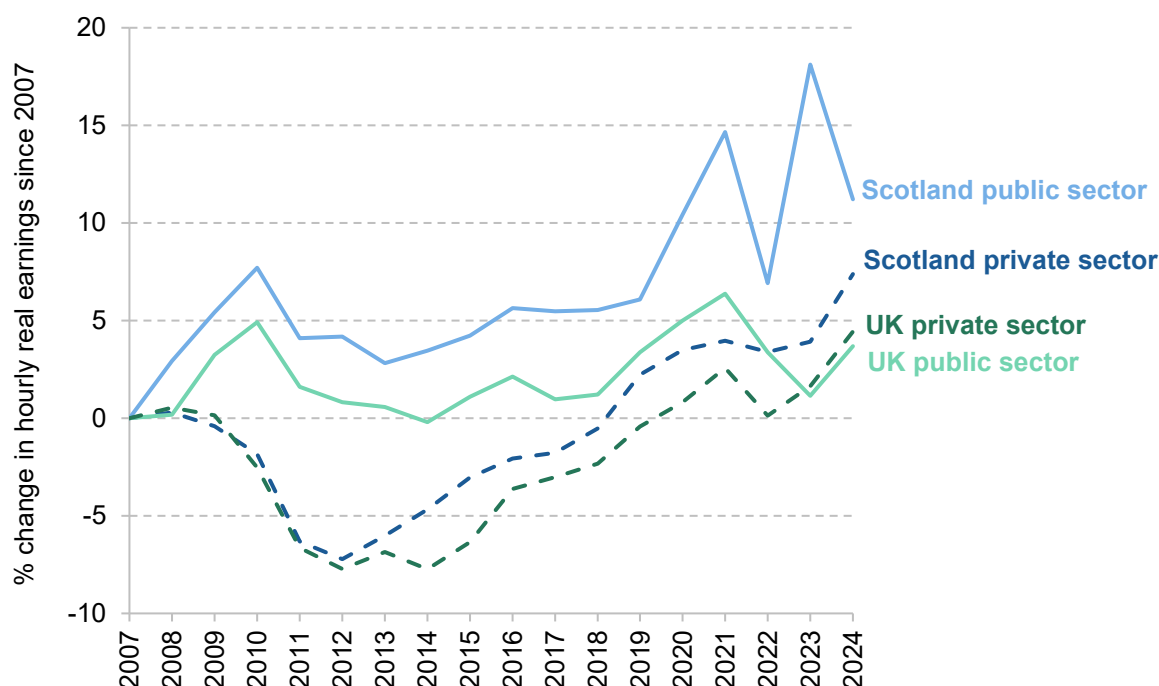


Note: Data measured in April of each year. The UK series include Scotland. All series are deflated using monthly CPIH and expressed in April 2024 prices.

Source: ONS dataset '[Earnings and hours worked, UK region by public and private sector: ASHE table 25](#)'.

⁴¹ These figures show that there is lower pay inequality in Scotland than in the UK as a whole. Figure 5A.1 in the appendix shows this by plotting the ratio of the 75th percentile of hourly earnings to the 25th percentile of hourly earnings over time, separately by sector for Scotland and the UK. By April 2024, the 75th percentile of hourly public sector pay was 70% higher than the 25th percentile in Scotland, while the difference was 76% in the UK as a whole. In both, pay inequality is also greater in the private sector than in the public sector, although both parts of the country have experienced reductions in private sector pay inequality.

Figure 5.6. Changes in real median hourly earnings per worker for public and private sector employees in Scotland and the UK, relative to 2007

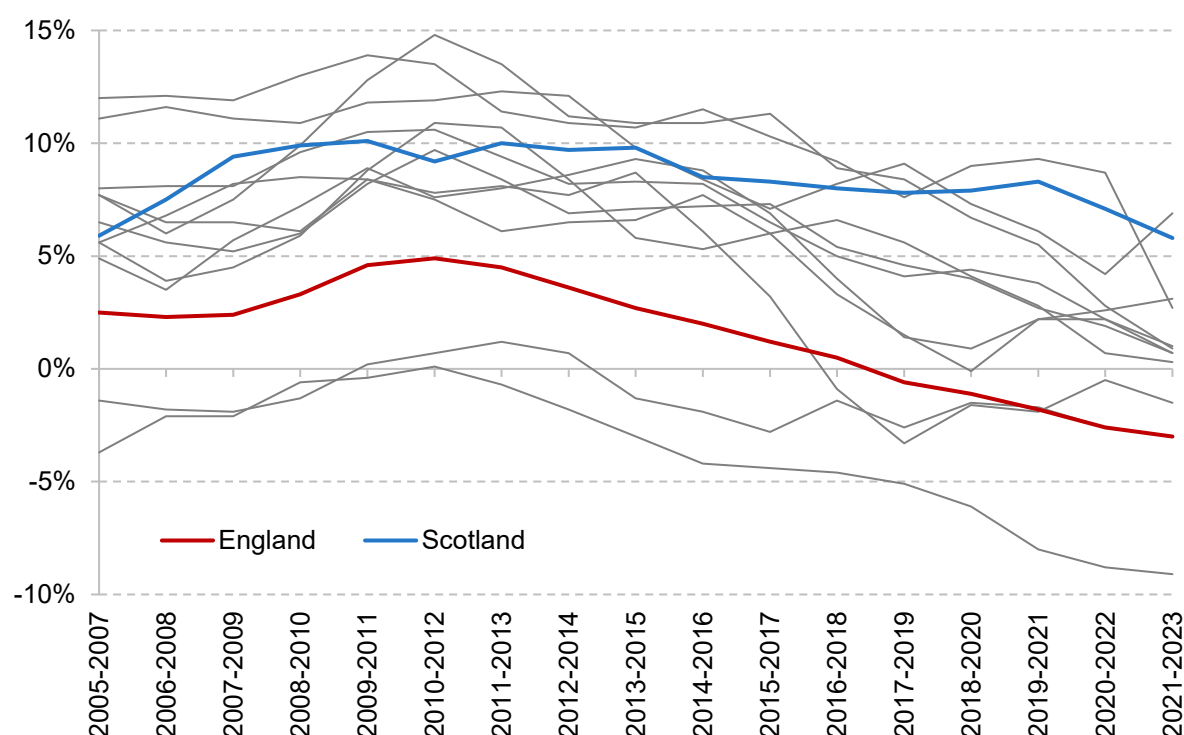


Note: Data measured in April of each year. All series are deflated using monthly CPIH and then compared with April 2007.

Source: ONS dataset '[Earnings and hours worked, UK region by public and private sector: ASHE table 25](#)'.

Notably, since 2019, median public sector pay has grown significantly more quickly in Scotland than in the UK as a whole – with pay growing by 5% in Scotland from 2019 to 2024, compared with no growth in the UK as a whole. As a result, from 2007 to 2024, median real hourly public sector pay grew by 11% in Scotland, compared with less than 4% for the UK. Growth in hourly pay in the public sector outpaced private sector pay growth in Scotland, as median real hourly private sector pay grew by 7%. In the UK, there were similar increases of just 4% in both public and private sectors.

Especially over 15 or 20 years, changes in pay could potentially reflect changes in the composition of the workforce in different sectors or parts of the country. To see how public and private sector pay evolved compared with each other in each part of the country, controlling for compositional change, Figure 5.7 shows the hourly pay differential between the public and private sectors across the UK controlling for workers' characteristics, such as age, sex, education and experience. The series for England and Scotland are shown in red and blue respectively, with the series for Wales, Northern Ireland and the regions of England shown in grey.

Figure 5.7. Public sector pay differential, for Scotland, England and other UK regions

Note: The differential is calculated controlling for age, education, experience and region, all interacted with sex, and interactions between education and experience. Figures are for hourly pay and exclude employer pension contributions. All series are three-year rolling averages.

Source: Authors' calculations using the Labour Force Survey.

The graph shows that in recent years (2021–23), Scotland has had the second-largest public sector pay differential (5.8%) in the UK (following that in the north of England). Scotland was not as high up the ranking prior to the financial crisis (2005–07), nor in any of the years up until the mid 2010s, when this public–private pay differential was much more similar to those in many English regions. The public–private pay differential in Scotland was essentially the same in 2021–23 as in 2005–07. In contrast, in England on average this measure of the public–private pay differential fell from +2.5% in 2005–07 to –3.0% in recent years, and indeed it has fallen in every English region over this period.

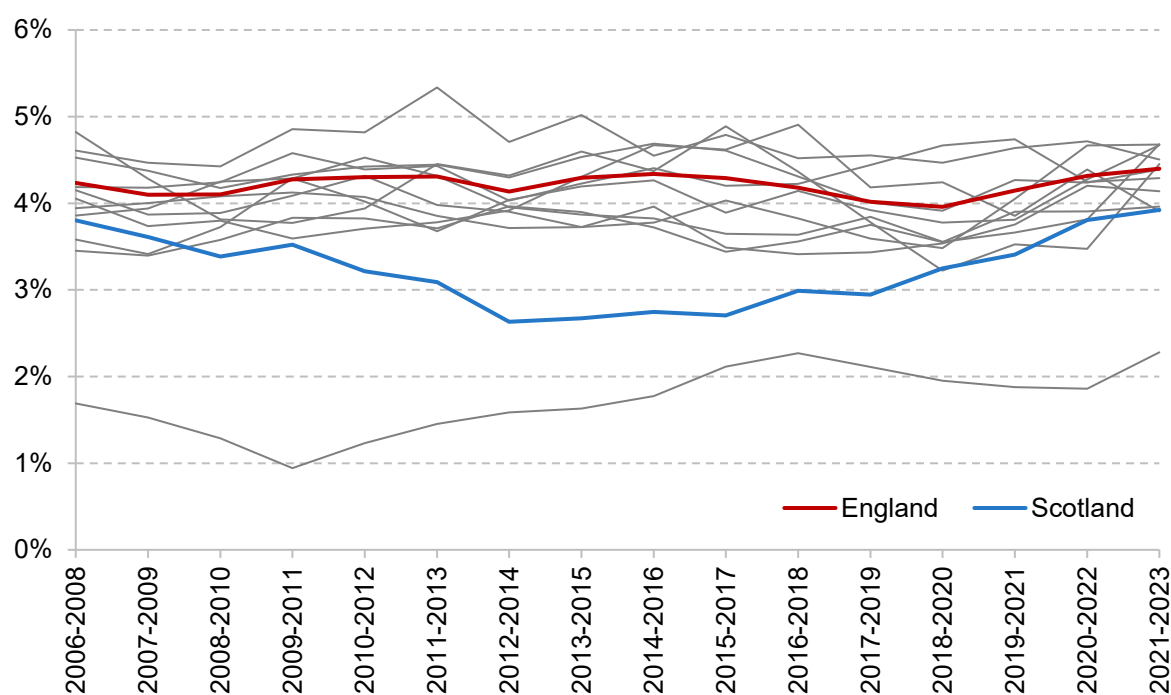
Overall then, public sector pay is higher in Scotland than in the rest of the UK, with median pay in the public sector in Scotland almost 5% higher than in the UK as a whole. Similar differences are found when comparing the pay scales of NHS workers and starting teacher salaries. These differences between Scotland and the rest of the UK have opened up in particular in the years since 2019.

5.4 Retention in the public sector in Scotland

A key potential rationale for increasing public sector pay is to improve recruitment and retention of staff, as well as motivate them to help deliver high-quality public services. Recent work at IFS has summarised that, in England at least, there have been signs of recruitment and retention problems in a number of public sector occupations, including teaching and the police (Cribb, Domínguez and McKendrick, 2024).

Without the detailed data available to public sector employers (or Pay Review Bodies) themselves, it can be hard to judge the extent of these problems. However, we are able to observe changes in retention in public sector jobs in publicly available data from labour market surveys. Retention in the public sector is important not only because losing key staff can disrupt work, but also because of the cost of recruiting new staff.

Figure 5.8. Percentage of public sector workers leaving the public sector over the course of three months: Scotland, England, and other regions and nations of the UK



Note: The part of the UK with the lowest fraction of public sector employees leaving the public sector is Northern Ireland.

Source: Authors' calculations using the two-quarter longitudinal Labour Force Survey, 2006 to 2023.

Figure 5.8 shows the fraction of public sector workers who leave the public sector over the course of three months, as measured in the Labour Force Survey. The graph shows how this has changed over time and in different parts of the country. Note here that if an individual leaves their public sector job (e.g. in a state school) and immediately moves to another public sector job

(e.g. in a different state school), that is *not* counted as ‘leaving the public sector’. So, the lower the rate of leaving the public sector, the higher the retention of employees in the public sector as a whole. In the latest data (covering 2021–23), the fraction of public sector workers leaving over the course of three months was 3.9% in Scotland, compared with 4.4% in England. This leaving rate is lower than in most other parts of the country except Northern Ireland. However, there is no evidence of the retention of Scottish public sector workers improving during the period in which pay has been increasing in Scotland relative to the rest of the UK, though pay is far from the only determinant of job retention. Indeed, if anything, retention has fallen (with the leaving rate rising), both in absolute terms and relative to England.⁴²

Therefore, we do not see higher retention in public sector occupations in Scotland that could be straightforwardly linked to higher public sector pay in Scotland. This is not to say that there are not necessarily other potential benefits to public services from higher pay for public sector workers in Scotland in terms of recruitment and/or motivation. However, it does suggest that, given the cost of increasing public sector pay scales across the board, it would likely be wise to target increases in pay scales at the parts of the public sector where recruitment, retention and motivation issues are most keen, and where additional pay may help to resolve them. In addition, given the spending involved in increasing public sector pay, the Scottish Government should undertake, or commission, research into the impacts of its higher public sector pay policies.

5.5 Conclusion

The public sector workforce in Scotland has grown significantly since 2017, recovering the level last seen in 2009 and now comprising 22% of the total workforce – higher than in any English region but lower than in Wales and Northern Ireland. Pay for public sector workers is also relatively high compared with other parts of the UK, with median hourly wages around 5% above the UK average for the public sector. This reflects larger increases in public sector pay scales since around 2019 compared with the increases implemented by the UK government, Welsh Government and NI Executive. It is notable that Audit Scotland and the Scottish Fiscal Commission have both commented on how pay rises in 2023–24 in particular and to a lesser extent in 2024–25 exceeded those suggested in the Scottish Government public sector pay policies for those years, putting pressure on Scottish public finances.

The higher levels of public sector pay present a fiscal challenge for the Scottish Government, especially if it wants to align with (or exceed) the pay increases implemented by the UK government while starting from a higher baseline level of both employment and pay. We have

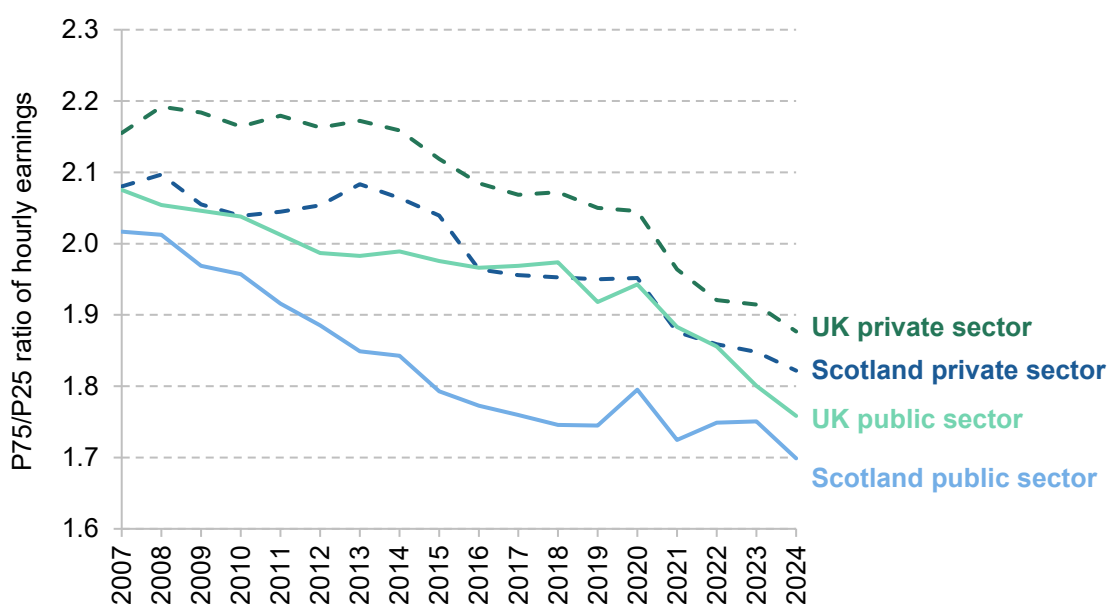
⁴² Figure 5A.2 in the appendix shows that these differences in trends between Scotland and England do not reflect very different trends between the two nations in retention in private sector jobs, as retention by private sector employers has seen very similar trends in England and Scotland.

not identified any clear trend in retention in the public sector in Scotland that could plausibly be related to higher pay. There may well be other effects that are hard for us, as analysts outside government, to observe. In addition, the Scottish Government's public sector pay policy explicitly includes distributional concerns, encouraging employers to consider a 'progressive approach to pay', highlighting that delivery of public services is not the only consideration when setting pay (Scottish Government, 2024).

Whether or not these pay rises have had positive effects on public service delivery to date, given the cost of across-the-board pay rises the Scottish Government should consider targeting pay rises strategically, focusing on occupations where recruitment and retention challenges are most acute. As with its income tax policies, which have increasingly diverged from those in the rest of the UK, it should also commit to evaluating the impact of its public sector pay policies on recruitment, retention and productivity, making data available to researchers as necessary.

Appendix 5A. Supplementary figures

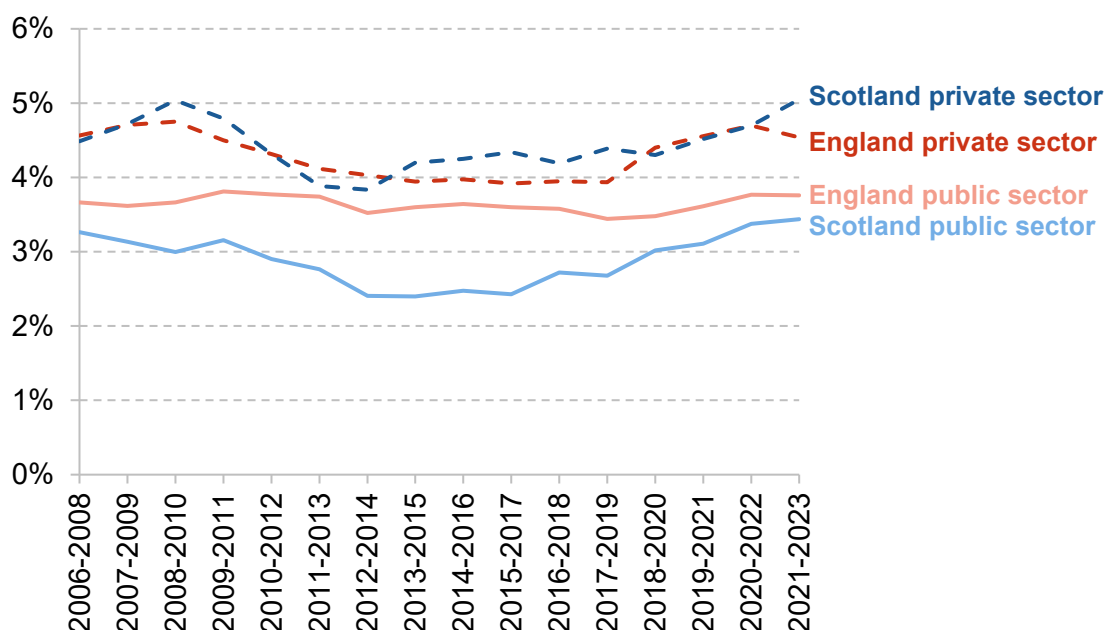
Figure 5A.1. Ratio of 75th percentile to 25th percentile of hourly earnings for public and private sector employees in Scotland and the UK, over time



Note: Data measured in April of each year. All series are deflated using monthly CPIH.

Source: ONS dataset '[Earnings and hours worked, UK region by public and private sector: ASHE table 25](#)'.

Figure 5A.2. Percentage of public and private sector workers who cease working for their sector over the course of three months: England and Scotland



Source: Authors' calculations using the two-quarter longitudinal Labour Force Survey, 2006 to 2023.

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6. The overall funding and spending outlook

Bee Boileau and David Phillips

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

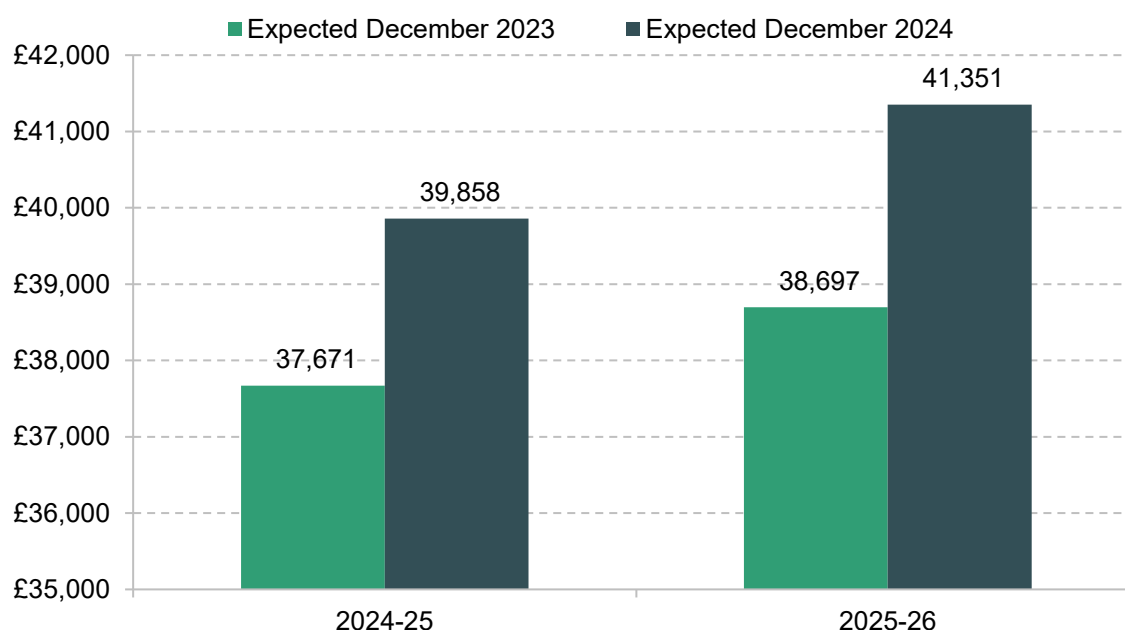
The Budget published in December and now working its way through the Scottish Parliament relates to the coming financial year, 2025–26. However, to understand its implications for Scottish public services and investment, it is also important to consider recent changes in funding and planned spending 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.

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.⁴³ 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 any block grant adjustments (BGAs) to account for tax and social security devolution.

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).

⁴³ 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).

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.⁴⁴ In turn, the BGAs change each year in line with changes in revenues for the equivalent taxes in England and Northern Ireland.⁴⁵ 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.

⁴⁴ 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.

⁴⁵ 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.

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.⁴⁶ 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

⁴⁶ See, for example, Fraser of Allander Institute (2025).

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.

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).

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).

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.

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 (£0.3 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.

Table 6.3. 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.

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

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.

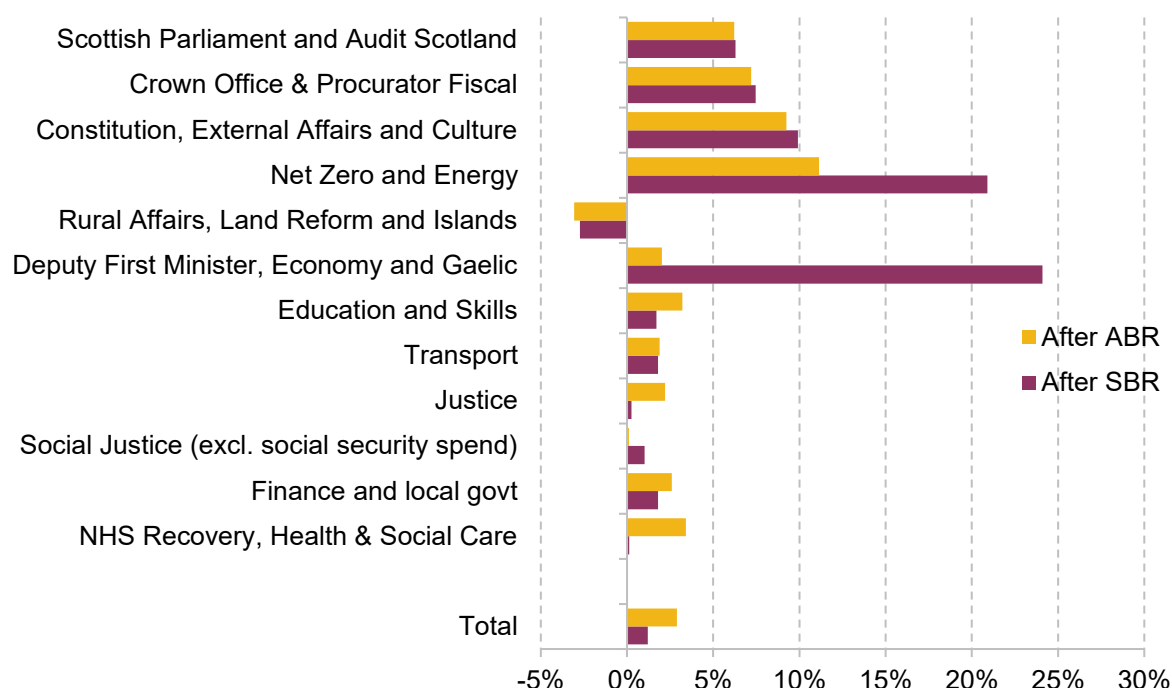
In this context, we may expect some slippage in capital spending plans in 2025–26. Indeed, to maximise the value-for-money of the funding provided, it might make more sense to ramp up spending a little more slowly by borrowing and drawing down less Scotwind funding in 2025–26, and more in later years.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

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%.

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.

^a Note 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.

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 2024–25 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

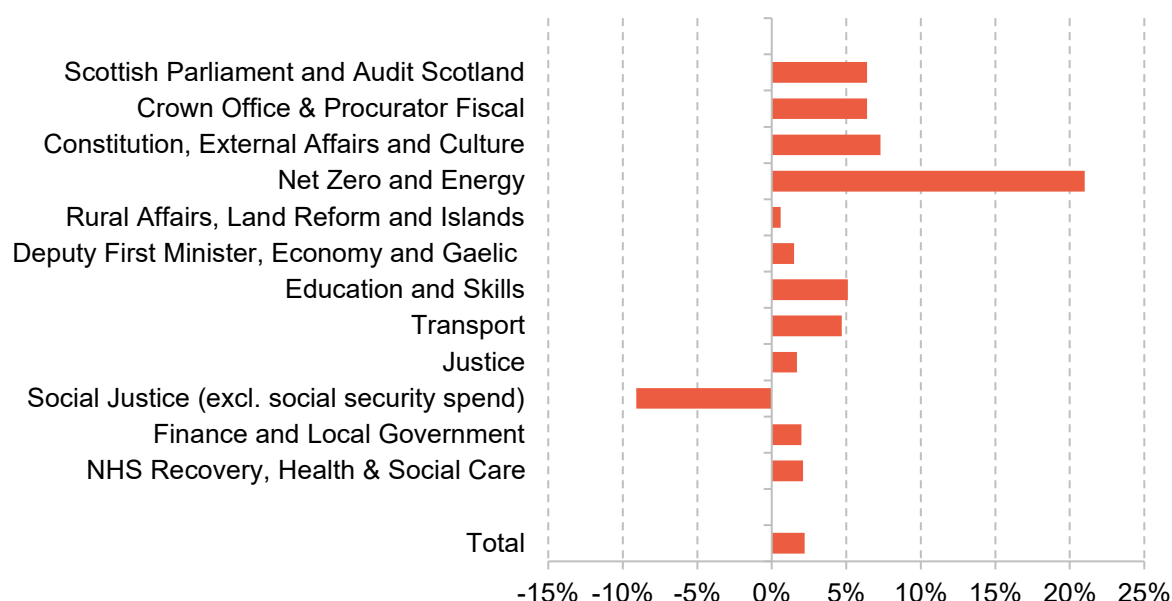
forward for Health and Social Care to support 2025–26 costs'. It would arguably have been more transparent to have allocated this element of the contingency immediately to Reserves, making clear the intention to carry it forwards. If the remainder of the contingency and any underspends by specific services 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.

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).⁴⁷ 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.

⁴⁷ 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.

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.

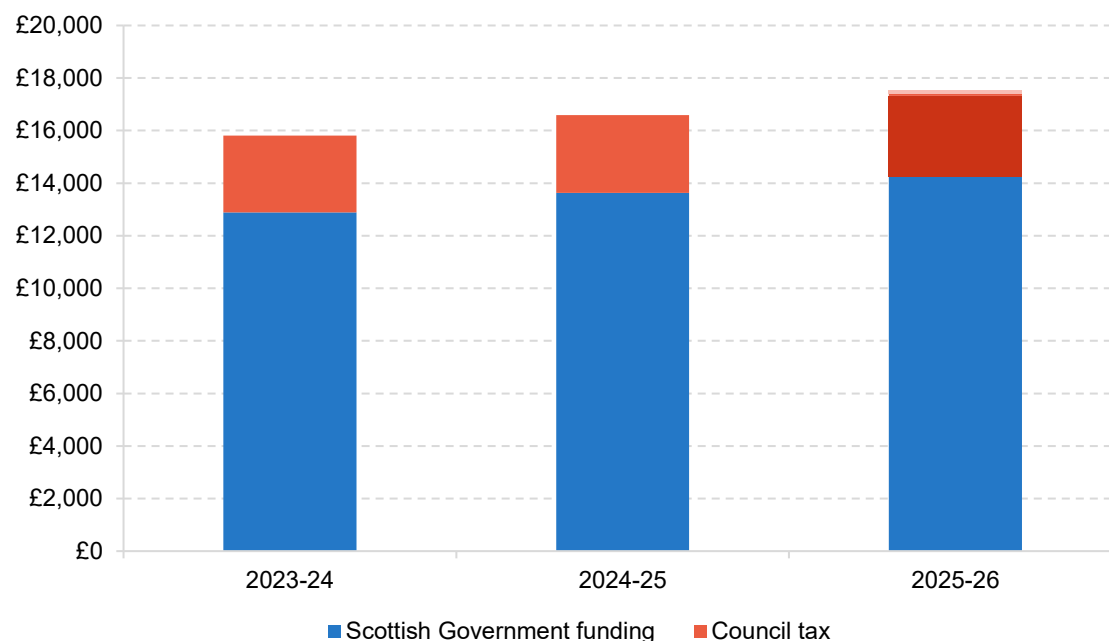
Source: Authors' calculations using Scottish Government (2024c, 2024d).

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 in 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. English councils are set to receive £1.05 billion, equivalent to an additional 0.8% in funding.⁴⁸ 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.

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

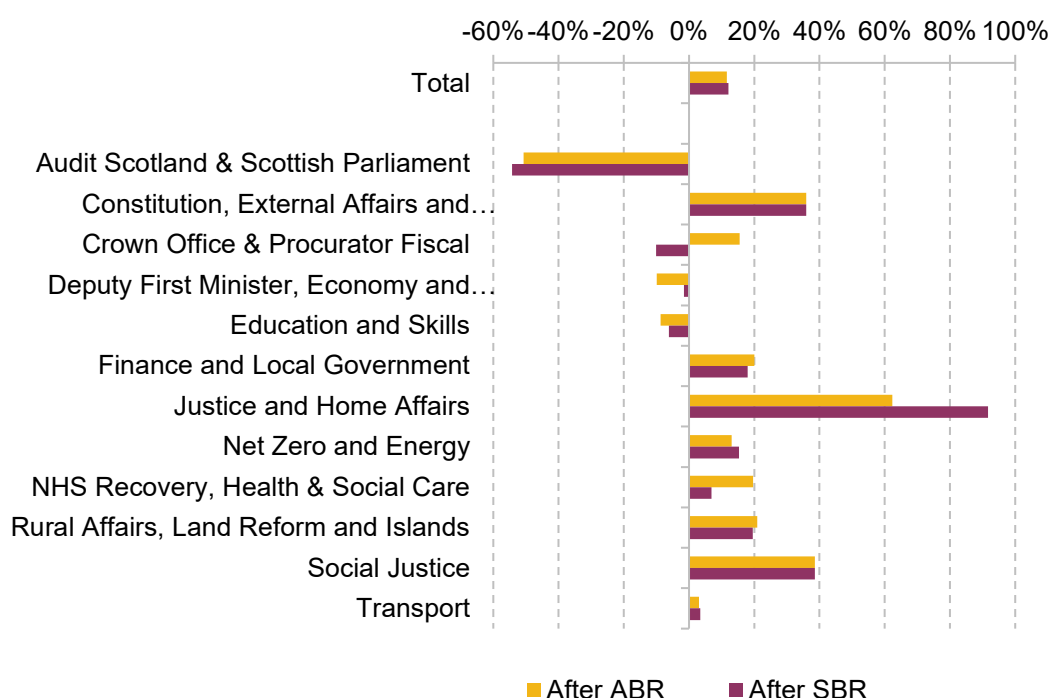
⁴⁸ See Department for Environment, Food and Rural Affairs (2024).

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.⁴⁹ 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.

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).

⁴⁹ 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.

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.⁵⁰ 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

⁵⁰ The Barnett Squeeze was discussed in detail in chapter 2 of our 2023–24 Scottish Budget report (Boileau and Phillips, 2023).

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.

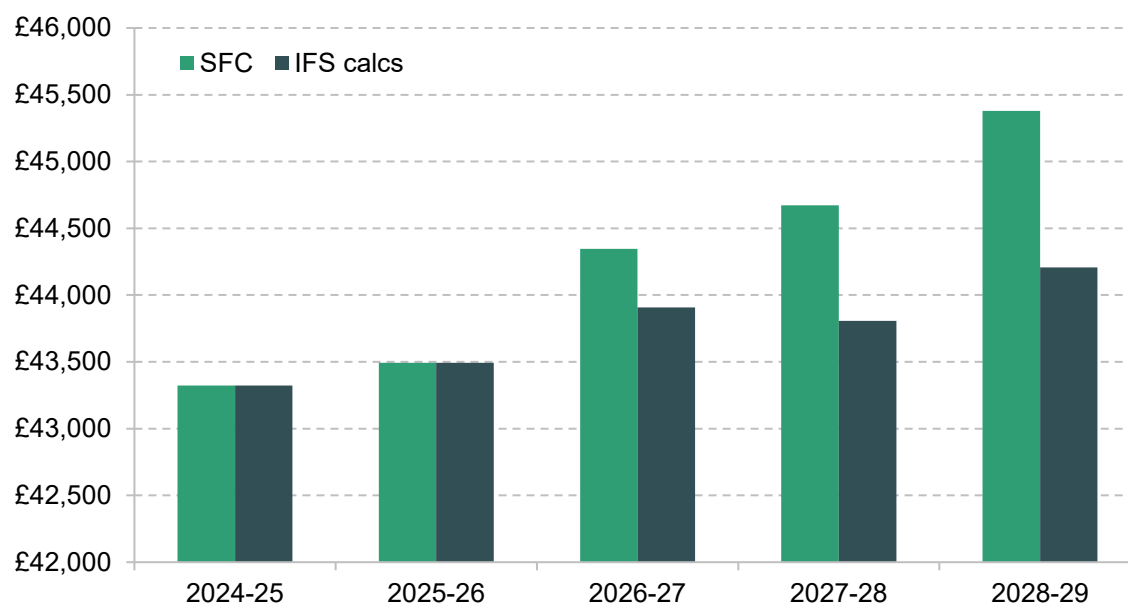
For LBTT, the main factor seems to be that after a period during which Scottish property prices and transactions have held up better than in the UK as a whole (boosting the net revenue position), SFC and OBR forecasts imply slightly weaker growth in prices and much weaker growth in transactions volumes 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, a 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



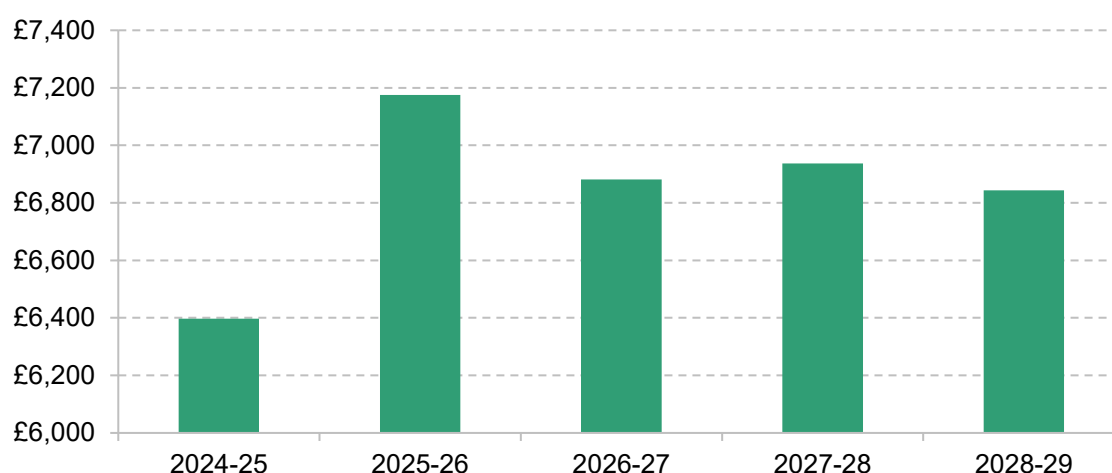
Note: The IFS calcs scenario assumes that block grant funding grows more slowly and that the income tax net position is adjusted downwards. Both projections strip out projected social security spending in this period, including the forecast cost of mitigating the two-child limit after 2026–27.

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.⁵¹ 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.

⁵¹ See box 3.2, Capital spending plans: how much will actually be spent? (<https://obr.uk/box/capital-spending-plans-how-much-will-actually-be-spent/>) in Office for Budget Responsibility (2020).

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.

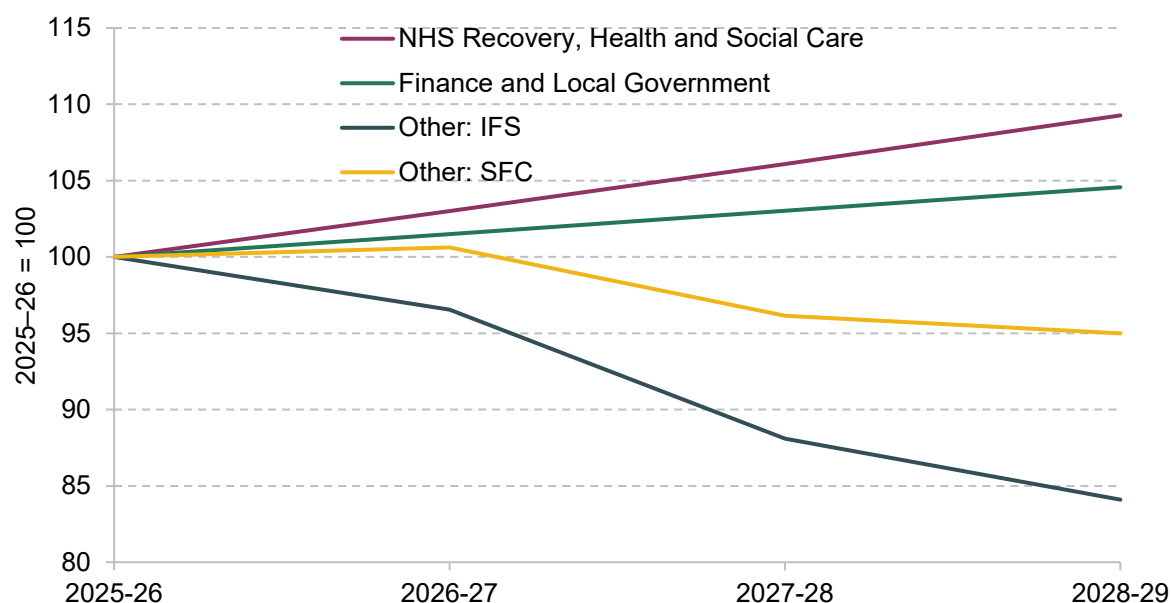
Figure 6.8 shows resource funding for the Health and Social Care, Finance and Local Government and all other portfolios (excluding social security benefits) over the period 2025–26 to 2028–29 under one such set of assumptions. In particular, we assume that resource funding for the Health and Social Care 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.

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.

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).

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 to 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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